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Chain-Gang Economics

by Walden Bello; [Foreign Policy In Focus](#) ; November 03, 2006

“The world is investing too little,” according to one prominent economist. “The current situation has its roots in a series of crises over the last decade that were caused by excessive investment, such as the Japanese asset bubble, the crises in Emerging Asia and Latin America, and most recently, the IT bubble. Investment has fallen off sharply since, with only very cautious recovery.”

These are not the words of a Marxist economist describing the crisis of overproduction but those of Raghuram Rajan, the new chief economist of the International Monetary Fund (IMF). His analysis, now over a year old, continues to be accurate. Global overcapacity has made further investment simply unprofitable, which significantly dampens global economic growth. In Europe, for instance, GDP growth has averaged only 1.45% in the last few years. Global demand has not kept up with global productive capacity. And if countries are not investing in their economic futures, then growth will continue to stagnate and possibly lead to a global recession.

China and the United States, however, appear to be bucking the trend. But rather than signs of health, growth in these two economies—and their ever more symbiotic relationship with each other—may actually be indicators of crisis. The centrality of the United States to both global growth and global crisis is well known. What is new is China's critical role. Once regarded as the greatest achievement of this era of globalization, China's integration into the global economy is, according to an excellent analysis by political economist Ho-Fung Hung, emerging as a central cause of global capitalism's crisis of overproduction.¹

China and the Crisis of Overproduction

China's 8-10% annual growth rate has probably been the principal stimulus of growth in the world economy in the last decade. Chinese imports, for instance, helped to end Japan's decade-long stagnation in 2003. To satisfy China's thirst for capital and technology-intensive goods, Japanese exports shot up by a record 44%, or \$60 billion. Indeed, China became the main destination for Asia's exports, accounting for 31% while Japan's share dropped from 20% to 10%. China is now the overwhelming driver of export growth in Taiwan and the Philippines, and the majority buyer of products from Japan, South Korea, Malaysia, and Australia.

At the same time, China became a central contributor to the crisis of global overcapacity. Even as investment declined sharply in many economies in response to the surfeit of productive capacity, particularly in Japan and other East Asian economies, it increased at a breakneck pace in China. Investment in China was not just the obverse of disinvestment elsewhere, although the shutting down of facilities and sloughing off of labor was significant not only in Japan and the United States but in the countries on China's periphery like the Philippines, Thailand, and Malaysia. China was significantly beefing up its industrial capacity and not simply absorbing capacity eliminated elsewhere. At the same time, the ability of the Chinese market to absorb its own industrial output was limited.

Agents of Overinvestment

A major actor in overinvestment was transnational capital. In the late 1980s and 90s, transnational corporations (TNCs) saw China as the last frontier, the unlimited market that could endlessly absorb investment and endlessly throw off profitable returns. However, China's restrictive rules on trade and investment forced TNCs to locate most of their production processes in the country instead of outsourcing only selected numbers of them. Analysts termed such TNC production activities "excessive internalization." By playing according to China's rules, TNCs ended up overinvesting in the country and building up a manufacturing base that produced more than China or even the rest of the world could consume.

By the turn of the millennium, the dream of exploiting a limitless market had vanished. Foreign companies headed for China not so much to sell to millions of newly prosperous Chinese customers but rather to make China a manufacturing base for global markets and take advantage of its inexhaustible supply of cheap labor. Typical of companies that found themselves in this quandary was Philips, the Dutch electronics manufacturer. Philips operates 23 factories in China and produces about \$5 billion worth of goods, but two-thirds of their production is exported to other countries.

The other set of actors promoting overcapacity were local governments investing in and building up key industries. While these efforts are often "well planned and executed at the local level," notes Ho-Fung Hung, "the totality of these efforts combined ... entail anarchic competition among localities, resulting in uncoordinated construction of redundant production capacity and infrastructure."

As a result, idle capacity in such key sectors as steel, automobile, cement, aluminum, and real estate has been soaring since the mid-1990s, with estimates that over 75% of China's industries are currently plagued by overcapacity and that fixed asset investments in industries already experiencing overinvestment account for 40-50% of China's GDP growth in 2005. China's State Development and Reform Commission projects that the automobile industry will produce double what the market can absorb by 2010. The impact on profitability is not to be underestimated if we are to believe government statistics: at the end of 2005, Hung points out, the average annual profit growth rate of all major enterprises had plunged by half and the total deficit of losing enterprises had increased sharply by 57.6%.

The Low-Wage Strategy

The Chinese government can mitigate excess capacity by expanding people's purchasing power via a policy of income and asset redistribution. Doing so would probably mean slower growth but more domestic and global stability. This is what China's so-called New Left intellectuals and policy analysts have been advising. China's authorities, however, have apparently chosen to continue the old strategy of dominating world markets by exploiting the country's cheap labor. Although China's population is 1.3 billion, 700 million people—or over half—live in the countryside and earn an average of just \$285 a year, according to some estimates. This reserve army of rural poor has enabled manufacturers, both foreign and local, to keep wages down.

Aside from the potentially destabilizing political effects of regressive income distribution, this low-wage strategy, as Hung points out, "impedes the growth of consumption relative to the phenomenal economic expansion and great leap of investment." In other words, the global crisis of overproduction will worsen as China continues to dump its industrial production on global markets constrained

by slow growth.

Vicious Cycle

Chinese production and American consumption are like the proverbial prisoners who seek to break free from one another but can't because they're chained together. This relationship is increasingly taking the form of a vicious cycle. On the one hand, China's breakneck growth has increasingly depended on the ability of American consumers to continue their consumption of much of the output of China's production brought about by excessive investment. On the other hand, America's high consumption rate depends on Beijing's lending the U.S. private and public sectors a significant portion of the trillion-plus dollars it has accumulated over the last decade from its yawning trade surplus with Washington.

This chain-gang relationship, says the IMF's Rajan, is "unsustainable." Both the United States and the IMF have decried what they call "global macroeconomic imbalances" and called on China to revalue the renminbi to reduce its trade surplus with the United States. Yet China can't really abandon its cheap currency policy. Along with cheap labor, cheap currency is part of China's successful formula of export-oriented production. And the United States really can't afford to be too tough on China since it depends on that open line of credit to Beijing to continue feeding the middle-class spending that sustains its own economic growth.

The IMF ascribes this state of affairs to "macroeconomic imbalances." But it's really a crisis of overproduction. Thanks to Chinese factories and American consumers, the crisis is likely to get worse.

End Notes

Ho-Fung Hung, "Rise of China and the Global Overaccumulation Crisis," paper presented at the Global Division of the Annual Meeting of the Society for the Study of Social Problems," August 10-12, 2005, Montreal, Canada. A revised version of this paper will soon be published in a leading international relations journal.

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