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Is China Turning Latin?
China's balancing act between power and dependence on the wave of global imbalances

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Abstract

This paper investigates whether China has escaped the vulnerabilities of peripheral and dependent late industrialisation in the build up to the current global economic crisis, with reference to structuralist critiques of Latin American industrialisation in the 1960s and examined through China's balance of payments data. While it would seem that China's huge surpluses amid sustained growth eliminate any comparative relevance to Latin America, the paper argues that analogous vulnerabilities exist. These were more evident before China's spectacular surplus surge in the 2000s, although even in the midst of the surge, volatility on the capital account and in the errors of omissions was ominous. Changes on the trade account also reflect China's relatively subordinate position within the massive rerouting of international production networks via China that followed the East Asian crisis, for the most part led by Northern transnational corporations. In sum, overly optimistic appraisals of China's strength underestimate many of its persisting structural vulnerabilities as a contemporary developing country and distract attention away from important lessons for other developing countries.

Keywords

China; global imbalances; balance of payments; late industrialisation; international production networks; transnational corporations; structuralism

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Acronyms

BoP	Balance of Payments
CEPAL	Economic Commission for Latin America and the Caribbean
FDI	Foreign Direct Investment
FFEs	Foreign-Funded Enterprises
GDP	Gross Domestic Product
ISI	Import Substitution Industrialisation (or Industries)
SEZ	Special Economic Zone
TNC	Transnational Corporation
WTO	World Trade Organisation
USD	United States dollar

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Introduction

Has China escaped the vulnerabilities of peripheral and dependent late industrialisation in the build up to the current global economic crisis? This question is important with regard to expectations now being placed on China to play a central role in mediating the crisis due to its large holdings of foreign reserves and its large trade surpluses with the US and Europe.[2] It is also important with regard to the degree to which the Chinese experience of the last decade, during which most of its reserves were accumulated, can or should be held up as a replicable or sustainable model for other developing countries, or whether it vindicates important lessons from development experiences of the past, albeit on a much larger and more dramatic scale.

In this sense, China brings us back to development debates of the 1960s and 1970s over dependent growth in Latin America, then the most industrially-advanced region of the Global South. While China was still under the autarky of Maoism during this earlier post-war phase of emerging international financial disequilibria,[3] Latin America was experiencing decently rapid rates of growth, with Brazil briefly hailed as a growth miracle. In the meantime, China has now arisen as the new growth miracle among large poor countries, charting a new path for those disillusioned (or never illusioned) with the remedies of the dominant international financial institutions.

There are obviously enormous differences between China and these earlier experiences of peripheral late industrialisation, whether in Latin America or East Asia. Besides the difference in sheer scale, China began its ascent into rapid growth from the basis of an entirely state-owned and controlled economy, under which considerable industrial and technological capacity had already been developed, mostly on the basis of domestic resources. Much of this state ownership remains in the economy, whether explicitly or implicitly, particularly in key strategic sectors. Even today, all rural land is still owned by the state. Banks are still largely state-owned, albeit in an increasingly

[1] Although not responsible for any of the views expressed herein, this paper benefitted enormously from many exchanges with Kari Polanyi Levitt and Mary Zsamboky. Much thanks is also due for the feedback on various manifestations of this paper over the last two years from (in alphabetical order); James Galbraith, Jayati Ghosh, Gong Sen, Charles Gore, Arjan de Haan, Jan Kregel, Tak-Wing Ngo, Howard Nicholas, James Putzel, Ken Shadlen, Max Spoor, Geoff Tily, and Zhu Ling. I am also grateful for the lasting influence of Athar Hussain and Tom Naylor. In particular, my attention was initially drawn to many of the issues discussed in this paper during the three years I worked for Tom in the early 1990s researching international underground finance.

[2] See Fischer (2009d) for a detailed discussion of these positions as expressed by Martin Wolf, Ben Bernanke, Paul Krugman, and even, somewhat ambiguously, by Robert Wade.

[3] See Kregel (2008) for a discussion of these phases of financial disequilibria.

decentralised manner. In this context, the terms 'liberalisation' and 'privatisation' have carried fundamentally different implications in China than in Latin America, the latter with its mixed economies, transnationalised private sectors, and high degrees of inequality rooted in colonial legacies of private land tenure. However, bearing in mind these very pertinent differences, 'opening and reform' in China since the late 1970s has ushered in a variety of notably Latin American characteristics, setting it aside from some key attributes of South Korea and Taiwan. These include rapidly rising inequalities to levels that are now within the lower range of Latin American countries, or else the rapid transnationalisation of ownership in its manufacturing export sector.

Hence, despite the rave about the rise of China as a new economic superpower, there is merit in examining its recent experience through the lens of earlier structuralist critiques of post-war late industrialisation in Latin America by economists involved with the centre-periphery approach of the Economic Commission for Latin America (CEPAL), notably Raul Prebisch, Celso Furtado, and Osvaldo Sunkel. Their critiques focused on two patterns of disequilibrium; one internal in the form of polarisation and marginalisation in the domestic economy and society, and one external in the form of structural weaknesses in the balance of payments. Out of these two patterns, rising inequalities in China arguably carry stronger comparative potential to Latin America.[4] However, this paper focuses on the less obvious issue of external disequilibria.

On first reaction, it would seem that China's huge current account surpluses and its enormous build-up of foreign exchange reserves effectively eliminate any comparative relevance to these earlier structuralist critiques. However, analogous vulnerabilities remain perceptible. These were more apparent before China's spectacular surplus surge since 2001, although certain underlying patterns continued even in the midst of the surge. The surge itself also reflects China's relatively subordinate integration within the massive rerouting of international production networks via China that followed the East Asian crisis, for the most part led by Northern transnational corporations.

These findings are presented in two parts. The first reviews some of the main CEPAL structuralist insights on the external vulnerabilities of peripheral dependent industrialisation, focusing on the contributions of Celso Furtado and Osvaldo Sunkel in particular. The second part offers an inductive time-series analysis of China's balance of payments position with the world from 1982 to 2008 and a regional breakdown of its trade accounts. The conclusion reflects on the dialectical nature of China's strengths and vulnerabilities that have flowed from the relatively dependent nature of its rapid integration into global production and trading systems dominated by transnational corporations. In this light, overly optimistic evaluations of China's strength do little service to China or to the important lessons that other countries of the Global South need to learn from China's experience.

[4] Domestic processes of polarisation and marginalisation are beyond the scope of the current article. For some discussion of polarisation in Western China, see Fischer (2005; 2009a; 2009c). For an introduction to some Chinese literature on new processes of marginalisation in China, see Rolleau-Berger (2009).

1 CEPAL structuralists on external disequilibria

External disequilibria received the brunt of attention in early development economics because these were understood as potentially snubbing out nascent efforts at rapid industrial catch-up. Similar to other leading pioneers of the sub-discipline, the early CEPAL economists principally focused on chronic foreign exchange gaps that arose due to the intensive import demands of late industrialisation and urbanisation, and subsequent tendencies towards domestic price inflation and balance of payments instability and crisis.[5] Raul Prebisch argued that declining terms of trade in primary commodity exports further exacerbated these disequilibria, in tune with many of his contemporaries such as Ragnar Nurkse, Hans Singer, and Arthur Lewis.[6] The dominance of Northern firms in various services, such as transportation, insurance, finance, and patent and royalty payments, was also commonly noted as an additional route by which Southern surpluses were siphoned. While Prebisch, like Lewis and others, initially posited in the late 1940s that aid or foreign direct investment (FDI) could have a positive and stabilising influence on these external disequilibria, later work by Furtado and Sunkel (as well as by Prebisch and Lewis)[7] became increasingly critical of the rising dominance of transnational corporations (TNCs) in Latin American import-substituting industries (ISI). Together, this combined tradition of structuralist thought highlighted the trade and financial mechanisms that accentuated the already-existing structural propensity of peripheral developing countries to experience chronic foreign exchange shortages in their attempts to industrialise.

