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## IMBALANCES OF THE GLOBAL ECONOMY

It is now widely acknowledged that the increasing international integration and liberalization of the past decades has ushered in an era of turbulence and uncertainty in the global economy. [\[1\]](#) The growth and fragility of financial markets, the impact of their excesses upon real economies, the disruptive effects of China's dramatic rise, the scale of America's foreign debt and the effects of intensifying competition on national labour markets all point to continuing instability in the decades ahead. What follows is a survey of some of the most salient trends in the world economy today and a sketch of the directions they may indicate.

To begin with the United States. It is worth recalling that, as recently as 1989, an MIT Commission on Industrial Productivity set up to consider the risk posed to the us economy by rising productivity levels in Europe and Japan, could begin its report with the gloomy warning that:

To live well a nation must produce well. In recent years many observers have charged that American industry is not producing as well as it ought to produce, or as well as it used to produce, or as well as some of the industries of some other nations have learned to produce. If the charges are true and the trend cannot be reversed, then sooner or later the American standard of living must pay the penalty . . .

Products made in the United States are said to be inferior . . . American factories are accused of inefficiency; the work force is said to be indifferent and ill-trained; and managers are criticized for seeking quick profits rather than pursuing more appropriate long-term goals. [\[2\]](#)

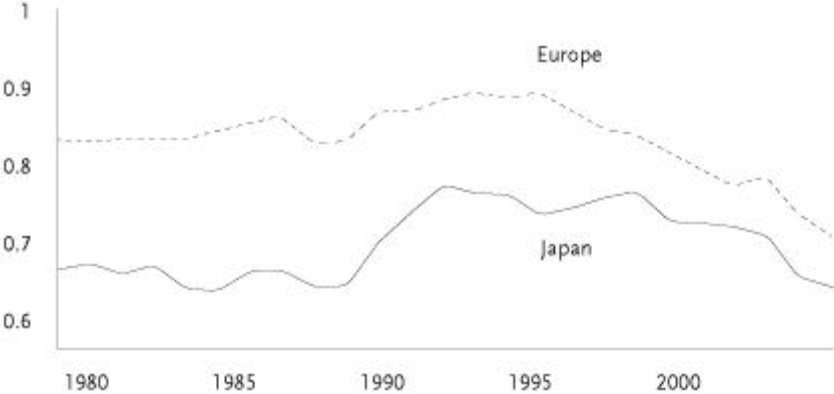
The MIT Commission carried out eight case studies, including cars, computers and consumer electronics; in each industry, the seriousness of the competition posed by European or, more often, Japanese companies was stressed. Given the excitement that has since surrounded the nimble high-tech companies of the 'new economy' boom, the Commission's comment on semiconductors is striking: 'The contest was between small, single-product, inexperienced under-financed American start-ups and the heavyweights of Japanese industry. David did not defeat Goliath'. [\[3\]](#)

The turnaround came after 1995, as American productivity growth accelerated and both Europe and Japan, having made considerable headway in catching up with the US in the post-war period, fell further behind again (Figure 1). Although these can only be very approximate, comparisons of productivity levels suggest that European and Japanese manufacturing industry had got within striking distance—80 to 90 per cent—of American levels by the mid-1990s, then sank back to around 65 to 75 per cent.

One effect of the relative improvement in American economic performance was to encourage massive inflows of capital into us financial assets, driving up the value of the dollar which appreciated by 29 per cent against the currencies of its main trading partners between 1995 and 2001. Figure 2 shows the shifts in both the nominal value of the dollar against other currencies and in the 'real exchange rate', measuring the cost competitiveness of us manufacturers by adjusting for labour-cost changes. As is clear from the chart, the

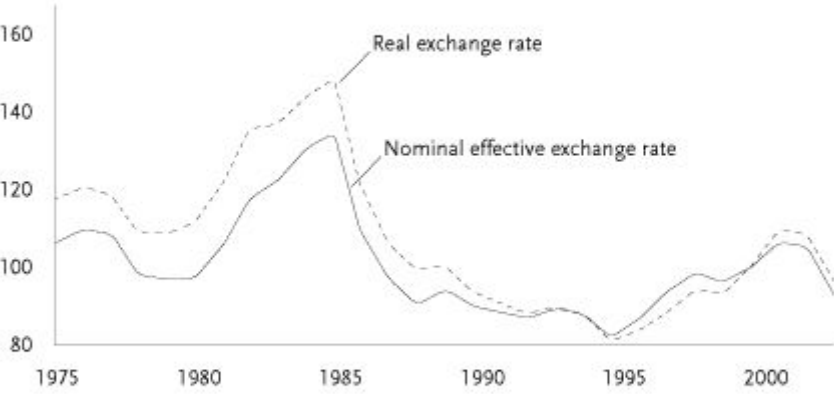
overwhelming influence on the real exchange rate has been the fluctuation in the nominal exchange rate of the dollar against other currencies. The real dollar exchange rate appreciated by some 40 per cent in the first half of the 1980s, fell rather more than that in the later 1980s and early 1990s, before appreciating by around one third during the subsequent boom. The real depreciation in the early 1990s was a bit more than the nominal depreciation, as us costs also rose relatively slowly. However, for each of these big swings, including the most recent dollar depreciation, shifts in the nominal rate have dominated.

Figure 1: *Relative levels of manufacturing productivity: USA=1*



Source: The series measure for output per hour worked. Relative productivity levels from Groningen Growth and Development Centre, ICOP 1987 Benchmark Database (for Japan), 1997 Benchmark (for Europe), linked to Bureau of Labor Statistics manufacturing productivity data for Japan (from 1987) and Europe (from 2001).

Figure 2: *US exchange rate: nominal and real, 2000=100*



Source: IMF International Financial Statistics. Real exchange rate measured by the IMF's series for relative unit labour cost (RULC), which includes both the impact of exchange rates and relative changes in wages and labour productivity. A rise in the index represents real or nominal appreciation.

The early 1980s rise in the dollar can, of course, be explained by the attraction of the rise in us interest rates implemented by Volcker at the Federal Reserve, and then reinforced by a rising budget deficit. The US government maintained a policy of ‘benign neglect’ towards the exchange rate until it had pressured Tokyo to open up Japanese capital markets in 1984. This was supposed to lead to a capital flow towards Japan (thus reducing the dollar’s value) but its greater impact probably lay in making it easier for Japanese investors to chase the rising dollar. The perverse effect of the high dollar on us manufacturing was of little concern to Wall Street, which was more interested in access to Japanese markets. Indeed, it has been argued that in the early 1980s some us banks ‘hoped, with the Federal Reserve, that the appreciation of the dollar would force rationalization and cost-saving upon what they perceived to be a spendthrift and undisciplined manufacturing sector’. By early 1985, however, the strength of complaints from manufacturing about the neglect of the dollar ‘had multiplied greatly’ and was ‘certainly a major influence’ on the Reagan Administration’s shift to a more activist policy. [\[4\]](#) The (gross) profit share of us manufacturing value added was 24.8 per cent in 1985, very close to the 24.3 per cent level of 1979 before the recession and recovery. Given the extraordinary decrease in us competitiveness implied by the rise in the dollar, a sharp decline in profitability might have been anticipated. That it did not materialize suggests the degree to which us manufacturers had ‘rationalized’. [\[5\]](#)

The speculative nature of the dollar’s rise became hard to dispute as it carried on into 1985 after us interest rates had begun to fall relative to those on competing investments. In February the bubble deflated and the dollar fell back. In September 1985, and with a less dogmatic team at the us Treasury, finance ministers of the G5 meeting at the Plaza Hotel agreed that ‘some further orderly appreciation of the non-dollar currencies is desirable’ and that they ‘stand ready to co-operate more closely to encourage this when it would be helpful’. Background papers mentioned a 10–12 per cent dollar depreciation. The dollar dropped by 4 per cent immediately and then resumed its downward slide, encouraged by sales of \$10 billion by central banks including the Fed. By the end of 1986 Japanese exporters were feeling the pinch. In the Louvre Accord of February 1987, G7 finance ministers announced that the previous dollar decline had brought currencies within the range ‘consistent with underlying economic fundamentals’ and that further changes could be damaging. Though it was not made public, there was an apparent understanding that exchange-rate fluctuations should be kept inside a ‘reference band’ by central bank intervention in the foreign-exchange markets and, if necessary, by co-ordinated macro policies. Heavy central bank intervention—including \$100 billion purchases of dollar securities by the Japanese government—restrained and then halted the dollar’s slide. But its depreciation after 1985 had helped push up the manufacturing profit share by 5 percentage points, to reach 30 per cent in 1988–89.

