

The Theoretical Framework and Experience of Institutional “Being Poor”

Fundamentação teórica e experiência da “pobreza” institucional¹

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Abstract: While inheriting and discarding development theories with Eurocentrist elements, this paper endeavors to innovate the theory of being poor in institutional economics by proposing the hypothesis of the asymmetry of cost and benefit in the institutional structure. It reviews and analyses a common historical understanding: that cost-transferring is the intrinsic institutional cause of underdeveloped nations being poor during different stages in the development of capitalism. (Part Two will analyze the experience and intrinsic mechanism through which China avoids the ‘developmental pitfall’ entrapping developing countries in general.)

Keywords: institutional being poor, the logic of history, primitive accumulation, cost-transfer.

Resumo: Simultaneamente adotando e descartando teorias do desenvolvimento com elementos eurocentristas, este trabalho tenta inovar a teoria da pobreza da economia institucional propondo a hipótese da assimetria de custos e benefícios na estrutura institucional. Revisa e analisa um entendimento histórico comum: que a transferência de custos é a causa intrínseca da pobreza dos países subdesenvolvidos durante diferentes estágios do desenvolvimento do capitalismo. Este texto é parte de uma reflexão maior. Em outro artigo, analisamos a experiência e o mecanismo intrínseco através do qual a China evita “a armadilha do desenvolvimento” que aprisiona países em desenvolvimento de um modo geral.

Palavras-chave: Pobreza institucional, lógica histórica, acumulação primitiva, transferência de custo.

Received 03/05/2011 . Approved in 08/06/2011

¹ Texto traduzido do chinês para o inglês por Erebus Wong e do inglês para o português por Sandlei Moraes.

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Introduction

The Economics of Being Poor is a field that most needs the effort of economists. It is also a theoretical enterprise that is much emphasized by Chinese leaders after launching the new strategy of building 'an overall moderately prosperous' society.²

The basic structural feature of global poverty is 'the law of 20/80,' sustained by the international economic-political order derived from it.

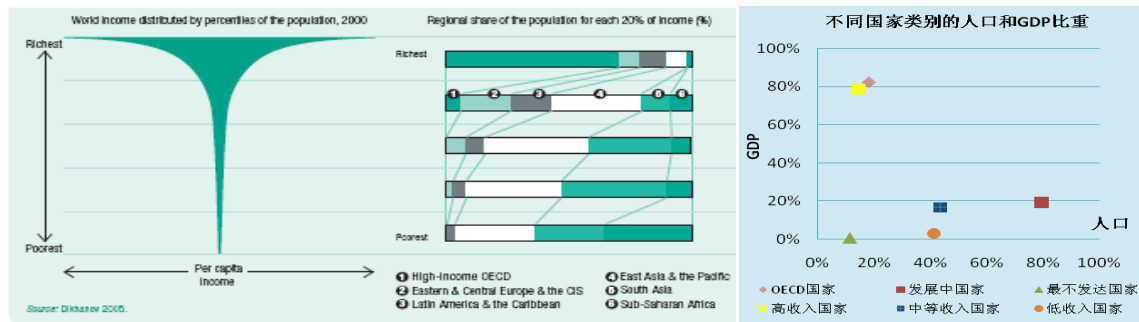
First, the wealth disparity between developed and underdeveloped countries is by a ratio of 20/80. 80% of the global GDP is controlled by developed nations with a total population of 1 billion. The remaining 20% is shared by the 5 billion population living in underdeveloped nations. The global Gini coefficient is 0.67, worse than any unevenness within a country. Second, in developing countries

² On a press conference during the Third Conference of the Tenth National People's Congress, Premier Wen Jiao Bao made statements such as 'we must understand the economics of being poor' and 'understand agriculture, then you understand the economics of being poor'. It echoed through China with vehement and drew wide concern in overseas. It was reported and highly valued in medias such as Singapore's *Lianhe Zaobao* and Germany's *Die Welt*. The economics of being poor is regarded the theoretical construction drawing most concern after Chinese leaders promulgate the strategy of building 'an overall moderately prosperous society'.

under the aftermath of colonization, foreign capital takes the lion's share (80%) of the share and profit, meanwhile within these countries, the richest 20% population enjoys 80% of the income from assets. It is evident that the global structure of 'the strong getting stronger, the weak getting weaker' has been reinforced by the institutional transition of an institutional arrangement and its aftermath since humanity marched into capitalist civilization (see graph).

The left is the contrast of per capita income in different income groups. The upper end represents the per capita income of the richest population. The thin line in the lower end represents the poorest. The graph in the middle is the geographical distribution of different income cohorts, the richest 20% mostly from high-income OECD nations, the poorest 20% mainly from East Asia and the Pacific regions, Latin America and Sub-Saharan Africa. The graph on the right represents population and GDP weight in different national categories of income level (Source: United Nations, *Human Development Report 2005*).

To take a closer look, we find that the 'poverty' in developing countries, as well as the term 'developing countries' in itself, is not intrinsic to human history. Poverty can only be the consequence of impoverishment.



Hence, according to the historical materialist requirement of congruence of logical and historical points of departure, studying how the developing countries generally 'become poor' and the conditional constraints thus incurred, is more valuable scientifically than studying the vicious circle from poverty to poverty.

As poverty is in essence the deprivation of rights and opportunities, both of which are determined intrinsically by specific institutional structure, therefore we have to investigate the formation and evolution of the institutional structure that impoverishes developing countries in general.³

³ The original definition of poverty is limited to income and basic subsistence security. In recent years, it is expanded toward aspects like opportunities and rights. For example, the Nobel laureate in economics (1998), Prof. Amartya Sen defines poverty by deprivation of capabilities rather than low income (Sen 1982). United Nations Development Programme suggests that poverty in fact is the exclusion of the basic opportunities and the right to choose indispensable to human development. These opportunities and rights are exactly what lead people to live a long, healthy and creative life, to enjoy a respectable life, freedom, self-esteem and

(A). Basic Concepts and Hypotheses

1. Basic Concepts: Institution, Institutional Gains and Institutional Cost

In terms of the conceptual extension of 'institution,' the old institutionalism as well as new institutional economics and Marxist institutional economics are in congruity. They all emphasize the constraint of institution and the relative stability of rules, defining institution as nothing more than rules and constraints that restrain and normalize individual actions (Yuan 2005).

Classical Marxist theories emphasize the class characteristics of institution, asserting that institution is an array of rules and constraints set up by the dominant individuals, blocs and classes through the power of state regime, upon which institutional transition is propelled. Daniel Bromley also thinks that efficiency, cost, and gains are all determined within an institutional structure. "However you define it, efficiency is always reliant on the institutional structure.

respect by others.