Of particular interest for the present analysis is the work of Celso Furtado and Osvaldo Sunkel, which was grounded on the centre-periphery approach of Prebisch (see UN/Prebisch, 1950). This approach aimed to elucidate the challenges posed by the historical integration of Latin America into the international economy. As outlined by Prebisch, the propagation of technical progress favoured technological development in centre and dependence on this technological development in peripheries. This pattern of propagation established the outward-directed, externally-propelled development of peripheries and the four characteristics of peripheral capitalist economies: declining terms of trade; marginalisation of disadvantaged populations in the peripheries; imitative metropolitan consumption patterns of periphery elites; and macroeconomic instability in the form of inflationary pressures and chronic foreign exchange gaps due to vulnerable economic structures.[8] Prebisch promoted ISI as a way to break this mould, although he was cognisant of the fact that the intensive import requirements of ISI would exacerbate the tendency of foreign exchange gaps, thereby calling for the support of foreign finance.

Furtado and Sunkel extended this CEPAL analysis to the patterns of ISI that were already emerging in Latin America as early as the mid-1950s,

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[5] See Fischer (2009b) for further discussion of these points.
[6] See Kaplinsky (2006) for a review of terms of trade issues with respect to China.
[7] See Lewis (1978: 38-46) for his discussion of the difference between foreign debt and FDI.
[8] See Polanyi-Levitt (2005) for a synthesis of the thinking of Prebisch.

including chronic balance of payments problems among the leading industrialisers in the region. They criticised the initial optimism of Prebisch, Lewis and other early development economists that FDI could lead or finance an autonomous process of ISI. Instead, they noted that it quickly led to the encroachment of US-based TNCs in key industrial sectors, particularly in Brazil and the Southern Cone. As such, Furtado and Sunkel were among the first theorists of the expansion of TNCs into the South and FDI-led strategies of industrialisation more generally, which at the time were novel approaches to funding late industrialisation. While steering clear of the more radical determinacy of the neo-Marxist tangents of 'dependency theory',[9] both brought particular attention to the structures of ownership and the resultant control over flows of wealth that ensued from these increasingly transnationalised forms of industrial organisation.

Furtado elaborated the understanding of technological dependence in the periphery. He noted that the way the peripheral Latin American countries accessed what he called 'industrial civilisation' was fundamentally different from even the late industrialisers that had preceded them. Earlier late comers such as Germany and, to a certain extent, Japan had largely developed their industrial technologies from within, on the basis of indigenous processes of innovation, whereas Latin American countries (as most post-war late comers) essentially accessed technology and industrialisation via imports. Domestic industrialisation therefore necessitated, by definition, import substitution in one form or another. Hence, Furtado (1973b: 20) argued that '…the ability of certain countries to control technical progress and to impose consumption patterns became the decisive factor in the structuring of the productive apparatus of other countries, which in consequence became "dependent"' (cited in Kay, 2005: 1204).

This dependence tends to lead to dualism in domestic consumption and production structures. The upper strata of these structures are increasingly based on the absorption of technology and consumption patterns from the centres, and eventually finance and ownership as well, which reinforces external orientation and dependence. Lower strata remain grounded on more basic technologies and consumption patterns. Although the lower strata supply labour, technology adoption lowers the relative absorption of labour per unit of growth before surplus labour is exhausted. Furtado made this last point in contention with the optimism of Lewis (1954) that industrialisation in the peripheries would eventually lead to an exhaustion of unlimited supplies of labour and, as a result, rising wages among these lower strata. Rather, he contended that this structural dualism explains the polarising effects of peripheral and dependent growth within the Latin American context, arguing that dependence is reproduced through a combination of internal and external

[9] It is questionable to what degree Furtado or Sunkel should be associated with the subsequent school of 'dependency theory'. Kay (2005: 1205) traces one of the earliest uses of the term 'dependency' by a social scientist to Furtado (1956), while he was still working in CEPAL, although he also notes that Furtado was later criticised by Cardoso and other 'dependency theorists' for having an exaggerated confidence in the ability of the state to lead an endogenous process of development (ibid: 1204). I am also indebted to discussions with Kari Polanyi Levitt for insights on these matters.

social relations, economic structures and patterns of ownership. The synergy of internal processes of exploitation with external processes of dependence could, in certain periods, lead to substantial growth, but this growth would tend to lead to an intensification of internal processes of exploitation, in contrast to the experiences of Europe and North America.[10]

Osvaldo Sunkel also elaborated the CEPAL structuralist analysis by examining the stratification of dependent economies in Latin America between transnationally-linked and excluded circuits of consumption and production. In the article that introduced him to the US academic mainstream, Sunkel (1972) argued that while it was originally thought ISI would free Latin American economies from their heavy reliance on primary exports, foreign capital and technology, the opposite situation resulted. After around 1955,

> …industry was taken over to a large extent by foreign subsidiaries, with the result that much of the benefit expected from industrialization has gone abroad in payment for capital equipment and in a transfer of profits, royalties and other financial payments... Although the massive penetration of foreign firms has accelerated growth rates, especially industrial, it has also accentuated the uneven nature of development (ibid: 518).

While he acknowledged that early pioneers such as Myrdal, Singer, Nurkse and even Prebisch emphasised the significance of foreign trade structure, he also noted that these earlier economists tended to see foreign financing and technical aid as having a positive and stabilising influence. The 'new studies of "dependencia"' led to an opposite recognition (ibid: 519).

The role of foreign investment was particularly central. Sunkel argued that the 'massive expansion and branch-plant nature of direct foreign investment has in fact some highly negative effects' (ibid: 525). He highlighted four of these. First, the process of vertical integration between subsidiaries and headquarters results in flows of goods, finance and technology, as well as market-sharing agreements, which generally take place within firms even if they are against a country's interests. Second, subsidiaries within one country tend to integrate horizontally, conglomerating among themselves and thereby influencing consumption and production patterns. They also influence the allocation of resources in the public sector, to the extent that they can acquire significant financial resources, private and public, with which to finance local expansion and foreign remittances, almost without the need of net additional foreign capital. Third, foreign subsidiaries exhibit a strong tendency to remit excess profits by manipulating the prices, kinds and quantities of their international transactions, which are mostly kept within the boundaries of the firm. Finally, a definite life cycle is associated with foreign subsidiary activities, with substantial initial contributions of capital, skilled personnel, technology and management, followed at later stages by cash outflows exceeding inflows and with little educational effect given the policy of retaining a monopoly of skills and technology within the firm (ibid: 525-27). Beyond these economic

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[10] Paraphrased from quote cited in Kay (2005: 1204); also see Furtado (1973a) for a corrective to his earlier stagnationist hypothesis regarding Brazil.

effects, he concluded that the socio-political consequences are of even far greater importance. (ibid: 527).

