WEEK 5: THE RETURN OF NEOLIBERAL CAPITALISM

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Introduction

- We will seek to answer 3 questions this week:

1. What explains the **politics** of the structural shift from ‘Keynesianism’ to ‘Neoliberalism’ in the 1980’s?
   a. From embedded to disembedded liberalism
2. Why has the wealth/income ratio returned to historically high levels?
   a. What are the long term determinants of wealth/income ratios?
3. Why is it structurally higher in Europe than the US?
4. What does this suggest about the future trajectory of capitalist development?

Note

- I use the term “neoliberal’ to empirically describe the macro-paradigm shift in economic policymaking
  - Macroeconomic
  - Fiscal/Monetary
  - Labour market
  - Employment

- In terms of **income distribution**, the core idea is that the market allocates income on the basis of worth.
  - Remove barriers to labour market clearing.
- In terms of **employment**, the core idea is that markets allocate resources (labour/capital) efficiently.
  - Remove barriers to labour market clearing

More specifically

For market liberals, **rising income inequality** is a function of the market paying people what they're worth.

For Keynesians, it is because the balance of power in labor markets has tilted in favor of business.

Underpinning both perspectives are distinct **ideas,** which benefit distinct economic **interests**.

These are baked into different **institutional** formulas.

The institutional formulas of the Keynesian era

Production regime

- Mass production (Fordism)

Labour regime

- Organised collective bargaining

Socio-economic regime

- Keynesian welfare state

International regime

- Bretton Woods/EEC

The underlying politics

- Memory of war/class conflict
  - Democratisation
- Economic ideas of state activism
  - Commitment to full employment
-
- Electoral partisan competition
  - Mass parties: Centre-left/centre-right
- Unidimensional left/right
  - Class politics/welfare state
- Gendered labour market

The institutional formulas of the neoliberal era

Production regime

- Shift to services/ICT

Labour regime

- Individual based/firm-level

Socio-economic regime

- Supply-side reforms/austerity

International regime

- Liberalisation/floating exchange rates/EU

The underlying politics

- Memory of stagflation/oil crisis/worker power
- Economic ideas of less state, more market competition
  - Technocratic/rules based decision making
- Electoral partisan competition
  - Decline of the mass party
  - Media/PR focused politics
- Multidimensional electoral space
  - Increased salience of identity politics
- Increased female employment participation rates

But… why? !

- Increased volume of jobs, but higher levels of *economic inequality*.
  - Is there a trade off?

- Globalisation and socio-structural change leading to:
  - Socio-economic change - occupations, class, jobs
  - Socio-cultural change - identity, immigration, gender

- Skills-based technological change (SBT) - a story of markets.
- Power-resource bargaining power (PRB) - a story of politics.

- Then came the great financial crash….. what next?
  - Think about Karl Polanyi.

- A return to more protectionism and the nation-state?

Determinants of wealth/income ratio

1. Slower growth and higher savings (primarily retained corporate earnings)
   - Long-term

2. Privatizations of public wealth since the 1970's
   - Short-term

3. Acceleration of real estate and stock market prices since the 1990's (asset booms/busts).
   - Short-term

Determinants of β

- Piketty's 'law' of capital states that the capital/income ratio is related to the savings rate and the growth rate.
- $\beta = s/g$

- β = capital/income ratio
- S = savings rate
- G = growth rate

- If a country saves 12% of its national income and it's economy is growing by 2%, $\beta = 600\%$

Low growth = higher W/Y ratio?

- Decreased growth (especially population) and a higher savings rate (households & corporate) is partially responsible for the return of private capital
  - And the variation between Europe and USA
- If growth falls to 1% and the savings rate equals 12% then β= 1200%. This would suggest a lot of hoarding.
- Conversely if growth increases to 3% and the savings rate equals 12%, what will β equal?

