# The Big Picture: Britain and China and the future of capitalism

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This paper looks at the economic trajectory of Britain from the late 19th century to help understand how China is going to develop and what the future may hold for capitalism after globalisation. Although history does not repeat exactly in different countries one can see in British history the effects that followed from the demographic transition. These same processes will come into operation in China with major effects on the evolution of global capitalism.

## 1 Britain

In the UK the migration from country to town was effectively complete 100 years ago. As the proletarian population became more stable and hereditary, trades union organisation spread, strikes disputes became more common. It became harder for employers to expand their workforce at the old level of wages. This process was already underway in the 'Belle Epoche' just before the first world war, a period that saw the rapid spread of general trades unions. Earlier unions had be craft based, organising skilled labour. It now proved possible to organise unions among the the bulk of the working class, not just an aristocracy of skilled artisans.

The dynamic interaction of industrial capital and the banks polarises capital and precipitates out a class of rentiers. By the late Victorian era this process was well underway. A capitalist class whose grandfathers had been the pioneering cotton masters or iron masters of the industrial revolution had been transformed into a rentier class. Where frugality and accumulation had once been their watchwords, they now increasingly aped the lifestyles of their former political enemies, the landed aristocracy. Fortunes were spent constructing stately homes in the country and on employing retinues of domestic servants. With so much going on luxury consumption less was left for investment. The late Victorian rate of investment was low. Typically, less than 15% of profit was reinvested in new plant and equipment within the UK ( see Figure 1). Another factor offsetting domestic accumulation was overseas investment in the empire or semi-colonial countries like Argentine. British rentiers were indifferent as to where their investments occured so 15% underestimates their total capital accumulation.


Figure 1: The evolution of accumulation as a share of profit over a century in the UK: Michaelson et al. (1995).

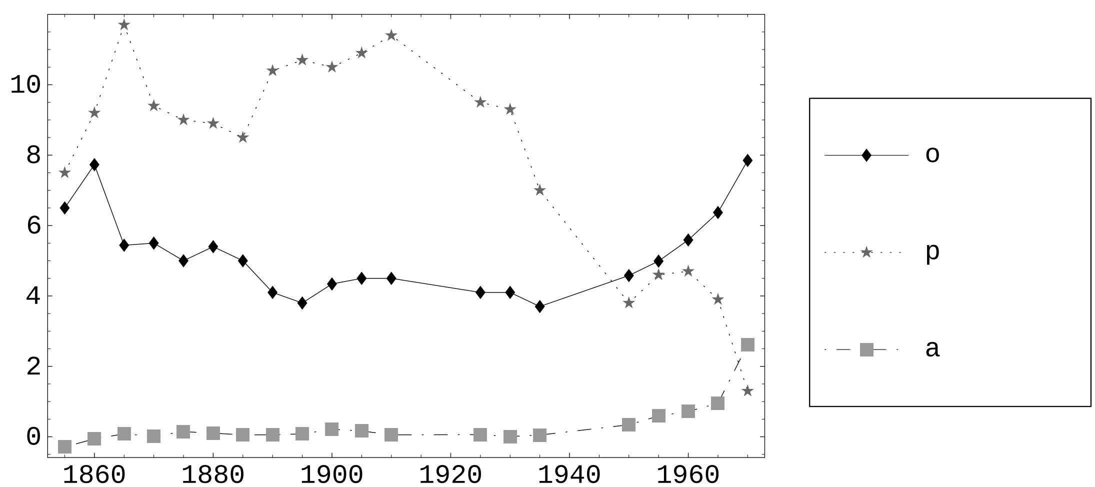


Figure 2: The evolution of organic composition of capital, profit rate and accumulation as share of profit in the UK 1855..1970: Michaelson et al. (1995).