Furtado and Sunkel provided important insights into how TNC-led FDI could undermine national processes of accumulation even in the midst of relatively rapid growth. In particular, they brought attention to ownership structure, in contrast to the earlier structuralists who focused on trade and production structure, thereby shedding light more clearly on various financial mechanisms of wealth transmission from peripheries to centres. These mechanisms could be identified on the income account (i.e. remitted profits of TNCs and interest payments on debt), or on the financial account (i.e. licit or illicit capital flight by domestic elites or else various mechanisms of capital repatriation by TNCs as private international capital flows were gradually liberalised during the 1960s). As noted by Sunkel, some of these mechanisms of financial transmission could also take place on the trade account through the emerging techniques of transfer pricing practiced by TNCs, as further demonstrated by Vaitsos (1973). Indeed, these emerging TNC practices added additional insight to the dilemma of declining terms of trade. Notably, these financial aspects of vulnerability accentuated the already-existing propensity of late industrialising countries to run chronic current account deficits due to their structures of trade and production.

2 China's accounts and balances since Opening and Reform

There are several attributes of China's external position that are worth comparing to these previous analyses of peripheral and dependent post-war industrialisation in Latin America. Several important distinctions also require qualification, notably the exceptional manufacturing export performance of China, which bears more resemblance to East Asia than anything Latin. However, a similarity with Latin America is the TNC dominance in China's export industries, comparable to the TNC dominance in Latin American ISI sectors. Moreover, as noted by Naughton (1996), industrialisation in China is best understood as mixture between export-orientation and import substitution. It therefore bears more similarity to the industrialisation of large Latin American economies such as Brazil in the late 1960s than is normally accorded, albeit at a much larger scale and with more careful retention of national ownership in its ISI sectors, while segregating TNC participation to its export sectors.

Indeed, this interplay between export and import substitution strategies is a key difference between China and both Latin America and East Asia. Both South Korea and Taiwan were able, for various reasons, to excel in manufacturing exports during their intensive catch-up phases without relinquishing control in their export industries to foreign ownership.[11] In

[11] See Amsden (1989) for a seminal analysis of this in the case of South Korea. Also, see Zhu (2010) for an interesting discussion of the difference between earlier industrialisers in the first phase of globalisation (i.e. the UK, the US, Germany and Japan), which mainly relied on debt as their main source of foreign financing, versus China in the recent phase, which has mostly relied on FDI, particularly post-1985.

contrast, the export sector in China today is dominated by 'foreign-funded enterprises' (FFEs). The FFE share of China's exports rose from 13 percent in 1990 to 41 percent in 1995, 48 percent in 2000, and 58 percent in 2005 (Li et al, 2007: 93). While 'round tripping' undoubtedly accounts for some of this increase,[12] particularly in the 1990s, the bulk of the share represents genuinely foreign forms of ownership. In other words, the doorway for TNC entry into China has been, up to recently, predominantly through the export sector. This in turn contrasts with Latin America in the 1950s and 1960s, where TNC entry occurred largely through FDI in the ISI sectors as means to take advantage of protected domestic markets through foreign-owned subsidiaries. The Chinese model has resulted in exceptional export performance but also considerable foreign control over its means of earning foreign exchange.

Terms of trade is another related point of comparison that has received some attention in the literature. It is already well established that China has been experiencing deteriorating terms of trade in its manufacturing exports, in some cases even within a single product category.[13] According to Zheng and Zhao (2002), this deterioration was greater vis-à-vis developed countries than developing countries, it was less pronounced for labour-intensive manufactures, and it was worse in the medium to high technology intensive manufactures such as computers and office equipment, which were precisely the sectors in which China has increased its participation in international production networks most rapidly (before and after 2001). At the time, the authors concluded that this reflected the segmentation within such product categories between high-technology or high-value inputs produced outside China and the labour-intensive processing of these inputs in China, with the result that China's involvement in international manufacturing networks effectively relies on leveraging its supply of cheap low-skilled labour even within these high technology exports. Similarly, Li et al (2007: 94) argue that the deterioration of China's terms of trade since the 1990s has been the result of large FDI inflows into labour-intensive export sectors. They also suggest that TNC practices of transfer pricing for the purpose of tax avoidance as another possible cause, which bears strong similarity to the criticisms of TNC-led industrialisation in Latin America by Sunkel (1972) and Vaitsos (1973), as discussed above.

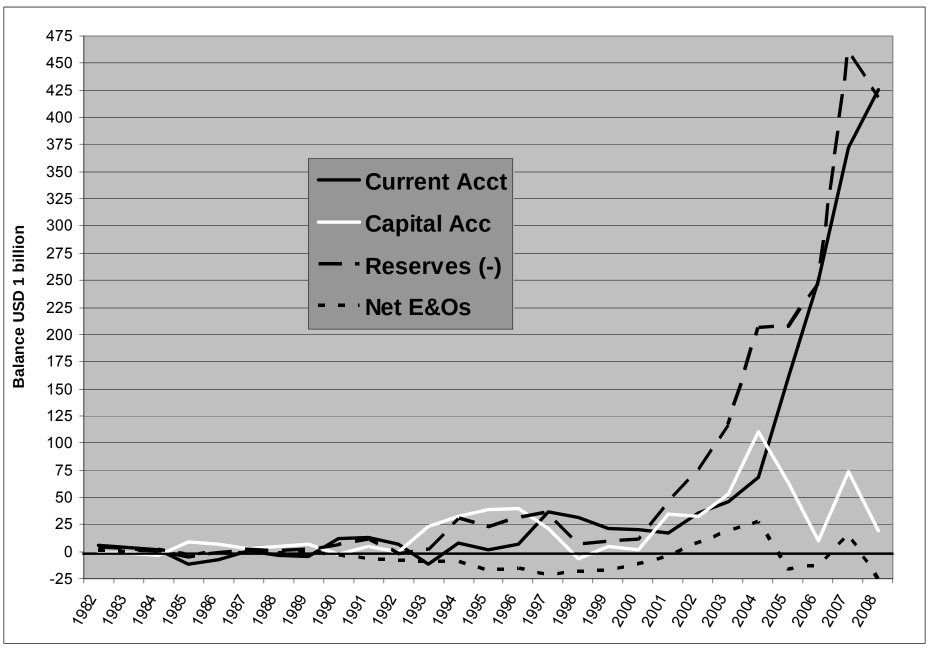
Arguably, the dazzling export performance of China would seem to compensate for these various weaknesses. In order to judge whether China has

[12] Round-tripping is the term used to describe the evasion of capital controls by Chinese nationals, who then invest from Hong Kong to take advantage of preferential terms for FDI. World Bank (2002: 41) estimated that such round-tripping accounted for about one quarter of FDI flows to China in the 1990s, although care must be taken with this estimation because clear definitions and explanations of the estimation techniques were not provided and also because of the policy agendas implied. It was also probably less of a factor in the 2000s, in comparison to the 1990s when the capital account was much more closed, when there was more of a distinction in the treatment between FDI and domestic investment, and when traditional export sectors held a greater weight in total exports.