The case of Ireland

- But does more capital not mean more/better investment?
- From 2000-2008 the total capital stock for investment increased from 228bn to 447bn.
- 72% of the increase went into housing (188bn).
- Of the 50bn that went into productive investment 75% was coordinated by the public sector - the state! (33bn)
- Productive private sector investment made up a meagre 17bn. In terms of bank lending, less than 1% went to R/D.
  - The data suggests that the state is better at investing in innovation.

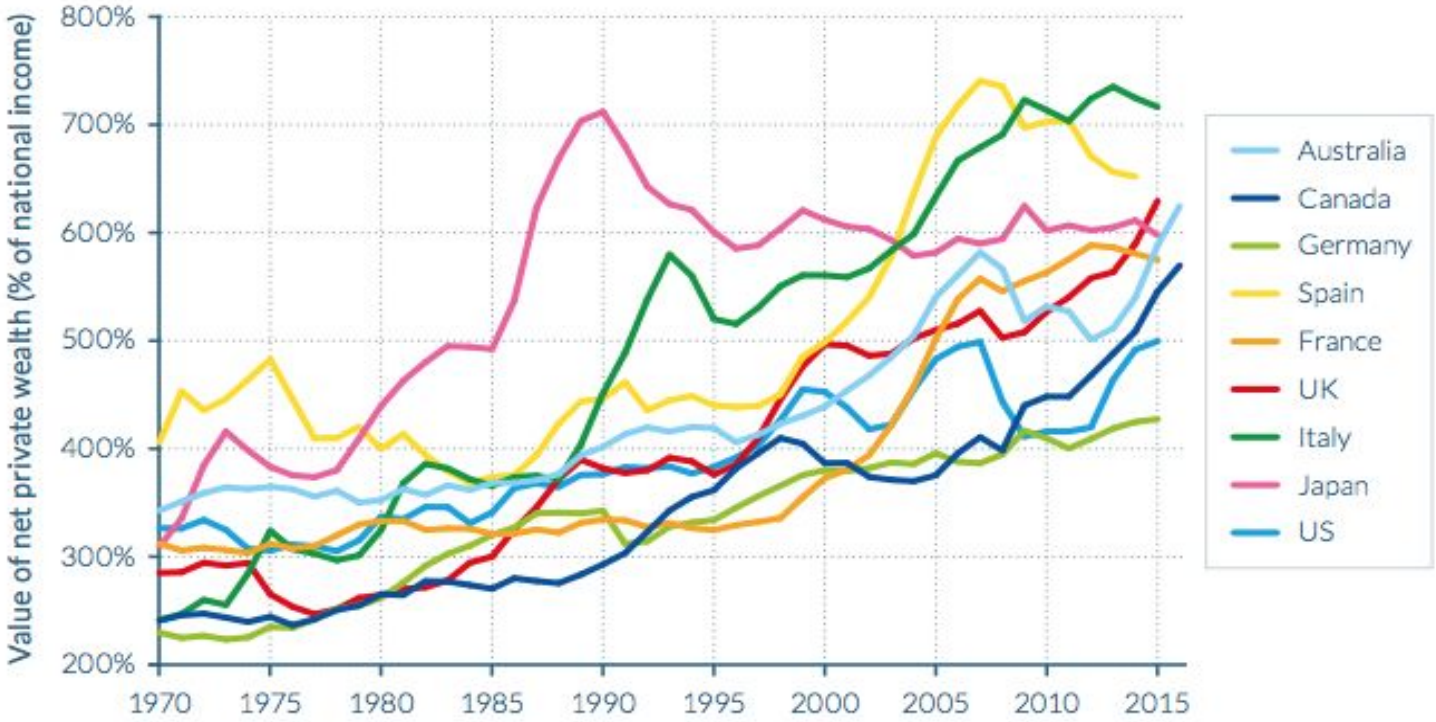
$\beta = s/g$

- The s/g dynamic gives a good account of structural evolution of capital over the very long-run.
- However, it must assume that asset-prices move in tandem with consumer prices. But do they?
- It also assumes a stable savings rate.
- It does not explain the political shocks to capital.
- It also has very little to say about financialisation

