29th ITFA Conference, Livorno, May 29 – 31, 2019

Industry, trade and finance in the US and China: a long- run view

Vittorio Valli
Professor emeritus of Economic Policy, University of Turin

Author of:

***The American Economy from Roosevelt to Trump*, Palgrave Macmillan, London, November 2018.**

***The Economic Rise of Asia: Japan, Indonesia and South Korea*, Accademia University Press, Turin, 2017**

***The Economic Rise of China and India,* Accademia University Press, Turin, 2015**

ABSTRACT- - 1

The economic history of the last 150 years shows that the country with the largest economic size and a good level of industrialization and technical progress can become the main economic power, a leading player in international trade and then the world strongest financial power.

The United Kingdom, helped by its immense colonial empire, had, in the 1870s, the largest GDP in PPPs among the industrialized countries and a strong position for its currency and its balance of payments, while London had become the world main financial center.

Since the last decades of the XIX Century the United States had surpassed the UK as the largest industrialized economy, but it could become the dominant financial center only several decades later, during and after the second World War.

After WWII the United States consolidated their economic and financial supremacy, maintaining a consistent trade surplus till the late 1960s. However, thereafter, its balance of current accounts started to badly deteriorate, becoming structurally negative. Consequently, its international financial position, hugely positive in the 1960s, became negative after 1987. Indeed, in the 2000s the United States has been the world largest net debtor country. The value of the dollar could remain relatively strong only because the U.S. dollar was the key currency in the international monetary system, largely utilized in international trade, financial transactions and as the denominator of a rapidly growing mass of financial assets.

Abstract- 2

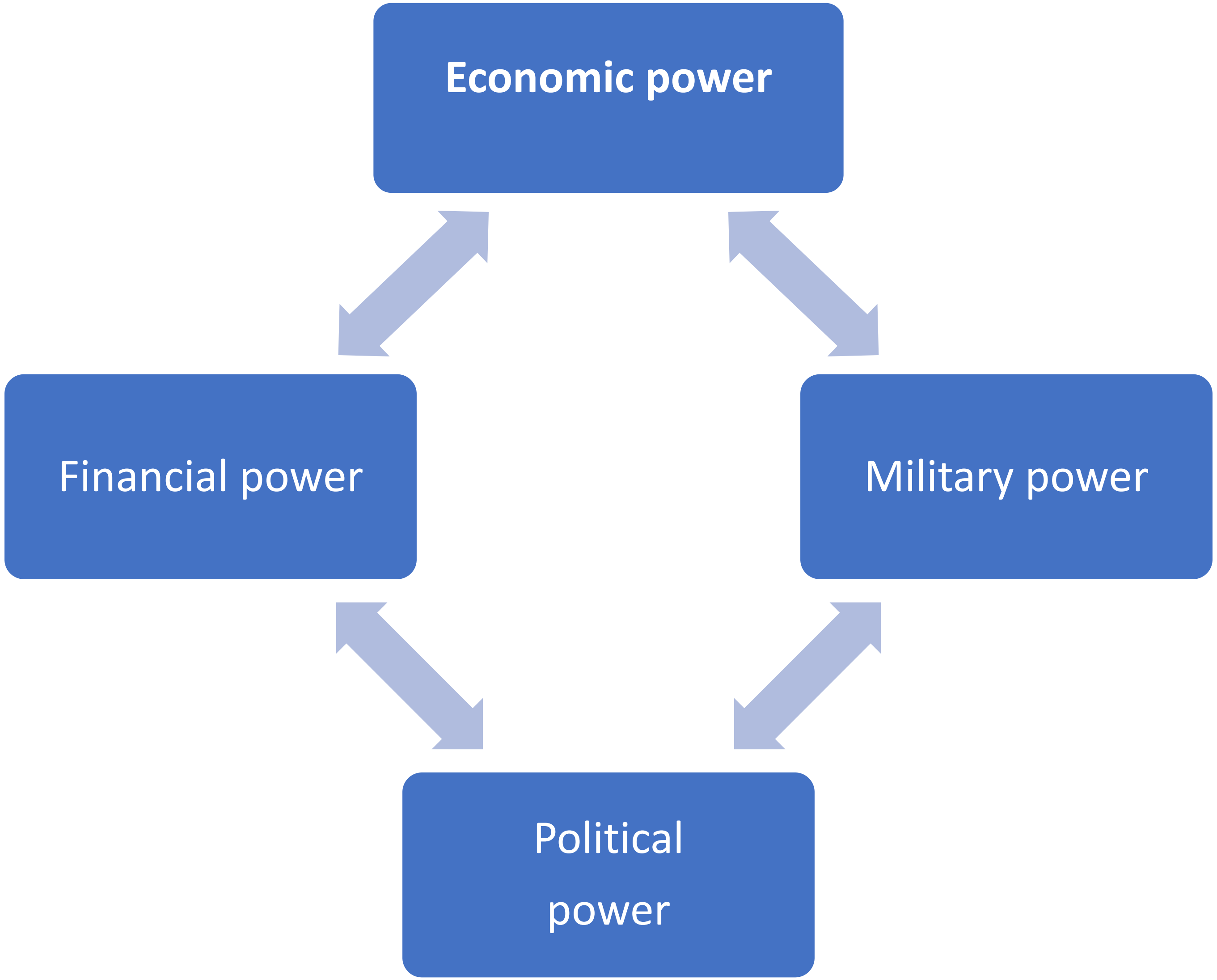
Since the mid-1990s the situation has been gradually, but inexorably, changing. The main factor of change consisted in the rapid economic ascent of China. While the US entered a phase of rapid de-industrialization, China massively industrialized. Since the balance of current accounts is mainly determined by tradable goods and services, and the bulk of trade transactions consists in the exchange of manufactured goods, China could manage to rapidly expand the volume of its net exports and therefore to pass from a negative balance of current accounts to a large positive one.