The institutional structure gives meaning to cost and gains and determines the incidence rate of such costs and gains." Economic institution determines the relation of distribution and shapes the budget constraints to different economic subjects. Relative to market force, it is a more hidden precondition.

As for the functions of institution, the major perspectives of the new institutionalist economists include the following: 1. Coase points out lowering the transactional cost is an important function of institution; 2. Demsetz suggests institution can help people forming rational expectation and provide with the reward mechanism of internalizing externality; 3. Douglass North sums up by 'personal rate of return approaching the social rate of return' and 'to establish a stable structure of interpersonal interaction to lessen uncertainty'; 4. Justin Yifu Lin suggests that institution has 'safety function' and 'economic function,' the former being the security against risk and disaster, the latter including both the internalization of externality and the economy of scale produced through collective actions; 5. Schulz states out the five functions of institution: facilitation, lowering transactional cost, providing information, sharing risk and providing commons (services).

New institutional economics defines and analyzes the efficiency, cost and gains of institution by institutional

functions. Institutional costs mainly include costs like defining, design and organization during institutional transformation, as well as fees to organize, maintain and implement the institutional and the 'Dependence Theory'⁴ by Samir Amin are more elaborate. Both of them assert that the unequal exchange between developed countries and underdeveloped countries in the stage of industrial capitalism is a continuation of the historic process of colonial plundering by the core nations for the sake of primitive accumulation of capital. Wallerstein points out that *capitalism in the capitalist world economy means restless capital accumulation and monopoly whereas the world economy is consisted of the axial division of labor of core (monopoly) and periphery (competition)*. The restless and reckless pursuit of capital accumulation and monopoly makes the core activities shifting all the times and finally leads to the cyclic

⁴ The Dependence Theory as represented by Samir Amin suggests that the 'core-periphery' structure of the capitalist world system is a structure of 'dominance-dependence'. The periphery in the world economy is merely supplier of source materials and primary products. National industries heavily depend on western developed industrial countries. The import replacement strategy of the periphery fails to be effective due to the tariff barriers of developed countries and hindrance from domestic conservatives. As a result, its politics and economy are the yoke of foreign powers. As to 'de-linking,' it is an analysis by Amin on the success of China's industrialization based on the theory.

crisis of capitalism, namely, the contraction of profit. Amin states that *within this structure, development in the periphery can only be 'a development of underdevelopment'*. *The scenario of a mature and autonomous capitalism in the periphery is basically* operations. 'Institutional gains' means the degree of encouragement or constraint to the *homo economicus* by lowering the transactional cost, lessening the externality and uncertainty through institutions (Yuan 2005). However, it is in fact a relatively static approach to the institutional transition, cost and gains.

We are more concerned with the distribution of the so-called institutional gains and institutional cost.

During the economic development of human societies with the capitalization of resources as its main content, how the return of added value is distributed and 'the negative feedback' generated in the process is shared.⁵ Such are the core problems of institutionally being poor. *Through certain institutional*

⁵ The Theory of Relativity suggests that when a force is increasing in power, it would also induce a 'negative feedback' suppressing the tendency of increment. Its implication is much wider than the concept of 'cost' in general sense, including various explicit and present costs, and also implicit and future costs, for instance, the irreversible consumption of the earth's reserve resources, environmental destruction and social conflicts, etc.

arrangements, certain subjects can partake more of the gains during the institutional transition while the others bear more of the costs. If the institutional cost and gains are symmetrical within an institutional framework, then different economic subjects' rates of return will converge toward the social average rate of return. Otherwise there exists an asymmetry in the distribution of institutional gains and costs, or cost-transferring wherein the institutional gains concentrate toward certain subjects while the institutional cost is transferred to others in opposite direction.

Apparently, we are discussing a well-known phenomenon: how come there always exists serious disparity between gains and costs? (Wen 2009: 6).

2. Hypothesis and Innovation

Expositions on the intrinsic disequilibrium in global development are copious. Among them the 'World System Theory'⁶

⁶ The main object of Immanuel Wallerstein's theory is the modern capitalist world system emerged in the 16th century Europe. The theory comprises of capitalist world economy, inter-states system and Geo-culture. He suggests that since humanity moves into what Marx calls the 'capitalist civilization,' nearly all races are gradually incorporated by the core nations into a world economic system, forming the 'core—semi-periphery—periphery' structure. Through unequal exchange, the surplus in semi-periphery and periphery was unevenly transferred toward the core. In the process the core nations became increasingly powerful while the peripheral

represented by Immanuel Wallerstein *hopeless*.

Arrighi thinks that since the 1970s, especially after the financial liberalization in the 1980s, the polar mechanism of the world development mainly reveals the shift of the accumulation cycle from material expansion to financial expansion in the world capitalism. As for the Wall Street financial meltdown in 2008, he would suggest that it is the crisis of the world hegemony originating from its internal contradiction and a shift in the history of world hegemony (Arrighi 1994).

In this field, Chinese researchers have made substantial contributions with more realistic connotations. For example, Wang Jian has analyzed the de-industrialization in developed countries, the profit mechanism of finance capital and the world hegemony (Wang 2008). Wang Xiaoqiang demonstrates the internal relationship between the US capital market bubble and China's export-driven economic growth (Wang 2008b). Fang Ning et al. have depicted the three stages of capitalist development and the respective profit mechanisms (Fang et al. 1999). All of these have helped us to understand the essential mechanisms of the world economy.

nations weakened (Wallerstein 2004). We think that the concept of 'semi-periphery' reveals the multi-tieredness of the world politico-economic setting and therefore is more elucidatory in regard to the reality.

Standing on the shoulders of the researches both international and in China, this essay systemically reviews the institutional transition of the capitalist system and the trap of institutional "being poor" caused by the cost-gains asymmetry between the dominant countries and others. We agree with the perspective that right from the beginning of early capitalist primitive accumulation, an institution had taken shape with the intrinsic mechanism whereby the core nations (then European countries) partook the gains and transferred the cost to other peripheral nations. We take a step further to make the following theoretical innovations: first, this institution that has taken shape and persisted in the primitive accumulation and is protecting the increasing institutional gains to the core nations has the impact of an innate 'path dependence' over the subsequent institutional transition. Second, in the three stages of capitalist development, namely the early primitive accumulation, the industrial capital expansion in the middle stage, and the late globalization of finance capital, the cost-transferring has been persisting and deepening, hence aggravating the polarization between developed countries and developing countries.

Thus we reach a logical conclusion: the serious disparity in institutional cost and gains between developed and underdeveloped nations is the

innate institutional cause of the impoverishment of developing countries and the constant

(B). Empirical Research: the deepening of cost-gains asymmetry in capitalist development and the impoverishment of developing countries

We have divided the historical process of capitalist civilization into three stages: the early colonization facilitating primitive capital accumulation, the expansion of industrial capital along with the transfer of contradictions in the middle stage, and the late globalization of finance capital.