The first two years of the Clinton Administration saw a further decline in the dollar. In 1995 policy switched, with the White House announcing that it wanted a ‘strong dollar’. The G7 finance ministers were persuaded to declare that a reversal of its decline against the yen was now desirable and to initiate heavy foreign-exchange intervention to that end. Larry Summers, later Secretary of the Treasury, justified the policy by arguing that pushing the dollar down would lead to a lack of confidence in financial markets and ‘undermine the discipline needed to increase productivity’. [\[6\]](#) The dollar rose again, as Figure 2 shows, though to nowhere near the level in real terms of the early 1980s. [\[7\]](#) But though the ‘strong dollar’ policy may initially have helped the currency rise, a more important influence was the excitement surrounding the ‘new economy’ boom. Overseas purchases of us assets such as equities and bonds were four times as high in 2000 as they were at the end of the 1980s boom. ‘The capital inflow’, as one observer put it, ‘is the way foreigners share in the higher profits and future

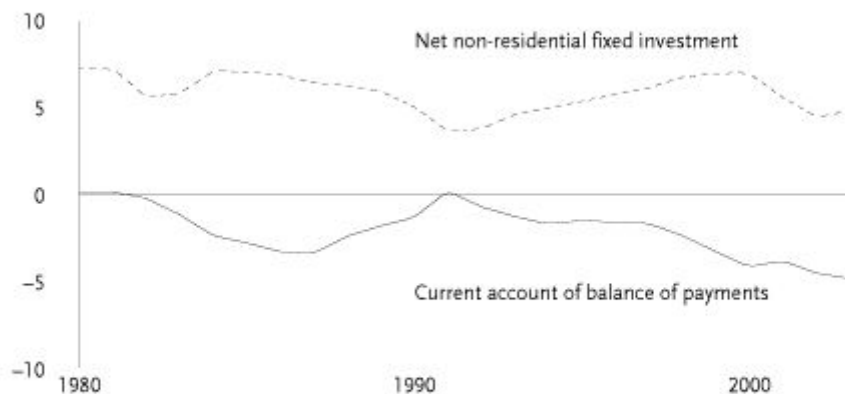
profits that new technology is expected to bring'. [8] With both the stock market and the dollar rising, returns on such investments in the USA were soaring and this in turn attracted more speculative inflows.

### *Current-account deficit*

The gyrations in US exchange rates did not simply redistribute wealth between speculators; the real economy of exports and jobs was also involved, and with it the balance of payments. As shown in Figure 3, the US current account has been in deficit every year since 1982. While there was an improvement when the dollar fell in the second half of the 1980s (compare Figures 2 and 3), the deterioration through the 1990s appears inexorable. The deficit in 2003 was thus considerably larger as a percentage of GDP than it had been in the mid-1980s when the real exchange rate was vastly more appreciated and manufacturing less competitive.

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Figure 3: US current account and domestic investment (% GDP)



Source: Bureau of Economic Analysis, International Transactions, Table 1 and National Income and Product Accounts Table.

The consumer boom of the late 1990s had sucked in large quantities of consumer goods, from China in particular, with the volume of imports into the USA rising by 75 per cent between 1995 and 2000. Imports took 26 per cent of the US market for manufactures in 2000, including 80 per cent for leather and shoes, 57 per cent for apparel, 51 per cent for computers and electronic equipment, and 33 per cent for cars and a wide swathe of machinery. [9] At the same time, the overvaluation of the dollar and the collapse of the high-tech boom, which had boosted exports of ITC equipment, took their toll on US exports which lost one fifth of their world market share between 2000 and 2003. The growing current-account deficit reflected a

growing deficit in goods, and even the services account declined a little to near balance in the early 2000s. By 2004 the debts of the US government and firms overseas exceeded American-owned foreign assets by the equivalent of some 30 per cent of GDP. Even so, the us was still making a small net surplus on the returns from its investments overseas, much of which had constituted high-return 'direct' investments by American companies with subsidiaries abroad. Though there was a big inflow of direct investment into the us in the 1980s and especially during the 'new economy' boom, a good deal of this was invested in taking over existing assets, yielding a lower return than us multinationals earned on their direct investments abroad in new production facilities. Nevertheless, if the current-account decline persists and the overseas debts continue to pile up, the investment income account will inevitably go into the red, pulling the current account further into deficit. A persistent current-account deficit of 5 per cent of GDP implies an overseas debt ratio rising towards 100 per cent of GDP, given an underlying growth rate of the economy of around 5 per cent in nominal terms (say 3.5 per cent growth and 1.5 per cent inflation).

The prospect is thus of increasing indebtedness until the pattern of growth can be twisted away from consumption and imports and towards exports. Wynne Godley has suggested that a real devaluation of one third from the 2002 level would be necessary to bring the US into reasonable balance. [\[10\]](#) As mooted in an alternative set of calculations, the nominal fall in the exchange rate would have to be considerably greater than the 'necessary' real change, since some of the competitive advantage would inevitably be eroded by faster us inflation as the dollar price of imports rose. [\[11\]](#) But we should also note the proportion of net fixed investment (investment in excess of depreciation) in buildings and machinery of us business, plotted in Figure 3. By 2002, the current-account deficit—i.e., the amount borrowed from overseas—matched net business investment. It was as though the whole of the meagre us savings was absorbed by the government's budget deficit and by house-building, leaving *all* net business investment in the us to be financed by borrowing the savings of other countries, an astounding position for the richest country in the world. [\[12\]](#)

If the US has been borrowing so much, who has been doing the lending? The first row of Table 1 shows the average size of the current-account deficit, building up to more than 5 per cent of GDP from 2003. A first possible source of finance would be from overseas firms investing more in new factories in the US, or in purchasing us companies, than us firms were doing. However this category of 'direct investment' (inflows minus outflows), having been small throughout the 1980s and 1990s, became a net outflow from 2003 on as American firms were investing more overseas than their counterparts were doing in the us (see line 2 of Table 1). A second source would be for overseas individuals and financial institutions to buy us bonds or shares in US companies, or to deposit money in us banks. Again the issue is the balance between finance coming in and corresponding outflows by us residents and financial institutions. In fact the overseas private sector provided modest finance for the US current-account deficits in the 1980s and 1990s, but almost all the extra finance required when the deficit blew out over the years 2000–02 (line 3). It seems surprising that the collapse of the US stock market and of exaggerated expectations about the 'new economy' boom did not undermine the supply of private-sector finance earlier. Since 2003, however, a third source of finance, that coming from overseas governments piling up foreign-exchange reserves in the form of us Treasury bills and bonds, has been most salient. Extra 'official' holdings were quite small until 2003–04, when Asian governments in particular began to acquire huge quantities of dollars as they intervened in foreign-exchange markets to sell their own currencies (line 4), in heavy demand, and thus prevent them rising in value relative to the dollar and making their exports less competitive. In 2003–4 the US currency was only

prevented from freefall by governments in the Far East being prepared to accumulate seemingly endless piles of dollar assets, as a counterpart to export surpluses. By the end of 2003 overseas governments held 1.474 trillion dollar assets, equivalent to 13 per cent of us GDP.

TABLE I. *Financing the us balance of payments deficit*

<i>Percentages of GDP*</i>	1980-89	1990-99	2000-02	2003-04
Current account	-1.7	-1.5	-4.3	-5.6
Direct investment (net)	0.3	-0.1	0.4	-1
Other private capital (equities, bonds, bank deposits)	0.8	0.9	3.7	3.2
Overseas govts' holdings of us assets	0.4	0.7	0.6	3.2

\* - means deficit or outflow; sources of finance are +.  
Source: calculated from BEA Balance of Payments table 1.

The Bank for International Settlements underlined the precariousness of the position of the dollar in 2005: the widening current account deficit of the United States is a serious longer-term problem. That is, it could eventually lead to a disorderly decline of the dollar, associated turmoil in other financial markets, and even recession. Equally of concern, and perhaps closer at hand, it could lead to a resurgence of protectionist pressure. The unprecedented size of the deficit, the speed with which external debts are growing, the increasing reliance on the official sector for deficit financing, and the fact that us borrowing has primarily financed consumption (rather than investment) all suggest an eventual problem. Moreover, given the interdependency of modern financial markets, it is likely that problems would not be confined to the dollar alone. [\[13\]](#)

### *China's rise*

More broadly, it is capital accumulation that remains the fundamental driving force of the economy, even if the precise relationships at stake have been hotly contested. Increases in investment are usually the most dynamic element in expansions of aggregate demand, particularly on a world scale where one country's exports are another's imports. [\[14\]](#) On the supply side, growth of the capital stock is a precondition for expanding capacity, while investment has a symbiotic relation with new technology, the route through which it enters the production system and which also renders it more profitable. Table 2 shows how the rate of accumulation on a world scale slid back after the 1970s, with the industrial countries now accumulating at a slower rate than the world as a whole, implying that the developing countries are accumulating distinctly faster. (Calculations are based on partial information so small differences in growth rates should not be taken literally.) The numbers in bold show major countries whose accumulation rate is estimated to be more than 1 percentage point above the world growth rate for capital at the time. The fall in the capital stock growth is clear across the OECD, as the baton of 'super-accumulator' passed from Japan in the 1960s to Korea (and Taiwan) in the 1970s and 1980s, and then to China in the 1990s. In the early 2000s the growth of capital stock in China could easily be 12 per cent or more.

