World Turned Upside Down? Rise of the global South and the contemporary global financial turbulence

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World Turned Upside Down? Rise of the global South and the contemporary global financial turbulence

RAVI ARVIND PALAT

ABSTRACT  By focusing on the consequences of the dismantling of regulations over the financial sector, the current debate on the causes of the global economic meltdown obscures the cyclical occurrence of speculation in capitalism, as the accumulation of more capital than can be profitably invested in the production and sale of commodities results in financial expansion. Historically financial expansion has signalled the end of one world-scale system of accumulation and the transition to a new system as capital flows from declining powers to rising powers. However, the contemporary period is distinguished by capital flows from rising powers to declining ones. An analysis of the current crisis suggests a reversal of this anomaly as it reduces the ability of China and other East Asian states to support the US dollar. At the same time ‘emerging market economies’ have begun to forge new relationships that could provide the framework for a new system of partnership between states and enterprises to reconstruct a new cycle of accumulation if two hurdles are overcome: 1) absorption of labour that is being displaced because of the high organic composition of capital and 2) dampening of the growing inequalities in income which has not only restricted the growth of markets but is also fuelling increasing social conflict.

Signalling a sea-change in world politics, at the close of the Chinese National People’s Congress in March 2009 Premier Wen Jiabao implored the USA to remain a ‘credible nation and ensure the safety’ of the $1 trillion his country had invested in US treasury bills.1 This reversal of the usual practice of Western policy makers lecturing leaders of Asia, Africa and Latin America to follow ‘prudent’ economic and financial policies was echoed by the Brazilian president, Luiz Inácio Lula da Silva, who told the visiting British prime minister, Gordon Brown, that the contemporary financial crisis ‘was caused by no black man or woman or by no indigenous person or by no poor person [but] by irrational behaviour of some people that are white, blue-eyed’.2 Additionally, an advisory committee set up by the UN General Assembly
noted that the dollar-based financial system compelled poorer countries to lend their foreign exchange reserves to rich countries at virtually zero interest rates. This dampened global aggregate demand and locked up trillions of dollars which could have been used to lessen the impact of the financial crisis. This pattern of financial flows had attracted so much capital to the USA that its imports in 2006 exceeded its exports by the magnitude of India’s GDP. Declining confidence in the dollar was underlined by a 51% increase in investor demand for gold in the second quarter of 2009—with India, China and other countries sharply shifting a portion of their foreign exchange assets to the precious metal. Finally, the clearest admission of the dawn of a new world order came in September 2009, when the G7 grouping of the richest economies in the world disbanded itself in favour of a larger grouping, the G20, which included Brazil, China, India, Mexico and other ‘emerging market economies’, as the major forum to discuss world economic issues.

The proximate cause for an overhaul of the global financial system—the third since the end of the Second World War—was a breathtaking collapse of world financial markets: by one estimate stock markets across the world lost some €3000 for every person on Earth in the last nine months of 2008. Based on a series of financial innovations since the late 1970s, banks had developed a complex system of selling their credit risks to third-party investors, trading them on the basis of computer models. By mid-2008 the global derivatives market topped $530 trillion. To place this in perspective, the New York Stock Exchange was valued at $30 trillion at its peak at the end of 2007.

Shedding their credit risks by selling them to other investors enabled banks to make more loans and to extract the savings of low-income households by lending them money to buy commodities, and especially houses, that they could not afford. The opacity of the system meant that neither regulators nor the bankers themselves could comprehend the scale of the concentration of risk. Once default rates of sub-prime mortgages began to rise in June 2007 and credit ratings agencies began to downgrade the risk-worthiness of mortgage-linked products, investors became far more cautious and this led to a sharp fall in investment funds, further accelerating rates of mortgage defaults. In March 2009 the Asian Development Bank estimated the losses worldwide of the write-down of assets at $50 000 billion, the value of the global economic output. The impact of this decline was most marked in the USA—where the financial quicksand swallowed up five of the most hallowed investment banks on Wall Street. Conversely, reflecting China’s enormous trade surpluses, five Chinese banks are in the top 20 financial institutions in the world by market capitalisation, including the three largest—the Industrial and Commercial Bank of China, China Construction Bank and the Bank of China—when there were no Chinese banks in the top 20 just 10 years ago. Correspondingly the number of US banks in the list decreased from 11 to three.

Financial collapse led to precipitous declines in manufacturing output and to a corresponding rise in unemployment. By the end of January 2010 the US unemployment rate stood at 9.7% and, if those who had given up the search for jobs or had settled for part-time employment are factored in, the rate was
estimated to be 16.5%—since the downturn began in December 2007 the economy had shed 8.4 million jobs, the most lost in a recession since the Second World War. The situation was so dire that migrants to the ‘richest country on earth’ were receiving remittances from relatives in poorer countries in a stark reversal of historical patterns.