A substantial part of China's net export revenues was used to buy financial and real assets in the United States and in other countries, sustaining the dollar and the persistence of a delicate and fragile world equilibrium. However, if Trump's neo-protectionist policy will not completely disrupt the present trends, in the long-run the growing economic and commercial strength of China will also lead to a strong challenge to the world financial supremacy of the United States. The shifting in financial power, which in the past went on between the UK and the United States will probably happen between the US and China. However, Fernand Braudel and Giovanni Arrighi admonished us that the financial phase of a dominant power can be an important sign of the beginning of its decline, and what is now going on in the United States will probably happen also in China in the future.

Introduction

- **The economic history of the second half of the XIX° Century and of a substantial part of the XX° Century suggests that, in the long-run, a large country which has a good technological level and a robust industrialization expansion can have a rapid rise in productivity, per capita and total GDP, and so in the size of its domestic market.**
- **This can favour the international competitiveness of the country, the relative strength of its national currency and, in several cases, the accumulation of surpluses in the balance of current accounts and the acquisition of an important status of net creditor country in the international financial position.**
- **Economic and trade power can lead, with some delay, to a strong military and political power, and then, some decades later, to a solid financial power, favoured by a positive feedback between the four different powers (see Figure 1).**

Figure 1. Economic, military, political and financial powers



An important historical example: the US versus the UK

- **An important historical example can be obtained investigating the changes in the world leadership in economic and financial power.**
- **In 1870 the United Kingdom was the largest industrialized economy, the top exporter of manufactured goods, the most technologically advanced country and the major financial center in the world. It had also the largest military and commercial fleet and was the center of the vast and mighty British Empire.**
- **However, in 1872, according to the estimates of Angus Maddison, the US surpassed the UK in economic size, roughly measured by the total GDP in PPP (purchasing power parities) (see Table 1), and then exceeded the UK's level of per capita GDP in 1905 and that of labor productivity a few years later.**
- **In a few decades the economic situation had drastically changed. In 1913 the US economic size have more than doubled the UK's level. However, the UK continued exporting a little more goods than the US (and more than twice as to the manufacturing goods) and continued to maintain its financial supremacy, though weakened by the rise of the US and Germany. Only in the 1940s, during WWII, the US could finally conquer the world leadership in the financial sphere.**

Table 1. Long-run trends of major economies

GDP in PPP (purchasing power parities). Source: Conference Board, 2018.

Countries	1870	1913	1952	1952	1973	1990	2008	2017
	GK	GK	GK	EKS	EKS	EKS	EKS	EKS
China	192.9	46.7	18.8	2.7	4.7	18.8	68.8	120.4
India	137.1	39.5	14.4	13.3	11.7	15.8	29.5	47.3
U.K.	101.8	43.4	22.0	25.0	19.7	16.7	15.4	14.9
USA	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
USSR-Russia	85.0	44.9	33.6	33.6	42.8	33.2	22.4	20.7
France	73.3	27.9	14.8	17.2	20.3	18.6	15,7	14.7
Germany	73.3	45.9	19.4	26.7	33.4	27.2	22.2	21.5
Italy	42.5	18.5	11.7	15.3	19.5	18.8	14.4	11.9
Japan	25.8	13.8	12.4	13.9	35.6	40.5	30.3	28.0
Brazil	7.1	3.7	6.1	8.8	14.8	16.7	17.4	16.7

