Shifting Centers of the Global Economy:
The Case for a Chinese Cycle of Capital Accumulation

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Abstract

The world market economy progresses through cycles of capital accumulation. Beginning in Northern Italy and moving first to Holland, then to London and eventually to New York, the center of accumulation continues to shift as the systemic structure of the global economy evolves. Based largely on this theory, developed by Giovanni Arrighi, this essay attempts to make the argument that the current global crisis signals the end of the US cycle. Following that, a case is made for the possibility of a new China-centered cycle. Evidence of systemic evolutions is provided, as well as the fiscal realities that support the claims.

Giovanni Arrighi's book (1994), *The Long Twentieth Century,* has offered an important analysis of the global market system. Extrapolating on Fernand Braudel's (1973) idea of cyclical periods of economic expansion, Arrighi defines the modern world system as a series of systemic cycles of capital accumulation that began with the city-states of Northern Italy around the Twelfth Century. The financial center originated in Genoa, then moved to Amsterdam, to London and finally to New York. His research carefully traces what he sees as the development of the global market as an increasingly efficient system that is continually and progressively evolving. He argues that states trading with the hegemonic power of the time will emulate its successes and eventually incorporate innovations that will propel it into the role of hegemon. In other words, when a new and more efficient process enters the system, the state that most benefits from it will soon become the new center of the global market. Over time the improvement will spread throughout the global system, but another innovation will emerge elsewhere, and the center will shift again. While Arrighi gives in-depth examples to support his argument, I will discuss them only briefly here. The Northern Italians developed the art of high finance and trading centers that the Dutch (and indeed most of Western Europe) eventually began to copy. The Dutch improved on the financial institutions and trading and added joint-stock companies. The British co-opted the idea of joint-stock companies (most notably the East India Co.) while also improving its protection militarily and promoting territorial expansion. In its turn, the US incorporated the idea of territorial expansion (Manifest Destiny) while also introducing improved corporate structures like vertical integration and managerial bureaucracies.

As global markets continue to plunge, the case can be made that the US cycle is now drawing to a close. In an attempt to place the current financial crisis within its proper historical context, this essay seeks to apply Arrighi's theory of systemic cycles of accumulation to the contemporary condition of the global economy. This will be accomplished by comparing the previous shift—from the UK to the US—with what is perceived to be a new transition—from the US to, perhaps, China. The focus will be on the similarities in the monetary conditions of the two transitions, as well as the respective systemic evolutions. The first sections will review some of the factors that contributed to the rise and fall of the US cycle. Following that is a discussion of the way in which China has risen to economic prominence in the shadow of the US's hegemonic position. Finally, an argument will be made for the possibility that China could emerge from the current chaos as the new center of capital accumulation.

The Rise of the US Cycle

As noted above, the US cycle was preceded by the British cycle. How did the so-called Washington Consensus assume the central position in the global economy? Scholarly literature across the academic spectrum acknowledges the decline of the British Empire over the first half of the Twentieth Century. It is also clear that the US assumed economic hegemony in the second half of that century. The focus of this essay will be on the larger systemic nature of the shift from Britain to the US, and on the more tangible fiscal factors that allowed it. While the points discussed do not constitute an exhaustive list, they are relevant to discussing those systemic and monetary conditions that are relevant to the current geo-economic transition.

As Arrighi (1994) noted, each shift in cycles of capital accumulation was accompanied by a systemic innovation that provided an advantage to the new center of the world economy. In the previous cyclical shift, the British overtook the Dutch by, in part, incorporating territorial expansion and improving protection. Likewise, the US cycle began with a systemic innovation. Throughout much of the Nineteenth Century the US followed the British path of territorial expansion, in North America by way of Manifest Destiny, and in Latin America through a combination of hampering European involvement—i.e. the Monroe Doctrine—and exerting military might—directly in Mexico, Central America and parts of the Caribbean, and indirectly in South America by supporting the Bolivarian struggle. The US then gained a systemic advantage by incorporating the innovations of vertical integration and managerial bureaucracies.

Carnegie Steel may be credited with being the first to develop the idea of vertical integration. By the latter part of the Nineteenth Century Carnegie Steel owned every aspect of the steel production process, including the mines, the factories, the ships for transporting ore, and the trains for delivering the finished steel. This system of total ownership greatly reduced production costs and was soon adopted by other companies. It would become the *modus operandi* of multinational companies in the Twentieth Century. In addition to this innovation, there also emerged a class of managerial bureaucrats to oversee the processes of production. Elites began attending universities in order to study business and accounting rather than philosophy or the arts. For the first time vocational education and training became more important than one's pedigree (Arrighi, 1994); though it could be argued that access to education was still largely determined by economic class.