Reverberations of the collapse of the US market were felt across the Pacific as Chinese exports fell by 16% in 2009. As Chinese demand for intermediate products fell and Chinese corporations sought to compensate for the collapse of their markets in North America and Europe by increasing exports to middle- and low-income states, the 10-member Association of Southeast Asian Nations (ASEAN) registered a collective trade deficit of $74 billion with China in the first nine months of 2009—in sharp contrast to earlier years, when ASEAN states posted surpluses in their trade with Beijing. Japan experienced its first current account and trade deficits since the Second Oil Shock and these deficits sapped both Japan’s ability to build up its foreign exchange reserves and the rationale for accumulating these assets. Declines in Chinese manufacturing ricocheted halfway across the world in Africa—in the Democratic Republic of Congo, for instance, a decline in the production of cell phones led to a fall in the price of cobalt from $49 a pound in 2008 to $14 a pound in 2009 and to the closure of many mines, with a consequent spike in unemployment rates. Apart from declining volumes of trade, economic contraction in wealthier countries translated into falling rates of remittances and investments to low-income states. The World Bank estimates that the crisis has pushed some 90 million people across the world into ‘extreme poverty’—less than $1.25 a day.

Precisely because the present crisis was triggered by the collapse of financial markets across the world, efforts to revive the world economy have centred on re-regulating financial and non-financial institutions and curbing speculation in the derivatives market. Yet what is striking about discussions about the contemporary crisis is the complete absence of an historical perspective. At best commentators and scholars remark that the current crisis is the worst since the Great Depression of the late 1920s and early 1930s. Not only does this ignore the extended debate on financial capitalism as the ‘last stage of capitalism’ at the turn of the last century, but also, as Fernand Braudel has reminded us, it forgets that ‘financial capitalism was no new born child of the 1900s’. In his longitudinal survey of historical capitalism Braudel demonstrated that financial expansions have followed waves of economic expansion so regularly—as competitive pressures have led to an accumulation of capital in excess of that which can be ploughed back into the production and sale of commodities without sharply curtailing profit margins—that they could be interpreted as signals indicating the maturity of one world-scale system of accumulation and the beginning of the transition to another, ‘a sign of autumn’. Taking his cue from Braudel, Giovanni Arrighi argued that the recurrent tendency for capital to withdraw from production and trade into financial speculation has been a means both to redistribute income and wealth from workers, peasants and other strata to agencies that control mobile capital—and thereby further the process of
financial expansion—and to transfer surplus capital from declining to rising centres of capital accumulation.\textsuperscript{20} Thus, as Dutch power waned, capital from Amsterdam flowed towards London while, as British power declined, capital from London flowed towards the USA.

The flow of capital from declining to rising centres of accumulation arises from the very mechanisms necessary to surmount the crisis of accumulation, namely the emergence of new partnership arrangements between states and enterprises to organise an expanded scale of production by accessing strategic industrial raw materials (wood, coal, iron, oil) of progressively higher grades and with more precisely specified chemical and physical properties from increasingly distant locations. The Dutch oligarchy’s power was based on their control over world-encircling networks of finance rather than on commercial networks that could be bypassed.\textsuperscript{21} In contrast to the parsimonious territorial acquisitions of the United Provinces, the Second British Empire was based on extensive territorial control of the non-Western world, designed to control supplies of raw materials required for industrialisation. After the Second World War the USA linked Marshall Plan aid to European allies to their loosening colonial control over strategic industrial minerals and petroleum. While peripheral states initially welcomed these investments, as the hoped-for revenues did not materialise they nationalised mines and oil wells. Scarred by the oil price rises of the 1970s, Japanese transnational corporations sought to expand supplies of strategic industrial raw materials by entering into joint-venture projects with resource-rich states and to create an excess of supply to lower prices.\textsuperscript{22} Despite its economic strength, as a US client state, Japan was not politically or militarily positioned to change the broad parameters of worldwide structures of capital accumulation.

Underpinning these structural changes in world accumulation were the multiple organisational, technological, financial and political innovations required for a progressive increase in the scale of production. As raw materials are not evenly distributed across the world, and as producers tend to utilise conveniently located sources first, emerging powers have had to access raw materials from further away and, as the size of transportation technologies evolve, this requires more extensive infrastructures, the harnessing of more energy and the employment of more labour. While this eventually increased economies of scale and reduced unit costs to expand markets and make ever-larger projects lucrative, it has historically required new combinations of state and enterprise partnerships. The Marshallian industrial districts that had transformed England into the ‘workshop of the world,’ were no match for the multi-unit, vertically-integrated, large-scale enterprises of the USA. Hence, rising centres became magnets for mobile capital as older centres of production become less competitive.\textsuperscript{23}

If financial expansions have been a recurrent tendency in historical capitalism, as Arrighi has noted, one of the peculiarities of the present situation is that capital is flowing from the rising centres in East Asia—especially from China—to the USA instead of the other way around. Leo
Panitch and others have argued that this peculiarity underlines the pervasive strength of the USA as it enables it to maintain high levels of consumption and is a sign of its imperial power rather than a weakness. Such an analysis ignores not only the historical patterns sketched above but also the conditions of production in historical perspective. Investments by China and India are not merely following earlier patterns of resource extraction by Japan: their scalar magnitudes and the innovations in transportation and infrastructures involved have led to new patterns of state–enterprise relations in which state owned corporations are playing a key role, along with some Chinese and Indian privately owned transnational corporations. The demographic weight of these two giant economies implies that the transfer of manufacturing operations and information technology services to them bears no resemblance to prior shifts in manufacturing to lower-waged sites. Moreover, before the recent financial crisis, Beijing had viewed the US market as indispensable for the growth of the Chinese economy, but the credit crisis led to the loss of millions of jobs and has stimulated a rethink. The Chinese economy’s swift recovery through an extensive stimulus programme also illustrates that the US market is not as vital as was once thought.

