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## The capitalist development of China and Latin America

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The capitalist transformation of the People's Republic of China is the defining element in the history of this social system for the late 20<sup>th</sup> century and it will remain so during much of the 21<sup>st</sup> century. Furthermore it can be said that China's transformation is as momentous as the transition, engendered by the transformation of England, from mercantile to industrial capitalism. I will begin with a brief historical excursus of the rise of capitalism in the Eastern part of Asia, Notice how in each of the following phases, economic evolution is governed by the question of realization.

### *Capital Accumulation in Asia*

The process of capitalist accumulation in (East) Asia has gone through 2 phases and, with the launching in China of the 4 modernizations program in 1979, it has entered a crucial third phase which began to materialize in the early 1990s gathering momentum after the Asian crisis of 1997. The period up to the Asian financial crisis, has seen two phases of growth and accumulation in Asia.

#### *Phase 1*

The first phase of accumulation is characterized by the European encroachment upon China and the industrialization of Japan strictly connected to its imperialist expansion into China, including formerly Tsarist Manchuria, and into Korea.

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WW1, representing a paradigmatic external source of demand in the Luxemburg-Kalecki fashion - solves the external debt problem of Japan, thanks to the alliance with Britain. WW1 acts as a classical external market and as an import substitution device. The search for markets is restarted in earnest with the Great Depression and the related Manchuria incident in 1931. This event, which ignites the long war against China and, in appropriate historical terms, WW2, is the factor which propels the heavy and chemical industry process of capital accumulation in Japan, operating therefore in an eminently Kalecki/Rosa Luxemburg form of imperialism *cum* accumulation. At the same time however, the imperialism of Japan's capitalism had one crucial weakness regarding the structure of the balance of payments. As shown by the works of Nakamura Takafusa, while the Yen area was generating a surplus for Japan it was not doing so in terms of the trade with the dollar and sterling areas (Nakamura 1983). Japan's imperialism towards China clashed more and more with the role ascribed to China by the United States - defined by the open door policy elaborated in the years leading to the war against Spain in 1898 which brought the USA to Asia through the conquest of the Philippines. Washington's move towards sanctions and oil embargo against Japan turned the dollar and sterling components of the balance of payments of Japan into an insurmountable obstacle out of which grew the conditions for total war.

## **Phase 2**

What remained of **Phase 1** was the structural change caused by the heavy and chemical industrialization of Japan. Kosai Yutaka has presented convincing estimates regarding the extent of the war damage (**Kosai 1986**). While the damage was extremely severe in shipbuilding it turned out to be milder in the machine producing capacity of the economy, although more serious than in the case of Germany. But Japanese capitalism lost the functional connections between markets and raw material supplies that it has been establishing through imperialism for half a century up to 1945. Thus **Phase 2** can be seen as formed by three sub-periods.

**Phase 2a:** This first sub-period is centred on creating the conditions for an economic anchor for Japan; **Phase 2b** is marked by the formation of a Japanese oligopolistic zone in East and Southeast part of Asia. **Phase 2c**, the third sub phase, begins in 1971 with the US abandonment of the dollar-gold convertibility. Phases 2a and 2b, spanning from 1945 up to



1971, are characterized by US public expenditure connected - in a pure Baran-Sweezy fashion - to military expenditure and to the special institutional arrangements made by the USA to have Japan quickly accepted within GATT in 1955. In Phase 2a, covering more or less the years going from 1945 to the beginning of US intervention in Vietnam, Japan benefited from Washington's public expenditure on the Korean war through the Special Procurement program which was continued also after the end of the war in 1953. In addition to that, the United States ushered Japan into Gatt by convincing both France and Britain to drop their opposition dictated by Japan's unwillingness to reciprocate. In this context US authorities signed 13 trilateral trade treaties offering to third countries greater access to US markets provided they forwent the use of clause 35 of GATT which allowed setting up trade barriers against any country not accepting trade reciprocity (Forsberg 2000). US policies allowed Japan to lift the balance of payments ceiling which is another way of saying that the limited availability of internationally profitable effective demand was less of a constraint on decisions concerning investment and accumulation.

**Phase 2b** is that of the Vietnam War which the US historian Michael Schaller, a most distinguished scholar, has characterized as Japan's re-entry in Asia (Schaller 1985).