TABLE 2. *Capital accumulation: growth rates of fixed capital stock (per cent per year changes)*

	World	Industrial countries	USA	Europe	Japan	Korea	China	India	Brazil
1960s	5	5	4	4.6	12.5	8.9	1.9	4.5	5.8
1970s	5.1	4.2	3.8	3.8	8.5	14.6	7.2	4.1	9.6
1980s	4	3.1	2.8	2.9	6.1	11.2	8.4	4.9	4.1
1990s	4	3.3	3	2.8	4	9.6	10.9	6.2	2.2
2000–04	-	-	1.8	2.4	3.2	-	-	-	-

Source: calculated from background data for Barry Bosworth and Susan Collins, 'The Empirics of Growth: An Update', *Brookings Papers on Economic Activity*, 2 (2003), pp. 113–206, except USA, Europe and Japan from OECD *Economic Outlook* June 2004, table 22 and background data. Europe data for 1960s and 1970s are the unweighted average growth rates for 10 countries.

How should we construe the broader patterns of China's rise? First, although there was an expansion of state employment during the early stages of China's high-growth period, including in the dynamic and crucial manufacturing sector, from the mid-1990s onwards this entered a sharp decline. 'Through a combination of management and worker buy-outs that converted firms from public to private, some bankruptcies and a substantial workforce downsizing in firms that remain state-owned, manufacturing jobs in the state sector have declined by almost three quarters from their peak'. [15] In its most recent phase, private capital accumulation has dominated the growth process in China.

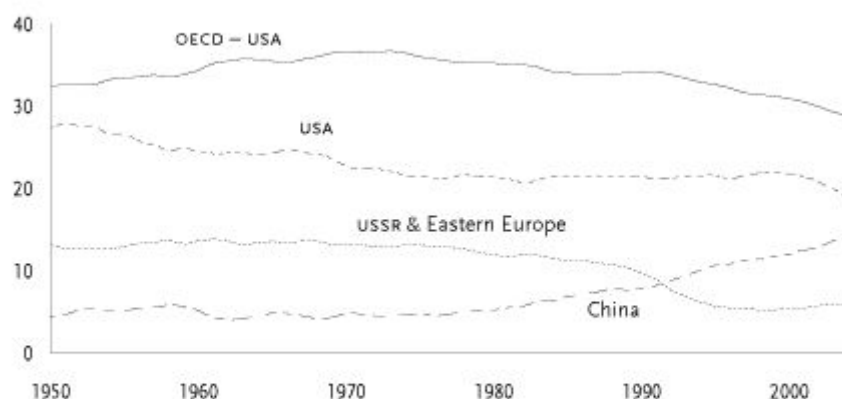
A fast growth of the capital stock requires high ratios of investment to GDP. Maddison's adjusted official figures give a Chinese investment share of about one third for 1978–94, which is very close to that reached in Japan and Korea. [16] Indeed confining attention to machinery and equipment investment, often seen as the main driver of growth, its ratio to GDP has been running at around 20 per cent, about 6 percentage points less than in Korea and Japan during their maximum growth periods and only 3–4 percentage points more than France and Germany during their Golden Age. [17] So, even with a further sharp rise in the investment share in 2003 and 2004, China's productive investment effort is not wholly unprecedented. Importantly, however, it is playing out on a massive canvas and with vastly larger supplies of surplus labour than were available to its Asian predecessors in the catch-up process.

After some decline in profitability in the later 1990s, Chinese industrial profits in money terms rose by a factor of five between 1999 and 2004, and profits in the distribution sector rose at an even faster pace. Conventional calculations for the rate of return to equity holders suggest a higher return on capital in 2004 than in the mid-1990s. Domestically funded companies have considerably lower reported profits than foreign-owned ones, with those owned in Hong Kong, Macau and Taiwan most profitable of all (despite a tendency to under-report profits for tax reasons). Foreign-owned companies export around one third of their sales, three times the share for domestic companies. [18]

Total employment in China is estimated at around 750 million, or about one and a half times that of the whole of the OECD and nearly ten times the combined employment of Japan and Korea. About one half of China's employment is still in agriculture. This constitutes an enormous labour reserve available to flood in from the less developed interior of the country as labour markets tighten in the coastal industrial areas. Estimates of the number of workers who may be pulled out of agriculture, where their incomes are very low, into industrial and service jobs in the towns, range as high as 150–300 million, depending on the timescale. [19] There are already very large numbers of workers making some kind of living in the informal sector of the urban economy, including both new recruits from the countryside and those made redundant from state enterprises. They constitute an additional part of China's huge 'reserve army of labour'.

Very rapid capital accumulation has brought a spectacular rise in China's share of world GDP, nearly tripling from 5 per cent to 14 per cent in a quarter century. China on its own has made up for all the collapsed output share of the ex-Soviet Union and Eastern Europe and much of the downward drift in the share of Europe and Japan. [20] Figure 4 suggests that if current trends continued for another decade or so China will be challenging the US's title as the world's largest economy.

Figure 4: Percentage shares of world output

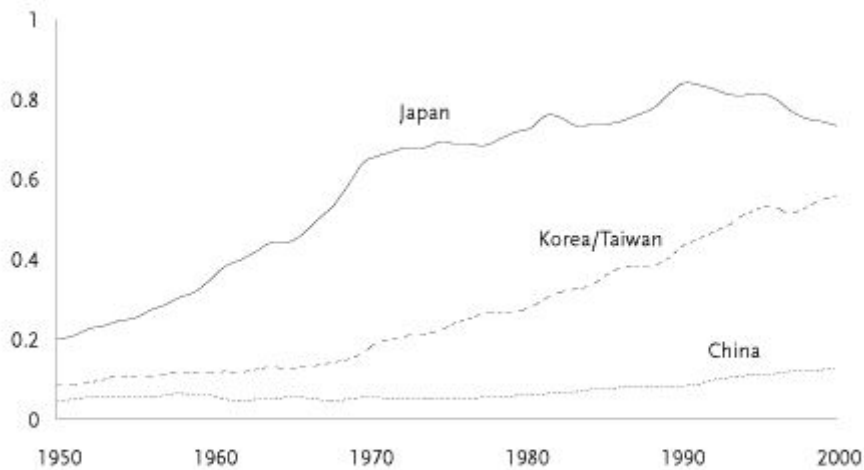


Source: calculated from database in Angus Maddison, *The World Economy: a Millennial Perspective*, Paris 2001. GDP is at PPP (Maddison's version). Data is extended to 2004 from IMF World Economic Outlook Database. OECD refers to 'old' OECD (i.e. excluding Korea, Mexico etc).

Whilst becoming the world's largest economy will be a notable development, China's vast population means that this would occur at less than one quarter of the US level of GDP per head. Figure 5 sets the growth of China in the longer-term perspective of Asian catch-up. Despite the doubling of the ratio of per capita GDP compared to the USA over the past 20 years, China is still as far behind the USA as Korea and Taiwan were before their three decades of rapid catch-up beginning in the late 1960s; its percentage GDP is still well below that from which Japan started its spectacular growth climb in the mid-1950s. [21]



Figure 5: Catch-up in Asia: per capita GDP, USA=1



Source: calculated from database in Maddison, *The World Economy*. GDP per capita is at PPP (Maddison's version).

China is obviously far larger, in terms of population, than the earlier examples of Asian 'catch-up'. However it is also, after two decades of spectacular growth, still far behind, in relative terms, the positions from which their growth spurts were launched. Both aspects contribute to China's gigantic growth potential. Of course, there is nothing inevitable about China continuing along its present trajectory. Yet if it does, the problems of adapting to this major shift in the structure of world trade and output will be correspondingly severe.

The current and prospective development of China dwarfs all other current trends in the world economy. For example it more than accounts for all the reduction in the inequality of the distribution of income on a world scale. Large numbers of Chinese have received increases in their real incomes, raising an important layer from the bottom of the world income distribution. [22] Despite major increases in inequality *within* China, the improved living standards of so many millions has had a greater effect in reducing income differences on a world scale. [23]

#### *Shift in world trade share*

Table 3 records the tenfold growth in Chinese manufactured exports as a share of world exports over the past twenty-five years. Since 1990 this growth has exceeded in absolute amount that of the nine next largest 'low-wage' manufacture exporters put together. [24] Ominously for them, since 2000 their combined export share has fallen whilst China's has risen rapidly. An analysis of the impact of Chinese exports on its Asian competitors has suggested that countries producing consumer goods based on low wages have suffered, while capital-goods producers like Korea were gaining from the expanding market in China. [25] Between 1980 and 2000 one half or more of the increase in China's export share in labour-intensive sectors such as clothing, travel goods, footwear and toys was at the expense of Korea, Taiwan and Singapore, [26] with the pressure now rising on India and Indonesia. Up to one third of Chinese manufactures are produced from foreign-owned plants, mostly Japanese, and this generates a flow of machinery and component imports into China from Japan to sustain export production. [27] In 2003 China (including Hong Kong) ran a trade

surplus of nearly \$100 billion with the USA, but was in substantial deficit with Japan, Korea and Taiwan. [28] Although foreign-owned plants account for around one half of Chinese exports, more of their production is sold to the rapidly expanding home market than is exported.