1. Early Capitalism: Global colonial expansion underpinning the primitive capital accumulation

It is generally agreed that modern capitalism has marked its birth in the 15 century when Columbus 'discovered' the new continent and Vasco da Gama reached India. However, few have pointed out the following two factors that were closely interwoven.

First, the essential reason behind colonial expansion is Europe's long-term trade deficit with China. Since its population reaching 100 million during the Song and Ming dynasties, China's industry and commerce that were dependent on the rural areas and compatible with the peasant household economy grew substantially. Export of silk,

weakening of the underprivileged cohorts.

porcelain and tea taking the advantage of sea route exploration grew continuously, which became an important cause of the Silver Crisis in Europe (along with the subsequent long-term wars and social turmoil). Merely in the period from the mid-16th century to the mid-17th century alone, the influx of silver into China had reached around 7000-10000 tons. That meant China possessed one fourth to one third of the silver produced in the world.⁷ According to studies by European researchers, till the mid-19 century before the invasion by the West, China's GDP amounted to a third of the world GDP. If the long-term scarcity of precious metals as hard currency is considered as the cause, then the overseas expansion known as the 'great geographical discovery' is the result of having recourse to violence by the Occidental world, nurtured by the Roman civilization, under a long period of deficit crisis that could not be resolved internally.

Second, state regime and the capital, these two entities of alienation in human society, were conjugated

⁷ From 1300 to 1450, the production of gold and silver mines in Europe declined gradually. At the same time, a huge amount of trade deficit with the Orient drained its gold and silver, leading to a serious scarcity of precious metals. (Andre G. Frank, *ReOrient: The Global Economy In The Asian Age.*)

directly in the stage of primitive accumulation, i.e. in the criminal process of violence against human beings. As feudal city-states did not possess enough surplus to cover the huge cost of overseas expansion, the earliest colonial expeditions overseas were patronized by monarchies of early nation-states. It was illustrated in a letter by Columbus soon after the discovery of the American continent in the March of 1493,

'If I am supported by our most invincible sovereigns with a little of their help, as much gold can be supplied as they will need, indeed as much of spices, of cotton, of mastic gum (which is only found in Chios), also as much of aloes wood, and as many slaves for the navy, as their Majesties will wish to demand.'⁸

What was mentioned in the letter, along with what happened subsequently, was nothing more than a general knowledge of history: the correlation between western capitalism's 'first bucket of gold' and bloody slave trade triangle. The Europeans plundered the aboriginals in Africa 'at low cost,' who were sold to the colonies in America as slaves. Economy of scale was thus made possible in the mining of silver and gold and the subsequent plantation. The 'returns of scale' were expropriated and shipped back to the European suzerains. Colonizers then used the

wealth thus gained to take part into the global trade and contest for the world hegemony.

Those took part into the early colonial expansion overseas were exactly those nations with narrow territories and limited land resources in the northwest Europe along the Atlantic coast, such as Spain and Portugal, then Holland and England which were often denigrated as barbarians in the Europe⁹. What came after that were the emergence and unification of the despotic Austrian and German Empires in the European continent and the inevitable path duplication after the rise: colonial expansion.

Obviously, a discussion on the political institution of capitalist civilization must not neglect the 1648 *Peace of Westphalia*, which as an international law framed the basic setting of modern world. It remains the landmark institution of the legitimization of national crimes in the stage of primitive accumulation of capitalism in the West. In the European core nations, the treaty confirmed the nation-state's unlimited sovereignty and boundary. Nation-state in modern

⁹ Some western scholars believe that in medieval times, the Venetian usurers at the back of sea-borne trade and piracy migrated to England and formed an interest bloc, which raised the curtain of the historical drama of the Anglo-Saxons, who excelled in geo-politics, instigating conflicts among European nations. The Britons took advantage of the opportunity to expand their power and territories.

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<http://usm.maine.edu/~maps/columbus/translation.html>

sense took shape and became the prime agent of international politics; as to regions like Africa and America, which were yet to adopt the European model of nation-state or still in the process of nation-formation, the treaty dictated the forms of conquest, occupation and colonization; subsequently, upon semi-colonized nations that could not be totally subject to the colonial yoke, such as China and the Indian subcontinent, the dumping of opium and commodities was forced after opening up by wars. In the historical process of capitalist primitive accumulation, national crimes that blatantly emerged as a remarkably beneficial means of institutional supply and execution thus gained international legitimacy and implied the function of path dependency in the subsequent institutional transition.

Stavrianos points out,

‘The world of 1763 richer than that of 1500, and the economic growth has continued to the present day. But from the beginning, northwestern Europe, as the world’s entrepreneur, received most of the benefits at the expense of the other regions.’ (Stavrianos 1999: 390)

The cost was that a majority of the regions and population in the world became the sacrificial offering on the capitalist altar of a handful of European powers. The aboriginal Indians in the America were at the well as the downfallen aristocrats, the ‘underprivileged’ as compared

verge of extinction; Millions of African black people were enslaved in the American plantation; The original ecologically diverse socio-economic structures were gradually eroded and altered; Unitary colonial economic structure are still ‘transfusing blood’ to the overseas...

The first and prominent institutional gain was of course to facilitate the completion of primitive accumulation of capital in advanced industrial nations. Only upon the foundation of large-scale colonial expansion abided by the ‘legal norm’ in accord with the interests of the West did the institutional transition in those northwest European nations become possible, the technological innovations regarded as the dawn of contemporary capitalism become viable and the crisis become an opportunity. The silver crisis elicited by huge trade deficit led to overseas plunder. Then Europe caught up swiftly to seize the global hegemony.

The second important institutional gain is the ‘political civilization’ much praised by later generations. Along with the colonial expansion were the massive influx of overseas wealth and the mass exodus of the European poor population (including the unemployed and criminals created by recession as

with the

new bourgeois class) toward the colonies. These movements had made it possible to gradually alleviate social conflicts like those between the bourgeois aristocracy and the feudal aristocracy, as well as the capitalists and the labors. The renowned 'round-table conference' within a nation could be possibly held in a civilized manner.¹⁰

In a letter to Marx, Engels (1858) pointed out

...the fact that the English proletariat is actually becoming more and more bourgeois, so that the ultimate aim of this most bourgeois of all nations would appear to be the possession, *alongside* the bourgeoisie, of a bourgeois aristocracy and a bourgeois proletariat. In the case of a

¹⁰ When the market flow of labor factor is now emphasized, it is rarely noted that the labor population in Europe at that times underwent a 'structural transformation'. On one hand the marginalized population in Europe was massively transferred to the Americas and Oceania; on the other hand local inhabitants from Asia and Africa were enslaved in Europe and the colonies. The later rise of the United States also depended on migrants as the main labor force for the industrial capital. (See Stanley L. Engerman & Robert Gallman ed., *The Cambridge Economic History of the United States Volume 1 & 2.*) In the mid-1820s only 145 thousand migrants from Europe was recorded. But in the mid-1850s, the number had reached to about 2.6 million. From 1900 to 1910 the number was up to 9 million (about 60 times than a century ago). In 1688, British migrants concentrated in the narrow piedmont along the Atlantic coast amounted to 300 thousand; at the times of revolution, the population in the British colony was not less than 2 million. (See Stavrianos *A Global History: From Prehistory to the 21st Century.*)

nation which exploits the entire world this is, of course, justified to some extent.