Aside from the systemic evolution that created an advantage for the US, certain historical circumstances provided the more tangible, monetary factors that allowed the economic center to shift across the Atlantic. One of the keys to the ascension of the Washington Consensus lies in the role of the US in international finance. Due in part to simple geography, the US avoided much of the devastation of the First World War. It was during this period, largely through loans for munitions, that the notion of a Washington Consensus first emerged. Loans, not subsidies, were granted to the Allied Powers beginning in 1917. These loans, in turn, were used to buy equipment, weapons and ammunitions from US suppliers. Therefore, the government made money via interest paid on the loans, and US manufacturers made money through the sale of weapons to the Allied Powers in Europe. Michael Hudson (2003) noted that 'obligations of the Allies to the US government grew to $12 billion by 1921, starting with a $3 billion credit granted in 1917'(p.41). Hudson went on to say that 'Secretary of the Treasury Andrew Mellon acknowledged that US profits on some war transactions ran as high as 80 per cent'(p.41).

What is clear about this period, and about the role of the US financiers in it, is that the United States profited tremendously by accumulating European debts and feeding its domestic industrial base in the process. But it is also important to note that this merely marked the beginning of the US ascension to economic hegemon. It was during the Second World War that the US would again avoid the devastations of war on its own soil, and when it would again make huge profits by financing its European allies.

Though the US did not officially enter World War II until Pearl Harbor was attacked in December 1941, it allied itself with France and Britain more than a year earlier. It was at the end of 1940 that the US began the Lend-Lease program with Britain. In short, this agreement meant that the British could borrow military equipment from the United States and only pay for that which could not be returned following the war. The profits from such an arrangement alone would be relatively insignificant, but one very important amendment effectively ended the British Empire. US negotiators demanded that Britain agree to abandon Imperial Preference, which meant that British colonies would be opened for trade with the United States. According to Hudson (2003), the terms of Lend-Lease 'compelled [Britain] to relinquish Empire Preference and open its markets to US competition, at a time when Britain desperately needed these markets'(p.131). Churchill was quoted as saying, 'the United States was capitalizing on British adversity to seize control of the British Empire' (Hudson, 2003, p.124).

Beginning with the Inter-Ally loans of the First World War, and continuing through the Marshall Plan in the aftermath of World War II, the US served as creditor for European debts. By 1944 the US had accumulated almost seventy-five per cent of the world's gold reserves (Hudson, 2003, p.275). The combination of controlling such a disproportionate amount of gold and depriving Britain of the advantages of empire gave the US clear hegemony. The favorable conditions on which the Bretton-Woods system emerged in the post-war era are testament to the control the US had garnered over the global economy.

The Demise of the US Cycle

The over-accumulation of gold in US reserves became as much a problem for the American economy as it was for all of the states that were deprived of bullion. As long as the US controlled such a disproportionate amount of gold, it struggled to find export markets for its goods. Even its largest trading partners lacked the capital to purchase US products. In response to this problem, the US managed to redistribute its gold reserves so effectively that it became a debtor nation within only twenty years. Wars in Korea and Vietnam helped drive the US deep into debt, and by the end of the 1960's it had essentially abandoned the gold standard as the backing for the US dollar—though it was not official until 1972. US debt continued to grow throughout the 1970 s, exacerbated further by the oil crisis (Hudson, 2003).

Despite running increasing deficits, the US continued to assert its dominance in the global market. The US dollar became the de facto replacement for the gold standard, which meant that its value became equally important to the global economy. Additionally, as a large consumer-driven economy, many states relied on the US as an export market—i.e. Japan. Finally, a strong US would continue to provide the military aid on which many states relied throughout the Cold War. It is clear that the US maintained hegemonic power throughout the final decades of the Twentieth Century, but the massive debts would eventually play a part in ending the US cycle of capital accumulation.

Another important factor in the demise of US hegemony was the deindustrialization of the last quarter of the Twentieth Century. US manufacturing reached its height at 28 per cent of total employment in the mid 1960 s. By 1994 that share had fallen to just 16 per cent (Rowthorn and Ramaswamy, 1997, p.2). This is particularly significant in the context of Arrighi's model. Paraphrasing Fernand Braudel's claim, Arrighi (1994) notes that 'the maturity of every major development of the capitalist world economy is heralded by a particular switch from trade in commodities to trade in money'(p.109). This can be seen in the deindustrialization of the US as services, such as high finance, overtook manufacturing as the base of the economy.

As with each previous cycle of capital accumulation, the 'maturity' of the cycle marks the beginning of that cycle's final stage, and it indicates that a new cycle will likely emerge.

The Rise of China

At the time of Mao's Revolution, China was among the poorest nations in the world. Only sixty years later it may be poised to become the center of a new cycle of capital accumulation. The following paragraphs will explore the similarities between the US' ascension to hegemonic power, and China's recent economic expansion. As with the previous section, the focus will be first on the systemic innovations and then on the fiscal conditions. Finally, it will be argued that these factors constitute a strong argument for the possibility that China will emerge as the new economic hegemon.