**Digression 1.1** British monetary policy in Africa.

The essential interdependence of state and money is particularly clear in the history of empires. On conquering Africa, the Europeans face the problem that

> if the subsistence base was capable of supporting the population entirely, colonial subjects would not be compelled to offer their labor-power for sale. Colonial governments thus required alternative means for compelling the population to work for wages. The historical record is clear that one very important method for accomplishing this was to impose a tax and require that the tax obligation be settled in colonial currency. This method had the benefit of not only forcing people to work for wages, but also of creating a value for the colonial currency and monetizing the colony. In addition, this method could be used to force the population to produce cash crops for sale. What the population had to do to obtain the currency was entirely at the discretion of the colonial government, since it was the sole source of the colonial currency. (Forstater 2003)

Empire provided Britain's rentiers with a way to sidestep the demographic transition in the home country. New populations were brought into the cash economy as described in Digression 1.1. The Queen's African subjects could be exploited even more ruthlessly than those at home. By investing overseas rather than at home, the organic composition of capital in Britain (see Figure 2) was kept down. This prevented the main mechanism that Marx had forseen as bring down the rate of profit. Empire also allowed a more intensive exploitation of the domestic working class even while living standards rose.

Canada, Australia, New Zealand and Argentine provided cheap grain, meat, butter, and wool. West Africa provided edible oils, cacao and kola. The replacement of less productive British agriculture by Empire suppliers cut the number of hours of labour needed to produce the weekly groceries of the average working class family. As a result a wage sufficient to maintain the same, or even an enhanced living standard represented fewer hours labour. In 1875, the wage that the average worker got for a 10 hour day was able to purchase the product of 4 hours 40 minutes of labour. By 1910, the wage for 10 hours would purchase the product of only 4 hours and 5 minutes labour. The difference of 35 mins labour per day had been transfered to property income.

As a consequence of Empire, late Victorian and Edwardian profitability remained high through the British demographic transition. These economic gains came at a huge social and political cost. From the 1890s there was increasing rivalry between the main industrial powers of Europe : Britain, France and Germany. This was not a simple trade rivalry, but a rivalry over the control of African colonies. The ensuing arms race culminated in the catastrophe of the Great War.

Britania emerged victorious from the war. Her two main historical rivals Russia and Germany were abased, their military and economic power in ruins. George V was still on his throne as King Emperor whilst his fellows William and Nicholas lost their thrones or lives. But the prosperity of the pre-war period had

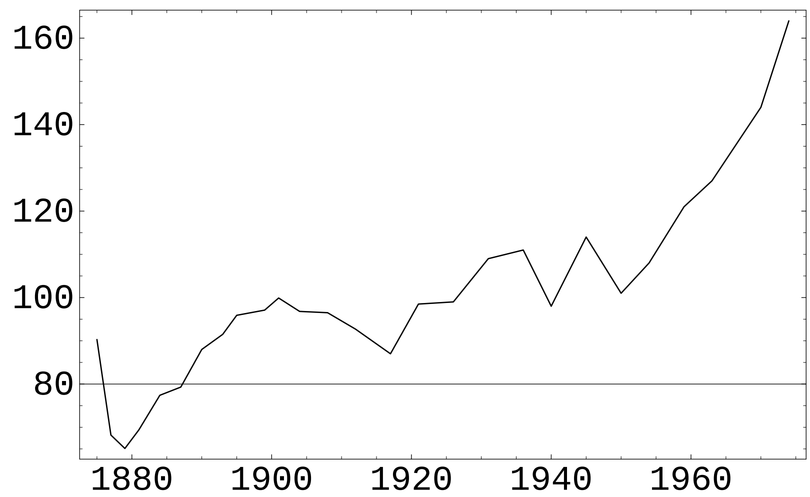


Figure 3: Index of real wages in the UK 1874..1974. Year 1900 wage rate taken as 100 : Michaelson et al. (1995).

vanished. As Keynes (1920) described the extent to which the war had disrupted the network of trade on which that prosperity had rested, and predicted the dire consequences of excessive reparations on the defeated powers.

