LECTURE 7: CRITICAL POLITICAL ECONOMY

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Introduction

- Political economy is interested in
  - Power (within whose interests does a given policy regime serve?)
  - Institutions (what are the rules of the game that shape and constrain behavioral choices?)
  - Distribution (who gets what, when and how?)
- This began with Smith but took a critical turn in 1867
  - Karl Marx and the publication of *Das Kapital*
- Think about 1867 – what was happening across Europe?

Historical context

- 1848 The European revolutions
  - Same year Marx wrote the Communist manifesto
- Think about wages, rent, profit in national income (Smith)
  - New emergent industrial class structure
- Charles Dickens published Oliver Twist in the same period
  - Rising poverty
  - Stagnant wages
  - Rising profit
- Marx set out to scientifically study capitalism

Das Kapital

- He sets out to systematically analyze the internal logical contradictions of the system using:
  - The Hegelian dialectic method
- He accepts the Smithean argument on markets and proceeds to deconstruct it entirety.
- For Marx competitive markets lead to
  - The centralization if capital (big firms eat little firms)
  - The concentration of capital (class power)

The theory (M-C-M)

- The capitalist starts out with money (M)
- He then purchases two commodities: labour power (L) and means of production (P)
- He puts these to work using a given technology to produce a commodity (C).
- This is then sold in the market place with a surplus to make a profit (P)

The theory (M-C-M)

- But the capitalist does not consume everything. He must reinvest and expand the M-C-M production.
- Why? For Marx the *coercive laws of competition* compels the process of infinite accumulation.
- If the market system is crisis free (equilibrium) then there would be no problem.
  - But for Marx the system inevitably leads to crises.

5 crises tendencies

- Money - where does it come from?
  - Secure the legal apparatus of state
- Labour - how to source supply and demand?
  - Weaken unions and collective bargaining
- Environment - how to deal with scarcity?
  - Extract raw materials
- Technology - the falling rate of profit?
  - Invest in technology
- Debt – how to keep the system liquid?
  - Ensure aggregate demand

Discussion

- What did Marx get right?

- What did he get wrong?

- In the 20th century, the narrative of capitalist development went from apocalyptic endings to happy endings, why?

Simon Kuznets

- Simon Kuznets published an important paper in 1955 titled "*economic growth and income inequality*".
  - A rising tide lifts all boats.
- Capitalist development initially creates inequalities but market competition equalizes.
- Balanced growth path.
- This was the period of Keynesian macroeconomic demand management:
  - Commitment to full employment
  - Commitment to social protection