In this way, propelled by US war expenditure the area becomes structurally dependent upon Japan, first in terms of imports, and later in Thailand, Singapore, Malaysia, and Indonesia, in terms of capital inflows, while being dependent upon the United States for exports. But the crucial pillars of the area of Japanese oligopolistic hegemony are The Republic of Korea and Taiwan notwithstanding that, unlike Thailand, Malaysia, and Singapore, the two countries did not develop solely and not even principally on the basis of direct multinational investment. Yet it is in relation to Korea and Taiwan that the model of structurally dependent accumulation was shaped and it has been this model, rather than the flying geese paradigm, that has shaped capitalist power relations in East Asia (Lim 1985, Hart-Landsberg 1993). This factor has been recognized also by economists involved with establishment institutions (Hatch and Yamamura 1996). The

essence of the asymmetries lay in the role of Japan as a poor buyer but as a strong oligopolistic seller, while solutions to financial crises had to be undertaken by the United States (Woo 1991).



**Phase 2c** is represented by the sharpening of US disengagement as the global coordinator of developed capitalism which began in 1971 but gathered pace after 1980 with the deindustrialization of the USA. Japan became the adjustment variable of US monetary and exchange rates policies while the part of East Asia under US geopolitical and military control became an increasingly important rear for the dominance of Japanese monopoly capital.

Initially this happened by countering the devaluation of the US dollar in the 1972-79 period by further tying Asia to Japan structurally. Then, with the systemic devaluation of US \$ from the Plaza accords in 1985 to the end of April in 1995, Japan's strategy towards Asia aimed at recouping through Asia's growth and exports and Japan's own economic hegemony, the squeeze in profit margins of Japanese corporations on their exports to the US and also on the activities of transplants. The US market has for Japan greater competition than the Asian one so that it was impossible to transfer fully the increase in the value of the Yen onto Japan's export prices towards the USA. Furthermore, for the same reasons, the transplants could not pass fully the increased dollar costs of imported technologies and machinery onto their final US prices. It is in this context that East Asia, whose currencies were pegged to the US dollar, became the most important source of Japan's net balance of payments position. We can conventionally set the end of

**Phase 2c** with the outset of the Asian crisis in 1997 but in reality the whole second phase was being terminated by the capitalist transformation of the People's Republic of China. The Asian crisis was a real crisis of capital accumulation determined by the dynamics of structural asymmetries and not by factors, such as corruption and lack of transparency, usually mentioned in traditional studies.

### ***Post Asian Crisis: Phase 3***

The first step to take for the assessment of the role that the PRC has been acquiring in influencing the tendencies in world capitalism will be to ascertain the degree of sustainability of accumulation process in China, not in relation to some normative objectives but in relation to the Marxian and Post-Keynesian notion of profitability and effective demand. This requires the analysis of dualism based on the following criteria which cannot be gotten from orthodox economics.



To what extent China's accumulation validates or not the conditions of *comparative productivity change advantages*? (Pasinetti 1981) These have got nothing to do with the static fixed factor endowments theory of comparative advantages. Instead it is a rather Smithian dynamic principle according to which if productivity increases are not retained within the same economic system (defined in terms of its polity, currency and institutions), but are instead leaked abroad mostly through fall in export prices, the country will develop in a dualistic manner without an adequate growth of domestic demand. The adequacy of the growth of domestic demand is not measurable by aggregate GDP figures but by whether or not the growth of productivity in the leading sectors flows back in roughly equivalent increases in wages and productivity in the domestic sectors. While such a gap cannot be avoided, its systemic persistence and widening will set a limit to the expansion of per capita demand of wage earners creating conditions of chronic underutilization of capacity.

The *principle of comparative productivity change advantages* has a special corollary which works in reverse. The country as a whole may find itself on an unwarranted accumulation path if the productivity of the dynamic, say exporting, sectors does not flow back as greater domestic purchasing power but is instead leaked abroad through persistently lower export prices. The corollary lies in that whenever the growth of productivity of the dynamic export oriented sectors exceeds significantly the growth of productivity of the equivalent sectors abroad, the sectors in the foreign countries cannot hold onto their own productivity growth and must shed workers as well as undertake capital flows externally. The paradox is that a less advanced industrial country has a much greater chance of developing sectors whose productivity growth is both much higher than that of the rest of the domestic economy and that of the corresponding sectors abroad.

