WEEK 4: THE RISE OF DEMOCRATIC CAPITALISM

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Introduction

• When financial markets are left to their own devices they will produce the inequality $R > G$.
  • This increases the wealth/income ratio.

• Remember: the total amount of capital stock divided by national income gives us the wealth/income ratio ($\beta$).

• If the total capital stock is equal to 6 years of national income then we write $\beta = 600\%$.

• In the low growth zero inflation economies of the 19th century, wealth was accrued through land/government bonds
  • Has capital become more entrepreneurial in the 21st century?
Public/private wealth

• The purpose of owning a capital asset has not changed. It is to produce a reliable steady income flow.

• A government bond is a claim of one portion of the population from another portion of the population.
  • Those who lend to government and those who re-pay in taxes.

• For Piketty capital at its inception is always risky and entrepreneurial but evolves into rent as fortunes grow.
  • Père Goriot the pasta manufacturer in Balzac.
National capital is worth about 7 years of national income in Britain in 1700 (including 4 in agricultural land).
Sources and series: see piketty.pse.ens.fr/capital21c.
National capital is worth almost 7 years of national income in France in 1910 (including 1 invested abroad).

Sources and series: see piketty.pse.ens.fr/capital21c.
Britain/France

1. The capital/income ratio follows a similar U-shaped curve (it fluctuates between 6-7 to 2-3 to 6-7 times national income). These are very large swings.

2. Despite the long-term stability of the capital/income ratio the composition has totally changed (the collapse of farmland and rise of housing and financial capital).

3. Net foreign capital is no longer significant (reflecting the end of colonialism and imperialism).

• We need to discuss whether capital is public or privately owned.
Figure 3.3. Public wealth in Britain, 1700-2010

Public debt surpassed 2 years of national income in 1950 (vs. 1 year for public assets).

Sources and series: see piketty.pse.ens.fr/capital21c
Figure 3.4. Public wealth in France, 1700-2010

Public debt is about 1 year of national income in France in 1780 as in 1880 and in 2000-2010.

Sources and series: see piketty.pse.ens.fr/capital21c
Public debt

- Britain and France offer two different case studies on the relationship between public debt and private capital.

- After the Napoleonic wars and WW2, Britain never defaulted (even with a debt/GDP ratio of 200%).

- After 1798 and WW2 France cancelled all public debt, raised wealth taxes and created a large public sector.

- Important point: public debt is a vehicle for redistribution whether it is repaid or not.

- What is Irish public debt? How much does it cost to service? Why did Irish public debt skyrocket after 2010?
Public wealth

• Public assets rose from 50 to 100% of national income during the interventionist Keynesian years (1950-1970).

• Governments owned around 30% of national wealth.

• In France this economic system is often referred to as ‘dirigisme’ – capitalism without capitalists.

• The rise of national models of mixed market capitalism: Rhenish, Rehn-Mender, Dirigisme, Anglo-Saxon.

• Later: social democratic, conservative and liberal
Inflation

- In the 20th century most European governments reduced their public debt through inflation.

- From 1914-1950 inflation was 13 per cent per annum in France and 17 per cent in Germany.

- Britain only reduced its post-war debt when it experienced high-inflation during the 1970’s.

- Inflation is also a vehicle (albeit an inefficient one) of redistribution.

- Why is the ECB - and Euro policy makers – trying to encourage higher rates of inflation today? Where is the inflation?
Figure 4.1. Capital in Germany, 1870-2010

National capital is worth 6.5 years of national income in Germany in 1910 (incl. about 0.5 year invested abroad). Sources and series: see p2kett.pse.ens.fr/capital21c.
Germany

- The trend is much like France and Britain. Agriculture has given way to residential and commercial real estate.

- But the capital/income ratio is around 4 times national income.

- Unlike most countries Germany now has a net foreign asset position (equal to 50% of national income).

- Lower wealth/income ratio can be explained by lower stock market valuation and stricter rent controls.

- The stakeholder variant of capitalism. Property is a legal-social construct, and therefore, property rights vary.
The fluctuations of national capital in Europe in the long run are mostly due to the fluctuations of private capital.

Sources and series: see piketty.pse.ens.fr/capital21c.
To recap

- National capital (wealth) is equal to $\frac{6}{7}$ times income in most European countries.
  - National income is $2.5$ trillion in France so multiply it by 6.

- The ratio has remained stable since 1800 but the composition has fundamentally changed.
  - With the exception of the 1950-1980 capital shock.