In fact, among the early industrialized nations, the UK did not only have the most remarkable colonial land size and population but also export the largest number of migrants. From 1871 to 1900, the territory size of the Great British Empire increased by 4.25 million square miles, the population by 66 million. Nearly one third of the UK population, and up to a half in the relatively barren Scottish highlands, had migrated outward to the British Empire 'on which the sun never sets'. Such was the 'justification' mentioned in Engels' letter. Colonization had increased the French territory size by 3.5 million, population by 26 million; Russia in Asia by 5 million and 6.5 million; German 500 thousand and 8.5 million respectively.

However, these criminals acts directly against humanity by the state apparatus in the stage of the primitive accumulation of capital in the West which did not originate from the so-called 'technological revolution' or benefit by the so-called 'institutional advancement,' were then played down, bleached out or simply neglected in various expositions by contemporary social science.

As to the two major schools stimulated and then alienated by the early industrialization in the West,

namely Marxist political economy and the economic liberalism represented by Adam Smith, it should be noted when we want to draw the wealth of thoughts:

First, Marxist political economy was born in the sharp opposition of the capital-labor contradiction. Nevertheless, the reason for it to translate into realistic worker movement was that the large-scale expansion of the industrial capital toward the colonies made the elemental allocation going through a structural transformation; industrial labor in relation to the industrial capital became an increasingly scarce element, which allowed the labor to have a better position in negotiation and the substantial condition for success in struggle. The unsubsidized upheavals of labor movement imperatively called for a theory easy to understand. Marxism was thus simplified as an ideological tool facilitating worker mobilization. Diversified social movements involved by many petite bourgeoisie at that times one by one betrayed the intent of the classic thinkers of Marxism. Marx was so irritated that he exclaimed, "I have sown dragons' teeth but harvested fleas." And referring to different incidents and groups Engels had repeated Marx's remark: "if that is Marxism, then I am not a Marxist."¹¹

¹¹ According to Engels, in regard of the French students who regarded 'materialism' as a formula and those French materialists who objected historical materialism, Marx said, "All I know is that I am not a Marxist." (Engels 1890) While the Chinese government sponsors the theoretical enterprise of Marxism nowadays, we must be careful of a similar tendency.

Second, in the stage of industrial capitalism, 'economic liberalism' had taken the place of 'mercantilism' as the mainstream ideology in the West. It reflected the fact that in that time industrial capitalists who were still bound by the 'localization' of industry must struggle against the imperial power and those aristocrats who were also 'localized'. This demand of interests which was indeed an advancement to the Europe at that age marked the beginning of a genealogy of various forms of developmentalism which in essence remain Euro-centric and regard capitalism as fostering 'human' productivity but in a lesser or greater extent neglect its precondition of 'anti-humane' national crimes, namely the colonial plunder and massacre.

If developing countries take the developed countries as the target and model to catch up with, they must ponder the viability of 'duplicating' the latter's development path. Due to the path dependence of institutional transition, developed countries must realize the further intensification of growth mechanism by externalizing the institutional cost. Developing countries will find it even more 'impossible' to lessen this disparity mechanism, not to mention reversing it!

Hence, as its logical point of departure is not its historical starting point, western developmentalism does not imply the scientificity of repeatable

verifiability, therefore as a guideline to the developing countries it exactly incurs the opposite effect. The above generalization also supports Chinese economists like Justin Yifu Lin's point of view that western economics does not apply to China's experience of development.

2. Middle Stage of Capitalism: exacerbation of contradiction in the phrase of industrial capital expansion and industry transference

After the primitive accumulation had completed, it was bound to move into the stage of structural expansion of industrial capital. At the same period, in Europe, the core region of capitalism, competition became aggravated under the condition of industrial isomorphism. Basically, it was the result of exacerbating inner contradictions led to by the path dependence formed in the previous stage of primitive accumulation.

Among the core European nations, wars broke out incessantly in the process of primitive accumulation to contest for trade rights, colonies, markets and industrial resources. As it went on to the beginning of the 20th century, European powers in the stage of capital expansion crowded in that peninsular-like continent. Nearly simultaneous expansion under industrial isomorphism led to overproduction and exacerbating

competition. These nations still had recourse to wars in a path-dependent manner. The so-called colonies were forced to get involved. Wars in the past were frequent but limited to conflicts among city-states and nations. But now it evolved into two great world wars that scourged all human beings. The First World War was basically limited within the Occidental powers, still a continuation of the previous European wars. But the Second World War involved over 2 billion of the world population, incurring heavy casualties of 55 million, half of them being civilians.

The following must be understood as the basic knowledge of history. These two world wars under the backdrop of vicious competition among nations, waged in Europe, were the extreme ways of straightforward national crimes after the first transference of crisis through overseas colonial wars as the form of direct criminal acts by nations in the early stage of capitalism.

We then pose a common-sense question: why does the world not repeat the same track after the First World War? 60 years after the Second World War, the Third World War, once the most worrying issue in the world, has not yet happened. After the WWI, the western nations had enjoyed a short period of boom. What ensued were the great recession and another world war.

After the completion of post-war reconstruction, the western nations in the 1960s had gone through a period of pervasive social turmoil, belief crisis and even urban guerrilla. However before long the West in the 1970s drove into the highway of the so-called 'second modernization'¹². The internal contradictions within the capitalist core were alleviated.

Admittedly, people were well aware of the massive destruction in the two world wars. On the one hand, the capitalist pernicious competition due to overproduction was resolved; on the other hand, the war led to a sharp drop in young and prime population. The shortage in labor force fostered the rise of post-war worker movement and socialist movement. At the mercy of various factors, the labor condition in the capitalist nations did improve significantly; the labor-employer conflicts were relatively alleviated.