Private wealth since 1970

Figure 3.1.1

Net private wealth to net national income ratio in rich countries, 1970–2016



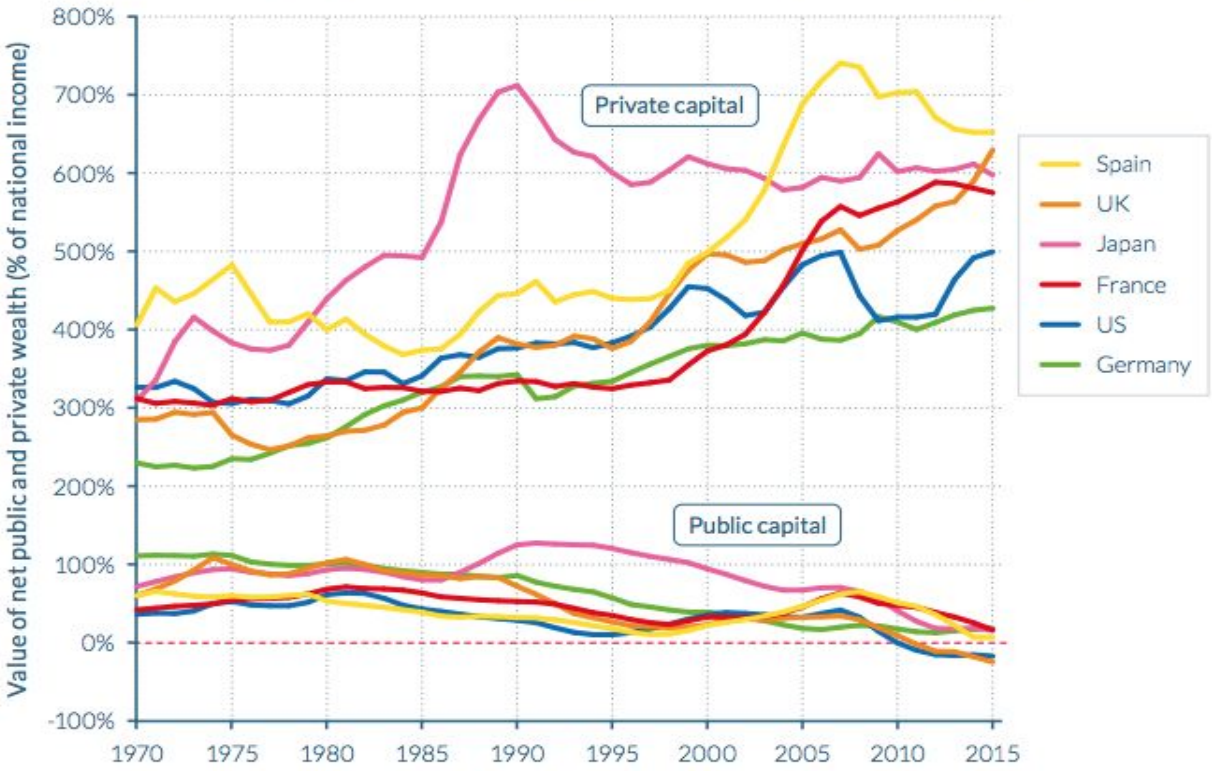
Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net private wealth in the UK was 629% of net national income, i.e. it was worth 6.3 years of national income. Net private wealth is equal to private assets minus private debt. Net national wealth is equal to net private wealth plus net public wealth.

Privately rich, publicly poor

Figure 3.1.3

Net private wealth and net public wealth to national income ratios in rich countries, 1970–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net public wealth (or public capital) in the US was negative (-17% of net national income) while the value of net private wealth (or private capital) was 500% of national income. In 1970, net public wealth amounted to 36% of national income while the figure was 326% for net private wealth. Net private wealth is equal to new private assets minus net private debt. Net public wealth is equal to public assets minus public debt.