The PRC is a unique case in the world of transfer of global capital towards an economy which in absolute terms is now bigger than Germany's but in relative per-capita terms is so much lower than any of the OECD countries. And this situation is likely to last for quite a long period.

There have been other cases of industrial development for large countries such as **Brazil**, **Mexico** and **India**, but neither in per capita nor in absolute terms have they ever surpassed



any of the big capitalist countries of Europe and of course Japan. Japan, when it began to outgrow in absolute terms the large Western European countries it did so when it reached the stage of industrial maturity with a high wage level per unit of labour. The PRC by contrast can stay for a long time on the lower end of the scale with the dynamic sectors operating according to the *principle of comparative productivity change advantages* and its reverse corollary for the industrialized world. The PRC can therefore be in absolute terms bigger than, say, Germany and France together, while remaining in per capita terms well below Mexico.

International oligopolies have here a double edged role. On one hand by investing in productive facilities they expand the array of sectors having dynamic productivity growth, but on the other hand, they tend to reinforce the dualistic features of that growth domestically and the corollary internationally. Let us make the following cases.

(a) A multinational company invests in China for the local market as it is now the case for autos. In this instance the capital goods will be provided by the parent company and the domestic Chinese economy will supply the basic commodities. Profits will spring mostly from the low wage costs and from productivity gains. By contrast if after a while the foreign company starts ordering its capital goods from Chinese industries, then there is a structural flow back both in terms of productivity growth and in terms of the expansion of the array of domestic sectors. But, and this we know from advanced economic theory, even orthodox, there is no guarantee that market mechanisms will ensure such a transition. It will more likely depend on the determination of the central authorities to steer investment of multinationals into developing the capital goods sectors in China.

(b) Assume a foreign multinational invests in order to export by supplying itself with capital goods ordered from the home country or from any of the high wage countries of the TRIAD. Then this means that the foreign multinational is only interested in using the lower wage costs coupled with its own price making capacity in the developed countries (markets). This case, just perpetuates dualism while hollowing out the corresponding sectors abroad.

(c) Assume a foreign multinational subcontracts/outsources its orders in China. There may be then a greater use of domestic inputs, but the entire operation is



based on the principle of maximizing the 'benefits' stemming from low wages and from the price making powers of the multinational in question.

Both in the case of (b) and of (c) the expansion of per-capita income and demand in China is constrained by the strategic role played by low wages, so that demand may expand absolutely but less so in per capita terms. while at the same time hollowing out the productive basis of the advanced countries. Cases (b) and (c) are, for the long terms objectives of the PRC's authorities to transform China into a significant industrial and military power, to be discarded. Yet they may nest into the Chinese political economy thereby creating a permanent structural fault or weakness in the way per capita income and demand progress in the country. Given the Communist Party of China orientation to have a sort of NEP with world capitalism, the best solution is to have multinationals which (i) invest in China for both the domestic and the export markets and (ii) produce in China the capital goods and the required technologies or at least a growing part of them. This eventuality however does not solve the question of the hollowing out of the advanced countries. At the same time however even for China reliance on foreign multinationals cannot continue for too long a period because the crucial decisions making processes and crucial technological development will occur outside it. Thus only by creating its own oligopolistic multinationals will China be in a position to be on the path of becoming an advanced industrial and military power. But if China does not get substantial technological transfer to be incorporated into its own corporations, that is, not just for the foreign corporations operating in China, the country will not escape easily from dualism and technological dependency, while at the same time generating a hollowing out of the productive system of other economies.

### ***Why specifically China (and not Brazil)?***

No other developing country has managed to enter world capitalism the way China is doing. If we look at the Brazilian experience we see that there capitalist development has been constrained by persistent low wages which limited the expansion of the market. The State helped multinationals to invest in a market whose enlargement was constrained by the poverty of the masses, while internationally Brazil stayed mostly within the traditional role of



a raw materials and cash crops exporter. In this context Celso Furtado's analyses are still valid. Investment in a constrained market favors the acquisition of monopolistic rents and makes investment itself biased towards relatively less advanced technologies. Thus the economy's capital stock requires persistent protection as new openings would knock a significant part of it out. It is not that Brazil did not develop industrially, it did. But it has never achieved a situation in which its domestic market could be on a par with that of the advanced countries, mostly because of the drag represented by low wages. This also meant that the structure of capital stock in Brazil was deficient especially in terms of its internal coherence. Again, as Furtado pointed out many times the inward oriented market based industrialization of Brazil implied that multinationals elected to employ inferior technologies, thus any further opening of the economy would jeopardise the existing capital stock without ensuring a different and more advanced expansion.