Nevertheless, we'd like to supplement the problem with two alternative answers:

On one hand, in the pursuit of

¹² 'The second modernization' is a term proposed by a Chinese scholar He Chuan-Qi in 1999. It refers to the transition from the industrial age to the age of knowledge, from the industrial economy to the knowledge economy, industrial society to knowledge society, industrial civilization to knowledge civilization. (See Ho Chuan-Qi, *The Second Modernization: the revelation of civilization process*. Beijing: Higher Education Press, 1999.)

industrialization to become a developed country, developing nations have taken up the institutional cost in their respective 'modernization transition'. At present, there are 193 independent sovereign states in the world, of which 128, mostly in the third world, were established after the WWII. The very primacy of these newly independent nation-states has been the pursuit of modernization. In practice, they became the 'new continent' to absorb the capital and productivity excess from developed nations.¹³ In effect, it triggered a structural adjustment in the capitalist core and the second externalization of crisis. In 1950, the US investment in developing countries amounted to 51.7% of the latter's total foreign investment. In 1960 the ratio was 39.4%. Investment from Western Europe increased drastically in the 1960s, the distribution being the same as the US.¹⁴ During 1960-1980, capital export from the West added

¹³ Fang Ning calls this process as "the Second Great Geographical Discovery". See his 'The Second Great Geographical Discovery: the origin of new colonization,' in Fang Ning, Wang Xiao Dong and Song Qiang eds., *China's Path Under the Shadow of Globalization*, Beijing: China Social Science Press, 1999, pp. 245-62.

¹⁴ That had to do with the change in geopolitics. After the completion of post-war reconstruction, Western Europe was eager for freeing itself from the US hegemonic domination and establishing diplomatic relationships with developing nations. France was the first western country to restore diplomatic relation with China (1965).

up to US\$ 550 billion. In the early 1950s, 90% of the investment in the third world was foreign. In the 1960s the ratio remained over 80%.¹⁵ On the other hand, what should be noted is: in fact, the industry transfers from developed countries to developing nations were by echelon and restricted. What had been first transferred were those labor-intensive, resources-intensive and pollutant industries with productivity excess. As these backward industries incurred labor-employer contradictions and social conflicts most seriously, their outbound transfer released the confrontational labor-employer tension and international

¹⁵ The South Commission, *The Challenge to the South: The Report of the South Commission*, USA Oxford University Press, 1990. In 2008, when economic panic strikes the core nations again, the prescription by economists is not different from 50 years ago. For example, the American economist Jeffrey Sachs, who had prescribed 'Shock Therapy' to the Soviet Economy, says that, 'the world's poor regions need to be seen as investment opportunities, not as threats or places to ignore. At a time when the major infrastructure companies of the US, Europe, and Japan will have serious excess capacity, the World Bank, the European Investment Bank, the US Export-Import Bank, the African Development Bank, and other public investment funds should be financing large-scale infrastructure spending in Africa, to build roads, power plants, ports, and telecommunications systems.' (Jeffrey Sachs, 'A Sustainable Recovery,' <http://www.project-syndicate.org/commentary/sachs147>.) Once again, developing nations are on the agenda as the targets of transferring the productivity excess.

contradictions correlated with the stage of 'localization' of industrial capital in the West.¹⁶

However, those developing nations receiving the contradiction transfer in the stage of industrial capital expansion enjoyed little institutional gains. It was because most of the developing nations born in decolonization receiving low-end and unitary industry found it impossible to form a complete industrial structure and gain economic sovereignty. Furthermore, as soon as the developing beneficiary nation disobeyed the geopolitical strategy imposed by the benefactor (usually the former suzerain) or its strategic value declined, the benefactor nation would cut or even stop investment¹⁷; that led not only to the abruptness of

¹⁶ The US in the age of industrial capital was once under the fascist influence, having the largest cases of labor bloodshed in the industrial nations. In 1934 alone there were 1856 cases of strikes. Over 2500 enterprises hired thugs to sabotage the strikes (data by The American Civilian Liberties Union). In one case of automobile workers strike the National Guard shot 27 persons. See Wang Wen, 'The US almost went Fascist,' in *The Global Times*, 2009-4-8, p 13.

¹⁷ For example, after the disintegration of the USSR, as the West-East confrontation disappeared, Africa's strategic significance in the US global strategy became relatively abated. The aid to Africa was regarded as an unfillable hole. The US began to cold-shoulder Africa, cutting the economic aid massively. See Peng Pei, 'On the Aid to Africa by the Western Developed Nations,' in *Journal of Henan Radio and Television University*, 2008, Issue no. 1, pp 14-5.

industrialization in the beneficiary nation, but inevitably also to political unrest and even social turmoil, as the superstructure established according to the suzerain's request in the aid period became unsustainable; the 'reaction' from the economic base against the superstructure manipulated by the interest blocs benefited by the suzerain expressed itself in a complex manner; what followed would be the direct or indirect intervention by the suzerain who was originally the disaster-maker, and then the irrevocable entanglement in the so-called 'developmental trap'.¹⁸

Due to these two aspects of substantial transformation, part of the governments that originally served as direct means of the national crimes evolved into the watchman of 'democracy' and 'welfare state' in the process of acquiring the abovementioned institutional gains.¹⁹ At the same

¹⁸ Especially in Africa where the colonizers, instead of taking the traditional tribal territories into consideration, delineated in 1884 the regime boundaries straightaway by the longitudes and latitudes to cater for the suzerains' power demarcation. After the colonizers withdrew, Africa has become a geo-ethnic landscape fraught with genocide. Colonialism was the ruination.

¹⁹ It explained from another perspective the West's throe in the 1960s. The rise of new technological revolution transformed the technological base of social production from mechanization to automation and information, which led to a general unemployment. In the 15 years from 1950 to 1966, about 8000 types of occupation

time, military technology and equipment innovation in the Great War was internally transformed into civilian use, promoting the industrial structure in the West upward to a capital/technology intensive model while conducting unequal exchange with the low-end industries in the Third World.²⁰

Thus, after the completion of industry transfer the core nations

disappeared from the labor market in the West with the emergence of 6000 new occupations. Moreover, the government-led post-war reconstruction gave birth to the largest bureaucracy in history, which led to the expansion of bureaucratism and the non-democratization in policy-making. Weber would call it the bureaucratization of social life, the modernity syndrome of political alienation. Habermas combines Marxist critique of social monetization and Weberian bureaucratization of social life to elaborate the double oppression of labor alienation and power alienation in modern capitalist society and even believes that the alienation by power is more prevalent than labor alienation. The economy kept booming during the 1960s. Nevertheless it was a turbulent age of radical politics and cultural rebellion. The uprising of student movements was to some extent the product of this contradiction which foreshadowed the subsequent neo-liberalism. (See Zheng Qian, 'The Turbulent West,' in *China: from Cultural Revolution to Reform*, Beijing: People's Press, 2008.)

²⁰ For instance, information technology did not originate from civilian innovation but military demands. When military technology suddenly turned civilian, capital interest bloc like traditional telephone and communication industry had no choice but to concede to the imperative of the maximization of national interest, hence the rise of the ICT industry and the subsequent bubble.

not only enjoy the double gains of institutional transition, namely industry structure upgrade and capital surplus, but also transfer the contradictions in the stage of industrial capital toward developing countries.