The use of sovereign wealth funds and new patterns of state and state-owned and private Chinese and Indian corporations to secure reliable supplies of strategic raw materials and energy may well form the scaffolding of a new system of accumulation on a world scale. However, in order for this to be achieved two enormous hurdles must be circumvented: first, thanks to the high capital intensity of production, the ability of economies to absorb labour has been steadily diminishing; second, the inability to absorb labour has resulted in growing inequalities in income and wealth which have not only constrained the growth of markets but are also fuelling massive social unrest, especially in China and India.

From this perspective the next section outlines the implications of the rise of China and India for the global economy. It argues that the steady downgrading of manufacturing in the worldwide divisioning of labour and the growth of inequalities in wealth and income on a planetary scale, and particularly in the fast-growing economies of the global South, have made economic growth in these countries reliant on markets in the global North. In turn, the recycling of their trade surpluses, above all to the USA, has deepened an ongoing financial expansion that has now ricocheted across the globe.

The next section suggests that, by reducing the flow of foreign direct investments to China, India and other emerging powers and by constraining the markets for their exports, there are strong indications that the flow of capital from the rising powers to the declining ones will ebb and bring to a close the US cycle of accumulation. For a new cycle of accumulation to emerge, it is essential that the increasing inequality of incomes and wealth is reversed, and that economic growth and jobs are provided to millions of workers when a secular growth in the organic composition of capital is reducing the need for labour.
Being Bangalored and the China Price

The relentless transfer of manufacturing operations to China that *Business-week* said made ‘the China price . . . the three scariest words in US industry’, and the equally relentless transfer of information technology jobs to India that made ‘being Bangalored’ synonymous with outsourcing represent a seismic shift in the trajectory of the world economy and have radically transformed the conditions of production everywhere. This shift in the centre of gravity of the world economy has often been attributed to the maintenance of artificially low exchange rates, especially by China, and to the vast demographic size of these two continent-sized states. Wage rates in China are, however, in historical and relative terms so low, as indicated by Table 1, that no mere manipulation of exchange rates can undermine their competitiveness.

Average wages in the Chinese manufacturing sector are, in fact, much lower than were wages in the handloom sector in England during the early Industrial Revolution, or those in mid-19th century lumber yards in Chicago.

Low wages alone do not account for the magnetic pull that China and India exert towards manufacturing and service jobs—since wages are lower in several other jurisdictions in Asia and Africa. Both countries have stable political systems and their governments provide access to land at low prices, as well as several important incentives and, in the case of China, an impressive transport infrastructure, while India has a large pool of English-speaking graduates. As the phrase ‘being Bangalored’ implies, in both cases services and manufactures are centred on specific cities and regions. Bangalore has become a hub of

<table>
<thead>
<tr>
<th>Monthly Wage (in US$)</th>
<th>As percentage of US Wage</th>
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<tbody>
<tr>
<td>United States</td>
<td>2898.2</td>
</tr>
<tr>
<td>Japan</td>
<td>2650.2</td>
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<tr>
<td>South Korea</td>
<td>2331.4</td>
</tr>
<tr>
<td>Argentina (2001)</td>
<td>837.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>732.7</td>
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<tr>
<td>Czech Republic</td>
<td>612</td>
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<tr>
<td>Poland (2004)</td>
<td>585.9</td>
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<tr>
<td>Chile</td>
<td>432.4</td>
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<tr>
<td>Turkey (2001)</td>
<td>427.5</td>
</tr>
<tr>
<td>Mexico (2004)</td>
<td>341.9</td>
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<tr>
<td>Brazil (2002)</td>
<td>308.7</td>
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<tr>
<td>Peru</td>
<td>237.8</td>
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<tr>
<td>China (2004)</td>
<td>141.3</td>
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<tr>
<td>Thailand (2003)</td>
<td>133.5</td>
</tr>
<tr>
<td>Philippines (2004)</td>
<td>98.8</td>
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<tr>
<td>Indonesia (2001)</td>
<td>54.1</td>
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<tr>
<td>India (2003)</td>
<td>23.2</td>
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information technology-related services—India’s ‘Silicon Valley’. In China, just as in the English Industrial Revolution, Marshallian ‘industrial districts’ specialising in the production of components for specific products have emerged: 5000 factories in Zihili township in Zhejiang province make clothing for children, 1000 factories in Shengzhou in the same province produce about 40% of the world’s neckties, one factory in southern Guangdong province alone makes half the world’s microwaves, and most of the world’s computers are assembled in the city of Dongguan in the same province. Such industrial districts imply that potential rivals have to compete not only against specific manufacturers but also against the entire production chain.27

Just as artificially low exchange rates and low wages do not provide sufficient reasons for the continued transfer of production and services to China and India, the significance of their demographic size also needs to be qualified. The entry of hundreds of millions of low-waged workers from China and India has, of course, vastly expanded the available pool of labour and dampened labour militancy elsewhere as employers threaten to relocate their operations to these Asian behemoths.28 Notably, although the Chinese population will age rapidly in the next 10 to 15 years, fully 50% of India’s population of over 1.1 billion is under the age of 20.29