The United States in the 1990s

- **At the beginning of the 1990s the US was undoubtedly *the top economic, military, political and financial power* in the world.**
- **In 1990 no other country had reached the 41% of US total GDP in PPP; the Soviet Union had been severely struck by the consequences of the fall of the Berlin wall and was near disaggregation; Japan was falling into a long structural crisis; Germany, the main Western European economy, had about one fourth only of the US economic size; the two great emerging Asian economies, China and India, and Brazil, had each less than one fifth of the US total GDP in PPP.**
- **In the military, technological and financial spheres the US was far ahead of the other major powers.**

Structural weaknesses in the United States

However, the US had maintained some great, creeping, *structural weaknesses*:

1) **it had become, before the recent vast exploitation of shale gas and shale oil, a large net importer of energy sources and other raw materials;**
2) **it has entered a rapid process of *de-industrialization,* since the 1970s in % of total employment and since 1979 as regards the absolute level of employment in manufacturing, partly associated to the globalization trend.**
3) **in almost all years since 1970 it has registered *a structural deficit in the balance of current accounts*;**
4) **since the late 1970s the US has shown *a rapid rise of income and wealth inequalities*;**
5) **among the major economies it has recorded *a much lower rate of growth of per capita GDP* than Japan and several European countries in the 1950-73 years; than China since 1978 and India since 1992.**
6) **It has allowed an excessive financialization process, nurturing big structural bubbles in the housing and stock exchange market which has led to the 2008-2010 great recession.**

The great recession and the response of Obama and Trump

- **The subprime financial crisis and the *great recession* has further slowed down the trend rate of growth of the American economy and of several other industrialized and emerging countries.**
- **Obama's has been rather good in his anti-cyclical response to the great recession and in some aspects of his industrial, green and welfare policies, but he has only attenuated, not solved, the great US structural problems.**
- **Trump could win the elections also because of his populist appeal: he promised to stop de-industrialization, globalization, immigration and the power of the elites. Yet, through his fiscal reform he actually favored more the super-rich then the lower-middle class, and in general he made a very divisive policy, both internally and internationally through his poor environmental and welfare policies and his badly devised neo-protectionist approach. Towards China, Trump is playing a sort of *trade war-game*, which is potentially dangerous for both the countries and the international economic order.**

China versus the United States -1

- **Since 1978 China's economy has grown much more rapidly than the US, vastly reducing its gap for per capita GDP and even surpassing the US by over 20% in terms of total GDP at purchasing power parities in 2017. (see Tables 1 and 2).**
- **Moreover, In the 1978-2018 years, *while the US de-industrialized, China rapidly industrialized* its productive system. These trends accelerated in the 1990s and 2000s, in particular up to the beginning of the great recession.**
- **From 1991 to 2018 the percentage of industry on total employment went down in the US from 25.5% to 19.4 % while it went up in China from 21.6% to 28.6%, though diminishing a little from 2014 up to now. Since 2011 China has also surpassed the US in total manufacturing value added, though also in China the service sector was growing faster than the industrial one.**
- **From 1986 up to now, but in particular in the 2000s, China has accumulated large merchandise trade surpluses vis-à-vis the US, only in small part compensated by deficits in the services. In the 2000s China has bought a large value of US financial assets. Trump's policy is starting to have a disrupting effect on Sino- US economic relations.**

Table 2. USA, CHINA, INDIA

INDICATORS	USA		CHINA		INDIA	
	1990	2017	1990	2017	1990	2017
GDP in PPA in % of USA	100.0	100.0	18.8	120.4	15.8	47.3
Per capita GDP in PPA in % of USA	100.0	100.0	4.1	28.5	4.7	12.1
Population in % of USA	100.0	100.0	453.9	421.9	335.5	391.8
Gross investment / GDP (%)	21.5	19.7	34.7	43.6	29.0	30.7
Average years of schooling. (25+)	12.3	13.4	4.8	7.8	3.0	6.4
R.& D. spending in % del PIL (a)	2.4	2.8	0.6	2.1	0.6	0.6
Stock exchange capitalization, % of GDP (b)	123.9	165.7	30.9	71.2	46.5	89.8

NOTES: (a) 1996 and 2015; (b) 2003 and 2017. Sources: Conference Board (2018), UNDP (2018), World Bank (2018).