Let us now look at the structural and historical context in which China undertook the 4 modernizations program in 1978. In the case of China the very low level of wages during the Mao period did not matter that much. It was not a market economy after all. By 1978 China had a pretty consistent capital goods and industrial sector geared not toward consumption, but towards itself and military hardware production. In other words, the system can be portrayed as a closed input-output matrix where coal and steel are needed to produce coal, while steel and coal are needed to produce steel. Production serviced mainly these sectors and the most important final outlet (demand) component was the military sector. The urban population had to ride bikes, wear one suit, eat basic food and live in minimal dwellings. The military sector was not secondary at all. Given the hostility in the relations with the USSR, by the 1970s China could produce all its weapons, that is hundreds of airplanes and helicopters, tens of thousands of vehicles, of tanks, artillery pieces and so on. In addition it had to produce its own electronic communication equipment, as well as all the stages of nuclear weaponry, including missiles of all kinds. All that stuff requires pretty complex industries, engineering, machine tools production, which China was able to set up on a large scale. The scale was not big relatively to the consumption dynamics of the population, but was large enough to create a material base needed to confront the USSR in a credible manner.



Thus, after stabilizing the Cultural Revolution, Mao permitted the key industries to grow. Most of the blows of the Cultural Revolution were felt in the countryside. Even during the urban turmoil of the Red Guards movement, strategic industries, such as the nuclear and missile sectors, were protected and its workers and scientists exempted from performing the well known ideological rituals. Contrary to what happened during the Great Leap forward (1959-1962) – which ended in a massive famine and where both industry and agriculture suffered heavily – the Cultural Revolution witnessed a consolidation and strengthening of industry mostly because of military needs related to the threat from the Soviet Union. We now know that that threat, while it never existed vis à vis the West, was quite real in relation to China as the USSR wanted to bomb Beijing's military nuclear installations and even asked the permission, rejected, from the USA to do that.

When in 1978 the 4 modernizations were launched China was not abandoning the cold war with the USSR. Deng Xiaoping was reshaping the country's foreign policy by making it operate in tandem with the USA in Asia. Beijing was determined not to have the USSR capitalize on the alliance with Vietnam which would have brought Soviet bases on the Southern part of China. Hence from 1979 throughout the 1980s, China and the US closely cooperated in support of Pol Pot, as well as in supporting the guerrillas in Afghanistan. It is from this connection that grew the credibility towards the economic policies of Deng Xiaoping. Just consider the fact the Washington extended to China the Most Favorite Nation status in 1982 when the reforms were barely in place. However the international modalities of the new economic line of the Communist Party were negotiated and discussed in meetings between Chinese and US officials during the very formulation of the 4 modernizations program and in their immediate aftermath. The swift acceptance by Washington of China's new policy was the factor that convinced the Chinese diaspora to believe in Deng's objectives. Interestingly, the more Washington and Beijing postured on the Taiwan issue, the more Taiwan businessmen sent money to China in one of the most opaque financial circuit in Asia. But this very factor demonstrates that Taiwan's entrepreneurs (of all shades) understood what the real drift was about.

Therefore the Chinese out China trusted the possibility of making money by investing in China and, until the Asian crisis, they provided more that 66% of the foreign capital flowing into the country. That amount of money – along with the free trade zones which absorbed a



good part of it - proved crucial not so much for development as such but for cushioning the country against a too negative deterioration in the balance of payments during the transition phase.

The transitional phase lasted from 1979 to 1993 when the government put an end to the dual exchange rate regime leading to a real devaluation of the yuan relatively to the US dollar (and the Asian currencies pegged to it) estimated at above 50%. What was the hallmark of the transitional period? As mentioned earlier China had already in place its advanced industrial sectors, the main purpose of which was in connection to military needs. This means that while the country had the engineering capacity to generate a new structure, the existing one was not at all geared to investment for exports and for consumption goods. The transitional phase was mostly characterized by contradictory policies aimed at expanding the heavy industry in a traditional centralized manner while transforming it to favor a market approach. During that period, the position of China's balance of payments was not strong and this is why the money coming from the external Chinese was so important. What happened after 1993 is well known and we are witnessing it every day in terms of the growth rates production and exports from the People's Republic.