Foreign direct investment (FDI)-driven growth and the focus on export markets have most importantly not solved the problem of labour absorption in China or India. Since competitive pressures entail a steady improvement in the quality of manufactured exports, Chinese producers have to constantly increase the organic composition of capital—the mechanisation, automation and computerisation of operations—to increase labour productivity, and must resort to the informalisation of production processes, so that despite an almost 12% annual rise in manufacturing output over the last several years in China, there was also a 15% fall in manufacturing employment.30 A report by the Asian Development Bank indicated that, in the 1980s, for a 1% increase in employment in Chinese industries, output had to grow by 3% but, in the 1990s, to achieve the same increase in employment, output had to rise by 8%.31

Far from absorbing labour, the International Labour Organisation (ILO) reports that regular wage employment in the formal sector declined at an annual average rate of 3% between 1990 and 2002, while irregular employment (casual work and self-employment) grew at an annual rate of 18.5% on average during the same period. In absolute numbers state and collective enterprises laid off some 59.2 million people during this 12-year period and foreign and private enterprises in the formal sector hired 24.1 million people, leading to a net job loss of 35.1 million.32

By some other estimates unemployment in China had grown from three million in 1993 to 25 million at the end of 2001, with some sources putting it as high as 60 million. By 2002 the pool of urban poor had grown to between 15 and 31 million people, or about 4% to 8% of the urban population.33 Precisely because industrial growth has been disproportionately based on assembling parts manufactured elsewhere, employment prospects for young graduates have been dismal: by some estimates 50% of the 6.1 million graduates in 2009 have been unable to find jobs.34 Even worse, as the
determination of legal wages is highly decentralised, in many areas these wages have actually declined; this was especially notable in the two cities most closely linked to the world market: Guangzhou and Shenzhen.\textsuperscript{35}

These conditions continued to deteriorate after China’s entry into the World Trade Organization (WTO) in 2001. Imports of subsidised cotton from the USA alone are said to have led to a loss of some 720,000 jobs in the poorest provinces of Gansu and Xinjiang.\textsuperscript{36} As rural distress mounted, many migrants from the interior—estimates range between 60 and 120 million—were drawn to the coastal regions. Often these migrants have to pay relatively large amounts for a job that may pay less than the legal minimum wage, and even this is not guaranteed as unscrupulous employers promise to pay a part of the wages at the end of the year. Twenty percent of the respondents of a survey conducted by the All-China Federation of Trade Unions (ACFTU) in 1997 reported arrears in wages—and 46% of these had three months or more of wages owed to them. In these conditions the longer an employee has been at an establishment, the greater the hold the employer has on him.\textsuperscript{37}

Given the much smaller share of manufactured goods destined for exports, the organic composition of capital increased far more sedately in Indian industry. Between 1993 and 2003 India’s industrial production grew at an annual average rate of almost 6.7% but factor productivity contributed only about 1.1%, whereas in China industrial production rose by 11% annually over the same period, with the output per worker increasing by 9.8% a year, of which 6.2% was generated by rising factor productivity. Hence, while formal sector industrial employment by this measure grew by only 1.2% in these 10 years in China, it grew by 3.6% in India.\textsuperscript{38} Nevertheless, the number of workers in organised sector units employing more than 10 people in India has remained stable at just over six million since the reforms began in 1991, out of a total employment in the manufacturing sector of some 48 million. This suggests that the share of manufacturing employment in the informal sector increased from 80.5% in 1993–94 to 83.3% in 1999–2000.\textsuperscript{39} Finally, over two million people may be working in information technology-related sectors in India, but they constitute only about 0.5% of the country’s working population and hundreds of millions do not share in the boom—some 40 million were employed in the construction industry in 2008, earning a daily wage of around 50 US cents, despite the official minimum wage being $2 a day.\textsuperscript{40} For all its prominence in information technology and related sectors, India has the largest pool of illiterate people in the world.\textsuperscript{41} Moreover, entry into the WTO has worsened agrarian distress and this has led both to a spectacular rise in suicides among farmers and to a widespread Maoist armed insurgency which now afflicts 20 of India’s 26 states.\textsuperscript{42}

Additionally, increasing per capita GDP figures in China mask the consequences of the abrogation of rights to free education and health care, and to other social services including pensions, as well as of increased costs for housing, energy and other essential services. This is particularly evident in healthcare—which was once almost free—as the World Health Organisation (WHO) now ranks China 188th out of 191 states in terms of equality of financial access to medical care and medical personnel have been subject to attacks for
denying treatment to patients who could not afford to pay. As a result, although export-oriented growth has created a ‘middle class’ of over 100 million people in China, it has also lead to a widening chasm of inequality—and its Gini coefficient shows a more skewed pattern of income inequalities than for the USA, which is itself registering the highest levels of inequality since the 1920s. In turn, popular discontent is manifested by steep increases in protests: large-scale ‘public disturbances’ increased from 58,000 incidents in 2003 to 120,000 in 2008 and 58,000 in the first three months of 2009.

India may have a marginally better Gini co-efficient than China but the Gini co-efficient of land distribution is higher in the subcontinent, indicating a higher degree of landlessness. Moreover, there are more people living below $2 a day in India than in all of sub-Saharan Africa: some 456 million people, or 42% of the population, were estimated to live below the international poverty line of $1.25 a day in 2005 according to the World Bank. Several critics have argued that the World Bank estimates themselves are an underestimate of the extent of poverty in the country as a result of untenable estimates.