China versus the United States - 2

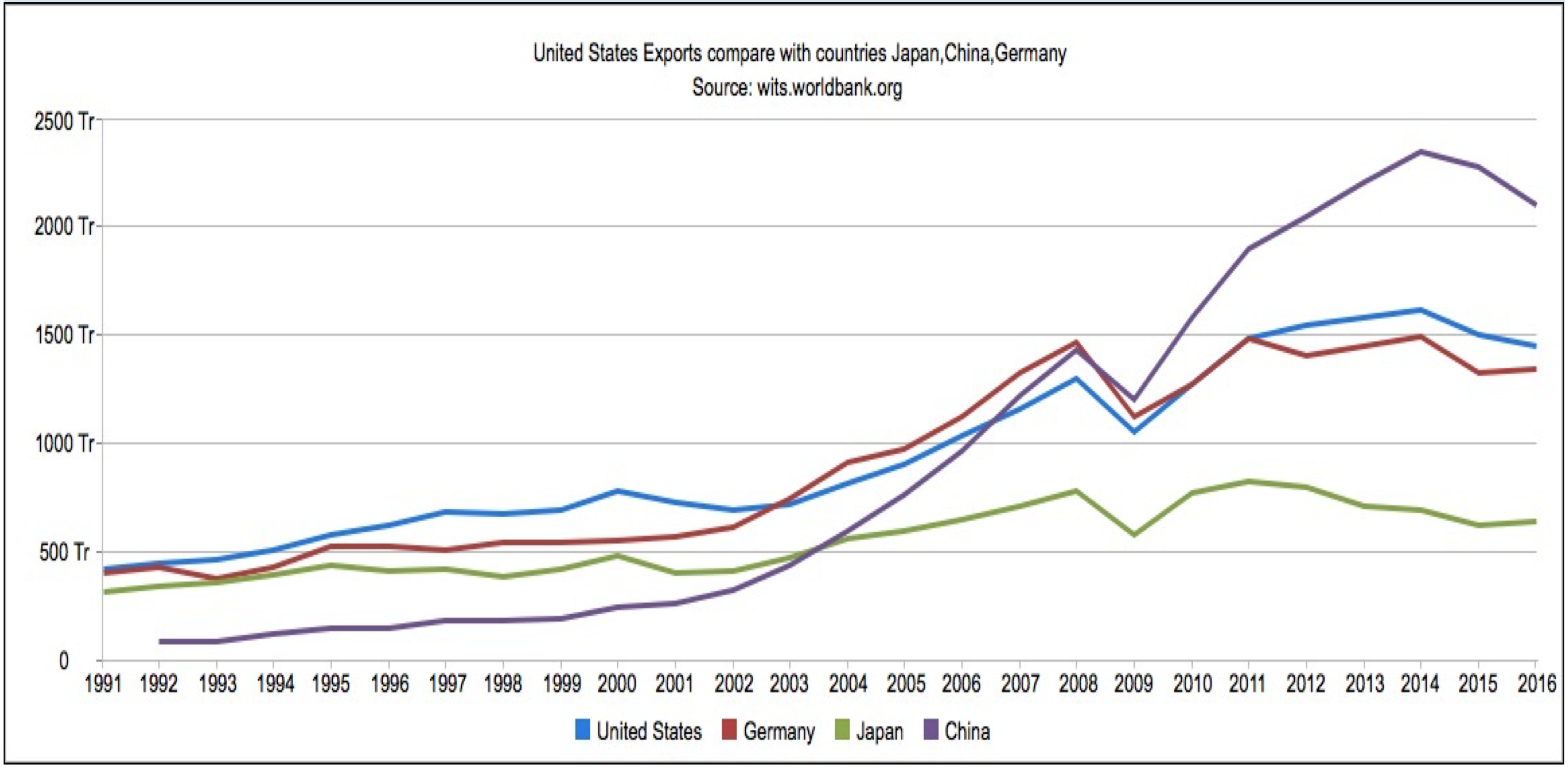
A large part of trade regards manufacturing goods. So, when a country, such as the US, de-industrializes too rapidly while its currency is sustained by large capital inflows, it can become a huge net importer of industrial goods, and it is likely to have large structural trade deficits and a rapidly growing net international debt. At the opposite, a country, such as China, industrializing very rapidly up to 2007, and keeping a somewhat undervalued currency, could maintain a structural surplus in its balance of current accounts and gradually become a great financial power. Yet, a relevant part of China's exports comes from joint-ventures with multinationals, partly American ones. Profits of US multinationals go back to the US, but they mainly accrue to US top managers and share-holders, not directly to US workers. This feature and other aspects of globalization, technological progress and economic policies have contributed to increase US economic inequalities.