The important element to retain from the foregoing analysis is that China has become a magnet for world capitalism because it had already built the industrial structure needed to feed further accumulation, but now with a composition of output consistent with market capitalist interests. The fact that capitalist enterprises incurred into zero costs because they found both the structure already in place and the transition to a new composition of output financed and/or guaranteed by the Government, explains why the People's Republic has become such an attractor of world's industrial investments. In other words, if China did not have that productive capacity and, especially, the ability to produce new productive capacity in the very sectors which feed the whole system (machine tools, iron, steel, aluminium, chemicals, cement; all sectors in which already in the late 1970s China had displayed an absolute size in terms of output roughly equal to France), it would not have been able to receive the amount of foreign direct investment it has been receiving. Nor would have devaluation worked. No country, except those of a very small size, can develop with FDI alone.



The reason is quite simple and can be grasped by referring to the theoretical approach to production put forward by Luigi Pasinetti (1981). Assume China did not have the above mentioned industrial structure, so that after 1978 all the changes would have had to be financed from FDI. Even leaving aside the issue of the persistent balance of payment deficit that such a situation would have entailed, the profitability of doing so would have depended of the very low wages measured in terms of foreign currencies. Assume that to be the case too. Then if all the machinery and equipment has to be imported from the advanced countries, the cost of that machinery would show up in the final cost of production of the commodities produced by Chinese labor with foreign machines. Yet the cost of those machines expresses the higher value of wages in the advanced countries. Therefore, the higher the gap between the wages in the advanced countries and those in China, the higher will be the capital charges showing up in the final price of the commodities produced by Chinese labor with foreign machines. This means that with fully imported machinery, the lower the wage rate in China the lower will be the value added generated in China relatively to the imported value added embodied in the imported machinery. Under these conditions FDI will take place only in niche sectors or in areas subsidized by the Government, but it cannot become a general magnetic process.

Thanks to its previous level of industrialization involving no international debt (unlike Brazil), and thanks to the fact that after 1978 the “Soviet” side of the Chinese economy had not been dismantled, but actually expanded, China could present itself to the capitalist interests with low labor costs on all the vertically integrated production lines, from raw materials to machinery, to the final output. Let us now turn to Latin America.

### ***Latin America as the opposite of China***

Consider now Latin America. It too needs a major change in the type of activities especially in relation to international linkages. China’s transformation, relying on the pre-existing heavy industries, enabled her to move quickly up the ladder of technological sophistication. If we take China’s exports to the USA as the paradigm, we see that upon the end of the dual exchange rate regime more than 70% of them were concentrated in textile and light industry products. To day the relation is reversed: more than 70% are concentrated in mechanical,



electrical and electronic products<sup>1</sup>. Latin America too needs a change: away from the exports of raw materials and crops. This is not happening, and the conditions for it not to happen are getting stronger rather than weaker. Furthermore Latin America does not have the pre-existing material structure to effectuate this change even if a political consensus were to be achieved.

We can look at the situation and possible predicament of the Southern American continent by using the approach employed to assess China. Let us consider the size of the industries whose products enter directly and indirectly into the production of most marketable commodities. From this angle Latin America is in a very bad shape, considering also the fact that it has an average level of education and of technical expertise above the absorptive capacity of those industries. There are only two countries that can claim to approach the interindustry status required to sustain a more advanced transformation without which the *favelas* will be eliminated, sewerage will not be contained; all things that require machinery and the activation of machine producing sectors. The two countries are Argentina and Brazil. On the whole therefore Latin America has a core productive capacity in crucial sectors many times smaller than China and not much bigger than a handful of small European countries. With that kind of core productive capacity Latin America cannot go anywhere. At best it can manage its own poverty as it is.