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TABLE 3. *China's exports*

A. Percentage shares of world exports of manufactures

	1980	1990	2000	2003
<i>China</i>	0.8	1.9	4.7	7.3
<i>9 other major low-wage countries</i>	6.8	10.5	16.1	15

B. Chinese share of imports into North America, Europe and Japan by sector

	<i>North America</i>		<i>Europe</i>		<i>Japan</i>	
	1995	2003	1995	2003	1995	2003
<i>All manufactures</i>	7.6	15.9	2.2	4.7	15.1	29.3
<i>Toys and games</i>	52.3	76.9	26	39.8	26.4	56.7
<i>Clothing</i>	14.9	16.9	7.9	12.2	56.6	80
<i>Office equipment etc</i>	5.4	23.7	2.5	10	5.8	28

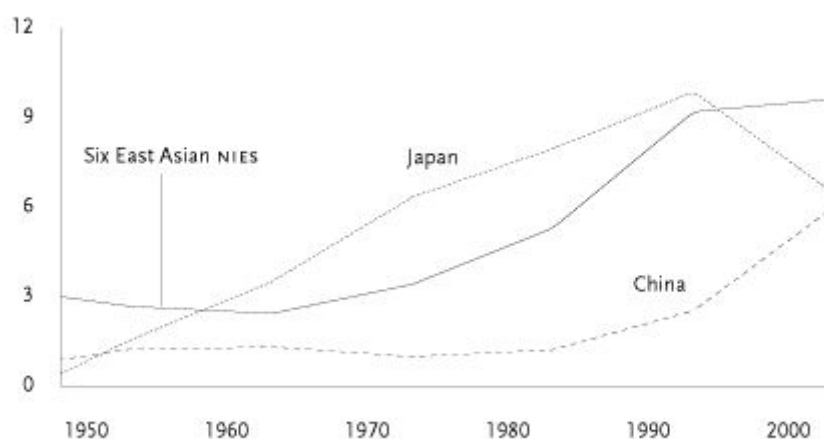
Source: WTO International Trade Statistics 2004; Table 11.3-5, 111.7.5, 11.26.

China now makes nearly one third of the comparatively limited amount of manufactured imports into Japan (Table 3b, line 1). It accounts for a larger fraction of imports into both Europe and North America than does Japan. In each case China's market share has more or

less doubled in under a decade. China dominates imports of toys and games and has 40 per cent of imports of clothing from low-wage countries; it is set to gain more market share for clothing as quotas are phased out with the end of the Multi-Fibre Agreement. Its share in office equipment, several rungs up the technological ladder, is already rising rapidly. In 2002 China displaced the EU and Mexico as the biggest exporter to the us of computers, consumer electronics and other it products, [29] though a large proportion of these exports involved assembly of high-tech components sourced abroad.

The growth of China's involvement in world trade is spectacular but, thus far, not without precedent. Just as the take-off of accumulation in China followed the pattern set by Japan and then Korea, so has the trajectory of its exports. Figure 6 shows that China's exports have not yet reached the shares of world trade achieved by Japan in the 1980s and 1990s, and then by the Asian NIEs. Even though the rising share of Japanese exports was a more measured and protracted process than China's, the latter's steep climb was matched by the NIEs in the 1980s. Sharply rising competition from the East has been a persistent trend over the past 40 years and China's export growth is its latest manifestation, rather than a qualitatively new phenomenon.

Figure 6: Percentage shares of world commodity exports



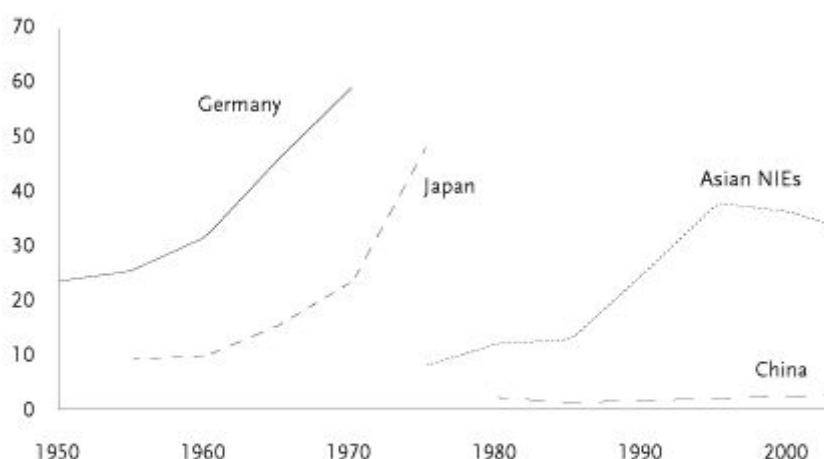
Source: WTO International Trade Statistics 2004; Table II.2

However, as noted earlier, China's size and current backwardness means that it has the potential to carry this process a great deal further. Another couple of decades of Chinese growth at something like current rates must involve an enormous expansion of Chinese exports to pay for the rising bill for imports of food, materials, fuel, semi-finished manufactures, capital goods and even luxury brands of consumer goods. Fast compound growth in China's exports has a greater and greater absolute impact both on its low-wage competitors and on domestic producers in the rich countries, as its share of world trade grows. Thus China's share roughly doubled in the 1980s, increasing by around 1.5 percentage points; it doubled again in the 1990s, pushing it up by 3 per cent. If per capita GDP growth rates of around 6 per cent per year in China persist, a further doubling of the export share in the next decade would probably be necessary to pay for the rising import bill. This would raise

China's export share by another 6 percentage points or so, more than the impact of the 'Asian tigers' in the 1980s. [30] Moreover, even after another decade of such expansion, China's per capita gdp would not nearly have exhausted the possibilities of further rapid growth as its productivity would still be far below that of the rich countries. Of course economic crises can stifle a country's growth at any level of development, as the stagnation in Japan, after the collapse of its bubble, and Indonesia, in the wake of the Asian crisis, illustrate all too well. But barring a collapse into longer-term stagnation China will continue to have a massive effect on the evolution of the world-trade structure.

A further huge expansion of Chinese exports will certainly increase competition for markets in the OECD countries, causing serious problems for the other Southern industries fighting for a share in them. China will at some stage move up the 'value chain' in the same way as did Japan and the Asian NIEs; when wage levels rise, industries can no longer compete so effectively in 'low-value' markets. The historical experience is that at a certain stage in the catch-up process wages do start rising substantially. At present, however, wages are still much lower in China than they were during the boom periods in Japan and the Asian NIEs and are not yet threatening China's position as low-wage producer par excellence (see Figure 7).

Figure 7: *Manufacturing wages during catch-up, USA=100*



Source: BLS November 2004 series for hourly compensation of manufacturing workers. China estimated from Statistical Yearbook series for annual manufacturing earnings in non-state enterprises divided by 2500 to give an hourly wage and deflated by exchange rate for Yuan, from IMF International Financial Statistics.

Real incomes have been rising in urban areas at over 5 per cent per year on average during the 1990s, although residents have also faced much higher charges for education and health. [31] Moreover these estimates do not include rural migrants, who make up much of the workforce for the exporting factories. In Guangdong province, where many export factories are situated, base wages are reported at about \$80 per month and working hours can be up to 80 per week. Wages are reported to have hardly risen in nominal terms in a decade and inflation has eroded their real value by up to 30 per cent despite the rapidly growing employment, suggesting that this group of workers has not shared in the general urban prosperity. [32] The migrants have to go through elaborate and expensive bureaucratic procedures to obtain permission to work

in the cities and it is frequently very difficult for them to change jobs. Labour discipline is very harsh, especially in Korean and Taiwanese-owned factories, where apparently in some cases 'workers are even marched to and from meals and to and from dormitories in tight military-style squads'. [\[33\]](#)

Independent unions are banned, workers are often jailed for organizing strikes and the official All-China Federation of Trade Unions 'for decades has aligned itself more closely with management than with workers'. [\[34\]](#) A senior provincial ACFTU official explained the union's attitude to poor conditions as being 'better than nothing':

Labour protections, working conditions and wages are related to a country's level of economic development. Of course we want better labour protections, but we can't afford it. We need the jobs. We need to guarantee people can eat. [\[35\]](#)

Foreign firms locating in the Industrial Parks find 'there is no union representation in the plant . . . There is no interference by labour unions in operations management. The labour union also seemed not to exert influence in the area of wages'. [\[36\]](#) Despite all these obstacles, websites regularly report on quite major strikes and other actions, including disputes over unpaid wages and compensation for redundancy. [\[37\]](#) There have been successive relaxations of the restrictions on migration to the towns, but labour shortages are reported in the coastal areas, giving button-sewers and shoe stitchers a bit of bargaining power for the first time. Factory owners cannot replace disgruntled employees as easily as they once could; wildcat strikes can cripple output for days or weeks. Almost imperceptibly, workers are starting to win concessions'. [\[38\]](#)

Provided the boom keeps going and the labour reserves are whittled away, then at some stage market forces will overwhelm the repressive measures and wages will start growing for the exporting factories just as they did in Japan and the Asian NIEs. Moreover continued export success will bring currency appreciation of the yuan which will further increase wages valued in terms of dollars and thus affect competitiveness. Rising wage costs will force Chinese firms to switch to production and export of goods requiring more skilled labour. This will relieve the pressure on the other very low-wage exporters now suffering from Chinese competition. In their stead, it will be other producers of the more sophisticated goods into which China moves, in the North and in the Asian NIEs, who will feel increasing pressure.