The growth in the capital stock

- The data clearly shows a comeback of private capital
  - (low growth and higher savings = patrimonial capital for Piketty).

- But note the boom-bust cycles of capital assets
  - The Japanese speculative bubble in the 1990's
  - The dot-com crash in the US in early 2000's
  - The property crash in the late 2000's
  - The tech bubble today (post QE)
  - 30-40% of stock of FDI globally is 'phantom'
  - Two thirds of the stock of Irish FDI is 'phantom'

- How important is housing in all of this?

Table 3.2.1

Domestic capital accumulation in rich countries, 1970–2015: Housing vs. other domestic capital

	1970 domestic capital / national income ratio		2015 domestic capital / national income ratio		1970–2015 rise in domestic capital / national income ratio	
	incl. Housing	incl. Other domestic capital	incl. Housing	incl. Other domestic capital	incl. Housing	incl. Other domestic capital
US	**357%**		**518%**		**161%**	
	132%	225%	179%	339%	48%	113%
Japan	**378%**		**532%**		**154%**	
	150%	228%	214%	318%	64%	90%
Germany	**326%**		**393%**		**67%**	
	160%	166%	268%	125%	108%	-41%
France	**343%**		**576%**		**233%**	
	122%	221%	412%	164%	290%	-57%
UK	**339%**		**624%**		**376%**	
	99%	240%	334%	290%	290%	50%
Italy	**238%**		**612%**		**374%**	
	108%	130%	439%	173%	331%	43%
Canada	**304%**		**520%**		**237%**	
	126%	178%	302%	218%	190%	47%
Australia	**429%**		**715%**		**286%**	
	184%	245%	410%	305%	227%	59%

Source: Piketty & Zucman (2014) and Estevez-Bauluz (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of domestic capital in Italy was 612% of net national income, i.e. it was worth 6.1 years of national income. Domestic capital is the market-value of national wealth minus net foreign assets.

Savings since 1970

Table 5.1. Growth rates and saving rates in rich coutries, 1970-2010				
	Growth rate of national income	Growth rate of population	Growth rate of per capita national income	**Private saving** (net of depreciation) (% national income)
U.S.	**2.8%**	1.0%	1.8%	**7.7%**
Japan	**2.5%**	0.5%	2.0%	**14.6%**
Germany	**2.0%**	0.2%	1.8%	**12.2%**
France	**2.2%**	0.5%	1.7%	**11.1%**
U.K.	**2.2%**	0.3%	1.9%	**7.3%**
Italy	**1.9%**	0.3%	1.6%	**15.0%**
Canada	**2.8%**	1.1%	1.7%	**12.1%**
Australia	**3.2%**	1.4%	1.7%	**9.9%**

Saving rates and demographic growth vary a lot within rich countries; growth rates of per capita national income vary much less.

Sources: see piketty.pse.ens.fr/capital21c

Corporate/household savings

Table 5.2. Private saving in rich countries, 1970-2010

	Private saving (net of depreciation) (% national income)	incl. Household net saving	incl. Corporate net saving (net retained earnings)
U.S.	7.7%	4.6% ***60%***	3.1% ***40%***
Japan	14.6%	6.8% ***47%***	7.8% ***53%***
Germany	12.2%	9.4% ***77%***	2.8% ***23%***
France	11.1%	9.0% ***81%***	2.1% ***19%***
U.K.	7.4%	2.8% ***38%***	4.6% ***62%***
Italy	15.0%	14.6% ***97%***	0.4% ***3%***
Canada	12.1%	7.2% ***60%***	4.9% ***40%***
Australia	9.9%	5.9% ***60%***	3.9% ***40%***