The post war period saw an intense struggle between financial and industrial interests in Britain. The rentier interest had been weakened by the loss of overseas assets to fund the war. They were keen to restore their international position revaluing the pound. During the war the pound had been devalued and convertibility to gold suspended. The rentier interest, personified in Montague Norman, head of the Bank of England were determined that the gold standard be restored. We have argued earlier that money was an irreducibly political institution, an outgrowth of the state's commuting labour taxes to symbolic taxes in coin. The metallist school of economists stressed instead the need for money to be backed by gold or silver. This theoretical doctrine disguised a real economic constituency - that of creditors in general and banks in particular. We have argued that the rate of interest depends on the ratio of bank liabilities to monetary reserves. If reserves of state money are constrained to grow slowly relative to total bank deposits, then interest rates will be high, a larger share of total profits will be appropriated by banks and rentiers. If the state issues money more rapidly, bank reserves increase and interest rates fall.

By the 1844 Bank Act, the Bank of England had been prohibited from issuing notes faster than the growth of its gold reserves. The commercial banks held Bank of England notes and deposits as their own reserves. Thus the Bank Act indirectly limited the total reserves of the banking system. This tended to hold interest rates higher than they would otherwise have been. During the war, the

**Digression 1.2** Capital Exports

What does it mean to say that a country is a capital exporter?
In part the notion of capital export is simply a conceptual confusion. It is play on words associating the notion of export of goods with something else - the acquisition of capital assets in an other country. In certain circumstances capital 'exports' and exports of goods coincide. Consider Japan in the 1980s or '90s. It ran a large trade surplus exporting cars and electronic goods to the USA. The dollar surpluses built up by Japanese firms allowed them to invest in factories in the USA and buy up US companies - Sony buying into Hollywood for example. The trade surplus Japan runs with the USA is part of the surplus value produced by Japanese workers - value they produce but do not consume as part of their real wage. The productive assets aquired by Japanese firms in the USA are the capitalisation of this export surplus.
Late Victorian Britain is often refered to as another capital exporter. But unlike Japan a century later, it ran an almost continuous trade deficit, indicating that it was a net consumer of surplus value. Despite this British rentiers continued to build up their overseas portfolios. Britains trade deficit was financed by the repatriation of profits on these portfolios. In order for their portfolios to grow, it was enough merely to refrain from repatriating the entirety of the profit. The flow imperial of profit in and out of the City of London made the reflux look like 'capital export' even though it was just a reinvestment of surplus produced abroad.

Bank Act had been suspended, and Sterling ceased to be convertible to gold at the Bank. The economics and politics of the inter-war period were dominated by the struggle over the gold standard. The attempt by Churchill to restore the link to gold, led inevitably [1] both to recession and to hightened class conflict. The General Strike of 1926 followed as a direct consequence.

If the value of the pound was raised, prices had to be reduced. If industrial capital was to remain profitable in the face of high interest rates and falling prices, then wages had to be cut. The miners struck to resist these wage cuts. The TUC called a General Strike in solidarity. When the timid TUC backed down in the face of Churchill's opposition, and the miners eventually lost, there was a big shift in the share of national income going as profit. Between 1924 and 1930 the rate of surplus value rose from 113% to 145%. Deflation and high interest rates combined to crush accumulation ( see Figure 1).

The British rentier interest met a nemesis in the German National Socialism to whose birth its punative reparations had contributed. An even longer and costlier war ushered in the end of Empire. 1945 saw the election of a socialist government commited to Indian independence and a strongly progressive system of taxation. A large share of private overseas holdings had been requisitioned by the state during the war to finance imports from the USA. In consequence it was no longer possible for the country to cover a trade deficit by the repatriated

[1] As Keynes (1925) showed.