- What explains this shock to capital and wealth in the 20th century in Europe?
  - How does it relate to the USA?
Figure 4.5. National capital in Europe, 1870-2010

National capital (sum of public and private capital) is worth between 2 and 3 years of national income in Europe in 1950. Sources and series: see piketty.pse.ens.fr/capital21c
The shock to wealth in Europe

- The drop in the value of capital in Britain, France and Germany was equal to 4 years national income.
  - Only a quarter of it can be explained by physical destruction.

- The budgetary and political shocks were far more destructive than combat itself (rent controls).
  - Decline in real estate and stock market prices = 25-33% of decline
  - Low national savings, loss of foreign assets and physical destruction = 66-70% of decline.

- It was a dark time for the wealthy in Europe.
The impact of politics

- The Bolsheviks defaulted on French loans
- Nasser nationalized the Suez canal
- Wealthy Britons forced to sell foreign assets
- Lenders to governments expropriated by inflation
- Wall street crash wiped out stocks and bonds

Then, post-1950 new fiscal policies were introduced to weaken the economic power of capital-asset holders.
  - Rent regulation (historically low real estate prices)
  - Capital/wealth taxation (dividends and bonds)
  - Nationalization of industries and banking (Renault)
  - Keynesian demand management (aimed at full employment)
  - Collective bargaining legislation (stronger trade unions)
The birth of the social state

Figure 13.1. Tax revenues in rich countries, 1870-2010

Total tax revenues were less than 10% of national income in rich countries until 1900-1910; they represent between 30% and 55% of national income in 2000-2010. Sources and series: see piketty.pse.ens.fr/capital21c.
Think about change in terms of…

- **Interests**
  - Electoral/voters (party politics)
  - Producer groups (collective associations)
  - Structure of labour market

- **Institutions**
  - Political parties
  - Welfare state
  - Collective bargaining

- **Ideas**
  - Keynesian demand management
  - Memory of war and class conflict
  - Nation-state oriented economies
Figure 4.6. Capital in the United States, 1770-2010

National capital is worth 3 years of national income in the United States in 1770 (incl. 1.5 years in agricultural land). Sources and series: see piketty.pse.ens.fr/capital21c.
USA

• Why was capital worth 7 times national income in France in 1810 but only 3 times national income in the USA?
  
  • Volume effect of huge amounts of land reduced prices
  • The population was predominately made up of immigrants
  • Accumulated wealth (inheritance) was less important
  • The Jeffersonian ideal - almost anyone could become a landowner

• Stronger population growth = lower capital/income ratios

• By 1910 capital/wealth had accumulated to 5 times national income.
Post-war changes

- Capital/income ratios were much more stable compared to the post-war shocks in Europe.

- But much like in Europe, under Roosevelt public policies aimed at reducing the influence of private capital:
  - No nationalizations but mass public investment in infrastructure
  - Introduction of progressive taxation (much more than in Europe)
  - Introduction of rent controls
  - Private wealth declined by 2.5 times national income by 1970
Public/private wealth

Figure 4.8. Private and public capital in the U.S., 1770-2010

In 2010, public capital is worth 20% of national income, vs. over 400% for private capital.

Sources and series: see piketty.pse.ens.fr/capital21c
The role of slavery

• In 1800, slaves represented 20 percent of the US population:
  • roughly 1 million slaves out of a total population of 5 million.

• In the South, slaves represented 40 percent of the population:
  • roughly 1 million slaves out of a population of 2.5 million.

• By 1860 the slave population had fallen to 15 percent or 4 million slaves in a population of 30 million
  • Primarily due to population growth in the north

• In the South it remained above 40 per cent.
Figure 4.10. Capital and slavery in the United States

The market value of slaves was about 1.5 years of U.S. national income around 1770 (as mush as land).

Sources and series: see piketty.pse.ens.fr/capital21c.
Figure 4.11. Capital around 1770-1810: Old an New World

The combined value of agricultural land and slaves in Southern United States surpassed 4 years of national income around 1770-1810. Sources and series: see piketty.pse.ens.fr/capital21c.
USA

• Slaves represented 1.5 years of national income in the early 19th century
  • this is equal to the total value of farmland.

• Slave-owners in southern states controlled more wealth than the aristocratic landlords in old Europe.
  • The North (land capital), the South (slave capital)

• Does this explain the absence of popular support for the development of a European-style welfare state?
Conclusion

• Prior to WW1, capital was highly concentrated in a few assets, and within a small class of people.

• The shocks of WW1, the interwar period, and WW2, radically changed the trajectory of capitalist development.

• Post WW2 – with the birth of democratic capitalism, taxation, and the social state, countries witnessed the emergence of a property owning middle class.

• Next week, we’ll discuss the the return of private wealth, globalisation, and the return of neoliberal capitalism.