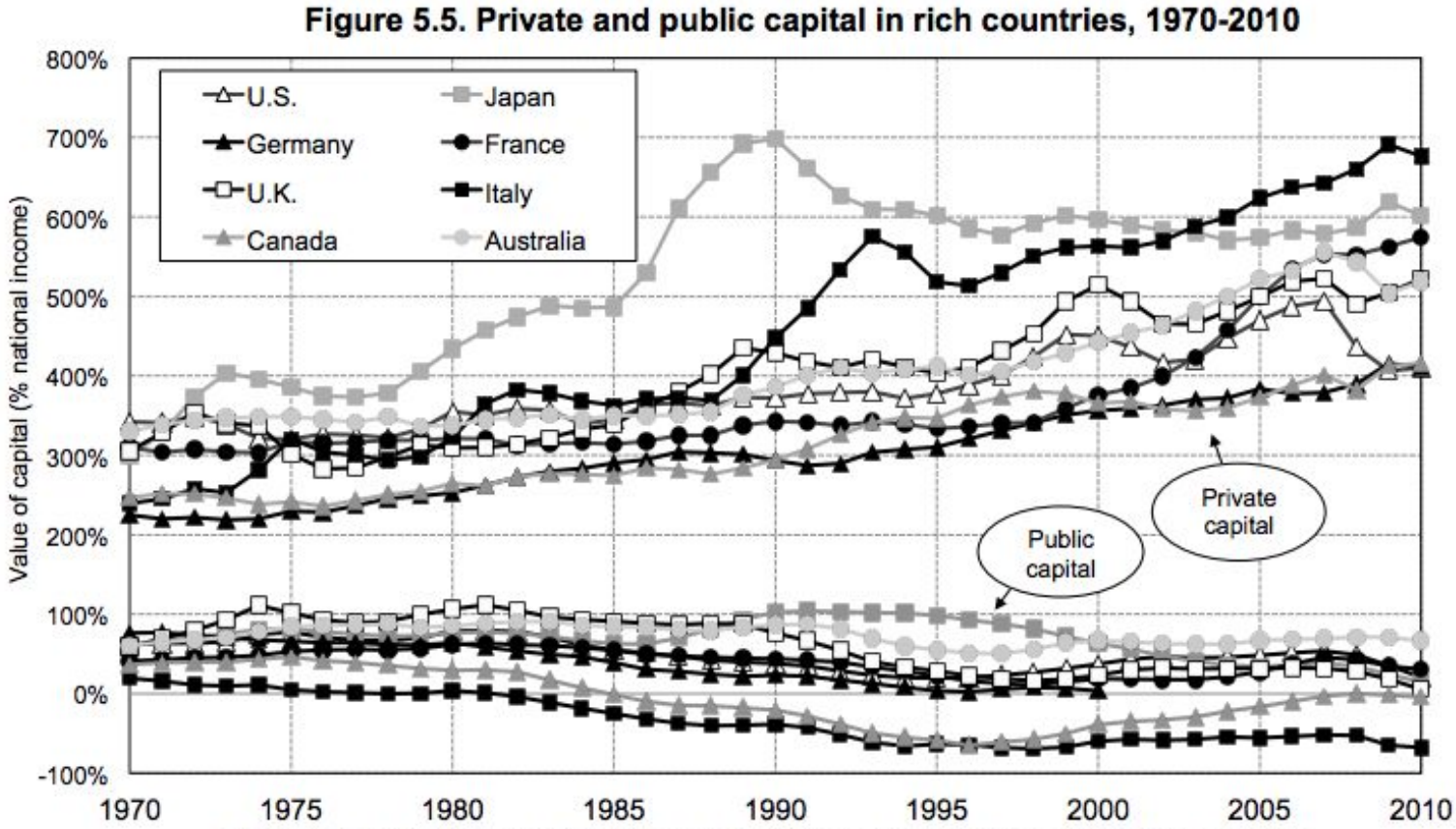
A large part (variable across countries) of private saving comes from corporate retained earnings (undistributed profits).