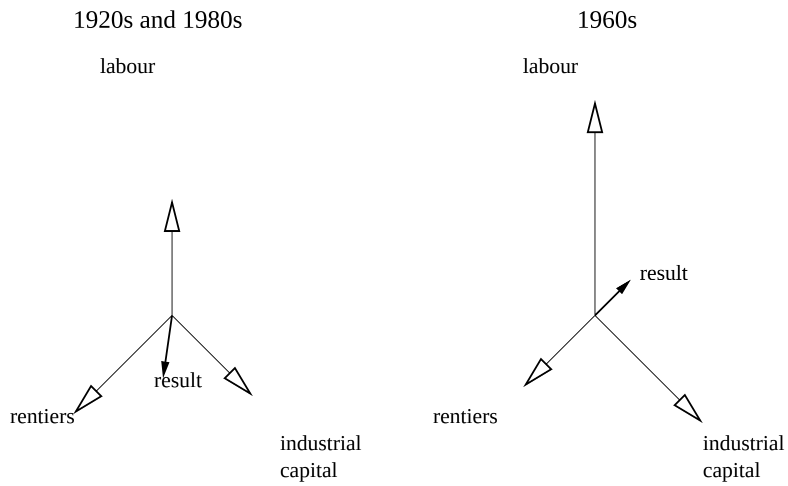


Figure 4: The political and economic forces acting in Britain at different points in time.

profits on overseas holdings. State economic policy was directed at restoring industrial production above all else, the interests of the City of London came much lower down the list of priorities than in the past. The deliberate devaluation of the Pound against the Dollar, a more rapid growth of the state monetary base, and a deliberate policy of stimulating industrial investment transformed the development of the economy. As Figure 1 shows, the rate of accumulation accelerated to previously unseen levels. For some 30 years from 1945 the state had a deliberate policy of maintaining full employment, attempting to stimulate demand and investment whenever unemployment threatened to rise. We can view labour, industrial capital, and the rentier interests as three vectors pulling in different directions, as shown in Figure 4. During the 1950s and 1960s the combined effects of labour and industrial capital predominated. Even a conservative leader like Macmillan was, due to his background in the industrial North, and his memories of the depression, more sympathetic to the industrial/labour axis than that of finance. Conservative and Labour governments continued to impose exchange controls limiting the outflow of capital.

Given that there were no significant reserves of agricultural population left - aside from marginal migration from Ireland, the rapid accumulation of capital combined with a much slower growth of the working population created social conditions that favoured the working class. Trades unions became much stronger and were able to gain consistent increases in real wages. Figure 3 shows how the rapid increase in wages during these 30 years was unlike anything that had gone before. If we compare Figures 3 and 1 we see that the rise in real wages almost exactly followed the rise in accumulation rates. Rapid accumulation increased the demand for labour and also raised labour productivity a combination highly

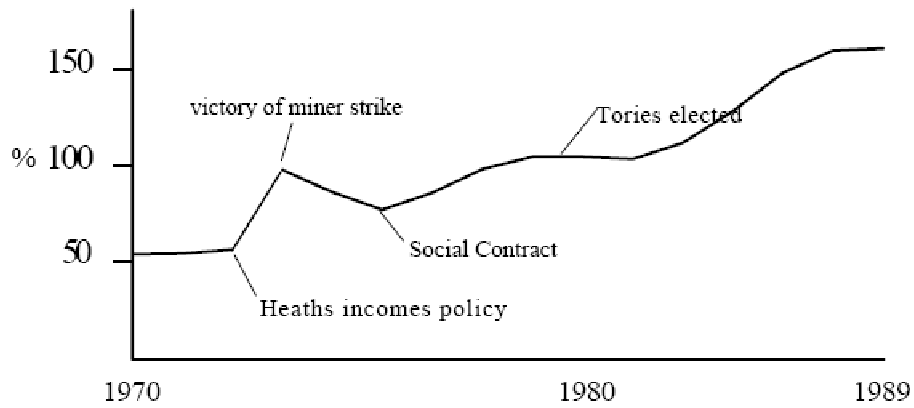


Figure 5: The trajectory of the rate of surplus value through and after the social crisis of the 1970s : Michaelson et al. (1995).

favourable to militant trades unionism. It also raised the capital labour ratio which, by the Marxian law of declining profits, caused the profit rate to plummet ( see Figure 2).