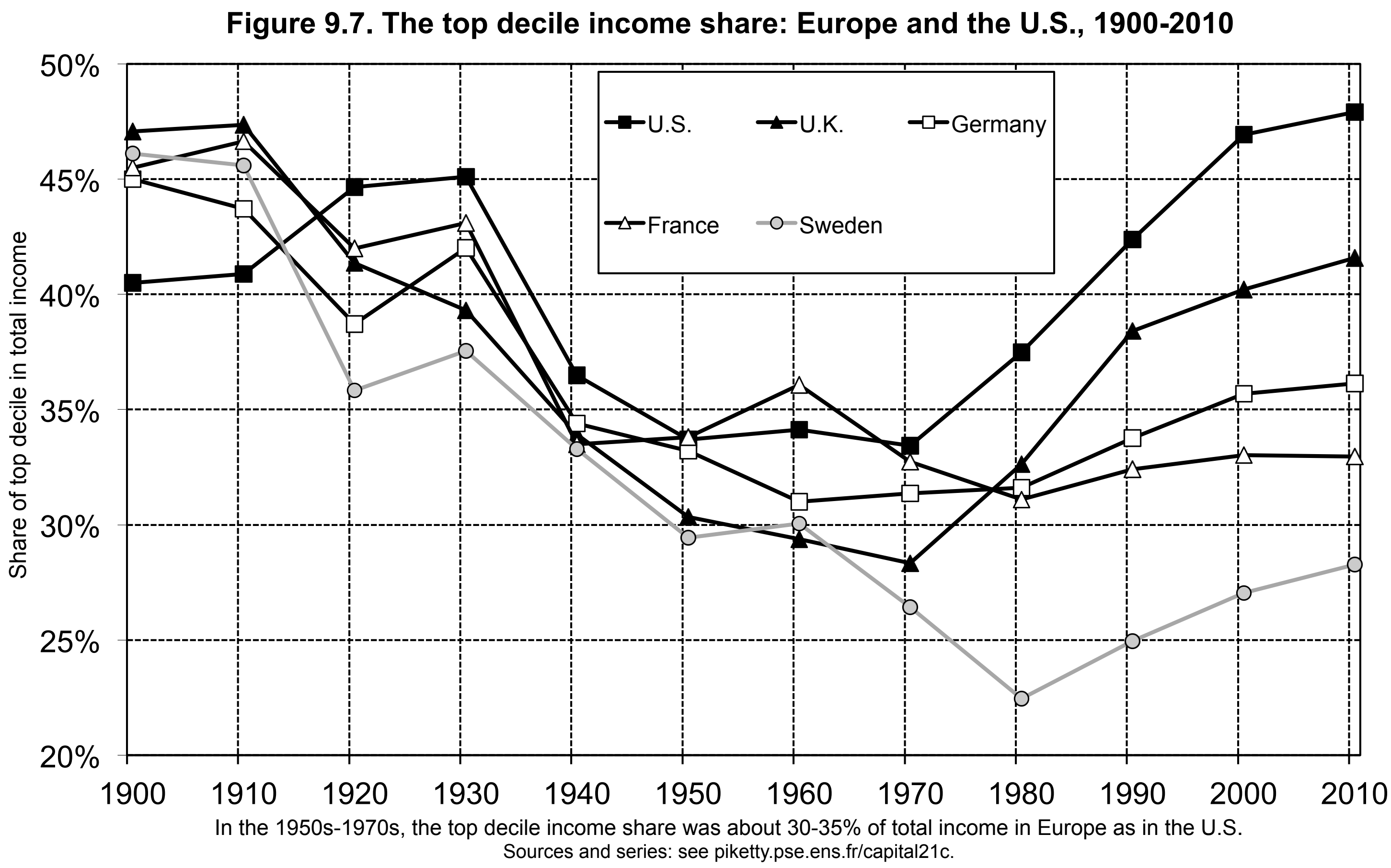
Theory

- Kuznets observed a sharp decline in income inequality in the USA between 1913-1948.
- In 1913 - the top decile claimed 45-50 percent of national income.
- By 1948 - this had declined to between 30-35 percent.
- The Kuznets curve - economic growth initially creates inequalities but then acts as a force of equalization.

Context

- Policymakers jumped at the findings and it subsequently shaped the debate on US distribution. Why?
- The debate was influenced by the Cold War. Capitalism was benefitting everyone, communism was not.
- The West needed to legitimate a new macroeconomic policy regime – Social/Christian Democracy + Keynesianism
- Piketty has developed Kuznets data (and scientific method) to expand the data to 20 countries over 200 years.
- He argues that Kuznets was wrong, and that the golden age of social democratic capitalism was short-lived.

Top decline income share



The great wealth divide

Table 7.2. Inequality of capital ownership across time and space

Share of different groups in total capital	**Low inequality** (never observed; ideal society?)	**Medium inequality** (≈ Scandinavia, 1970s-1980s)	**Medium-high inequality** (≈ Europe 2010)	**High inequality** (≈ U.S. 2010)	**Very high inequality** (≈ Europe 1910)
The top 10% "Upper class"	**30%**	**50%**	**60%**	**70%**	**90%**
including: the top 1% ("dominant class")	*10%*	*20%*	*25%*	*35%*	*50%*
including: the next 9% ("well-to-do class")	*20%*	*30%*	*35%*	*35%*	*40%*
The middle 40% "Middle class"	**45%**	**40%**	**35%**	**25%**	**5%**
The bottom 50% "Lower class"	**25%**	**10%**	**5%**	**5%**	**5%**
Corresponding Gini coefficient (synthetic inequality index)	0.33	0.58	0.67	0.73	0.85

In societies with "medium" inequality of capital ownership (such as Scandinavian countries in the 1970s-1980s), the top 10% richest in wealth own about 50% of aggregate wealth, the bottom 50% poorest about 10%, and the middle 40% about 40%. The corresponding Gini coefficient is equal to 0.58. See technical appendix.

Conclusion

- For Piketty, wealth inequality is growing because capital income is accumulating faster than economic growth (R>G).
- This can be measured by rising capital/income ratios.
- This means he certainly sides with Marx on the question as to whether markets left to their own devices produce inequality.
- But he differs in proposing a fiscal solution.
- Next week we are going to look at the structural transformation of capital/wealth from 1870-2010 in
  - Britain, France, Germany and the USA
- Please read chapters 3, 4, 5. P 113-164