Growing disparities in income and wealth and the lack of labour absorption has meant that domestic market growth in the emerging powers remains constrained. Although average urban disposable income in China rose by 8% in 2008, it was still only $2310 and rural income averaged a mere $698. Hence China, India and the raw materials-exporting states recycle their current account surpluses to the global North—especially to the USA to help fund its trade deficit and keep its domestic interest rates low and thus provide a market for their goods and services. Over the past five years Chinese purchases of foreign debt, mainly US Treasuries, accounted for one-seventh of China’s economic output and in 2008 it lent the USA the equivalent of 10% of the Chinese GDP. Cumulatively, at the end of 2009, some 66% of China’s foreign exchange reserves of $2.4 trillion were invested in dollar assets, although the percentage of US Treasuries bought by China declined from 47.4 in 2006 to just 4.6 in 2009. Although China is the largest official holder of US dollars, Japanese official and private investors may hold two or three times as much as Beijing, since almost all of its foreign exchange holdings are on the books of official institutions whereas, if the external currency holdings in private hands are included, Japan’s holdings are estimated to be about $6 trillion according to Akio Mikuni, the head of Japan’s only independent investor-supported ratings agency.

Large capital inflows to the USA fuelled a massive speculative boom—not only in the share market and in investments, but also in the derivatives and futures market. Thus, while the spike in oil prices is often attributed to the economic resurgence of China, India and other ‘emerging powers’, speculative activities by financial institutions and hedge funds is estimated to have accounted for some 70% of oil trades by 2008. Additionally, between 2003 and 2007, cross-border mergers and acquisitions by hedge funds and private equity firms averaged $100 billion per year and accounted for about 25% of FDI flows. Speculation in real estate and stock market prices increased, by Jeffrey Sach’s estimate, the net wealth of US households by $18 trillion between 1996 and 2006. This provided the foundations for an
extraordinary rise in consumption: in 2008 private indebtedness in the USA amounted to 295% of GDP.53

The massive deflationary pressures exerted by cheap imports even helps displaced US blue- and white-collar workers facing lower-paying jobs economise on their means of livelihood. If the emergence of China as a low-cost producer has led to a hollowing out of manufacturing sectors, especially in high-income states, the ‘China price’ of goods has exercised a major deflationary impact all over the world.54 By one estimate imports of products made in China saved the ‘average American family’ $500 in 2004.55

This pattern of capital movements—flowing from rising centres of manufacture to declining centres—stands in stark contrast to previous patterns, when capital moved from the latter to the former. It is the result in large part of technological changes in production processes that permit enterprises to fragment manufacturing operations to take advantage of cost and wage differentials.56 Hence figures for the massive increase in Chinese manufacturing are somewhat misleading. Lower wages in China and the availability of a large and pliant labour force have meant that enterprises in East and Southeast Asia are increasingly shipping parts and components to China for final assembly. Between 1992 and 2003 exports of parts and components accounted for half the incremental increase of exports from ASEAN; China (including Hong Kong) posted a deficit of $17.6 billion in its trade in these items with its regional trade partners.57 Since products pass through many hands in different places, only a fraction of the profits remain in China. Despite China producing 75% of the world’s toys, for instance, one estimate suggests that only 1/70th of the profit is retained in China. In 2006 the New York Times reported that, although a Barbie doll retails for $20, China receives only 35 cents.58 ‘Foreign-owned’ or ‘foreign-invested’ corporations accounted for 55% of China’s exports between 2000 and 2004 and 77% of the top 200 exporters in China, or 62% of the top 500, were overseas corporations. Although the Chinese government has championed a few ‘national leaders’—Lenovo, Haier, Huawei, TCL, Baosteel—foreign firms account for the bulk of exports in the electronics sectors: they accounted for 90% of computers and 75% of telecommunications products in 2003. Overseas firms even increased their share of the domestic Chinese market in electronics from 32% in 1998 to 45% in 2002.59

China’s move up the technological ladder in manufacturing is also exaggerated by taking indices such as the share of electronics in its exports, because the bulk of its exports in the high-technology sector—laptop computers, DVD players, and mobile phones—are mass produced commodities rather than products at the technological cutting edge. In the case of DVD players, while factories in China make 90% of all such players, royalty payments to the European, Japanese and US holders of key patents constitute almost one-third of the retail price of these machines, even when they are produced for sale in the domestic Chinese market.60

While the continuing pressure on wages exerted by the entry of large pools of low-wage labour has led to a downgrading of manufacturing and service activities in the global divisioning of labour, leading corporations in
high-income states try to control and shape the development of their respective industries by asserting their rights to intellectual property in fields such as information technology, communications, bio-chemistry and genetic engineering, and continue to reap huge benefits from royalties. As a contemporary Chinese proverb puts it: ‘Third-class companies make products; second-class companies develop technology; first-class companies set standards.’ Capitalising on their large internal markets, low cost structure, and the continued relocation of research and development activities, business and government elites in China and India have adopted several strategies to substantially reduce royalty payments. By promoting (or threatening to promote) the development of alternative technology standards such as the EVD or Enhanced Versatile Disc standard for DVD players, or by supporting open-source standards like Linux in software, the Chinese government has helped its domestic corporations to significantly lower royalty payments and participate in the creation of new standards worldwide.