[13] E.g., see UNCTAD (2002: 119); UNCTAD (2007: 11-12); Zheng and Zhao (2002); and Li et al (2007).

truly escaped from the external vulnerabilities of peripheral late industrialisation, it is useful to analyse the balance of payments data more broadly, as presented below. Figure 1 presents China's balance of payments in nominal current value terms from 1982 to 2008, with the sign of the reserves reversed in order to allow for easier analysis. Figure 2 normalises these nominal data as a proportion of China's current value GDP converted at year-average market exchange rates.[14] Episodes of major devaluation or revaluation of the exchange rate are also indicated. Figure 3 contextualises these data with general consumer price inflation rates and real per capita GDP growth rates.

FIGURE 1
China Balance of Payments, current USD, 1982-2008 (reserves reversed)

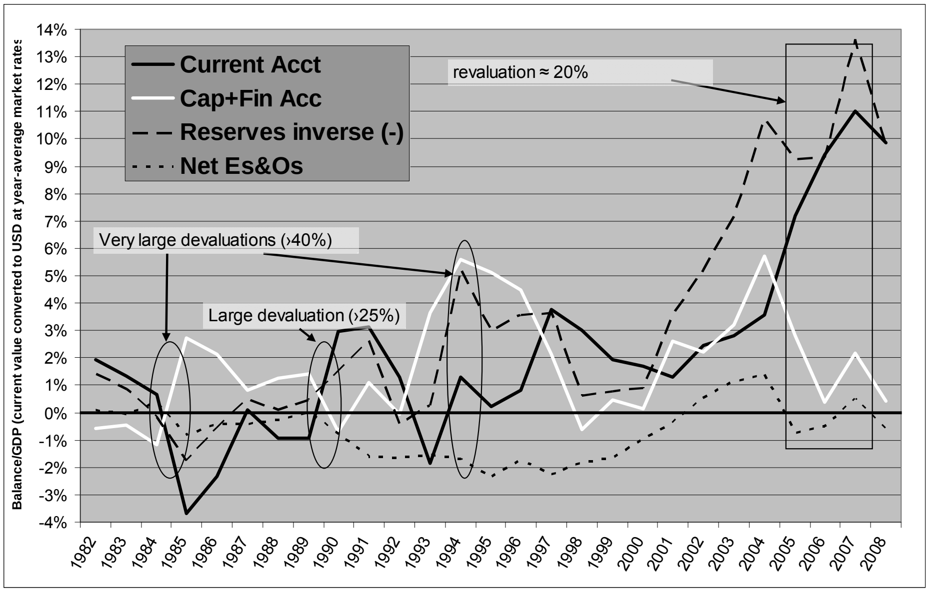


Sources: CTEESY (2007: Table 3-1); CSY (2008: Table 3-32); CSY (2009: Table 3-32).

Figure 1 presents the common view of China's balance of payments. It is difficult to analyse these nominal data, besides the fact that China's emergence on the global scene as a major surplus nation only became evident from 2002 onwards at the earliest. The increasing volatility on the capital account and in the errors and omissions is also striking. These patterns are much clearer in the next figure, which is presented together with Figure 3.

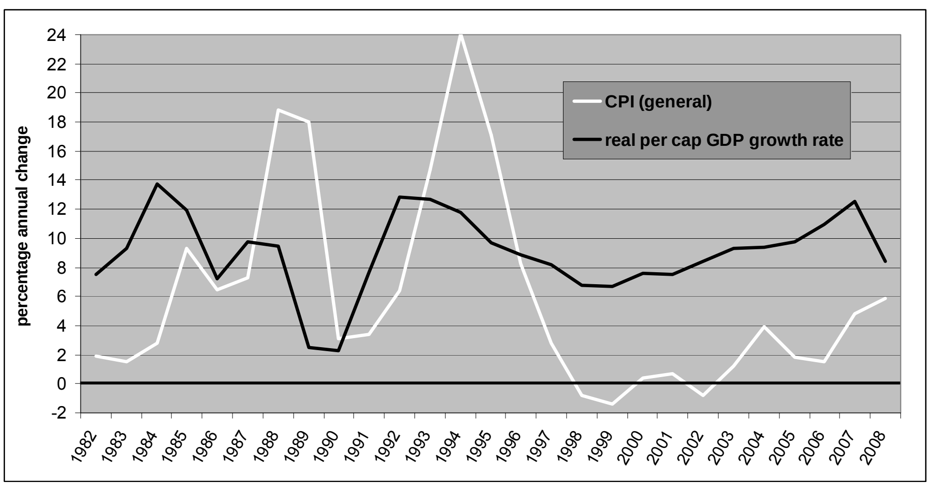
[14] Market exchange rates are used instead of a PPP conversion because they reflect the weight of external balances in the local economy, relative to local resources. This obviously accentuates the appearance of shifts on the various accounts in periods of devaluation.

FIGURE 2
China Balance of Payments relative to China GDP, 1982-2008



Sources: same as Figure 1 and IMF International Financial Statistics database (accessed 22 July 2009).

FIGURE 3
China price inflation and real per capita GDP growth rates, 1982-2008



Sources: CSY (2009: Tables 2-4 and 8-1) and equivalent in CSY (2000) for data in 1990s (note that RPI used instead of CPI from 1982-84 because CPI only starts in China from 1985 onwards).

From the perspective of the normalised data, it is clear that the internal and external imbalances of China epitomised the classic structuralist prognosis of post-war peripheral industrialisation up until the mid-1990s, albeit with vigorous attempts to escape from this predicament. Periods of spurting industrial growth tended to lead to both inflation and current account deficits, which in turn were only resolved through austerity (relative to Chinese norms). For instance, after a few initial years of rapid growth and moderate price inflation in the early 1980s, by 1985 the current account fell sharply into a deficit of -3.7 percent of GDP and China was losing reserves equivalent to -1.8 percent of GDP. This imbalance was corrected through a combination of a sharp devaluation of the official exchange rate by over 40 percent in 1984 together with further liberalisation of foreign investment in the Special Economic Zones (SEZs).[15] The current account deficit nonetheless persisted throughout the 1980s, while price inflation peaked at almost 19 percent in 1988 (amidst rapidly rising inequality). Both deficit and inflation were only corrected through the austerity that surrounded the events of Tiananmen in 1989, together with further large devaluations in 1989-90, after which the current account returned to a solid surplus in 1990-91. However, as soon as these brakes were released and strong growth resumed, particularly with the unleashing of SEZs across the whole country following the Southern Tour of Deng Xiaoping in spring 1992, the current account fell sharply back into deficit in 1993 (-1.9 percent of GDP), while inflation surged to a peak of 24 percent in 1994. China's take off was turbulent indeed; throughout this entire period, rapid growth tended to induce current account deficits, while strong current account surpluses were only achieved through austerity or slowdown.

Even in the lead up to China joining the WTO in 2001, it was not obvious that this predicament had been solved. The current account surplus was tenuous in 1994-96 despite another sharp devaluation of almost 50 percent in 1994 – the last and the one that also enacted the unification of the two-tiered exchange rate system – along with a huge surge of net capital inflows elicited by the new SEZ policy, which reached 5.6 percent of GDP in 1994. Moreover, the peak in the current account surplus in 1997 at 3.8 percent of GDP was again partly related to the slow down induced by the East Asian crisis, which also threw China into an entirely new internal disequilibrium of general price deflation in 1998-99 and again in 2002. The current account surplus was also counterbalanced by the capital account, which briefly turned negative in 1998, and by the strong illicit or unrecorded net outflows represented by the errors and omissions, which were equivalent to -2.3 percent of GDP in 1997. Notably, reserve accumulation in 1998, at 0.6 percent of GDP, was equivalent to the net capital outflow and only one-third of the net outflows implied by the errors and omissions in that year. From 1998 to 2000, reserve accumulation remained at less than 1 percent of GDP, while the current account surplus declined to 1.3 percent of GDP by 2001. From a contemporaneous view, this was not a particularly secure position, particularly given the increasing volatility on all accounts and the uncertainty that followed the bursting of the dotcom bubble in the US.