Selected indicators on international economic relations

	USA		CHINA		INDIA		EU 28	
	2000	**2017**	**2000**	**2017**	**2000**	**2017**	**2000**	**2017**
Exports of goods and services in billion $	**1312**	**2285**	**331**	**2442**	**95**	**507**	**1895**	**7941**
Balance of current accounts in % of GDP	**-3.9**	**-2.3**	**1.7**	**1.4**	**-1.0**	**-1.5**	**-1.3**	**3.7**
Stock FDI inflows in billion $	**2783**	**7807**	**193**	**1491**	**16**	**377**	**2322**	**9124**
Stock FDI outflows in billion $	**2694**	**7799**	**28**	**1482**	**2**	**155**	**2907**	**10632**

Sources: OECD (2018) and World Bank (2018) for exports and current accounts; UNCTAD for FDI.

Exports of goods of the US and other major countries (in billion $)



Stock exchange market capitalizations (November 2018)

(trillion USD)

Stock exchange markets	Capitalization	Country	Ranking by country	Capitalization
New York	30.9	USA	USA (a)	41.8
Nasdaq	10.9	USA	China (b)	10.4
Tokyo	5.7	Japan	EU (c)	8.4
Shanghai	4.0	China	Japan	5.7
Hong Kong	3.9	China	India (d)	4.1
Euronext	3.9	EU	UK	3.8
London	3.8	UK	Canada	2.1
Shenzhen	2.5	China	Switzerland	1.5
Toronto	2.1	Canada	South Korea	1.5
Bombay	2.1	India	Australia	1.3

Notes: (a) New York + Nasdaq; (b) Shanghai + Hong Kong + Shenzhen; (c) Euronext (Amsterdam, Brussels, Dublin, Lisbon, Paris) + Nordic Stock exchanges + Madrid + Milan; (d) the two Bombay stock exchanges.

China versus the United States -3

- **At present the United States remains the major economic, technological, military and financial power in the world.**
- **Yet China is rapidly catching up.**
- **It has surpassed the US in terms of economic size, total capital stock of capital; exports of goods; total number of people engaged in R.& D. activities (not in total R.&D. spending); total number of engineers and graduates, quality of education in major cities high school, etc.**
- **China is still much delayed in per capita GDP (about 30% of the US level), productivity, mean years of education, spending in R.&D. in % of GDP (2.2% versus 2.8%), military spending; size and sophistication of the financial sector, etc. but its rate of growth for all these indicators is much higher.**
- **China too has some structural weaknesses: high regional and personal economic inequalities; high and growing pollution; heavy corruption; aging; deficit in democracy and civil rights, etc.**
- **Yet, if more economic power leads, with some delay, to more technological, military and financial power, the second half of the XXI century might become China's era, although China's economic rate of growth will significantly slow down.**

Too much finance can spoil the economy……

- **In the long-run, the shift in economic and trading power can lead, with a delay of some decades, to a gradual shift in the leadership in financial power.**
- **However, too much finance can spoil the productive sphere.**
- **As Fernand Braudel in *Civilization and Capital* and Giovanni Arrighi in *The Long Twentieth Century* have admonished us, the last phase of financial power can prelude to a decline in economic and global power, as it has already started to happen in the US and might occur also to China in a more distant future.**

References

- **Arrighi Giovanni (1994), *The Long Twentieth Century: Money, Power and the Origins of Our Times,* New edition Verso (2010), London, New York.**
- **Braudel Fernand (1984), *Civilization and Capital*, *15th -18th Century, The Perspective of the World*, Harper & Row, New York.**
- **Conference Board (2018), *Total Economic Database, Output, Labour and Labour Productivity,* November.**
- **De Cecco Marcello (1974), *Money and Empire*, B. Blackwell, Oxford.**
- **Della Posta Pompeo (2019), *The Economics of Globalization. An Introduction*, ETS, Pisa.**
- **Dewey Peter, (2014), *War and Progress. Britain. 1914-1945,* Routledge, London and New York.**
- **Findlay Ronald, O'Rourke Kevin H. (2007), *Power and Plenty: Trade, War, and the World Economy in the Second Millennium*, Princeton University Press.**
- **Valli V. (2018), *The American Economy from Roosevelt to Trump*, Palgrave Macmillan, London, chapter. 12.**
- **Valli V. (2015), *The Economic Rise of China and India*, Accademia University Press, Turin.**