But let us now look at Argentina and Brazil. As to the first there is not much to say. The industrialization undertaken from the late 1950s throughout the 1960s is a thing of the past. Since the military regime in 1976, which was really the avant-garde of neoliberalism, the country has not ceased to lose productive capacity and to hollow itself out. The fatal blows had been administered during the fixed peso-dollar parity of the 1990s. To reconstruct Argentina a national multi layered set of plans would be needed and there is no sign of that at present. Brazil is the country which still has a non negligible capital goods industry. Yet

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<sup>1</sup> To avoid any misgivings, it is theoretically wrong to believe that textiles represent labor intensive industries. Without a price system there is no way to tell, but the notion of labor or capital intensive industries presupposes a measurement independent from the price system, i.e. it presupposes a real measurement. But the index of capital or labor intensity cannot be obtained without reference to prices which, obviously, vitiates the whole concept. The reason why textiles are the first item to be exported is because they have been around for thousand of years and just about every country has the know how needed to produce them (However the dresses of the West African women are made of yarns made in Germany). Textiles may actually be more capital intensive than a computer chip.



such sectors have been weakened by the same, albeit less rigid, policies undertaken in Argentina. They have been further enfeebled by the crisis of 1998 and by the sluggish growth of the recent years. These factors contribute to substantial unused capacity so that the core sectors, instead of being a pillar of the transformation process, act as a burden. Latin America does not have the internal and international political conditions to reinvent itself. Contrary to China, which used its debt free domestic structure to undertake an extroverted transformation, Latin America needs rather the opposite.

Latin America has been extroverted for centuries, indeed since the European conquest<sup>2</sup>. In its phase of capitalist development the Continent's patterns were conditioned by its position as supplier of raw materials and crops. The whole Prebisch approach was based precisely on the objective of breaking that dependency and privileging domestic demand. The objective of development away from the traditional patterns led to a constant see-sawing between industrial, agrarian and mining interests. Latin America, and especially Argentina since 1976, operated as a trailblazer of the financialization of economic interests so that industry itself became, through finance, rentier like (Basualdo, 2002). Testimony to that overall financialization of the economy is the exorbitant weight of the service sector in Brazil, clearly not geared to facilitate social and productive efficiency. It therefore follows that the transformation of Latin America cannot be achieved by means of even more extroverted policies.

With China becoming the world factory, the only way in which Latin America, and Brazil in particular, could partake in the cumulative process set in motion by China but centered on China itself, is to out-Chinese China. For this purpose Latin America would require an initial capital goods sector far more advanced than that existing in China. Yet the reality is just the opposite. The capital goods sectors' expansion has been stunted and they are plagued by unwanted excess capacity due to financialization (Argentina) and low growth (Brazil). In China after 1978 these sectors, which were the linchpin of the steel-coal-coal-steel+military complex model, were not abandoned. Instead they grew further otherwise the country would

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<sup>2</sup> The term extroverted is much clearer than that of "open economy". In fact modern Latin America has been set up first and foremost for the needs of the users of raw materials, sugar, coffee, tobacco, etc. The local population, hence the domestic material conditions of existence, mattered very little. The extroverted nature of Latin America was very well captured by the 1969 highly theoretical movie of Gillo Pontecorvo *Quemada*.



not have been in a position to produce nearly 10 times more steel than Brazil, 250 million cell phones, 950 million tons of cement, 6 million cars and trucks, etc. In Latin America the same sectors always had a difficult life and in the last 20 years, with the financialization of the economies, they became ever weaker.

How do the relations between China and Latin America operate in this context? Not in favor of Latin America. According to the United Nations comtrade data base, from 1995 to 2005 exports to China have increased in nominal dollar values by more than 11 times for Argentina (from \$285,730,784 to \$3,154,288,661) and by nearly 6 times for Brazil (from \$1,203,741,184 to \$6,830,977,328). Both countries have a trade surplus with China; the latter has become Brazil's third trading partner and it is likely to become the second after the United States as the Brazil-China trade is poised to overtake the Brazil-Argentina trade.

The net trade balance position in relation to China has become an important component of both Brazil's and Argentina overall surpluses. These have made possible to close the IMF debt completely, but so what? Why has the debt (re-negotiated in the case of Argentina, straightforwardly in the case of Brazil) been paid at all with the concomitant burden of a surplus budget, the attainment of which squashed social spending? In this context it should be noticed that the growth of exports did not lead to an export led growth in the overall economy. In Brazil the economy, in terms of per-capita growth, is expanding at a minimal pace and is therefore in a state of stagnation. In Argentina the significant growth rate in recent years (here the renegotiation of the debt leading to a 60% cancellation played the role of letting people breathe) is largely due to the expansion of the total wage bill due to the negotiations by unions. Essentially, the Argentinian growth of 7 to 8% since 2003 is a wage led growth and therefore pertains entirely to the domestic economy. The non-raw materials trade balance of the country is in deep deficit.