In Britain, the effects of demographic transition were delayed by half a century during which Empire and imperial wars held back domestic capital accumulation. When these brakes were removed, the law of the falling rate of profit re-asserted itself.

The falling rate of profit had, by the late 1970s, caused a general economic and social crisis. The bankruptcy of large sections of industry meant that major companies ( Rolls Royce, British Leyland, the steel and shipbuilding industries) had to be nationalised to keep production going. By 1973, capital accumulation stood at more than 400% of current profits. Profits were so low that accumulation relied heavily on state funded investment and on borrowing at what were, due to inflation, effectively negative interest rates. The capitalist system of production had reached its internal limits and Britain was sleepwalking towards a socialist economy. The old model of capital accumulation funded by rentiers via the stock market had ceased to operate. A politically directed process of accumulation funded out of taxation was replacing it.

It is the end point of capitalist development once the growth in the working population stagnates.

Of course we know that Britain today is quite different. The election of a conservative government in 1979 ushered in a determined attempt by the propertied interest to reverse this process. Monetary policies that had been discredited since the 1930s were reintroduced. Interest rates rose steeply and large sections of industry went bankrupt. Unemployment was now welcomed to weaken the power of labour. Anti Trades Union laws further reduced the bargaining position of workers. The combined effect was to increase the rate of surplus value, reduce the organic composition of capital and increase the rate of profit (Figure 5). The question is, why did these policies suceed in shifting the balance of social and political forces in British society?

There are several key reasons:

1. The global labour supply.
2. The discovery of oil in the North Sea.
3. Liberalisation of international capital movements.

**Global Labour Supply** Whilst labour supply had reached its limits in Britain, and similar demographic transitions were taking place in the other major economies of Western Europe, the same was not true of Asia. East Asia had huge reserves of labour. But these reserves were not effectively employable by European firms. Up until about 1980, China was completely off limits to Western investment. South East Asia was unattractive for investment because of the wars that had lasted from the Japanese invasion to the end of the 1970s. Communist insurgencies in Malaysia lasted down to the end of the 1950s, conflict between Britain and Indonesia lasted down to the late 1960s. South Korea and Japan although capitalist, were hostile to European investment. Only the remaining Imperial Colony of Hong Kong was open.

The 1980s saw huge changes. The Chinese government became pro-capitalist. The wars in South East Asia ended. It at last became possible to shift manufacturing from Britain, and later from other European countries to the East.

**North Sea Oil** In the period from 1945 to the 1980s, Britain had a constant struggle to maintain a positive balance of payments in international trade. Governments had to pay keen attention to fostering industrial production, as export industries were essential. The discovery of domestic supplies of oil transformed the balance of payments. The government could look with relative equanimity on the decline of key industries. Their exports were no longer needed.

Oil fueled trade surpluses allowed the City of London to once again build up its overseas investments. It began to have much more influence in shaping economic policy. The City also had indirect control over part of the oil surpluses of Gulf producers, who, lacking a sophisticated financial infrastructure of their own, deposited funds in London.

**Capital Movements** City lobbying led to the scrapping of UK exchange controls. From the '80s British governments launched an international diplomatic campaign to get other countries to follow suit. Capital became free to move to the new labour reserves.

Under these circumstances, industry and the industrial working class became effectively surplus to requirements. The City financial institutions on the other hand became even more important and influential than in the heyday of Empire.

Table 1: Growth in Chinese life expectancy over 50 years

| Year | 1955 | 1960 | 1970 | 1980 | 1990 | 2000 | 2005 |
|---|---|---|---|---|---|---|---|
| Life expectancy at birth | 40.8 | 44.6 | 59.6 | 65.3 | 67.1 | 69.7 | 71.0 |

## 2 China

The big story about the current world system is the entry of China and India as fully fledged capitalist economies. In these countries we see the same sort of rapid exponential growth that astonished continental observers of Britain in the early 19th century. These are economies undergoing a teenage growth spurt. They are economies currently free from the demographic constraint.