Merely adopting the successful processes of the current economic hegemon has never been enough to catalyze a shift in the center of capital accumulation, but it is a prerequisite, based on Arrighi's theory, for later implementing systemic innovations. China has done so in various respects, but one in particular warrants a brief explanation. China has been able to expand its economy in large part by simply emerging from isolation. As Andre Gunder Frank (1966) claimed it is only by emerging from a position of relative isolation that the economy of a satellite state can convergence with the world's core states. China became subordinate to Western powers around the end of the Nineteenth Century and remained so throughout much of the Twentieth Century. The Sino-Soviet split following China's 'abandonment of the Soviet model' (Meisner, 1999, p.156) in 1956 even denied China partnership with the Soviet Bloc, a seemingly likely alliance. But it was ultimately the emergence from this position of isolation that functioned as China's economic expansion in the same way that territorial expansion contributed to British and US growth. In all three cases economic expansion was made possible by the opening of new markets.

In addition to this economic expansion, China also drove the most recent systemic innovations in the global economy. The first of these innovations involves state-owned enterprises (SOEs). Both the British and the Dutch had capitalized on the use of joint-stock companies, but the Chinese further developed the system of joint-ventures. The modern Chinese economy, according to Arrighi (2007), consists of 'a mixed bag of newly created private, semi-private, and community-owned enterprises' (p.356). And in contrast to earlier models of semi-private ventures, China exposed them, as well as SOEs, to competition. This extent of state involvement might be argued to be socialistic in nature, but the purposeful exposure to competition is clearly Smithian.

Another example of China's systemic innovations is found in its adoption of and later departure from the vertical integration model. As the US gained an advantage by introducing vertical integration, so replacing it with a multilayered system of subcontracting has benefited China. In contrast to vertical integration, the multilayered system involves separate ownership of each part of the production process. While in the past total ownership of the processes of production reduced costs, the new multilayered system takes advantage of the increasing disparity of the Twentieth Century's Great Divergence (Pomeranz, 2000). Though this systemic innovation actually appeared in Japan first, it was Chinese expatriates throughout East Asia who made it possible. These entrepreneurs facilitated the relationships between the large multinational firms largely based in the economic core and small businesses in East Asia. In addition to playing an important role in systemic innovations, these expatriate entrepreneurs also helped drive the economic expansion of the 1980 s (Arrighi, 2007).

Overseas Chinese accounted for the vast majority of direct investment in China for the first ten years of China's rapid expansion following the economic reforms of 1979. It was not until the 1990 s that foreign direct investment began to catch up with the capital provided by expatriates. According to Arrighi

(2007), 'foreign direct investment, which had totaled only $20 billion for the whole decade of the 1980s, soared to $200 billion by 2000 and then more than doubled to $450 billion in the next three years'(p.353). This foreign capital, though it did not initially drive the Chinese economic expansion, helped to create the kind of fiscal situation that the US used to overtake the British as the center of the world market economy.

The New Cycle?

As noted in the previous section, China's current position is similar to that of the US in the mid-1900s. It experienced tremendous economic expansion in the shadow of a foreign economic hegemon, drove the evolution of the global market system—vertical integration in the US, competition for SOEs and multilayered subcontracting in China—and it accumulated large amounts of foreign capital. The latter point may best support the argument for a Chinese cycle of capital accumulation.

Based on Arrighi's theory, China appears to be fulfilling the criteria necessary to replace the US as the new center of the global economy. Perhaps most notably, China has accumulated huge amounts of capital, while also serving as lender to the current hegemonic power. And with economic crisis crippling Western markets, it is poised to further elevate its position as international financier. According to Linda Yueh (2008), China holds 'nearly $2 trillion in foreign exchange reserves' (p.1). Additionally, in September 2008, China surpassed Japan as the largest foreign lender to the United States. The Treasury (2008) reported that China holds $585 billion in treasury securities. As previously noted, the US capitalized on British war spending and financial crisis in order to usurp economic hegemony. With the US fighting wars in Iraq and Afghanistan, as well as struggling with financial crisis and heavy debt, China is now similarly positioned to emerge as the new center of the global economy.

China has also avoided, thus far, at least one of the key factors in the decline of US economic power. The erosion of the manufacturing base in the US left the economy in a precarious position. Due in large part to the size of the Chinese population, China has been able to expand its knowledge-intensive sector without abandoning its labor-intensive industries (Arrighi, 2007, p.357). The US, as well as the other core states, encouraged a rural exodus in the wake of the Industrial Revolution in order to provide labor for the expansion of manufacturing. Deindustrialization then led the labor force to shift from manufacturing to services. Contrarily, China has maintained a strong agricultural sector based largely on peasant farmers, a labor-intensive manufacturing sector, and knowledge-intensive technology and service sectors. This is only feasible in an economy of scale like that of China.

Conclusion

Giovanni Arrighi's model of cycles of capital accumulation provides strong arguments for the evolution of the world market system. This model also offers a means by which to place the current economic crisis within historical perspective. While the future is far from certain, there is some evidence to support an argument for China as the new center of the global economy. By adopting the methods of past cycles and then developing more efficient structural innovations, China has fulfilled one of the key criterion of Arrighi's theory. Additionally, China has positioned itself as international financier just as each of the previous centers did, from Genoa to Amsterdam to London to New York. As architects of the most recent evolution of the systemic structure and holder of vast amounts of liquid assets, China appears likely to emerge from the current tumultuous economic conditions as the center of a new cycle of capital accumulation.

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