Sources: see piketty.pse.ens.fr/capital21c

Privatisations

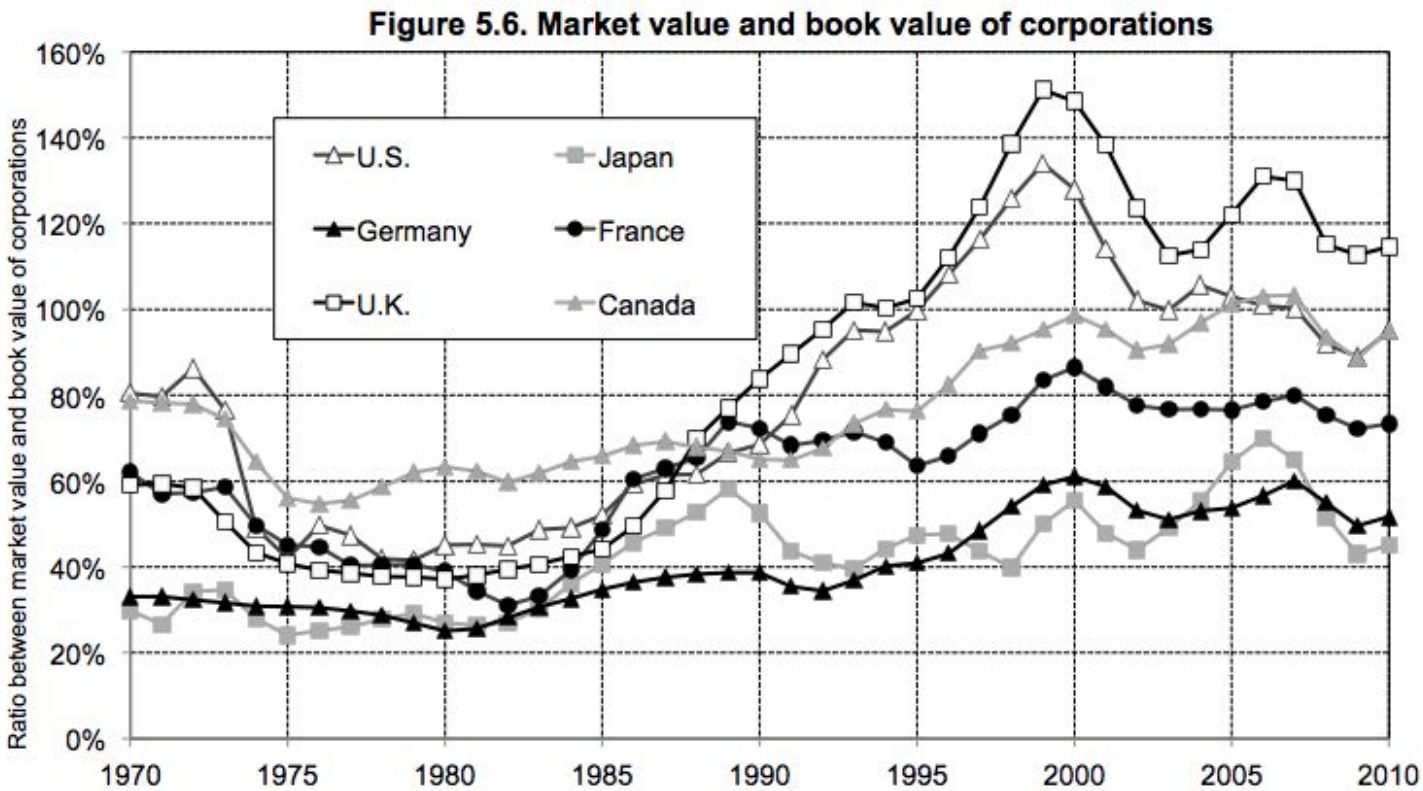
- The decrease in public wealth equals equals around 1/5th or one quarter the increase in private wealth.
- The case of Italy is particularly clear.
  - The wealthy lend to government and buy their assets.
- At a global level the biggest privatisations took place in the former Soviet Bloc.
- The public-private capital was completely reversed.
  - Think about the rise of Russian Oligarchs (buying very cheap public assets).