Similarly, loose patent laws and large reservoirs of low-cost scientific labour in India have enabled local pharmaceutical companies—Cipla, Dr Reddy, Ranbaxy, Nicholas Piramal and Wockhardt—to copy drugs made by large Western companies and sell them at a fraction of the cost. Consequently foreign pharmaceutical companies are now entering into partnerships and transferring their patented molecules to Indian companies who undertake all developmental costs, including those of clinical trials. To be sure, this is in part a result of changes in the pharmaceutical industry: easier ‘blockbuster’ drugs (treatments for major diseases like cardiac arrests and cancer) have already been developed and the costs of developing additional drugs have soared. Because large US and European pharmaceutical companies have extensive libraries of patented molecules, they now have more than they could conceivably develop on their own. If licensing molecules helps lower development costs—developing a new drug in India is estimated to cost about $100 million compared to $1 billion in the USA—and helps Western companies reap royalties without significant outlays, the extensive experience Indian companies have in reverse-engineering drugs makes the development of copy-cat generics all the more likely.

The inability of rapid expansion of FDI-led manufacturing to generate adequate employment opportunities in China, and the relatively low pace of industrial growth in India, has thwarted the growth of consumption in these economies. Consequently they have been over-reliant on the US market at a time when large-scale retrenchments and ‘jobless recoveries’ have widened income and wealth differences to a level greater than at any time since the depression of the late 1920s. In these conditions states dependent on exports have cast the USA as a market of last resort, but the current crisis has exposed the vulnerability of this model.

Genesis of a new order in the womb of the old

The recycling of trade surpluses from low- and middle-income economies above all to the USA was seen by some economists in the early part of this
decade as being a new infrastructure for world trade—a Bretton Woods II. By this reasoning the only way China and other fast-growing economies of the global South could absorb tens of millions of new labourers each year was to buy low-yielding US Treasuries with their ballooning export surpluses. In other words, steady economic growth in the periphery was predicated on a transfer of their earnings to high-income states to finance a market for their products and services—it was not a self-sustaining process. Yet, as we have seen, continued reliance on export-led growth has led to a sharp increase in the organic composition of capital in China and to a corresponding inability to absorb labour in the formal sector where there has been, in fact, a contraction of employment. The information technology sector in India was even less able to absorb labour. Meanwhile, large inflows of capital to the global North, and especially to the USA, led to an unprecedented financial expansion that aggravated existing inequalities in income and wealth and thereby further constrained markets for commodities and services. In turn, the bursting of the financial bubble has affected the real economy and, by shrinking markets for commodities, constrained export markets for the ‘emerging market economies’ and thereby restricted their ability to finance US deficits. At the same time industrialisation on an unprecedented scale in China and to a lesser extent in India and elsewhere has led states and enterprises in these jurisdictions to forge denser relations with states with large endowments of strategic industrial raw materials and energy. The resulting density of South–South relations could provide a new armature for the world economy. In this context the fragmentation of manufacturing operations and the outsourcing of production that had enabled large US and European corporations to pressure their suppliers to steadily lower their prices is also being turned on its head as these original equipment/design manufacturers begin to market their products under their own brands rather than under better known US and European brands. We examine these issues in turn.

First, the economic crisis has sharply cut inflows of foreign investment to China as large corporations seek to curtail expenditures—foreign investments to China in the second half of 2008 were down a third from the previous year. Similarly, in contrast to a net inflow of foreign investments to India in 2007–08, there was a net outflow between April and December 2008. Overall net capital flows to ‘emerging markets’ in 2009 are estimated to drop from $929 billion in 2007 to $165 billion. Second, by reducing Chinese exports there was less pressure on Beijing to prevent the rise of its currency and hence its purchases of dollar-denominated securities fell sharply. Additionally, central government revenues, which had soared by 32% in 2007, began to decline substantially as a result of falling demand for Chinese exports. As this coincided with a $600 billion stimulus programme, especially on infrastructure, announced by the Chinese government to counter the impact of the crisis, it further constrained China’s compulsion to finance US debt. The government also directed banks to increase lending to small- and medium-sized enterprises—fresh lending by banks is estimated to have been
almost 10 trillion renminbi—and restored export tax rebates for garments that it had been phasing out. Municipal governments have stopped raising minimum wages. Greater availability of credit has spurred domestic consumption—in 2009 sales of cars, desktop computers and durable consumer goods in China surpassed sales of these goods in the USA. This is not to suggest that Chinese demand alone is going to pull the global economy out of the current downturn in the short term, as the average price tags of products sold in China are substantially lower than in the high-income countries—average prices of new cars were about $17,000 in China and, although in numerical terms the Chinese car market was 25% larger than the US market in 2009, in value terms the latter was 66% larger than the former.

Perhaps more importantly, thanks to massive infrastructure projects—with booming consumption of construction equipment and materials, cement, steel and furniture—there has been a significant reorientation of labour supplies. Large numbers of migrant labourers who were let go from coastal factories in 2008 and 2009 found work closer to home thanks to the new construction projects. As a result, when exports picked up in December 2009, labour shortages surfaced in Guangdong and elsewhere along the coastal manufacturing corridor. This is, however, likely to be a passing phase.

Be that as it may, industrialisation on a gigantic and historically unprecedented scale in China and India has also led to greater demands for strategic raw materials and energy, and, from middle- and high-income states, for intermediate and capital goods. Voracious demands for energy and raw materials by Chinese and Indian industries have propped up commodity prices. Between January 2003 and January 2008 the index of world energy prices increased by 170% and the index of world metal prices by 180%.