### **A perversion of Prebisch thesis**

To break the unhealthy extroverted dimension of the Latin American economies, Raul Prebisch (with reference to Argentina) developed the well known thesis about a structural dependency determined by the weakness of raw material prices and the monopolistically induced sensitivity of imported industrial commodities to cost prices. Under these conditions



exporters of raw materials could not possibly win. If raw material prices fell they would not translate into lower prices of imported industrial capital goods because of oligopolistic markups and, in this context, because of wage increase in the advanced world. Whereas whenever raw materials prices increased, imported industrial products would immediately reflect the higher costs of production. Thus, the Latin American countries could not improve their status by banking on an improvement in the terms of trade. This thesis is correct if industrial production is conceived to be solely within the framework of the Triad (the USA-Western Europe-Japan) where oligopolistic normalization is completed. It is no longer valid with the transformation of China into the world factory. Yet under the new conditions the structural dimension of the Prebisch thesis acquire even greater significance. In my view these dimensions have been laid out analytically in the mathematical models developed by Marcelo Diamand (1973).

The present nature of the economic relations with China do not solve the structural failures that Diamand identified in his work, failures due mostly to the incomplete nature of the capital goods sectors. China's persistent hunger for raw materials is increasing the specialization of the Latin American economies in their extroverted activities. The overwhelming majority of exports by Argentina and Brazil are in the raw materials and food sectors. The increase in the prices of these commodities strengthens the links between raw materials and creative finance (derivatives and the like) enhancing the financialization of the economies concerned. For the classes leading the process of financialization, domestic production is a costly business especially in the light of China's export expansion world wide. Hence, given that the domestic market is seen as being ancillary to extroverted activities, the feed back from the raw-materials-finance link into domestic production is indeed weak, to say the least. The raw materials export boom has all the hallmarks of a bubble. When prices will deflate there will be both a Prebisch effect, imported industrial products will not reflect the fall in raw material prices, and a financial crisis.

From China's perspective Latin America is mostly a source of raw materials, but in some cases it can be a possible export target. This is particularly true for Brazil. As noted above Brazil exports to China have increased by nearly six times between 1995 and 2005. Imports from China were \$417,913,152 in 1995 and \$5,824,546,895 in 2005. In other words, in 1995 imports from China were roughly 1/3 of exports, while in 2005 Brazil's imports from



China were more than 85% the value of its exports to the same country. In the coming years Brazil will run a trade deficit with China, which means that instead of creating employment at home it will create it in China through Harrod's link between export and employment in the exporting country. The Harrod export multiplier effect, positive for China and negative for Brazil, is particularly asymmetrical if we consider that Brazil's net exports to China are in raw materials, where linkages to the urban economy are minimal and run mostly through the financial sectors. By contrast China exports to Brazil industrial products which therefore compete against the productive capacity and the levels of employment of the country's industries. And this is most definitely what Brazil – and a fortiori any Latin American country - does not need.

Indeed, in terms of future dynamics, the only profitability that a country like Brazil can obtain from China's growing hunger for raw materials is the impact on world commodity prices. In this way Brazil – and also Argentina – stands to gain from its global trade in raw materials through the overall price increase of raw materials. Unlike the Prebisch scenario, the transformation of China into the world factory will not transmit the increase in raw material prices into higher prices of imported industrial products. In a situation of open capital markets and in a context where the financial and exchange rate profile of a country like Brazil is determined by the gains that traders in futures see in the appreciation of raw materials, a systemic rise in commodity prices will lead to a real revaluation of the currency. This will make domestic production even less profitable and capitalist financial interests in Brazil will gravitate even more strongly towards the raw material sectors. Brazilian industrial multinationals will see their future profitability linked to the possibility of outsourcing and or investing directly in China.

Reliance on export growth and on global financial dependency does not fit Latin America's needs. Any alternative, which cannot possibly avoid tackling the issue of constructing the Continent's flimsy capital goods sectors – without which, to use an Italian expression, any talk about fighting poverty and unemployment is just *cooked air*, must be undertaken through political planning means first since there is no a-priori economic mechanism capable to give birth to a new economic pattern. Indeed the odds are stacked against a renaissance of the Continent within the present hierarchically set global rules of the game.

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