Globalization and the Crumbling BRICS: From Promises to Threats

https://www.e-ir.info/2012/11/11/globalization-and-the-crumbling-brics-from-promises-to-threats/

JACK A. GOLDSTONE, NOV 11 2012

Brazil, Russia, India, China, South Africa are the leading economies of the world's emerging regions (e.g. outside of western Europe and North America): Brazil in Latin America, Russia in Northern/Central Asia, India in South Asia, China in East Asia, and South Africa in Africa. The sudden movement in these countries to rapid economic growth around the turn of the millennium led to their being heralded as a new motor of the global economy, the dynamic BRICS.

Of course, one can quibble about whether this list is complete. I would add Turkey as the leading economy of the Middle East, and add Indonesia to South Asia and Mexico to Latin America. But however one groups them, it seemed like global growth, which had long been dominated by Europe and North America and a few additional Tiger economies from Asia's Pacific Rim (Japan, South Korea, Taiwan, Singapore, Hong Kong), was shifting. The decisive realm of growth going into the 21st century was going to come from large emerging economies that were now quickly industrializing.

The data was very clear on this. From 2004 through 2007, the average annual growth rate of GDP in the BRICS was 7.7% per year, more than triple the growth rate of the advanced industrial economies of the G7 (the four largest western European countries plus the U.S., Canada, and Japan). If one adds several of the other big emerging economies – the BRICS plus Mexico, Indonesia, and Turkey – their average growth rate was still 7 percent per year. If this continued, given the size attained by the big emerging economies (BEEs) by 2011,with China the world's 2nd largest economy, Brazil 6th, Russia and India 9th and 10th, Mexico 14th, Indonesia 16th and Turkey 18th (as measured in US$ by the International Monetary Fund), it was clear that the top 10 rankings of the world economies would soon be dominated by the BEEs.

When the US and then Europe went into recession in 2008-2009, led first by the collapse of housing bubbles in America and then southern Europe, followed by banking and sovereign debt crises, there was an initial short-term impact on the BRICS and other big emerging markets. But economists believed that would be temporary. They thought that the growth momentum of the BEEs would be too strong to stop. Rich in natural resources (Brazil, Indonesia, Mexico, Russia, South Africa) or in cheap labor to supply manufactured goods and services to global markets (India, China, Turkey), it seemed there was no stopping them.

That was wrong. Since 2010, when a strong global recovery led by the BRICS and BEEs was expected to take hold, helping to pull Europe and the U.S. out of their slumps, a disturbing trend is evident. Growth in the big emerging markets has faltered. According to the IMF World Economic Outlook Database (Oct. 2012), average growth rates in the BRICs has fallen from 7 percent in 2010 (which seemed to auger a return to pre-recession growth) to 5.6 percent in 2011, and then to an expected 4.2 percent in 2012. If one adds Mexico, Indonesia, and Turkey, the result is the same – average growth of 7.7% in 2010 declining to 5.2% in 2011 and 4.1 percent in 2012.

This is, to say the least, alarming. Four years after the onset of the global recession, what were expected to be the strongest economies in the world, the motors of global recovering, are sputtering.

Why is this happening? The simplest explanation lies in the same factor that promoted their rapid growth in the last few decades: the deepening intertwining of all global economic activity that we call "globalization."

The emerging economies did not follow the path of economic growth pioneered by Europe and the U.S. in the 19th and early 20th centuries. For the most part, both the U.S. and Europe grew by serving their internal economies: the U.S. expanding across the continent to the Pacific, and building its rail and canal and communication networks for internal movement of goods, and Europe mainly trading within its borders, developing steel, auto, plane and service networks for the European population. Latin American nations in the early and mid-20th century tried to follow that path of domestic self-oriented economic growth, using import substitution policies. Setting up high tariff barriers to the import of goods and services from Europe and North America, they aimed to develop firms and industries to serve their own markets. Yet those efforts failed. Unlike the continental markets of the U.S. and Europe, the national markets of Latin American countries were too small to support spirited competition among large firms. Shielded from external competition and favored by government subsidies, their local firms became lumbering monopolies that were neither efficient nor innovative.