That is the intrinsic reason why humanity is well out of the Third World War, which in essence would be an extreme expression of the accumulation of negative feedback from pernicious competition during the stage of industrial capital expansion.

In the middle stage of capitalism, except China who 'delinked' itself historically and accidentally, most of the developing nations depending on the investment by former suzerains to prosper national economy failed to provide a model for the fulfillment of capital primitive accumulation and freeing from economic dependence.²¹ It was also the backdrop of the emergence of the dependent theory.

²¹ A few exceptional cases concentrate in the new industrial zone in East Asia, for example the 'four little dragons' receiving Japan's industry transfer and the 'four little tigers' later duplicating the path. Their rapid economic growth is eye-catching. However, due to territorial limitation and the prominence of geo-political factors, the experience is not a valuable reference to other developing countries. As to whether China is an exception, we will elaborate in another essay. ('The four little dragons' refers to Korea, Singapore, Hong Kong and Taiwan. 'The four little tigers' are Thailand, Malaysia, Indonesia and Philippines.)

3. Late Capitalism: Globalization of Finance Capital and Symbolic Economy and its Polarization Mechanism²²

The finance capital with state power as its credit base took shape in the late 17th century out of the demand for war through which the merchant interest groups and European monarchies gained huge profits. It took part into the profit distribution of industrial capital circulation and was closely correlated with the development of capitalism. In the three hundred years we witnessed intermittent cases of financial crisis like the Tulip Mania in the age of Dutch hegemony in the 17th century and the South Sea Bubble in the early 18th century after the rise of British hegemony. It was however only till the end of the WWII, especially after the disintegration of the Bretton Woods System that the finance capital leaped forward to boost a long-term extraordinary

²² Unless otherwise stated, the basic points of view and information in this section are taken from the first author's essays since the 1990s. Wen Tie-Jun, 'National Capital Redistribution and Civilian Capital Re-accumulation,' in *Xin Hua Digest*, December, 1993; Lyndon LaRouche and Wen Tie-Jun, 'The Global Crisis of International Finance capital and China's Reform,' in *Strategy and Management*, Fall 1996; Wen Tie-Jun, 'The Circulation from Paper to Paper: Rethink the International Finance capital Dominated by the Dollar,' in *Beijing Youth Post*, June 1999; The above essays are collected into Wen's work on macroeconomics, *What Do We Really Want*, Beijing, HuaXia Press, 2004.

growth in capital returns by symbolization through the 'globalization of finance'. The gainer of a lion share of these institutional gains is the US, a core nation who seizes on the hegemony and dominates the globalization of finance capital.

The WWII has led to a shift in the capitalist core. The US in place of the Western Europe has dominated the politico-economic order in the West. In addition to its irreplaceable unipolar political dominance, to an extent it was attributed to the Bretton Woods System established in 1944. As the US possessed 59% of the gold reserve and shouldered the investment responsibility of post-war reconstruction in Europe and Japan, the dollar has hence become the currency of settlement in the West. The key factor was the dollar's fixed exchange rate with gold. In practice the US has become the 'central bank' of capitalist nations in the world. The dollar has enjoyed a status of 'total monopoly', thus ended the currency war caused by an expansion of finance capital in the period of world economic crisis from 1929-1933 (somehow similar to the wars triggered by aggravated competition due to industrial isomorphism in the stage of industrial capital). The US in the post-war period of restoration became the major investor in the West and therefore enjoyed the chance of dollar-oriented finance capital expansion alienated from industrial capital.

In the 1960s, as production resumed and trade grew up, the foreign exchange reserves in various Western nations increased drastically. Furthermore, trade demand inside Europe made the 'euro dollar' hard to return to the US. That drove the astronomical increase in the US dollar supply to satisfy the need of liquidity and reserve. Subsequently the supply rigidity of gold necessarily led to the dollar deficit. As a consequence to the internal conflict between two interest blocs within the capitalist system, the US and Europe, the US president Nixon unilaterally renounced the dollar gold standard. At the moment of the integration of the Bretton Woods System, the US gold reserve (\$10.21 billion) amounted merely to 15.05% of its total external liquidity liabilities. After a brief financial market shock, other nations in order to avoid the depreciation of dollar reserves, had to entitle the status of world currency to a 'symbolic dollar' which despite delinked from gold, has been increasingly correlated with a special situation of credit propped up by military hegemony.

This once again demonstrated the intrinsic path dependence to the old interests setup during institutional transition. Free from fixed exchange rate with gold, the dollar supply has been allowed to soar enormously. Deficits, consumption by debt and financial bubble have been running wild at large. While shortening the

crisis cycles, finance capitalists have put much emphasis on the globalization of finance capitals to safeguard their way to make profits. And this too is a proof to the irreversibility of the parasitism intrinsic to finance capitals. Their major way to gain profit has no longer been taking part into the circulation of industrial capital. Instead, they have been gradually alienated from industrial capital and became the 'core' interest bloc.

Simon Johnson, a professor at MIT's Sloan School of Management, the chief economist at the International Monetary Fund during 2007 and 2008, points out, 'From 1973 to 1985, the financial sector never earned more than 16 percent of domestic corporate profits. In 1986, that figure reached 19 percent. In the 1990s, it oscillated between 21 percent and 30 percent, higher than it had ever been in the postwar period. This decade, it reached 41 percent.' Huge profits propelled the alliance between finance capitals and the governmental right. And 'elite business interests—financiers, in the case of the U.S.—played a central role in creating the crisis, making ever-larger gambles, with the implicit backing of the government, until the inevitable collapse' (Johnson 2009).

War among great powers to fight for industrial capital profit in the middle stage of capitalism now in the advanced age evolved into the war of the US as a super power to

defend the dollar and contest for the huge profit during the globalization of finance capital.

Let us take a look into two typical cases.