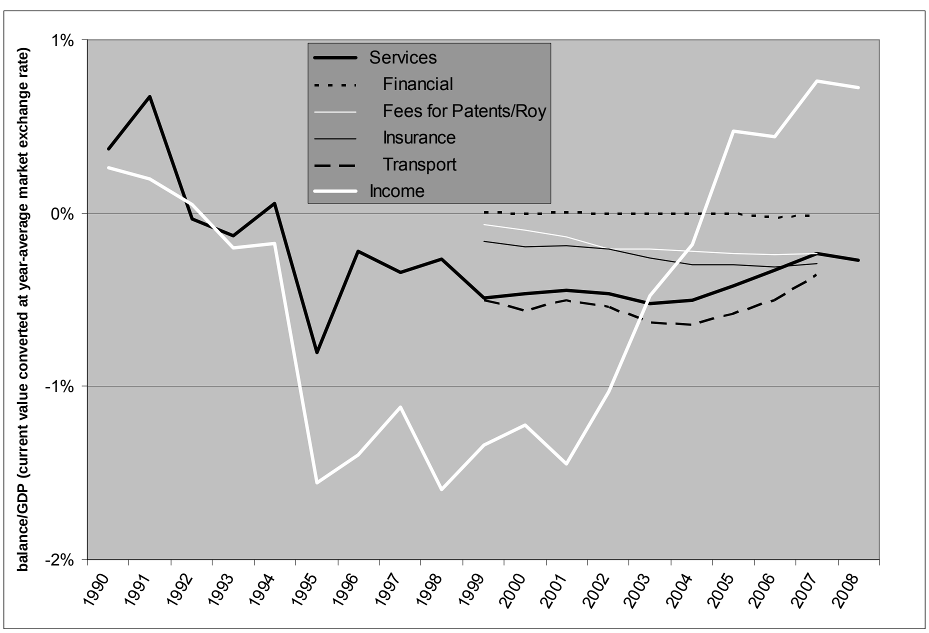
The reasons for government concern at the turn of the millennium are quite obvious in light of such fragile reserve accumulation and the persistent deficits in errors and omissions despite the relatively closed capital accounts, particularly considering the very fresh memory of chronic current account deficits earlier in the 1990s. Lessons from the financial meltdown in the ex-Soviet Union undoubtedly heightened these concerns. This perspective also helps to explain the government's resistance to revalue in 2004 and 2005,

[15] See Yang (1997) for a seminal discussion of these policy dynamics.

especially in the face of the sudden surge in speculative capital inflows reflected by the errors and omissions, which turned positive for the first time and reached 1.4 percent of GDP in 2004. These added to a surge in licit capital inflows reaching 5.7 percent of GDP in 2004, much of which were also probably speculative. If these net flows had suddenly reversed, which was a possibility given early warning signs of an impending credit crunch in the US economy already at that time, together they could have easily overwhelmed the budding current account surplus, which reached 3.6 percent of GDP in 2004. Such suspicions were not far off given that the capital account subsequently fell below 0.5 percent of GDP in 2006 and 2008; in both years, net outflows implied by the errors and omissions exceeded these meagre net capital inflows.

Moreover, minor deficits on various components of services and the income account have underlain the more general current account surpluses since 1995, parallel to the huge surge in net FDI inflows in the early 1990s (see Figure 4 below). Such deficits clearly differentiate China's subordinate position from leading industrial powers, which generally earn surpluses on these accounts, as discussed in the first section. In particular, transportation, insurance, and patent and royalty payments remained continuously in deficit from 1995 up to the most recent data. The income account fell sharply into a deficit of -1.6 percent of GDP in 1995, reflective of the increasing role of profit repatriation that followed in the wake of previous FDI inflows. It remained in that range up to 2002 and only turned positive in 2005, probably due to the building backflows of interest income coming from China's reserve holdings in the US, which counterbalanced the negative effects of profit repatriation apparent in the previous deficits.

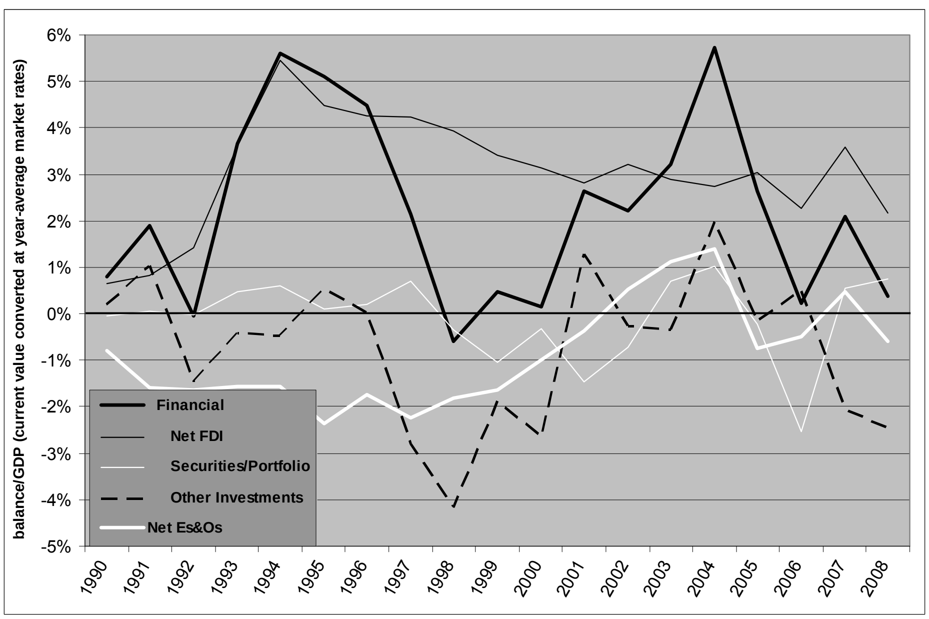
FIGURE 4
Selected services and income account relative to China GDP, 1990-2008



Sources: same as Figure 2.

The increasing volatility of capital flows is even more evident in the disaggregated financial account, shown in Figure 5 below. Other than FDI, the various components of the financial account and the errors and omissions followed a pro-cyclical pattern of boom and bust following the beginning of the East Asian crisis in 1997. For instance, the surge on the financial account in the early 1990s was entirely due to net FDI inflows. Since that time, net FDI was more or less a stable, slowly declining share of GDP at around 2-3 percent in the 2000s (Chinese net direct investment abroad only surpassed 1 percent of GDP for first time in 2008). In contrast, the volatility on the financial account from 1997 onward was due to 'other' investments and, increasingly, 'securities and portfolio', the latter registering a net outflow of -2.5 percent of GDP in 2006. Net outflows on 'other' investments reached -4.2 percent of GDP in 1998 (greater than the current account surplus in the same year), and again fell below -2 percent of GDP in 2007, reaching -2.5 percent in 2008. 'Other' investments include trade credits, loans, currency and deposits, and other assets, transferred by monetary authorities, general government, banks or other sectors. Given that the largest outflows on this account in 2007 and 2008 were with monetary authorities and banks, the plummeting of this account could represent a combination of large efforts by China's monetary authorities to shore up the US economy alongside major divestment from China by foreign banks that were selling off their recent acquisitions in China as a means to bolster their balance sheets back home.