Suppose we have a 'typical' firm in China. Let us suppose that the firm makes a 10% profit on turnover. Suppose half of the profit is consumed by the owner and the other half retained for internal investment. Then ideally the firm should be able to grow at 5% a year. The capitalist sector of the economy can show sustained growth rates of this order for a few decades. As the typical firm grows, it takes on more staff, buys additional stocks of raw materials and purchases larger premises. Let us suppose that the number of workers it employs grows in line with its turnover at 5%. Now if something grows at 5% a year, it doubles in size roughly every 14 years. Suppose that in 1990 there were 200 million people employed in such Chinese firms. By 2004 it would have grown to 400 million.

Clearly even in the most populous country in the world this kind of growth rate could not continue much longer. Such rapid growth in employment depends upon the existence of a surplus population drawn in from agriculture. Historically peasant populations have had the relatively high birthrate necessary for survival in the face of severe infant mortality. The first phases of modernisation in China, under the Communist government of Mao were accompanied by public health measures : the provision of 'barefoot doctors', innoculation campaigns, measures to restrict inset pests, provision of clean water supplies. These produced massive improvements in infant survival rates and increased life expectancies (see Table 1).

This created an enormous surplus population that could potentially be drawn into industrial employment (see Table 2). Under the Mao government the policy had been to use this surplus labour in comunally owned rural agro/industrial complexes: the so called 'Peoples Communes'. These were run on socialist rather than capitalist lines, with members being paid in 'work points' for labour performed, rather than money.

Under subsequent governments the communes were dissolved and there was large scale migration to the cities and absorbtion of the surplus population into an expanding capitalist sectors. As people move into cites and become wage workers instead of peasants there are changes in the family structure. The family is no longer a unit of production that for whom children are additional

Table 2: China's population by age groups, 1950 - 2050

| | 1950 | 1995 | 2010 | 2025 | 2050 |
|---|---|---|---|---|---|
| Total | 556.7 | 1,226.7 | 1,380.5 | 1,488.1 | 1,484.4 |
| 0 - 4 | 76.2 | 103.7 | 92.7 | 86.3 | 78.1 |
| 5 - 19 | 165.0 | 319.6 | 290.4 | 278.1 | 245.6 |
| 20 - 49 | 228.4 | 594.7 | 665.0 | 597.9 | 529.7 |
| 50 + | 87.1 | 208.8 | 332.4 | 525.8 | 631.0 |

Future years derived from United Nations Population Projection, 1998 Revision, Medium Variant (million)

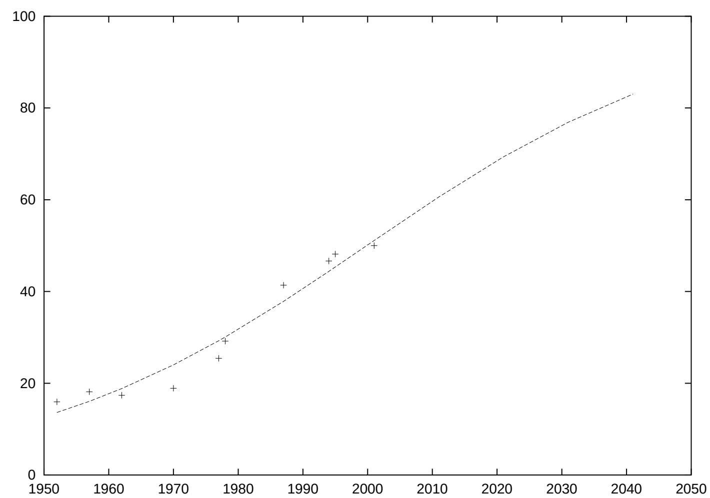


Figure 6: Growth of the non rural percentage of the Chinese working population. Figures after 2001 are projections using a logistic curve. Original data from: http://www.eco.rug.nl/˜maddison/china_book/chap_3_tables/table3.17.pdf.