Low technological quality and product lines meant that existing plants, typically small in scale and located in the interior for security reasons, were ill-suited to the expanded scale and sophistication of manufacturing in China. Similarly, rather than utilising domestic supplies to economise on costs, even though they were of lower quality, as was the practice earlier, the newer steel mills located in greenfield sites along the coasts, like Tangshan in Hebei province, are sourcing higher-grade iron ore from Australia, Brazil, India and Peru. To upgrade the country’s technological quality, Chinese firms sought foreign partners—Mitsubishi Heavy Industries, Mitsui, Nippon Steel and Nisshin Steel from Japan, POSCO from South Korea, Thyssen-Krupp from Germany, and Mittal Steel among others—in joint-venture projects. The social cost of this strategy, however, was the decommissioning of old steel mills with antiquated technologies and the further widening of inter-regional disparities in China, as unemployment in its northeast regions ranged from 30% to 70% by the turn of the millennium.

As China emerged as the world’s largest producer of steel in 1995, state and private firms sought to secure access to supplies of high-grade ore by
replicating the Japanese strategy of entering into long-term contracts with resource-rich states and negotiating joint-venture projects to minimise import costs and risks, while transferring the burden of most of the costs and risks to states and firms in the exporting states. This usually involved setting up infrastructural projects to facilitate the excavation of energy and minerals and their transport to the coast for trans-shipment. Typical of such investments was a project to mine manganese in Gabon, which is estimated to have deposits of some 330 million tons with an average content of 50% manganese—the world’s purest natural deposits. The Chinese National Machinery and Equipment Import–Export Corporation bested the Brazilian Companhia Vale do Rio Doce to develop a 175 million-tonne manganese reserve by agreeing to construct a 200 km railway from Belinga to Booué, a deep-water port at Santa Clara and a hydroelectric dam at Mayibout, and by agreeing to buy all the output from Belinga, whereas the Brazilians only agreed to construct a branch line between the mine and the already existing Transgabonais railway line. Chinese appetites for aluminium, nickel, copper and steel have led to a project to construct the world’s second largest dam to provide electricity to the mines in the Amazon basin on the Xingu River. In another variant, when international financial institutions were reluctant to advance developmental loans to the Angolan government, the Chinese Export–Import Bank offered a more than $4 billion loan for which the Angolan government had to put up a much lower quantity of oil as collateral and at a very low rate of interest, in return for an agreement that 70% of the contracts would be awarded to Chinese enterprises approved by Beijing. The Chinese government and state-owned enterprises are also cooperating to develop a transportation hub in Tanzania for commodities mined in Africa’s copper belt and linked through the Chinese-built Tanzania-Zambia Railway’s terminal to Kapirimposhi, which is connected to Angola’s Benguela railway—creating the first functioning east–west transport corridor in Africa.

As India did not have China’s large reserves of foreign exchange—and because its manufacturing base was much smaller—Indian efforts to secure supplies of energy and strategic raw materials have revolved around a different strategy. To secure access to energy—current estimates suggest that, by 2025, India will have to import 90% of its petroleum needs—New Delhi has been encouraging its private pharmaceutical firms to provide low-cost generic drugs, particularly anti-retroviral drugs, to African states, as well as to set up production facilities in the continent. The Indian government has also helped set up information technology centres such as the Ghana–India Kofi Annan Centre for Excellence in Information Technology in Accra and the Cyber Towers Information Technology Park in Mauritius, as well as providing technological and financial help in upgrading oil fields and laying gas pipelines in Sudan, building steel mills, power plants and oil refineries in Nigeria and agricultural support initiatives in a host of countries.

In a third development, as US, European and Japanese corporations have sought to pressure their subcontractors—especially in electronics—to lower
their prices, Taiwanese subcontractors, who were also original design and/or original equipment manufacturers, have begun to extend their own supply chains to China and to market their products under their own brands. A case in point is Acer, poised to become the second largest computer company in the world. After decades of producing computers for Hewlett-Packard, Dell and Apple and selling products under its own brand name only as a sideline, Acer started to aggressively promote its own line of computers in 2000. Another Taiwanese computer manufacturer, Asutek, pioneered the marketing of netbooks—the slimmed down laptops that have emerged as the fastest growing segment of the computer market—while HTC, which used to manufacture cell phones for other firms, became the first one to market a cell phone using Google’s operating system. After the Taiwanese government loosened restrictions on investment in the Chinese mainland in 2001, Taiwanese original design manufacturers shifted their production across the Taiwan Straits to take advantage of lower-cost land and labour and virtually all production is now in China, whereas before 2001 only 4% of Taiwanese computer production was on the mainland. This regionalisation of production has been accompanied by agreements signed between China and several countries—Russia, Belarus, Mongolia, Venezuela as well as ASEAN—to use the renminbi in bilateral transactions. This suggests the emergence of an integrated production zone in East Asia and the slow positioning of the renminbi towards full convertibility and as a safeguard against the depreciation of the dollar.

A similar increase in manufacturing may be developing in South Asia. Between the enactment of the Special Economic Zones (SEZ) Act in 2005 and May 2008, some 462 such zones comprising 126,077 hectares were formally approved in India. In these areas the government was empowered to exempt enterprises from central laws and workers typically worked 5.3 more hours than workers in non-SEZ areas and earned 34% less. At a time when there is an enormous thrust to develop electric cars, a small company in Bangalore, the Reva Electric Car Company, has the world’s largest fleet of all-electric vehicles on the road. In September 2009 General Motors agreed to buy Reva’s technology for installation in the electric version of its Chevrolet Spark. Bangladesh, meanwhile, has been receiving low-waged work in the garment sector as the Chinese government seeks to get enterprises there to move up the technology ladder.