FIGURE 5
China's financial account, composition relative to GDP, 1990-2008



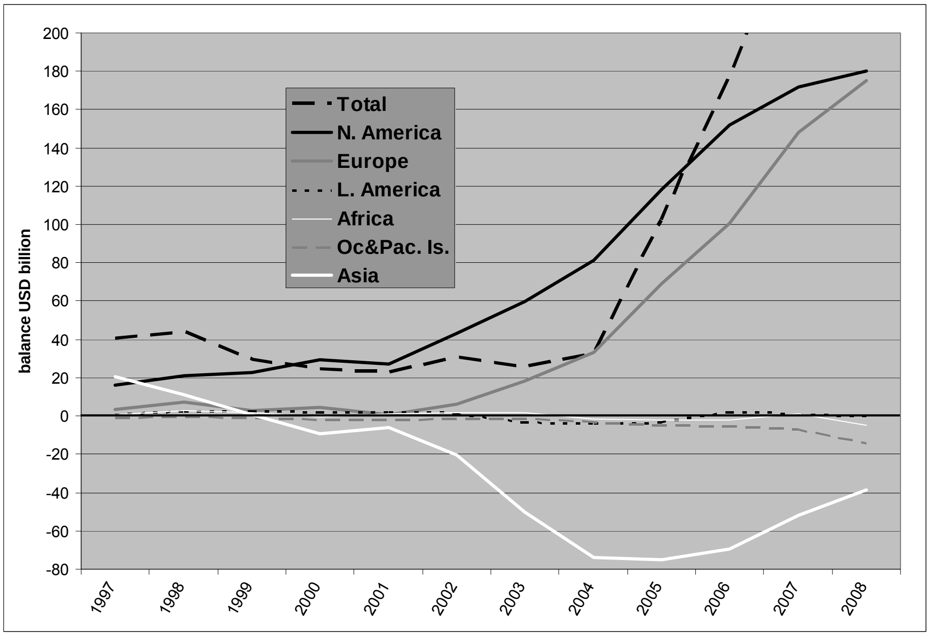
Sources: same as Figure 2.

Also notable is the pro-cyclical upswing in 2004 in all of the financial accounts besides FDI. This was in large part related to speculation on the anticipation of currency appreciation at the time, which was facilitated by the gradual liberalisation of the capital account and financial sector over this period. Much of the movement on the errors and omissions was also probably due to such speculative inflows and outflows surrounding the un-pegging of the renminbi in 2005, or else to currency speculation in the final phases of the international financial bubble in 2007 and subsequent deleveraging in 2008. Indeed, in light of the post-crisis return of what Nouriel Roubini has called the 'mother of all carry trades' lashing East Asia in fall 2009 (RGE 2009), it is easy to imagine how such financial volatility will continue to increase and, in the event of a pro-cyclical swing downwards, could overwhelm both the shrinking share of net FDI inflows and even a moderately strong trade surplus. Naughton (2007: 421-22) argues that this increasing ability of financial flows to subvert capital controls is precisely one of the strongest reasons for capital account liberalisation given that a legal, regulated open capital account might function better than the status quo of increasingly evasive flows. However, the logic is akin to arguing that the door should be left open because the thieves are getting better at picking locks.

Given the increasing volatility, the sudden surge in the trade surplus after 2001 has been crucial to the sustainability of this situation. Hence, it is important to question how the surge came about. It was not obvious even as late as 2001; the current account surplus (mostly trade in goods) only really took off above the previous heights achieved in 1990-91 (3 percent of GDP) and 1997 (3.8 percent of GDP), from 2005 onwards. As noted above, these earlier heights were achieved through slow-down. Hence, even as late as 2004 it would not have been clear whether the improvement on the trade account was simply another short bout or a lasting occurrence. The sheer collapse of the capital account surplus in 2005 no doubt encouraged the government to prepare for the worst and to buttress the trade surplus in case bubble came to bust on the current account as well. In other words, the idea of Chinese exceptionalism, that the country was free from the external financing constraints faced by most other peripheral late industrialisers, derives from very myopic hindsight. The government of China was clearly well aware of this, even if the western financial press was not.

The easy explanation for the surplus surge was China's entry into the WTO, although this alone only offers a surface glimpse of the underlying processes at work. At a deeper level, the surge appears intimately related to the systemic rerouting of East Asian centred international production networks through China that followed the East Asian crisis in 1997-98. A detailed analysis of this restructuring is beyond the scope of the current paper, although some brief insights can be offered through regionally-disaggregated trade accounts, presented in Figures 6 and 7 below.

FIGURE 6
China Regional Trade Balances, 1997-2008 (current USD)



Sources: calculated from CSY (2009: Table 17-8) and equivalent tables in earlier yearbooks.[16]

Figure 6 above shows how the pattern by which China has built very large trade surpluses with the North America (mostly the US) and Europe parallel to large trade deficits with East and Southeast Asia only emerged since the East Asia crisis.[17] The rising bilateral trade surplus with the US receives most of the popular attention; this did accelerate after 2001 and increased more or less continuously up until 2008, as did the surplus with Europe. Indeed, the surplus with Europe grew even faster, starting from almost zero in 2001 and actually surpassing the surplus with the US for the first time in 2009. However, these observations need to be qualified by the equally dramatic descent into deficit with the rest of Asia (mostly East and Southeast Asia), from a surplus equal to that with the US up to 1997, to a slight deficit in 2001, and then to a large deficit of -74 billion USD by 2004, almost equal to the surplus with the US of 81 billion in the same year. This descent stalled from 2005 onwards, not because of a slow down in trade but because China's exports to Asia started to catch-up with its imports from Asia. Nonetheless, about 29 percent of these exports to Asia in 2008 were to Hong Kong. Thus, they were also largely reflective of the broader production and trading networks occurring between Asia and Europe and North America, with Hong Kong serving a classic function as trading entrepôt.

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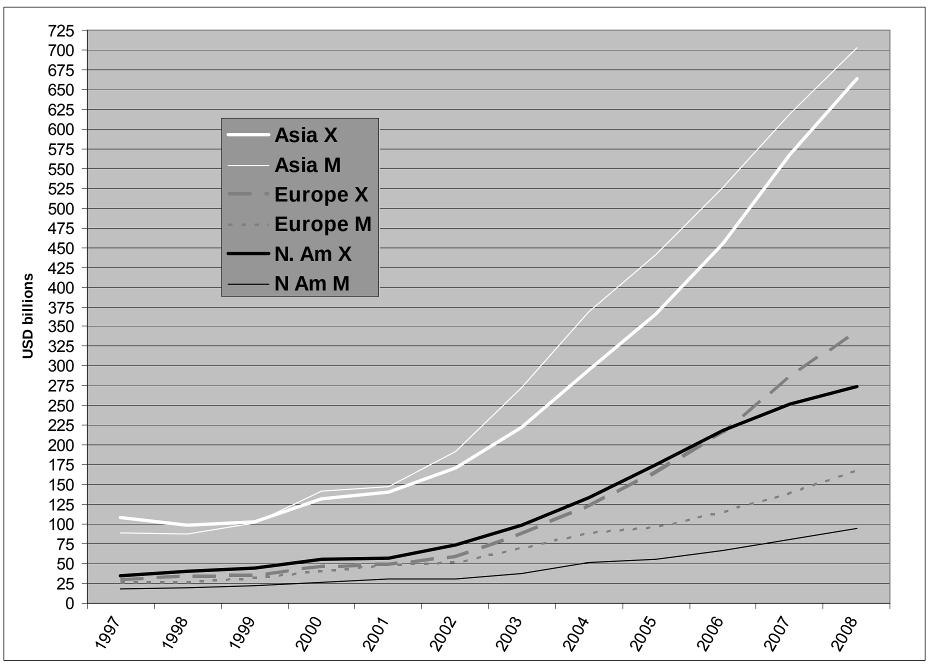
[16] Note that there is some inconsistency in the trade data from this source and the source used for Figure 1 above; this source reports marginally lower trade balances. However, the broad trends are similar.