The successful industrializing countries of the Pacific Rim followed a different path, one of export-led growth. As small economies in comparison to the rich nations (this was true of Japan after World War II as well as South Korea, Taiwan, Singapore, and Hong Kong), they could grow rapidly by aiming to take market share in the rich economies. Focusing on lower cost but higher-quality goods for export, these economies found rapid growth in exports of consumer electronics, motorbikes and then automobiles, cameras, copiers, machine tools, earthmoving and construction equipment, even shipbuilding, which in turn fueled their local steel production and plastic and silicon and other input manufacturing. The local service economy lagged (domestic retailing remained notoriously inefficient in Japan and S. Korea long after their exports were world-leading sectors), but that did not matter given the rapid growth in other areas. Profits from export industry were then invested in domestic construction and transportation to build the national economy.

The big emerging markets followed a path similar to that of the Pacific Rim tigers – emphasizing exports to the rich countries as their pathway to growth. Brazil filled glasses of orange juice and bushels of soy beans, but also filled runways with its regional jets. Russia bet on oil and gas exports to Europe. India exported services in back office and programming work. And China became the workshop of the world, taking over the markets for textiles, shoes, assembly of consumer goods, furniture, toys – anything where vast numbers of low to medium skilled workers with adequate capital and training but low wages could churn out products.

To manage exports on this vast scale (for the emerging markets economies were huge compared to the early development stages of the Asian tigers) required the reconfiguration of global transport and shipping infrastructure to support this trade. Enormous container ports for ever larger transport ships were required to bring the raw materials for production to China and India (coal, iron ore, copper, oil) and to ship manufactured goods to consumer markets abroad. Global supply chains were configured to ensure that every stage of complex products – research, design, production of components, intermediate assembly, final assembly, distribution and marketing, sales – was carried out wherever in the world it was most efficient to do so. Creating and selling a Nike shoe, a Nikon camera, a BMW motorcycle, or a Boeing jet plane might involve the work of vast teams of workers and facilities scattered around the world.

Finance was geared to this globalization of production and economic activity as well; recycling the profits from exports of goods and services or sales of raw materials (esp. oil and gas) provided huge opportunities for financial firms, but also temptations for excessive speculation and inflating asset bubbles in fashionable investments.

Finally, this globalization had a very different impact on the evolution of middle classes and equality than the domestic-oriented growth of Europe and the U.S. In the large continental economies, increases in worker output and productivity translated into gains in wages, as manufacturers had few alternatives for investment or growing their markets than to invest in the domestic economy and cooperate with their own workforces to boost output. But the export-led globalization of emerging economies, based on injecting literally billions of low-cost workers and hundreds of millions of new middle-class consumers into the world economy, changed all this.

In the U.S. and Europe (although to a lesser degree in the latter due to stronger unions and more pro-labor governments), manufacturers now had new opportunities to invest and seek workers overseas. Thus improvements in domestic worker output and productivity in the US and Europe no longer fed back automatically into gains in wages. Rather, firms selling into global markets (which now included tens of millions of consumers who gained from the growth in the large emerging markets, especially those engaged in running and managing exporting firms, high-ranking national and and provincial officials, and property developers, all of whom quickly became relatively rich) did not depend on the purchasing power of their own workers. Rather, labor became simply a cost of production to be minimized, completely separate from markets for products sales. Thus wages in rich countries stalled. Yet the managers and owners of firms serving much-enlarged global markets grew richer than ever. Thus inequality rose sharply throughout the west, although even more sharply in the U.S. than in Europe.

But inequality rose quickly in emerging and developing markets too. While growth was rapid, the gains from growth accrued mainly to those guiding the growth – property developers, financiers, firm owners and managers, and government officials – who controlled the opportunities to tap into the global market and directed investment flows. Workers saw increased opportunities and wages up to a point; but before long workers in big emerging markets were competing with each other: Shenzen vs. Hong Kong, India vs. the Philippines, China vs. southeast Asia. Moreover, the infrastructure and economic organization of the emerging markets was geared to serving export markets: Shenzen's production and transport were developed to serve Europe, not consumers in Chongqing or Harbin; the largest firms in Shanghai were networked mainly to branches, investors, and facilities in Tokyo, London, and New York, not to Fujian, Guilin, or Chengdu.