China's imports have been growing very rapidly and now comprise around 5 per cent of world imports of both agricultural products (food and materials) and mining products (metals and fuel), including 12 per cent of world imports of iron and steel. [\[39\]](#) Although the latter have received much attention, with press stories of shortages of steel capacity and China's voracious demand for oil and other inputs, imports of manufactures into China are currently worth about four times as much as those of agricultural and mining products. Imports of high-tech components (of computers, for example) for re-export play a very substantial role. However, imports of capital goods for domestic investment and consumer goods for domestic consumption have become increasingly salient. The fundamental point is that China is important not only as a source of cheap, and potentially disruptive imports, but is an increasingly significant market for exports. Again, if Persian Gulf oil producers or Brazilian soy bean farmers receive higher incomes through exporting to China, they in turn will tend to buy more imports. Thus, both directly and indirectly, China is becoming an increasingly important influence on the economies of the oecd countries.

## *Capital flow and currency crisis*

A further, well-documented source of disequilibrium has been the growth of international financial flows, stimulated by the progressive abandonment throughout the OECD of capital controls. Amongst OECD countries, five out of nineteen were classified by the IMF as having open capital markets in 1976, including the USA and Germany. The UK and Japan followed suit by 1980. By 1988 only one OECD country was classified as having controls in one of the five strongest categories, compared to half the countries in 1973. In the late 1980s and early 1990s the rest of the OECD liberalized, with Norway the last of the social-democratic strongholds to succumb in 1995. [\[40\]](#)

World foreign-exchange trading reached \$1,900 billion per day in 2004, more than three times the level of 1989. [\[41\]](#) Massive two-way flows of funds have built up as banks and other institutions simultaneously borrow and lend abroad. Estimates show the total value of stock of foreign assets of a large sample of countries as having doubled between 1980 and 1995, from the equivalent of 36 per cent of GDP to 71 per cent of GDP, having already more than doubled over the previous two decades. [\[42\]](#) By the early 2000s the ratio probably reached 100 per cent, getting on for twice its peak in 1900. Transactions in overseas securities by US residents increased 60 times in relation to GDP between 1977 and 2003. [\[43\]](#)

Theoretically, such activity parcels out risks and returns between holders of financial assets in an efficient way. In measuring its actual impact, we need to examine the effects on payments balances: to what extent has greater capital mobility allowed countries to run balance-of-payments deficits on current account, and has this helped or hindered stability and growth? Have capital flows facilitated rapid movement of exchange rates towards appropriate levels, or tended to exaggerate over- and under-valuations which have serious consequences for the real economy?

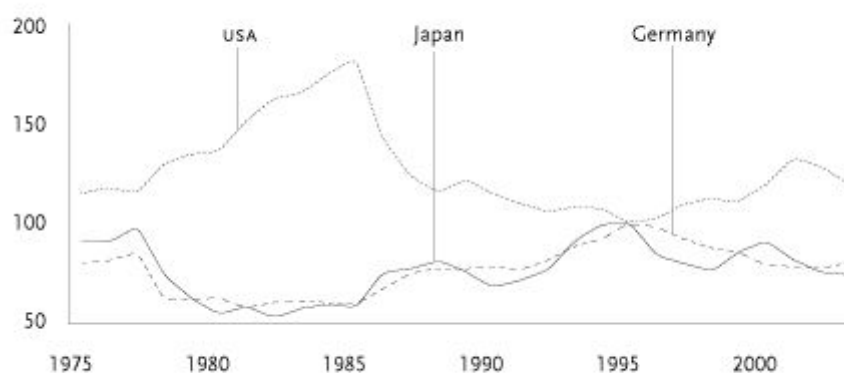
During the Bretton Woods period of pegged exchange rates, with devaluations only allowed in situations of 'fundamental disequilibrium', the current account of the balance of payments was generally regarded as a constraint to which domestic policy had to respond. Current-account deficits were small. Since the early 1980s, and especially in the 1990s, however, there has been a substantial increase in the average size of balance-of-payments surpluses or deficits (in relation to GDP). [\[44\]](#) Where larger deficits have reflected borrowing to invest productively by poorer countries, or those particularly well endowed with natural resources, the effects would clearly be beneficial. However deficits have more often been associated with consumer booms. If the rising US deficit at the end of the 1990s expansion could be regarded as facilitating investment, by 2004—with the current account in the red at 5 per cent of GDP—it was merely funding high levels of consumption and military spending.

Free mobility of capital is supposed to ensure that exchange rates smoothly offset trends affecting the competitiveness of a country's exports (rate of wage increases out of line with those of competitors, for example). This would mean that the 'real exchange rate'—the nominal rate adjusted for price or wage cost inflation—would be maintained, or only adjust gradually in response to long-run changes in underlying competitiveness. Here the record has belied free-market theory. On average the real exchange rate of OECD countries changed by about 3 per cent a year in the 1960s, and then 6 per cent a year in the 1970s as the Bretton Woods system collapsed. [\[45\]](#) Real exchange rate fluctuations subsided somewhat after the 1970s, but in the 1990s these year-to-year movements were still half as large again as in the 1960s. If these were merely random fluctuations around satisfactory trends they could

hopefully be absorbed by the real economy without undue costs, especially as the greater sophistication of financial markets and its participants made it easier to hedge against fluctuations in nominal exchange rates. However, these year-to-year movements have also coincided with longer-term swings in real exchange rates (and thus the cost competitiveness of the traded-goods sectors) which can have a lasting, distorting effect on the structure of the economy.

Confining attention to the three major currencies (dollar, yen and euro, superseding the deutschmark), Figure 8, shows the real revaluation of the dollar by around 70 per cent in the first half of the 1980s, followed by a sharp fall and then another substantial increase after 1995. The euro and the yen have also delivered large changes in real competitiveness, generally mirroring the dollar. Such sustained movements in the real exchange rate can be extremely damaging to the capacity of the economy in the medium term, as adjustments are made—companies withdraw from export markets; workers are made redundant—which are not readily reversed if the real exchange rate reverts to a more appropriate level. [46] A detailed study of us manufacturing found that dollar appreciation substantially increased job destruction and that this was *not* compensated by correspondingly lower job destruction or increased manufacturing job creation when the dollar depreciated again. [47] The authors also note the damaging effects of bursts of job destruction: ‘Workers are likely to have an easier time finding suitable re-employment when job destruction is gradual and diffuse than when an external shock [e.g. dollar appreciation] causes job destruction to spike and, consequently, a glut of displaced workers are searching for new jobs simultaneously’. [48]

Figure 8: Real exchange rates 1975–2004, relative unit labour costs



Source: IMF International Financial Statistics; measure is relative unit labour costs in manufacturing.

The pathological case of exchange-rate fluctuation, a full-blown ‘currency crisis’, is conventionally defined as a month when a combination of exchange-rate and foreign-currency reserve changes exceed a threshold level. One recent study of five OECD countries (four Scandinavian countries and Spain) found that each had experienced four or more crisis episodes since 1970. [49] As well as instances involving big budget deficits, current-account deficits or ‘financial excesses’ there were also crises caused by sudden shocks in international capital markets and self-fulfilling speculative attacks—‘crises also happen in economies with immaculate fundamentals’. [50] The incidence of crises with a currency element rose in the

period of floating rates since 1973, with the period up to 1987 being worse than the following decade. [51] In an admittedly rough and ready calculation Eichengreen suggests that re-imposing capital controls, with the presumed effect of suppressing currency crises, could add as much as \$100 billion per year to the *growth* of world GDP. However he did not favour such a move since he estimated the costs, in terms of reduced depth of financial intermediation, as 50 per cent more than the benefits. It seems unlikely that controls focused on short-term financial flows would have such dire effects on the financial system and thus economic growth. More fundamentally, the issue of who bears the costs or receives the benefits from financial liberalization could be brought in to the calculation. The World Bank estimated that the Asian crisis of 1997 increased the incidence of poverty in the region by 22 million. [52]

### *Financial instability and trade*

In addition to exchange-rate crises, those involving the banking system have also reappeared over the past few decades, having almost died out during the Golden Age. A comprehensive historical study found that banking crises became practically as frequent after 1987 as during the interwar period. In Scandinavia, for example, these caused output losses estimated at up to 7 per cent of GDP of the country over the period affected, and where they were combined with a currency crisis, the output loss was some 16 per cent of GDP. [53]

The Bank for International Settlements in Basle, charged with maintaining stability in the financial system, noted in its Annual Report for 2005 that ‘the global financial system seems to have become prone to financial turbulence of various sorts’. [54] A recent BIS paper argued that there seems to be a ‘common structural thread’ linking the increasing number of financial crises:

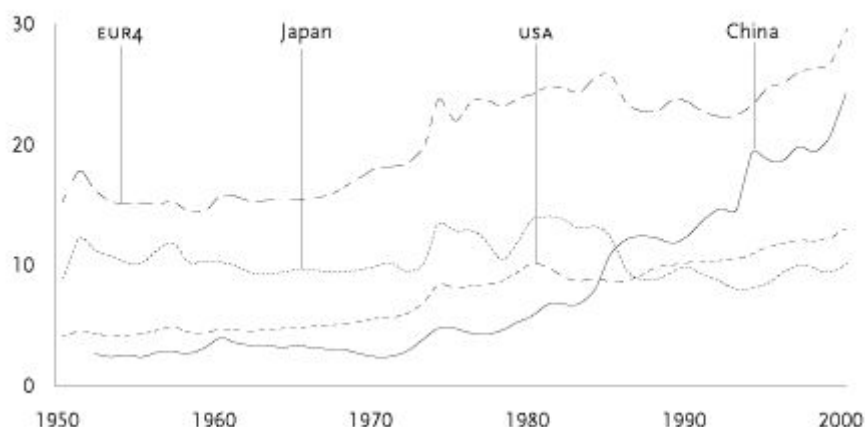
Increased risk-taking on the part of private sector participants in financial markets has been facilitated by financial market deregulation and technological change. Liberalized financial systems seem inherently more prone to . . . intermittent financial crises than do repressed financial systems.