[17] See Athukorala and Yamashita (2009) for a similar analysis, based on data from 1990 and with more detail on disaggregated product data.

The picture is even more dramatic from the viewpoint of gross import and export volumes with Asia, shown in Figure 6 below. These exceeded the combination of trade volumes with the US and Europe. For instance, China's imports from Asia increased from 147 billion USD in 2001 to 703 billion USD by 2008 (62 percent of total imports in 2008), while its exports to North America increased from 52 billion USD to 274 billion USD and its exports to Europe increased from 49 billion USD to 343 billion USD. In other words, growing trade imbalances have been built on an enormous increase in the scale of turn over in the regional economy, with trade volumes between China and the rest of Asia increasing by over 7 times in ten years.

FIGURE 7
China Regional Trade Volumes, 1997-2008 (current USD)



Sources: same as previous figure.

More specific disaggregation of these trade flows and balances with Asia further reveals the emerging third or even fourth-tier position of China within the restructuring of production networks implied by these data (and also implied by the balances of various services, as discussed above). For instance, China's trade surplus with Hong Kong was 178 billion USD in 2008. In contrast, its largest (and growing) trade deficits have been with Taiwan (at -77 billion USD in 2008); South Korea (-38 billion USD); and Japan (-34 billion USD). Following these three first and second-tier industrial leaders, China also had significant deficits with what are considered third-tier countries within the regional industrial networks, namely, Malaysia (-11 billion USD), Thailand (-10 billion USD), and Philippines (-10 billion USD). With the exception of obvious oil exporters, China otherwise ran relatively minor trade surpluses with most other Asian countries. Indeed, it would appear that China's trade expansion into other parts of Asia and the Global South is the twist side of its increasing integration and subordination within East Asian production networks.

A growing body of literature on TNCs in Asia confirms this observation of China's subordinate third or even fourth-tier position within these networks.[18] Athukorala and Yamashita (2009) argue that the growing trade deficit between China and the US is structural, 'related largely to the pivotal role played by China as the final assembly centre in global production networks' (p.41). This role, they argue, has been '…based on its ample supply of labor, and moves taken by US firms to supply high-end parts and components from their Asian bases to China' (ibid: 54-55). Hence, instead of China becoming an advanced-technology superpower based on its structural shift away from traditional labour-intensive products and towards ICT products, 'closer examination of the data suggests… the rapid consolidation in China's final-assembly stages of East Asian-centered global production networks of these products' (ibid:48). Yao (2009) similarly argues in a stinging criticism of Rodrik (2006) that the export surge in the sector of machinery and electrical machinery and parts in China does not necessarily represent technological upgrading. 'All indications suggest', he concludes, 'that the rise of the sector in China's foreign trade be closely associated with its processing trade regime and foreign outsourcing to China, a reflection of the country's trade development along the lines of its comparative advantage' (ibid: 63).

By referring to comparative advantage, Yao implies that China's participation in such trade is largely based on the use of its abundant and cheap labour within these processing sectors. That China has been able to amass such large trade surpluses on the basis of this specialisation is thus more a matter of sheer scale and productivity (within low-wage assembly work) rather than of technological upgrading or moving up the value chain of these international production networks. Of course, China is achieving much technological upgrading and capturing much value added in its domestic state-owned sector.[19] In this respect, a key aspect of China's industrial policy has been to use its export sectors to overcome the financing constraints of an import-substituting strategy of domestic industrialisation, similar to South Korea in the 1960s and 1970s.

However, in contrast to South Korea, the Achilles Heel of China's strategy is the increasing TNC dominance of its export sector. For instance, as mentioned earlier, 58 percent of China's exports (and imports) in 2005 were from foreign-funded enterprises. Thus, once the state purchases the foreign exchange surpluses generated by these enterprises, the resulting reserves effectively represent foreign claims on domestic financial assets. Similarly, the foreign exchange reserves collected through FDI also represent, by definition, foreign claims on domestic assets. Hence, Zheng and Yi (2007: 19) note that 'China's growing foreign exchange reserves do not imply wealth that is

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[18] In particular, see excellent contributions by Athukorala (2007, 2009), Li et al (2007), Sung (2007), Athukorala and Yamashita (2009) and Yao (2009). Also see Bergsten et al (2006).

[19] See UNCTAD (2002: 77-83) for an interesting discussion on the differences of value added generated by exports from foreign-funded enterprises as compared to state-owned enterprises.

disposable at any time, but rather a sizeable indirect debt.' They suggest that in 2005, 'only half of China's accumulated foreign exchange reserves were consistent with its wealth, which allowed Beijing to fulfill international payment obligations. The remaining capital inflows (FDI and short-term foreign borrowings) could be interpreted as implied debts… that China would have to pay back eventually.' Similarly, in communications with Jan Kregel, he indicated that from information presented to the recent meetings of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, it was quite clear that the external figures on the foreign exchange holdings of China are meaningless for most purposes, especially since a large proportion are apparently non-repatriated profits of joint ventures with foreign multinationals.[20]

Ownership is critical in this regard. It is useful to compare the situation of China with that of Germany, the other large surplus country in the global economy at the end of the first decade of the 2000s. Current account surpluses in Germany are by and large earned by the private corporate sector in Germany, generally based on German or trans-European forms of ownership. As a result, the net capital outflows that compensate the current account surplus mostly take place as private capital transfers. In this way, the public monetary authorities are not burdened by foreign reserve accumulation or sterilisation operations and current account surpluses become an instrument of German corporate expansion abroad. Similar processes of corporate expansion are also at work in the US given that it also sends net FDI abroad despite the general surplus on its financial account.[21] Both countries are able to mediate their imbalances in this manner because the vehicles of surplus accumulation and/or direct investment abroad are largely national, i.e. firms with head offices that are located in the national economy.