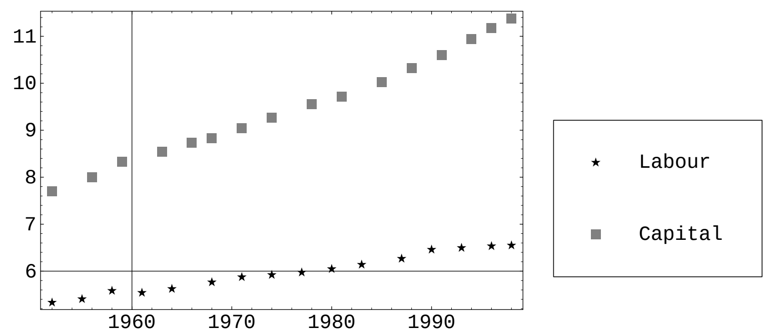


Figure 7: Growth labour force and capital stock in China on a log scale. Note that the growth slope of the capital stock is higher than that of the labour force. Derived from Li (2003).

labour. Industrial society demands that children go to school and be financially supported by their parents. After a generation or so working-class families end up being smaller, the population growth slows down and migration to the cities becomes less significant. Table 2 and Figure 6 shows how this process is developing in China. The demographic transition there has been accelerated by the one-child family policy, but earlier capitalist countries went through an analogous demographic transition. Notice how in China the most economically active section of the population will peak within the next decade. Migration to the towns will continue well into the middle of the century, but it should be noted that the degree of urbanisation of a country is just a proxy for its degree of proletarianisation. A portion of the rural population in China is employed in village enterprises as described for instance by Pan and Park (1998). In 2002 of the 489 million people economically active in rural areas 132 million worked in village enterprises. These enterprises are successors to the industrial parts of the communes and are still collectively owned. This portion of the rural population is not available to the capitalist economy, so Figure 6 understates the degree to which the labour reserve has been used up. In 2002 some 324 million Chinese were still farmers some 50% of the workforce by 2004 this had dropped to 47%. If the shift from agriculture to industry continues at this rate, and the economically peaks by 2025, then latent reserves of labour in China will be substantially exhausted in the next 20 years.

The long term rate of profit in an economy is determined by the relative rates of growth of the labour supply and the capital stock. Figures for capital stock are not given in the China Statistical Yearbook, but they can be infered from published data on investment. Li (2003) has estimated time series for the relative growth of capital stock and the labour force in China up to 1998. Figure 7 plots his data on a log scale to show the comparative rates of growth of the two variables. It can be seen that the trend rate of growth of capital stock was higher than that for the labour supply[2].

| Year | Capital Per Worker in 1978 Yuan |
|---|---|
| 1958 | 1350 |
| 1978 | 3537 |
| 1998 | 12537 |

Since 1998 the rate of capital formation has accelerated. In 1998 37% of GDP was going as capital investment, by 2004 that had fisen to 44%. In the first four months of 2006, investment was 1800 Billion Yuan against a total value of industrial output of 2461 Billion Yuan for the same period. Thus investment comprised an extraordinary 73% of industrial output. The rate of growth of industrial out put was 17%. This is a remarkable rate of growth of output by any measure, but a declining return on capital is evident. In 2004 capital formation was had grown by a factor of 10.1 over 15 years, national income had grown by a factor of 8.2. Higher rates of investment were not brining proportionate growth in the value of output. By 2006, to maintain that annual growth rate of 17% in output, capital investment was having to grow at an annual rate of 30%. China's rate of capital formation can not go much higher. China's rapid growth incidentally verifies Kalecki's thesis that investment is self financing. As the rate of investment has risen so too have the profits necessary to fund it. The role of foreign capital and of state appropriations as sources of funds has shrunk.

As the Chinese economy exhausts its supplies of peasant labour, the widespread but relatively isolated labour militancy of today can be expected to coalese into a powerful trades union movement. Real wages have been rising fast already, and this will continue. The very rapid high share of profits being accumulated will depress the proportional rate of return on capital. The profitability margin attracting capital from Europe to China will then become less marked. Faced with declining rates of return at home Chinese firms will look abroad for investment opportunities in the comming decade. The Chinese purchase of IBMs PC division, and of the remains of the UK car industry are early harbingers. China's trade surpluses mean that it is already in a position to be a substantial capital exporter. The process that occured with Britain in the 1880s or Japan from the 1980s onwards as these countries labour reserves were used up, shows us what to expect.