Increased competition, the paper suggested, could bring a ‘sharpening dilemma. Financial institutions find it harder to maintain rates of return even as shareholders demand that returns rise’. In conclusion, ‘the modern financial system seems to be subject to a wide range of problems: operational disruptions, institutional insolvencies, short-term market volatility, medium-term misalignments and contagion across countries and markets’. [55]

A common measure of the process of globalization over the last decades—understood as international economic integration—has been the increase of world export growth relative to that of world production. In fact the ratio of exports to world GDP has doubled since 1960, to around 25 per cent, with the rate of increase being slower in the second half of the period (having lost the boost from higher oil prices). [56] As Figure 9 shows, much of the increase reflects rising export shares in Europe and the USA; although in both cases, the ratio of exports to GDP in 1913 was only exceeded at the end of the 1960s. [57] Japan however shows an extraordinary stability of trade shares since 1950—if we ignore the oil-price induced humps—in striking contrast to China.



Figure 9: Trade as percentage of GDP (average of imports and exports)



The impact of international competition within national economies is most clearly displayed in the degree of import penetration of the domestic market for manufactures, as shown in Table 4.

TABLE 4. Import penetration of domestic markets for manufactures, 1913–2001

	1913	1950	1974	1991	2001	From 'South' 2001
USA	3	2	6	14	21	10
Japan	34	3	5	7	12	7
Europe	13	6	17	28	39	8

The figures represent imports as a percentage of apparent consumption (production plus imports less exports). Data for Europe are simple averages of UK, Germany, France and Italy.

Source: 1913–63: R. A. Batchelor, R. L. Major, A. D. Morgan, *Industrialisation and the Basis for Trade*, Cambridge 1980, table 3.3; 1974–2001: author's calculations from OECD Stan D Database, 1998 and 2004 editions. There are minor breaks in the series after 1950 and 1963, and for Germany after 1989. The figure for imports from the South (comprising all sources other than Western Europe, North America, Japan, Australia and New Zealand) is derived from total imports for 2001 and share of the South in manufactures imports in 2003 from WTO *International Trade Table* IV.25.

Increasing import competition, already noticeable during the Golden Age, has (with the partial exception of Japan) continued unabated, with import market shares doubling in Europe after 1974 and rising more than threefold in the USA. Although most of this competition has traditionally come from other OECD countries, imports from the South have grown rapidly and now take nearly one tenth of domestic markets in the USA and not far short in the rest of the zone, with China playing a major role.

The widespread impression of dramatically increasing international integration through trade surely derives from this growing penetration by imports of domestic manufacturing markets. But manufacturing only constituted 18 per cent of OECD employment by the end of the millennium (ranging from 15 per cent in USA to 24 per cent in Germany); a decline of one

third as compared to 1974. Does trade integration amount, therefore, to increasingly fierce competition for a diminishing and relatively small, but highly visible, share of the economy?

The significance of manufacturing is in fact underplayed by its share of employment, since other sectors make a contribution as suppliers of inputs to manufactured commodities. So part of the output of agriculture, mining, energy, construction, transport and finance and business services is, at one remove, subject to the international competition within manufacturing. Thus it is dependent on the success of the country's manufacturing sector in maintaining its share of the domestic and world markets. If we extended the calculation to include service inputs into manufacturing, and the value of agricultural and mining output which is heavily traded internationally, it would seem that around 30 per cent of the UK economy, for example, is directly or indirectly contributing to the production of internationally traded goods.

Some services are traded directly as well. In the late 1990s exports of commercial services were about 20 per cent of total exports for the world as a whole and for high-income countries. [\[58\]](#) But these are concentrated in a narrow range of specialized businesses (international transport, international finance, consulting, call centres and so forth) and imports are practically irrelevant for the mass of domestic service producers (distribution, education and health care, for example).

There is no obvious way of quantifying what part of services is seriously internationalized in this sense; but any plausible estimate would leave a majority of employment in OECD countries, possibly a substantial and even a growing majority, largely untouched by international trade competition. [\[59\]](#) Outside agriculture, mining and manufacturing only a small proportion of workers are subject to international competition, directly or indirectly, through services provided to traded goods sectors. Wholesale and retail trade, community, personal and social services, utilities and construction together account for some 60 per cent of employment in the OECD as a whole, rather more in the US. [\[60\]](#) These sectors are largely insulated from international trade competition. Available estimates for the 'outsourcing' of service activities—call centres or clerical work, for example—suggest that this is fairly limited in terms of its employment effects; one report puts such new outsourcing at only 1 per cent of jobs destroyed and created annually in the US. [\[61\]](#) Outsourcing of computing and business services in the US had doubled in each of the last two decades but is still only 0.4 per cent of GDP. Both the US and the UK, where there is more outsourcing, have substantial overseas payments surpluses in these services and Japan and Germany only have small deficits. [\[62\]](#)

The impact of internationalization through trade has been complex. For one section of the economy, comprising manufacturing production and its suppliers together with some specialized enclaves in the services sector, international integration on this front has deepened considerably and this will continue if rapid growth is sustained in China. Meanwhile large sections of the economy, including expanding ones like social and community services and retail, remain highly insulated from international trade.

The effects on Northern labour have also been uneven: living standards have been boosted by low-wage imports, yet there has been a substantial impact in terms of job loss. Indeed, even balanced trade between North and South involves a substantial loss of Northern manufacturing employment. A recent comprehensive study estimates that for every job in high-skill manufactures created by additional exports to the South there are as many as 6 jobs

displaced by the same money value of low-tech manufactured imports from there. [63] This disparity is just a reflection of the potential ‘gains from trade’. The qualification ‘potential’ is important—the realization of these gains depends on the workers concerned being re-employed. A study of employment change in us manufacturing over the 1980s and 1990s found that the industries most subject to import competition, including toys, clothing and electronic goods, accounted for more than one third of job losses. Around 40 per cent of those affected were out of work two years later, and half of those with jobs had suffered a wage cut of 15 per cent or more. Over the decade 1992–2002, trade with the South may have accounted for one quarter of the loss of manufacturing jobs in the EU and nearly one half of the loss in the USA. These job losses have particularly disruptive and damaging effects because manufacturing employment tends to be geographically concentrated. Where the plants involved comprise a significant share of local labour markets it is particularly difficult to reabsorb such displaced workers. [64]

### *Foreign direct investment*

The rapid increase in foreign direct investment over the last three decades, and especially in the second half of the 1990s, has been another salient feature of economic integration. The quantitative importance of FDI may be assessed by comparing the annual flow, inward and outward, with the total amount of domestic investment going on in the recipient country in that year. If the inflow of FDI were to continue at a particular percentage of investment, eventually it would constitute that percentage of the accumulated capital stock. Table 5 suggests that, should recent trends continue, around 13 per cent of the capital stock in both the developed and developing countries would be owned abroad. This would bring the share of FDI above its previous historic peak before 1914, though not by a large margin. [65] Within the developed economies FDI is exceptionally high in Europe, with much of the investment being within the EU (and thus showing up as both inward and outward). It is also exceptionally low in Japan, with the stagnant Japanese economy attracting little inward FDI—and, more surprisingly, Japanese firms investing only very modestly abroad. The US economy attracted more FDI than American multinationals invested abroad.

TABLE 5. *Foreign direct investment flows, 1991–2003 (% of gross investment)*

	World		Developed countries	USA	EU	Japan	Developing countries	China
	1992–97	1998–2003						
<i>Inward</i>	5.2	12.7	12.6	9.1	23.5	0.7	12.5	11.6
<i>Outward</i>	5.5	12	14.8	7.7	30.1	2.7	3.7	0.7

Source: Foreign Direct Investment Database, UNCTAD 2004, Annex Table B.5.