The opposite condition increasingly prevails in China. The bulk of its surpluses that are generated through foreign forms of ownership do not become a vehicle of expansion for the Chinese corporate sector except by way of the limited share of reserves that the government diverts to the activities of state-owned enterprises abroad or else to its sovereign wealth fund. In any case, and contrary to popular conception, the government is actually quite limited in terms of how it can use its reserves in this way given the need of the People's Bank of China to match, as much as possible, the reserve assets on its balance sheet with the domestic liabilities that it used to purchase these reserves.[22] Instead, the surpluses generated through foreign forms of ownership effectively serve as a vehicle for the expansion of foreign acquisitions in the domestic economy. Moreover, government efforts to sterilise the monetary effects of their currency purchases also effectively result in a subsidisation of these foreign claims on domestic financial assets. For instance, Zheng and Yi (2007: 21-22) note that China was paying out much

[20] Email communication with Jan Kregel, 22 August 2009.
[21] See an excellent discussion of the US case in Kregel (2008). I am also grateful for the insights on these matters provided by communications with Geoff Tily.
[22] See Pettis (2010) for a superb discussion on this specific point, albeit he does not consider the dimension of ownership as discussed here.

higher rates of return on inward foreign investment and on its related sterilisation operations in China than it was earning from the resultant sterilised foreign currency, largely held in US Treasury securities. In other words, China has not only been financing the US government deficits; it has also been effectively subsidizing such financing, as well as FDI in China more generally. Of course, this could be taken as argument for capital account and financial liberalisation, although there are several reasons why such capitulation would be a bad idea for China. One important reason is that liberalisation would probably facilitate the increasing denationalisation of China's means of generating foreign exchange, thereby worsening this underlying source of structural vulnerability.

This situation is actually quite analogous to earlier structuralist critiques that ISI policies were effectively subsidising the expansion of TNC operations in Latin America, as discussed in the first section with reference to Sunkel (1972). Similarly, although FDI accounts for a very minor share of total investment and value added in China, it has been strategically concentrated in the export sector to such an extent that foreign-funded enterprises have come to dominate the main means of generating foreign exchange. This in turn has become the focal mechanism of transmitting foreign ownership into the domestic economy, rather than through FDI as would be conventionally conceived. It is in this sense that while surpluses and reserve accumulation by China do represent aspects of strength in the global economy (although relatively minor in comparison to the ability of the US and related offshore financial centres such as the UK to create liquidity), in a dialectical manner, they also represent a significant source of vulnerability, similar to the early successes of ISI in America albeit through quite different mechanisms. Revaluation or capital account and financial liberalisation would not solve these underlying structural issues. Instead, the adoption of full convertibility could potentially render China very susceptible to the types of speculative attacks that occurred in the East Asian crisis.

3 Conclusion: between soft power and hard dependence

This paper offered a reflection on the nature of Chinese integration and dependence in the global economy. It drew inspiration from the CEPAL structuralist critiques of Latin American industrialisation in the early post-war period, in particular focusing on the contributions of Celso Furtado and Osvaldo Sunkel. Their work shed important light on the central issue of ownership and how the emerging dominance of foreign ownership in key import substituting industries exacerbated the already-existing external vulnerabilities faced by Latin American countries in their attempts at industrial catch-up. This recollection is not to suggest that China is the same, but that important analogous lessons can be learnt. Through an analysis of China's balance of payments from 1982 to 2008, the paper argued that simplistic evaluations of China's strength on the basis of its external surpluses are exaggerated. Notably, the trade surplus and reserves of China only started to surge spectacularly after 2001. Before this time, China's current and capital accounts were much more typical of a peripheral late industrialiser, in the sense that growth spurts ended out exacerbating domestic price inflation and driving the current account into deficit. This tension was exacerbated by persistent deficits on the service and income accounts. Parallel to this, increasingly large and volatile movements on the capital account and in the category of errors and omissions underscore the importance accorded to defensive reserve accumulation by China. Notably, many of these aspects of external disequilibria were highlighted by the earlier CEPAL structuralists.

Further inspection of the trade accounts also offers some clues on how China managed to transition in the early 2000s from classic peripheral late industrialiser to one of the largest surplus countries within the global trading system. Within the surplus surge on the trade account, China has built very large trade surpluses with the US and the EU parallel to large trade deficits with East and Southeast Asia, both patterns emerging only since the East Asian crisis in 1997-98. This reflects the massive rerouting of East Asian centred international production networks through China that followed the crisis, as well as China's subordinate third or even fourth-tier position within these networks as point of final processing before exporting to North American and European consumers, as argued by a growing body of literature on transnational corporations (TNCs) in Asia. The regional trade balances also reflect the parallel processes of financialisation in the US and Europe that fuelled not only consumption in these final trade destinations but also Northern consolidation of control over these production networks. Northern consolidation is further reflected by the fact that China's exports were increasingly derived from foreign-funded enterprises during the surge, resulting in an important transmission of foreign ownership into the domestic economy.

It is vital to view the current debates regarding China in this light. The presumption that China is in a position of strength and should thus move from its defensive strategy of reserve accumulation to one that adopts a much more pro-active position of mediating imbalances in the international monetary and trading system through greater financial openness is one that treats China as if it were one of the central powers behind the expansion and regulation of this monetary and trading system. A false evaluation of such strength could have dramatic implications for China, particularly if the proposed strategies of currency and financial liberalisation would result in accentuating vulnerability to volatile capital flows in the near-future reverberations of the current crisis. This concern is all the more important given that, despite the attention focused on China's reserves (much of them held in low yield and possibly depreciating US government assets), these have been in fact dwarfed by the volumes of international liquidity that contributed to the build up of the current crisis and that were largely generated by Northern financial systems. They are also dwarfed by the massive volumes of liquidity that were suddenly created by Northern central banks in response to the crisis, now estimated at well over 13 trillion USD (i.e. more than 6 times the total estimated reserves of China at the time of these central bank interventions). China's reserves are also dwarfed by the volumes currently involved in the enormous resurgence of (the still-unregulated) carry trading that reverberated from such central bank interventions. In the wake of such huge surges of international liquidity and the possible inflationary consequences, it is plausible that China's own foreign exchange reserves today could be quickly eroded in the medium term. From this perspective, the concern of the Chinese leadership with regard to the current situation would seem to be based not so much on maintaining the value of the country's saved assets stored in the US, as superficially suggested by many western commentators, but much more pertinently, on avoiding the predicament of boom and bust as experienced by Latin America and East Asia before it.

In other words, there is a dialectical aspect to China's rise. Its emerging clout in the global economy contains within it aspects of increasing vulnerability that are more peripheral and dependent rather than central and dominant in nature. This contrasts with the interdependent vulnerability associated with leading countries of the centre, which continue to retain the privilege of being the primary sources of expanding international liquidity and continue to display strong drawing power over this liquidity in times of crisis. This is important to acknowledge, particularly given that China is still a relatively poor country with enormous developmental challenges ahead of it. China's leaders are probably quite rightly concerned with the predicament of falling back into the stringent external constraints typical of post-war peripheral late industrialisation, from which China only very recently escaped on the basis of riding a wave of financialisation and industrial restructuring emanating from the North and driven by Northern transnational corporations.

Similarly, the wrong messages should not be sent to other developing countries through a false sense of strength of the so-called 'Beijing Consensus', as if the developmental lessons of previous late comers no longer apply or as if the Chinese experience of the last three decades could somehow be sustainably replicated. Moreover, China is only now entering a middle rung position within global industrial hierarchies, which is precisely where the leading countries of Latin America stalled and then fell after the 1970s. Hence, the strength of China must be qualified. Indeed, premature delusions of power might serve the leading global economic powers quite well, much as the ambitions of South Korea in the 1990s or of leading Latin American countries in the 1970s left them exposed to subsequent financial crises. While the channels of vulnerability might be different, the potential adversities are similar.

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