Privatisations



In Italy, private capital rose from 240% to 680% of national income between 1970 and 2010, while public capital dropped from 20% to -70%. Sources and series: see piketty.pse.ens.fr/capital21c.

The rebound in asset prices



Tobin's Q (i.e. the ratio between market value and book value of corporations) has risen in rich countries since the 1970s-1980s. Sources and series: see piketty.pse.ens.fr/capital21c.

Apple

Apple Inc.
NASDAQ: AAPL

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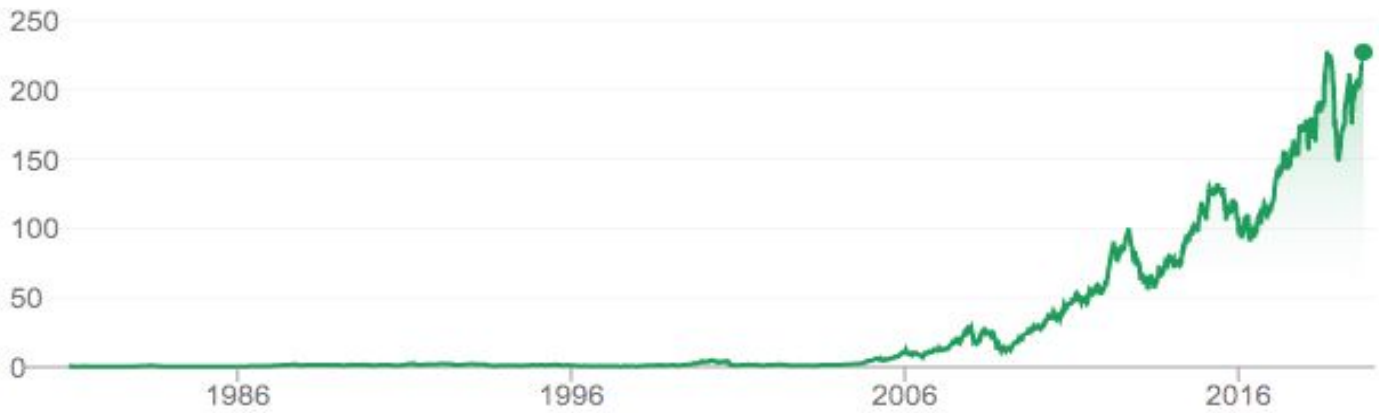
225.95 USD −1.18 (0.52%) ↓
8 Oct, 11:23 GMT-4 · Disclaimer

1 day | 5 days | 1 month | 6 months | YTD | 1 year | 5 years | **Max**



Open	225.82	Div yield	1.36%
High	227.22	Prev close	227.06
Low	225.06	52-wk high	229.93
Mkt cap	1.02T	52-wk low	142.00
P/E ratio	18.50		

Asset prices

- The price of capital is shaped by a whole host of unobservable factors. They are not ‘natural’.
  - Just think about the impact of Brexit on pound/euro exchange rate
- The book value and market value will diverge depending on a countries political and legal institutions.
  - Private property is a legally/socially defined construct.
- The sharp increase in asset prices (stocks and real estate) accounts for between one third and one quarter of the increase in the capital/income ratio from the 1980’s.

Conclusion

- For orthodox economists, the long-term trend in the rise of private capital can be explained by $\beta = s/g$,
  - Complemented by privatisation and rising asset prices.

- This assumes a long-term steady stable growth rate. But can we really assume this? What about war and politics?
  - How certain can we be about the future?

- Piketty's main concern is that with low growth, and lack of public investment, old money will play more of an influence in the present.

- This means inheritance and social class plays an important role in shaping the distribution of wealth, income and life chances.

  - If so, can we really say that free market capitalist democracies are based on hard work, merit, and equal opportunity?