Although the Chinese figure for inward investment does not look exceptional, the enormous share of gross investment in Chinese GDP, approaching 50 per cent by 2004, means that the FDI inflow was very large in relation to GDP—some 5 per cent. Much foreign investment in China comes from overseas Chinese capitalists in other Asian developing countries. Newspaper reports suggest that substantial inflows into China actually originate within the PRC itself, masquerading as FDI in order to obtain tax breaks. In addition, Western multinationals have of course been making substantial investments in industries like electronics and cars. Chinese companies have also begun to make investments abroad, in search of energy supplies and other inputs, or of brand names and manufacturing expertise. Even though this is, in effect, reinvesting back the equivalent of a small part of the inflow of FDI, it has created a furore; the recent Chinese bid for a modestly sized us oil company, Unocal, being a case in point.

The sectoral composition of FDI has not shown the same bias towards manufacturing that foreign trade has done; in the 1990s around half of outward FDI went to the services sector. Investment can, of course, reach into parts of the service sector such as retailing or restaurants that are immune to direct competition from imports, as when McDonalds or Walmart invests in a new country. Well over half of FDI inflows into OECD countries represent cross-border mergers and acquisitions, rather than companies setting up factories or offices from scratch. However this may still represent a heightening of competition for the other domestic firms. fdi represents an important qualification to the remarks above about the insulation of large parts of the services sector in the OECD zone from international competition. States with strong service-sector companies such as the US and the UK have been pushing hard for the liberalization of service provision and the FDI required to support it in WTO negotiations. [66] While the numbers presented above can give an impression of the magnitudes involved, it may be that the most important aspect of FDI is the enhanced potential for mobility of location for companies in the rich countries. Even if the threat is only exercised periodically it can still serve to weaken workers' positions at the bargaining table on wage or employment negotiations.

The labour market is surely the least integrated of global markets. For the US, despite a strong rise in the 1980s, inward migration in the 1990s was still only at one third of the rate seen during 1900–10. [67] The proportion of the world's population resident in countries where they were not born is estimated to have risen from a little over 2 per cent to a little under 3 per cent during the last 30 years and is around 10 per cent in both Europe and the USA. Rising supply of potential entrants has been met in most developed countries with a tightening of controls against unskilled migrants. In countries where unemployment is now relatively low, inward migration of both skilled and unskilled workers is an attractive option for employers seeking to hold down wages.

### *World uncertainties*

The genie of financial competition and expansion has been released by deregulation. Whilst the worst effects of the resulting fragility have been felt in the Asian countries hit by the crisis of 1998 it would be wrong to assume that the greater sophistication of financial markets in OECD countries insures them against such problems. The real economies of the US and Japan have been scarred by financial excesses and the whole system can be threatened by the unrelenting search for 'value' through ever more complex financial trades. Regulatory attempts to reap the benefits of liberalization whilst limiting the risks face formidable difficulties, and the chances of a major global financial crisis have surely increased.

Dwarfing in significance even the rise in density, international entanglement and fragility of financial markets is the growth of China, India and other developing countries. Until the 1980s the developing countries were economically significant for the rich economies only as suppliers of commodities, above all oil. The North never ran large enough export surpluses with the South for these to constitute a substantial factor in maintaining demand at home, as Rosa Luxemburg had suggested. Developing countries never posed a serious competitive threat to Northern producers. However, these countries are now 'emerging' on to the world economic stage with great momentum. Since the mid 1990s the majority of world GDP has been produced outside the old OECD countries and their share is declining. The centre of capital accumulation, the driving force of the system, is shifting away from the old core countries. For the North this has a number of quite contradictory effects.

Firstly, rapid growth in the rest of the world will bring buoyant demand for exports of those goods in which the OECD countries maintain an advantage. This in turn encourages capital accumulation in those industries and helps to keep aggregate demand rising. In order to maintain that advantage in the face of rising competition from the South in increasingly sophisticated products, core country currencies would have to depreciate. This would reduce real incomes in the OECD countries as they would no longer be importing such cheap consumer goods. [\[68\]](#)

Secondly, there is the impact of surplus labour in China and elsewhere, significant segments of which will be highly educated but with far lower wages than in the North. Access to this cheap labour could encourage a much higher level of FDI from the North, creating an investment drain away from the core zone. On a world scale the capital/labour ratio would decline by a third or more, [\[69\]](#) as the vast reserves of labour in those countries become inserted into the global economy. The result could be a major fall in the share of wages in the OECD countries as workers find their bargaining position weakened. [\[70\]](#) But wages of course play a dual role in capitalism, both as cost of production and as source of mass consumer demand. With investment attracted elsewhere by Southern wages, maintaining buoyant demand in the North would rely on increasing dollops of consumer credit or expanded government spending. Such a pattern looks unstable economically, if not risky politically. Although the emergence of new low-cost sources of supply is not a novel phenomenon, with China and India in many respects following the path of Japan and then the Asian NIEs, what makes the present position different is that the massive populations of these countries offer the potential for a far larger, and thus more disruptive, process of catch-up.

China itself could be a further major source of instability. Its credit system is notoriously shaky, raising the possibility of a financial crisis and recession that could have a severe impact on the North. The rate of absorption of labour could generate wage pressure and industrial conflict which the Chinese CP would find it difficult to restrain. China's appetite for energy and materials could precipitate spiralling prices, as markets try to anticipate long-run trends. A severe recession could develop in China as a result of a credit crunch and over-accumulation. Much slower growth for a period seems inevitable in the US if the unsustainable balance-of-payments deficit is to be righted, but this will only worsen the budgetary position until taxes are increased.

It is one of the paradoxes of the recent past that, despite the instabilities of the financial system and disruption caused by shifts in world trade, the economies of the rich countries have suffered smaller output fluctuations over the past decade than in any comparable period. The variability of output is one third less than it was in the rapid growth period of the 1960s

or in the stagnant 1970s and the same is true of the developing countries as well. [71] Indeed the present imbalances in the world economy could still be absorbed with a ‘soft landing’ and relatively little disruption. But so long as a major dollar crisis, some other triggering event which exposes global financial fragility, or a serious interruption to China’s growth remain on the cards, the capitalist system in the North finds itself peering into a highly uncertain future.

[1] This article is based on a chapter in my forthcoming book, *Capitalism Unleashed*, to be published by Oxford University Press early in 2006. I am grateful to Wendy Carlin, Susan Collins, Jonathan Garner, John Grahl, John Knight, Tao Ran, Mary Robertson, Bob Rowthorn and Bob Sutcliffe for help with data or comments and suggestions on drafts.

[2] Michael Dertouzos, Richard Lester and Robert Solow, *Made in America: Regaining the Productive Edge*, Cambridge, ma 1989, p. 1.

[3] Dertouzos, *Made in America*, p. 10.

[4] Jeffrey Frankel, ‘Exchange Rate Policy’, in Martin Feldstein, ed., *American Economic Policy in the 1980s*, Chicago 1994, pp. 301, 325, 322.

[5] Data from Bureau of Economic Analysis, gdp by Industry tables.

[6] Larry Summers, ‘Comment on “Between Meltdown and Moral Hazard”’, in Jeffrey Frankel and Peter Orszag, eds, *American Economic Policy in the 1990s*, Cambridge, ma 2002, p. 261.

[7] The profit share of manufacturing increased from 30 per cent at the beginning of the decade to 35 per cent in 1999 but this rise would have been bigger without the pressure from the high value of the dollar.

[8] Allan Meltzer, ‘Comment on “Between Meltdown and Moral Hazard”’, in Frankel and Orszag, *American Economic Policy*, p. 266.

[9] *Economic Report of the President*, Washington 2002, table 7.1.

[10] Wynne Godley, Alex Izurieta and Gennaro Zezza, ‘Prospects and Policies for the us economy’, *Strategic Analysis*, August 2004.

[11] Maurice Obstfeld and Kenneth Rogoff, ‘The Unsustainable us Current Account Position Revisited’, nber Working Paper 10869, 2004.

[12] The proviso ‘net’ investment and savings is important here. Much business investment is financed by depreciation, but it is net investment which expands capacity in the economy.

[13] Bank for International Settlements, *Annual Report 2005*, p. 144.

[14] A recent study arguing that the econometric evidence confirms the importance of accumulation in determining growth is Steve Bond, Arli Leblebicioglu, Fabio Schiantarelli, ‘Capital Accumulation and Growth: A New Look at the Empirical Evidence’, iza Discussion Paper 1174, 2004.

[15] Nicholas Lardy, ‘Trade Liberalization and its Role in China’s Economic Growth’, www.imf.org, 2003, p. 12. It has been argued that those made redundant from the state firms have been reluctant to take up jobs in the new export oriented factories: ‘It is said that in the cities, especially those in state enterprises, workers are accustomed to the idea that “workers are masters” and “there is no exploitation in socialism”, therefore they want jobs “close to their home, with high wages, short work hours and easy work”’. Hiroko Imamura, ‘Unemployment Problem and Unemployment Insurance in China’, *Far Eastern Studies*, March 2003, p. 59. On actual pay and working conditions see below.

[16] Angus Maddison, *Chinese Economic Performance in the Long Run*, Paris 1998. Maddison excludes large repair costs and military investments which are not usually classified with investment. Stockbuilding was also extremely high in China, as was housing investment. The broad pattern of the capital stock growth figures for Korea, Japan and China shown in table 2 is consistent with that shown by Maddison.

