LECTURE 3: MEASURING THE WEALTH OF NATIONS

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Introduction

• Political economy was born in the 19th century when moral philosophers began to ask questions about:
  • How nations prosper?
  • How do nations accrue their wealth?
  • How should this wealth be distributed?
  • What are the determinants of capitalist development?
  • What’s the relationship between the state and the market.

• Piketty’s contribution to political economy is to provide us with 200 years of data on income and wealth distribution.
  • His conclusions are clear. We are experiencing levels of inequality not seen since the patrimonial societies of the 19th century.

• But before we analyze this history of capitalist development we need a clear measure of things:
  • Wealth and income
National income

- National income can be broken down:
  - Labour income (wages, salaries, bonuses)
  - Capital income (rent, dividends, interest, profit, royalties)
  - National income = labour + capital income.
  - National income = the total amount of money *earned* in a nation.

- Income that is accrued in time can be either *spent* or *saved* (re-invested).
  - Albeit at very different *interest* rates.

- Wealth that is not immediately consumed = real capital

- Unearned income is the interest/rent accrued from owning property or financial assets. This is what concerns Piketty.
Household income distribution in Ireland

Chart 1: Distribution of Market Income, individuals in 2013

- 15% of individuals earning below €23,701
- 50% of individuals earning below €2,042
- Top 10% earning above €150,000

Median income: €23,701
Mean income: €2,042
Capital/wealth

- Wealth is the sum total of non-human assets that can be exchanged on some market. Market value.
  - What decides the value of a Damien Hirst artwork?
  - Who decides the price of Apple stocks?

- Capital/wealth is the sum total of non-financial assets (land, buildings, real estate, machinery) and financial assets (stocks, bonds) less debt in a given nation.

- In any given nation, the stock of capital can be public or private:
  - National capital = public and private capital.

In our societies, capital is almost entirely privately owned.
Household wealth in Ireland
Capital/income ratio

- The capital/income ratio is the total amount of capital divided by total yearly income ($\beta$).
  - If a country's capital stock is equal to 6 years national income we write $\beta = 600\%$.

- When the rate of return on capital exceeds economic growth the capital/income ratio grows ($R>G$).
  - This is heavily correlated with national savings rates.

- A high capital/income ratio is not a bad thing in itself. We all want to live in wealthy societies.
  - What matters is how it is distributed!
The fluctuations of national capital in the long run correspond mostly to the fluctuations of private capital (both in Europe and in the U.S.). Sources and series: see piketty.pse.ens.fr/capital21c.
Rate of return

• How do we calculate the rate of return on capital?

• Piketty finds that average economic growth rates = 1-2% whereas the average rate of return on capital is 4-5%

• Slow growth economies are capital-wealth dominated societies.
The growth rate of world output surpassed 4% from 1950 to 1990. If the convergence process goes on it will drop below 2% by 2050. Sources and series: see piketty.pse.ens.fr/capital21c.
Figure 10.10. After tax rate of return vs. growth rate at the world level, from Antiquity until 2100

The rate of return to capital (after tax and capital losses) fell below the growth rate during the 20th century, and may again surpass it in the 21st century. Sources and series: see piketty.pse.ens.fr/capital21c
Discussion

• To understand these concepts think about the Jane Austen novel ‘Pride and Prejudice’. Or the film.

• The aristocratic characters constantly remark that the rate of return on land in their rural societies was 4-5%.
  • The landed English gentry are perfectly aware how much they need to own (or marry into) if they are to live well.

• This is unearned income or ‘rent’ accrued from owning land (rather than employment or entrepreneurial activity).
  • Piketty argues that we are returning to this ‘patrimonial capitalism’.

• Why might this be a problem for democracy?