Case 1: 'Petrodollar'. In October 1973, the fourth middle-east war broke out. The oil price soared up steeply by three times. On the surface, wealth was transferred from the major western industrialized nations to the petroleum exporting countries. However in fact, the US and the OPEC had reached an 'unamenable' agreement²³, i.e. the US accepted the OPEC on the condition that the dollar was the only pricing and exchange currency. As a result, during the 1970-1980s, oil-exporting countries deposited huge amount of 'petrodollar' into the major US and European banks, leading to a liquidity flood in the European currency market. Then loans were offered to Latin American countries like Mexico, Brazil and Argentina (known as MBA loan) mainly through American banks. A global liquidity flood was triggered with incessant

²³ Michael Hudson (2008) points out, 'After the first grain-and-oil shock in 1972-73 when the United States quadrupled grain export prices, and OPEC responded by quadrupling oil prices. U.S. Treasury officials told Middle Eastern rulers that they could charge as much as they wanted for oil (thus providing domestic U.S. oil majors with a price umbrella that enriched their coffers), but that if they did not recycle their export earnings to the United States, this would be viewed as an act of war.'

flux of low interest rate loan into investment projects without basic feasibility study. Then the US contradictory monetary policy enthralled the Latin American countries into credit crisis. The MBA countries were the first to declare insolvency. What followed were exchange rate collapse, capital flight, government bankruptcy, and a disastrous decline in economy. There came the US government-IMF-World Bank Trinity's turn of politico-economic reconstruction program. The countries in crisis had no choice but to accept the 'overhauling' of their lifeblood industry by the creditor nations in order to get payment extension, new loan or debt exemption.²⁴ The dollar circulation has not only 'acquired' the oil resources in Middle East, but also Latin American Economy.

Since 2002, a new round of high oil price has made petroleum exporting the most profitable item in trade surplus. In 2005, the trade surplus of the petroleum exporting countries has reached 400 billion US dollar, twice the total trade surplus of all the Asian nations combined. Many countries regarded the movement of their petrodollar as state secret. However, investment into the US, especially US Treasury Bond, is still very important.²⁵ That would

definitely enable the reemergence of a vicious circle of financial crisis caused by the US over-issuing the dollar and its transfer toward industrial capital and resources exporting countries, as witnessed in the last round.

The mechanism of financial globalization is through 'a circulation from paper to paper,' the mechanism of dollarization, to 'acquire' the industrial capital (using the dollar to purchase resources and products by the industrial capital), then use derivatives of the dollar to cash back the dollar paid out. What are acquired include the shareholder's equity and foreign exchange reserve.

Case 2: The 'dollarization' of economic growth in developing countries. After the 1980s, due to the rise in prices of production factors in developed countries, the manufactory industry (or parts of the industry) was transferred toward several newly industrialized and export-oriented countries such as the 'Four Little Dragons' and 'Four Little Tigers' hence accomplishing fast economic growth. That necessarily led to huge balance-of-payments deficits valued in the dollar in developed countries. Most of the dollar income by the developing countries returned to the developed nations, which propelled an increase in the surplus of capital account. At the same period, the dominant Western countries started to urge forward financial

²⁴ Xiang Song Zuo, 'A History of the Dollar Hegemony,'

<http://szxiang.blog.sohu.com/65340541.html>

²⁵ Yu Pei Wei, 'The Movement of Petrodollar deserves concern,' China Economic Times, 2006-10-9.

liberalization and securitization and took a further step to relax financial regulation since the 1990s.

Economic consumption has been boomed through stimulating the need for their securities and derivatives in national and overseas capital markets and thus creating a wealth effect. An even more important function has been imbibing back the overseas capitals to support national consumptions by loan and overseas acquisitions by transnational corporations.

Actually, the dollarization makes developing countries provide almost 'free lunch' to developed countries. As the investment windows by the developed countries are limited, excluding those strategic industries with restricted access, foreign investment is narrowed down to bonds and derivatives markets.

That means the developing countries export resources and products only in exchange of an IOU the US unwilling and unable to pay back. Furthermore, developing countries are located at the bottom of the 'Smiling Curve' in such a setting of international industry division of labor.²⁶

²⁶ See Liu Huai Yu and Wen Tie Jun, 'The "Smiling Curve" as Tested by the so-called "Three-plus-one" Trading-mix' (custom manufacturing with materials, designs or samples supplied and compensation trade), Working Paper.

Therefore the cost of this 'free lunch' is pretty expensive. First, under a hyper-competitive condition, the economic growth propelled by manufacture and export in developing countries' is found on an under-pricing (or even negative price) of national resources, environment and labor welfare; second, the class opposition between a minority of comprador class and the majority of cheap labor causes massive social conflicts; third, the economic growth of developing countries depends too much on the consumption markets in developed countries.²⁷ How much more it is when compared with the tricks of 'skinning the ox twice' in Lenin's analysis of financial monopoly capital (Lenin 1916: Chap.9).

The relationship in the above cases can be revealed by the following diagram:

²⁷ Wang Xiao Qiang, 'Set in Motion an Economic Circulation with Both Ends insides'.
<http://www.strongwind.com.hk/catalog/999d9156-9863-4717-97aa-bd94b506a285.aspx>

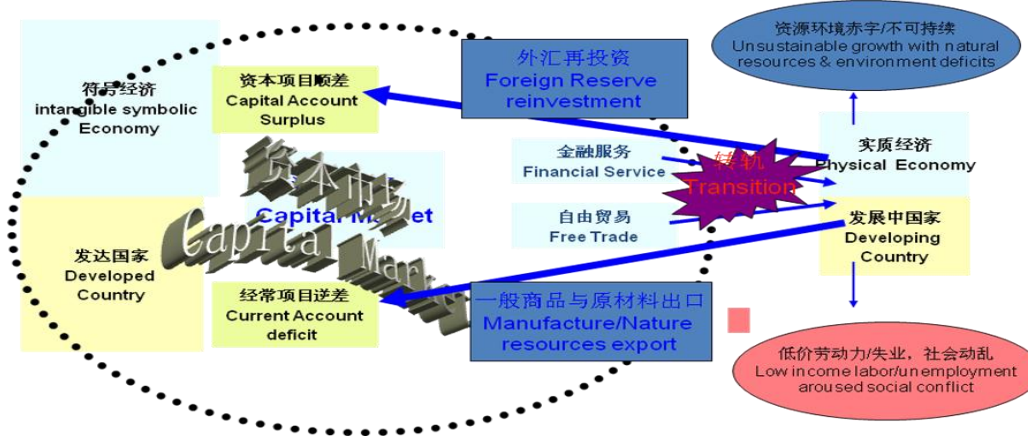


Diagram: The Economic Relationship Between Developed and Developing Countries²⁸

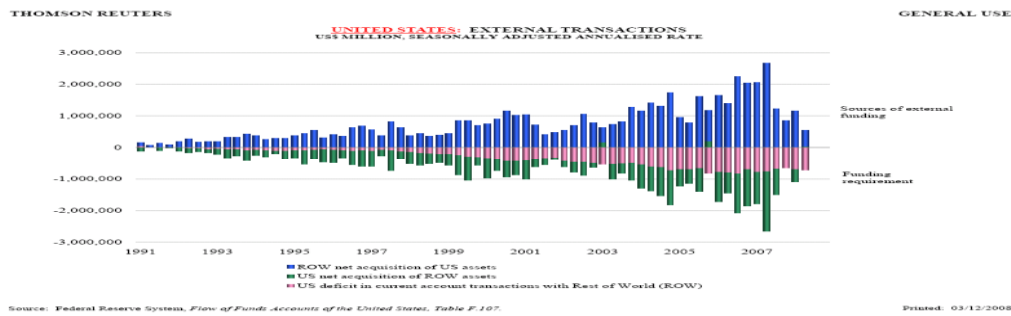
The crux marked in the middle of the above graph is a transition the ‘core’ countries must propel in the financial services and free trade of developing countries. If the military hegemony led by the US is the ‘hardware’, then the ‘software’ of its finance capital hegemony is neo-liberalism formed in the West according to practical needs and its ideological export to dismantle the developing nations’ measures of protection against the financial globalization by the capital exporting countries.²⁹