[17] Maddison, *Chinese Economic Performance*, table 3.9.

[18] csfb, 'Understanding China's profit cycle' in *China Market Strategy*, March 2005, figs. 24, 27–29.

[19] Ray Brooks, 'Labor Market Performance and Prospects', in Eswar Prasad, ed., *China's Growth and Integration into the World Economy*, imf Occasional Paper 232, 2004.

[20] Europe and Japan make up most of the 'non-usaocd' category. Not included in the chart is the mass of oil producers, developing and middle-income countries like India which, together, have also gained share over the last decade.

[21] In terms of the *absolute* level of gdp per capita, according to Maddison's measure China is at the level of Japan in the later 1950s and Korea/Taiwan in the mid-1970s. Such measures should be taken as no more than broadly indicative.

[22] Bob Sutcliffe, 'World Inequality and Globalization', *Oxford Review of Economic Policy*, vol. 20, no. 1 (2004), fig. 2.

[23] Yingyi Qian, 'How Reform Worked in China', in Dani Rodrik, ed., *In Search of Prosperity: Analytic Narratives on Economic Growth*, Princeton 2003, provides a fascinating discussion of how the incentives for China's growth have evolved despite a path of reform which has defied the conventional wisdom.

[24] Six Asian countries including not-so-low-wage Korea, plus Poland, Czech Republic and Mexico.

[25] Barry Eichengreen, Yeongseop Rhee and Hui Tong, 'The Impact of China on the Exports of Other Asian Countries', nber Working Paper 10768, 2004.

[26] Andrea Boltho, 'China—Can Rapid Economic Growth Continue?', *Singapore Economic Review*, vol. 49, no. 2, 2004, table 6.

[27] Hiro Ito and Yushi Yoshida, 'How does China compete with Japan in the us market?', August 2004, on European Trade Study Group website, www.etsg.org.

[28] Thomas Rumbaugh and Nicolas Blancher, 'International Trade and the Challenges of wto Accession' in Prasad, *China's Growth and Integration into the World Economy*.

[29] Lardy, 'Trade Liberalization'.

[30] See Figure 6.

[31] Xin Meng, Robert Gregory and Youjuan Wang, 'Poverty, Inequality and Growth in Urban China, 1986–2000', iza Discussion Paper 1452, table 2.

[32] Neil Gough, 'Trouble on the Line', *Time Asia Magazine*, January 2005.

[33] Anita Chan, 'A "Race to the Bottom": Globalization and China's Labour Standards', *China Perspectives*, March–April 2003, p. 46.

[34] Gough, 'Trouble on the Line'.

[35] 'Chinese Workers pay for Wal-Mart's Low Prices', *Washington Post*, 8 February 2004.

[36] Ulrich Jürgens and Rolf Rehbehn, 'China's Changing Role in Industrial Value Chains—and Reverberations on Industrial Action in Germany', wzb Discussion Paper spiii 2004-302, Berlin 2004, p. 17.

[37] *China Labour Bulletin* and *China Labor Watch*; see also the interview with Han Dongfang, 'Organizing Chinese Labour', in this nlr.

[38] Gough, 'Trouble on the Line'.

[39] Calculated from *wto International Trade Statistics 2004*, tables iv.1 and a.19

[40] Hali Edison, Michael Klein, Luca Ricci and Torsten Sløk, 'Capital Account Liberalization and Economic Performance: Survey and Synthesis', August 2003, Tables 2 and 3, available at [fletcher.tufts.edu/faculty/klein](http://fletcher.tufts.edu/faculty/klein).

[41] *Financial Times*, 29 September 2004.

[42] Maurice Obstfeld and Alan Taylor, 'Globalization and Capital Markets', nber Working Paper 8846, 2002, table 2.

[43] Rene Stulz, 'The Limits of Financial Globalization', nber Working Paper 11070, 2005, fig. 1 and p. 8.

[44] The standard deviation of current account balances roughly doubled between the mid-1980s and the early 2000s (Olivier Blanchard and Francesco Giavazzi, 'Current Account Deficits in the Euro Area: The End of the Feldstein-Horioka Puzzle?', *Brookings Papers on Economic Activity*, 2, 2002, fig. 1).

[45] Calculated from the imf International Financial Statistics series for relative unit labour costs.

[46] Changes in the real exchange rate may act in a stabilizing way if they offset adverse real trends or 'shocks'. The uk Treasury ('The Exchange Rate and Macroeconomic Adjustment: emu Study', 2003) has attempted to argue, not very convincingly, that this was typically true of uk swings.

[47] Michael Klein, Scott Schuh and Robert Triest, 'Job Creation, Job Destruction and the Real Exchange Rate', nber Working Paper 7466, 2000.

[48] Klein, 'Job Creation', p. 29.

[49] Graciela Kaminsky, 'Varieties of Currency Crises', nber Working Paper 10193, 2003, table 4.

[50] Kaminsky, 'Varieties of Currency Crises', p. 2.

[51] Michael Bordo, Barry Eichengreen, Daniela Klingebiel and Maria Soledad Martinez-Peria, 'Is the Crisis Problem Growing More Severe?', *Economic Policy*, 32, 2001, fig. 1 and p. 58.

[52] Eichengreen, 'Financial Instability', Eichengreen homepage 2004, p. 10.

[53] Bordo et al, 'Crisis Problem', fig. 1, table 1 and pp. 55, 58.

[54] bis, *Annual Report 2005*, p. 5.

[55] William White, 'Are changes in financial structure extending safety nets?', bis Working Paper 145, 2004, pp. 1, 2, 24.

[56] *World Development Indicators*, 2003. The comparison between exports and gdp is frequently made in constant prices. However, exports of manufactures tend to fall in price relatively to gdp since productivity growth is considerably faster in manufacturing than in the rest of the economy. Thus the share of employment engaged directly in exporting grows less rapidly than the volume comparison suggests; the current price ratio of exports to gdp reflects better the evolution of the share of employment engaged in exports.

[57] These series are the Penn tables Openness indicator (exports + imports at current prices as per cent of gdp all at ppp prices) divided by 2. Available at [www.bized.ac.uk](http://www.bized.ac.uk).

[58] Ronald Findlay and Kevin O'Rourke, 'Commodity Market Integration 1500–2000', nber Working Paper 8579, 2001, table 7.

[59] The *Financial Times* (11 January 2004) quotes Kenneth Rogoff, recently chief economist at the imf, as claiming that only one fifth of the us economy was subject to international competition. Jagdish Bhagwati, Arvind Panagariya and T. N. Srinivasan quote an estimate that 70 per cent of us jobs are in service industries requiring that the consumer and producer be in the same place, to which might be added construction, which is not tradable. Even so the estimate of one fifth seems on the low



side, not least because a number of these jobs provide inputs into manufacturing. See Bhagwati et al, 'The Muddles over Outsourcing', *Journal of Economic Perspectives*, vol. 18, no. 4 (2004), pp. 94–114.

[60] Calculations from oecd *Labour Force Statistics*.

[61] Quoted in Bhagwati et al, 'Muddles Over Outsourcing'.

[62] Mary Amiti and Shang-Jin Wei, 'Fear of Service Outsourcing: Is it Justified?', nber Working Paper 10808, 2004, tables 4 and 6.

[63] Bob Rowthorn and Ken Coutts, 'De-industrialization and the balance of payments in advanced economies', *Cambridge Journal of Economics*, vol. 28, no. 5 (2004), pp. 767–90.

[64] Bhagwati et al, 'Muddles Over Outsourcing', Rowthorn and Coutts, 'De-industrialization', Table 2.

[65] Paul Bairoch and Richard Kozul-Wright, 'Globalization Myths: Some Historical Reflections on Integration, Industrialisation and Growth in the World Economy', in Kozul-Wright and Robert Rowthorn, eds, *Transnational Corporations and the Global Economy*, Basingstoke 1997.

[66] See Gerald Epstein, 'The role and control of multinational corporations in the world economy' in Jonathan Michie, ed., *The Handbook of Globalisation*, Cheltenham 2003, pp. 150–64 and Scott Sinclair, 'The wto and its gats' in Michie, *Handbook of Globalisation*, pp. 347–57.

[67] As a proportion of the population. See Barry Chiswick and Timothy Hatton, 'International Migration and the Integration of Labour Markets', in Michael Bordo, Alan Taylor and Jeffrey Williamson, eds, *Globalization in Historical Perspective*, Chicago 2003.

[68] Such a process, whereby the 'gains from trade' for the North are reduced by development in the South, is discussed by Paul Samuelson, 'Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization', *Journal of Economic Perspectives*, vol. 18, no. 3 (2004), pp. 135–46.

[69] Richard Freeman, 'What Really Ails Europe (and America): The Doubling of the Global Workforce', [www.theglobalist.com](http://www.theglobalist.com), 3 June 2005.

[70] This possibility is floated by Bhagwati et al, 'Muddles Over Outsourcing'.

[71] Bill Martin and Bob Rowthorn, 'Will Stability Last?' mimeo, Cambridge 2004.