When one travels today in China or India, the most overwhelming impression one sees is the immense inequality. In India, the contrast between luxury hotels, modern office-towers and congested super-highways filled with men and women in the latest western fashions and the immediately surrounding fetid slums, crumbling side-streets, and traditionally-clothed barefoot or sandaled families thronging the streets and byways is stunning. It is clear that growth is being halted by the inadequacy of infrastructure, and the vast waste of human potential in the hundreds of millions of poorly educated underemployed men and women not sharing in globalization-led growth. In China, to see the contrast one must travel a bit more, looking beyond the modern capital cities to the villages in the countryside; but the contrast is stark nonetheless. More evident in China are the excesses of consumption by the corruption and trade-fueled dollar millionaires with private golf-clubs and water-fountain filled mansions in a country where usable land and water are in dire scarcity. Russia of course is a land of oligarch billionaires exporting nickel, oil, gas, and running mega-monopolies of railways, weapons production, and construction firm, while pensioners and average workers still struggle to make ends meet. And Brazil, always famous for the poor favelas (slums) filling the hillsides around the rich urban cores of Rio and Sao Paulo has a bigger mission in correcting the vast inequality between the relatively prosperous south and the still dirt-poor north.

The result of this growth pattern is thus to leave a vast and growing gulf between the rich and poor in all nations, in which growth in rich countries depended largely on a one-off process of tapping low-cost labor and export opportunities to reorient labor-intensive production from within the rich economies to the emerging markets, and growth in emerging markets depended on exporting goods and services and raw materials to richer nations overseas.

The global recession arose just as this process was becoming played out. Emerging markets had grown so large that their exports now nearly saturated rich-country markets, who had only sustained their consumption growth by unsustainable borrowing. Further growth in emerging markets would henceforth have to depend on shifting production to serve consumers in their own markets, and similarly low to middle-income consumers abroad.

But that is a huge undertaking, given that the bulk of the factory, labor, and infrastructure that propelled growth in emerging markets were oriented to production and sale to rich nation markets. In China, for most of the last decade domestic consumption contributed only about one-quarter of annual GDP growth, the rest being in exports and investment. For growth in China to return to pre-recession levels, the rate of domestic consumption growth would have to triple.

Globalization now means that as long as Europe is in semi-collapse due to its inability to resolve its banking and sovereign-debt problems, and the US economy is stagnant and hostage to partisan struggles over state spending and taxation, emerging markets will not be able to pursue their past growth strategy.

The real risk now is that facing high expectations and slow growth, the BRICS will turn from motors of the economy to threats of unrest and disruption. China is facing an uncertain transition to new leadership amidst growing waves of strikes, environmental protests, and demands for greater openness and democracy driven by rapidly-expanding social media. India is facing corruption scandals and a political transition as regional parties are supplanting the national consensus created in the past by the Congress party. Russia has seen unprecedented protests against President Putin since his return to power in disputed elections, while its prospects for oil and gas exports are threatened by the rapid expansion of fossil fuel production through fracking in the U.S. and rising production in Qatar, Iraq, and Turkmenistan. Brazil is perhaps best positioned to pursue domestic growth, as its ethanol-fueled economy and still-abundant land offer opportunities for its own population to improve their status. But South Africa faces severe risks from a still greatly underemployed young population that has yet to benefit economically from the end of apartheid and confronts increasingly corrupt and ineffective national ruling party (the ANC).

Europe and the U.S. had thus better focus hard on getting their own economic houses in order. Far from expecting the BRICS economies to lead them to greener pastures, they may need all their resources and attention to deal with looming unrest and disruption in the BRICS as the latter struggle with an end to easy export-led growth and try to find new pathways to economic growth.

—

Jack A. Goldstone *is Hazel Professor of Public Policy and a Senior Fellow with the Mercatus Institution at George Mason University. His latest books are Why Europe? The Rise of the West in World History (McGraw-Hill) and Political Demography: How Population Changes are Reshaping International Security and National Politics (Oxford). He blogs on the global economy, revolutions, and US Politics at www.newpopulationbomb.com*

About the author:

Jack A. Goldstone is Hazel Professor of Public Policy and a Senior Fellow with the Mercatus Institution at George Mason University. His latest books are Why Europe? The Rise of the West in World History (McGraw-Hill) and Political Demography: How Population Changes are Reshaping International Security and National Politics (Oxford). He blogs on the global economy, revolutions, and US Politics at www.newpopulationbomb.com