Prof. Chen Ping of the Peking University points out that the US not only ‘expends by loan’ but also ‘buys out massively through lending.’ The foreign exchanges earned in exportation by developing countries are being re-invested into the derivatives market in developed countries. The investment banks of developed countries then use these incomes to acquire the strategic industries of developing countries. The graph shows a positive study. Below the horizontal line is the total overseas capital expenditure, including deficit in current account transactions and the net acquisition of overseas assets by US individuals and corporations; above the line is capital income the US gets from foreign investors. The main sources of funding include securities, bonds, bank loans or companies and real estate sold to the foreign investors. It is quite obvious that the money used in acquisitions of assets in the rest of the world is borrowed.³⁰

²⁸ This graph is created by the first author in 2004 and used frequently in seminars during the last 5 years.

²⁹ For example, as Nick Beams points out, ‘Clinton alluded to the economic foundations of American militarism on the eve of the bombing of Serbia in April 1999. He said, “If we’re going to have a strong economic relationship that includes our ability to sell around the world, Europe has got to be a key... That’s what this Kosovo thing is all about.”’ (Beams 2008)

³⁰ Source: John Kemp’s column <http://cn.reuters.com/article/weNews/idCNChina-3072020081205>. Graph link: <https://customers.reuters.com/d/graphics/USXFTFLOWS.pdf>



As finance capitals work through leverage, high return is inevitably accompanied by high risk. However, return and risk are asymmetrical. According to IMF statistics, during 1975-1997, there were 289 cases of financial crisis, of which 73 were in industrialized countries, 216 in new markets. The latter number was thrice the former.³¹ However, 'the financial crisis in developed countries is just a financial crisis.

The worst is merely an economic crisis. Nevertheless, financial crisis in developing countries is more than an economic crisis. It would escalate into social turmoil, overthrowing of regime and national division.'³² For example, as early as during the European and US Crises in 1934 and 1935, China under silver standard was confronted with silver draining as the US raised the price of silver and hence plagued by credit crunch.

Commerce and industry were hit hard. Subsequently the authority was forced to abolish silver standard

and therefore the monetary reform failed. The government then failed to suppress social turmoil caused by economic crisis! Another example is the 'Debt Crisis' of Latin America in the 1970s. It too had its origin in the institutional cost transferred by the monetary hegemony patronized by great powers. Since the 1980s with the rise of the symbolic economy, the impacts by an excess of finance capital are even more frequent and lethal.

As early as in 1996, the first author of this essay has demonstrated the regularity of the collapse of economic bubble created by finance capital excess. It was later verified by the financial crises in East Asia and Latin America. Subsequently we witness the collapses of various bubbles one by one: IT, real estate, petroleum, food and minerals futures. During 2008-2009, the 'Wall Street tsunami' broke out in the heartland of finance capital and global economic crisis spread through the world. Just as in the first half of 20th century, in the stage of industrial capital, over-production and pernicious competition led to a violent outbreak of conflicts in the core. In the stage of over-competition of

³¹ Source: IMF *World Economic Outlook*, 1998, nos. 5 & 11.

³² Wang Xiao Qiang, *New Economy of Speculation and Gambling*, Hong Kong: Strong Wind Press, 2007.

finance capital alienated from industrial capital, its parasitism irrevocably leads to internal contradiction and economic crisis from the periphery to the core...

All in fact is a continuation into the stage of finance capitalism of a political system setting up the legitimacy of national crimes by the 1648 Peace of Westphalia. 'It won—and the world lost.'³³

C. Conclusion

When the full-scale economic and social crisis, a negative feedback in accordance with the Theory of Relativity, finally accumulates up to the point of breaking out in core nations, what people witness is still the empirical process verifying the hypothesis of this essay: the dominant nations in the core appropriating the institutional gains would arduously continue its path dependence of transferring the cost instead of consciously reversing the polarization since half an century ago. On one hand, the finance

capital appropriating the institutional gains without physical economy as its credit base would follow the trend to return to the national powers and capital alliance as its source of credit, forming swiftly a highly monopolized institutional layout closely interrelated with governments. On the other hand, through ways such as national debt dependence, money supply increase and trade barrier, along with machinating or intensifying the tension in geopolitical strategy, developing countries are forced to accept the cost of crisis-transferring.

Accordingly, the polarization setting is strengthened. The close conjunction of capital and government, two entities of alienation created in the stage of capitalism civilization, may push humanity itself into deep alienation. Disasters caused by overflowing desires are more and more transferred to the ecology. The disparity in institutional gains between developed and developing countries is getting worse. Developing countries have to depend increasingly on a looting exploitation on natural resources. The institutional cost is transferred to the ecology and the environment, which endure massive and irrevocable destruction. Finally, it will in turn react upon human beings as outrageous disasters.

The problem is: no matter it is the collapse of financial bubble or the outbreak of ecological and

³³ In his analysis of the East Asia crisis, Joseph Stiglitz said, '[US] Treasury, in conjunction with the IMF, encouraged rapid capital-market "liberalization"—that is to say, the opening of underdeveloped markets to the onslaught of highly speculative investment...Indeed, the overwhelming evidence—shown in a number of studies by the World Bank—is that rapid liberalization is extremely risky for developing countries. Treasury ignored this evidence and pushed for faster liberalization. It won—and the world lost.' (Stiglitz 2002)

environmental disaster, the underprivileged communities in developing countries and other nations remain to be the final bearer of institutional costs. Such institutional shackles make developing countries, despite having abundant resources and advantage in rich labor power, still entrapped by being 'capitalized' in the global economic system.

In comparison, the only exemption that could challenge the theory of institutional "being poor" is China under 'de-linking,' spending much less time than the West, without recourse to colonial expansion and with little foreign investment, has accomplished during 1950-1980 the primitive accumulation for national industrialization independently in relative sense; then subsequently under the banner of open and reform, it has marched into a stage of rapid expansion of industrial capitals mainly through the capitalization of national resources, a process lasting for three decades. A probing into the cause and the lesson in terms of anti-poverty for other developing countries would be the main contents of the second part of this essay.

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