While it is too soon to say, there are signs that the current financial crisis may indicate the end of the US cycle of accumulation. In the first instance, by contracting the US market, the crisis has irretrievably damaged the USA’s role as a market of last resort. This has not only reduced the pressure on China and other East Asian states to recycle their current account surpluses to the USA to fund its trade deficits and to finance its power pursuits. It has also exposed the vulnerabilities of ‘emerging market economies’ and demonstrated that export markets are not as vital to continued growth as they had believed. Second, the unprecedented pace and scale of industrialisation in China, and to a lesser extent in India, has led these states to forge new networks of supplies for raw materials and energy. The increasing density of
South–South relationships could provide a new armature for the revival of the world economy. The scalar magnitude of these investments, and the innovations in transportation technologies required to extract raw materials and ship them halfway across the world, are leading to new patterns of state–enterprise relationships and such partnerships have historically underpinned new systems of accumulation. Finally, the move by Taiwanese original design manufacturers to market products under their own brand names and move their production facilities to the Chinese mainland may suggest the emergence of an integrated production region in East Asia. Whether these issues will address the problems raised by growing inequalities in income and wealth that could undermine the new arrangements, and indeed even political stability in China and India, remains to be seen.

A recapitulation

The financial crisis enveloping the globe has crystallised the decline of the US-centred system of accumulation that had been partially prolonged by the flows of capital from China, Japan and other East Asian states as well as from the Oil and Petroleum Exporting Countries (OPEC) and other economies in the global South. As Braudel has observed, financial expansions regularly follow phases of economic expansion as an intensification in competition generates more capital than could profitably be invested in the production and sale of commodities. The deployment of technologies to fragment manufacturing operations into part processes and the relocation of these across the globe to take advantage of cost and wage differentials offer only a temporary solution.

Most notably a focus on export markets has also meant that measures to keep wages competitive in China have led to a growth in levels of inequality and a greater dependence on markets in the USA. This has compelled China, and other states in the global South, to recycle their current account surpluses to the USA to fund its trade deficits and finance its power pursuits. The continued inflow of capital encouraged US banks and non-banking financial institutions to implement a series of financial innovations that even sought to extract savings from low-income households and fuelled an unparalleled bout of financial speculation. When the bubble burst in 2008 with the collapse of Lehman Brothers and economies around the world spiralled downward, this adversely affected exports from China, India and other states. This constrained their ability to continue to recycle their current account surpluses to the USA and led to at least a partial unravelling of their export-led economic strategy.

At the same time, rapid economic growth in China, India and elsewhere in the global South has led to an increasing density of South–South economic relations as the emerging powers seek access to reliable supplies of high-grade strategic industrial raw materials and energy. This reconfiguration of spatial relations provides a framework for the emergence of a new cycle of accumulation. Relatedly, movements by original design manufacturers in Taiwan to market products under their own brand-names and move their
production to the Chinese mainland suggests the emergence of an integrated production region in East Asia. The Indian economy, which has not been as exposed to the financial meltdown because of its lower dependence on exports and its tighter financial regulation, also appears as an increasingly strong player in the world economy. Put differently, successive leading agencies of capitalist power—the erstwhile United Provinces, the UK and the USA—have represented a serial increase in size and population. In this progression, integrated production zones in East and South Asia could potentially represent the next phase in capitalist evolution.

However, the emergence of a new system of accumulation is crucially predicated on reversing growing inequalities in income and wealth globally, particularly in China and India. Their movement up the technological ladder has meant a steady increase in the organic composition of capital and an inability to absorb labour. High rates of growth have been accompanied by high rates of unemployment and widening inequalities in income and wealth magnify the possibility of political instability and threaten to fragment the world market and hence dislocate socioeconomic and political structures worldwide.

Notes
7 Wade, ‘Steering out of the crisis’, p 40.
21 Ibid, p 45.


38 M Wolf, ‘Asia’s other giant slowly awakes: can India integrate into the rest of the world as profitably as China?’, Financial Times, 26 January 2007.


42 Palat, ‘Rise of the global South’, p 52.


44 Palat, ‘A new Bandung?’, p 722. In 2005 the top 10% of the US population accounted for 48.5% of all reported income according to the Internal Revenue Service (IRS). They had only accounted for 33% in 1970, while in 1928 they had accounted for 49.3%. There was not only a relative increase in inequality, but an absolute deprivation of the poor as well. In 2005, while total income increased by 9% over the previous year, it dropped by 0.6% for the bottom 90%. The decline may be even greater since IRS estimates capture 99% of wage income but only 70% of business and investment income, which accrues disproportionately to the rich. Additionally, the poor rely more on welfare and fringe benefits which suffered cuts—especially in health care, child care and education. DC Johnson, ‘Income gap is widening, data shows’, New York Times, 29 March 2007.
51 RT Murphy, ‘US seigniorage, the world economy and Japan’, Japan Focus, V(1), 2009.
60 Bach et al, ‘The international implications of China’s fledgling regulatory state’, p 504.
61 Quoted in ibid.
62 Ibid.
64 Cf Palat, ‘Flailing eagle, crouching tigers’, p 3624.
73 Ibid, pp 201–207.
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