The critical difference between successive capital exporters is in their sizes. Japan was bigger than Britain, China is an order of magnitude larger than Japan. When it tries to become a major capital exporter the remaining underdeveloped parts of the world able to absorb that capital will be relatively small. China will of course export capital to Africa - probably comming to dominate it as much as Europe once did. South America too, will be a destination. As was the case with European imperialism a century ago, these exports will initially

[2]Li's data gives what Marx called the 'mass of capital' employed per worker since it measures capital in constant 1978 prices. This rise in the mass of capital need not imply a rise in the organic composition of capital, since the amount of capital invested as wages may have gone up comparably.

concentrated on the production of the raw materials needed to feed Chinese industry. Textiles, garments and toys will follow.

Since the 1980s the threat of jobs being exported to China has been held over European and American unions. In the 2020's Chinese labour unions would be less intimidated by the threat of jobs moving to Africa. Compared to Asia, Africa's labour reserves are modest. The international weakness of the labour movement since the '80s has stemmed from a glut of labour power on the world market. China's stupendous capital accumulation is rapidly reversing the balance. Capital not labour will soon be abundant. The processes that led to the European social crisis of the 1970s will, half a century later start to be replicated across Asia. Wages will tend to rise as a share of national income. The rate of return of capital will fall.

A fall in profits relative to interest rates provokes a polarisation of capital into debtor and creditor firms. A proportion of firms is pushed towards formal insolvency. If enough do go insolvent, there is a big recession.

China is governed by a Communist Party. It is a Communist Party that allows large scale capitalist development, and one whose leading members are closely linked to capitalist business. But it is also a Communist Party that has delivered sustained increases in wages and employment. There has never been a recession in the years since they abandoned Maoism and turned to the market. A big recession like the 1930's in America would be political dynamite. To prevent it the Chinese central bank will be under pressure to hold down interest rates.

Japanese experience shows the ultimate limits of such a course. Firms whose debts would otherwise have led them to collapse, remain trading. Bad or irrecoverable debts have come to dominate the balance sheets of Japanese banks. The same will happen in China. The state will, as happened in Britain, will have to nationalise, or in the Chinese case, re-nationalise, leading industries.

With wage rates are no longer held down by competition from peasant migrants, one could see the sort of wage inflation that was common in the West during the 1970s. Back in the 19th century British wages were regulated by cyclical recessions. Each recession drove down wages, which then rose again during the boom period. But this was in a very class divided society, one where the working class did not have the vote. With a universal franchise, severe recessions give opportunites to those who promise remedial action. Think of Roosevelt and Hitler. The alternative to recession is political regulation of wages. Many European economies experimented with prices and incomes policies during the 1960-70s The state set a maximum rate of wage increase and some cases regulated the prices of key consumer goods. The aim was to increase the share of national income going in profits.

Such incomes policies are highly political. They are only imposed because of the real economic power of labour. They can only be justified by appeals to fairness and social solidarity. Profit incomes, which in the case of unregulated capitalism appear the natural return to risk or enterprise, are shown up as being inversely related to wages. The distribution relations that underpin capitalist society are exposed on the surface of politics. This raises political demands for the taxation or regulation of profit incomes. The only social justification for profit is its role in funding investment. Where, as in China today, profits are associated with rapid economic growth and generally rising incomes, their legitimacy will be at least grudgingly accepted by the majority. If firms stop investing, and at the same time wages are regulated by the state, capitalism's political credit begins to run out. As the current cycle of global economic development, the cycle that started with the opening up of China, draws to a close, the capitalist social order will face economic and political crisis on a global scale. The issue of alternative ways of regulating the economy, alternatives forgotten since the end of the USSR will have to be faced.

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