The Rise and Decline of General Laws of Capitalism

—

D. Acemoglu and J. Robinson, in JEP 2015

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Social Choice and Voting
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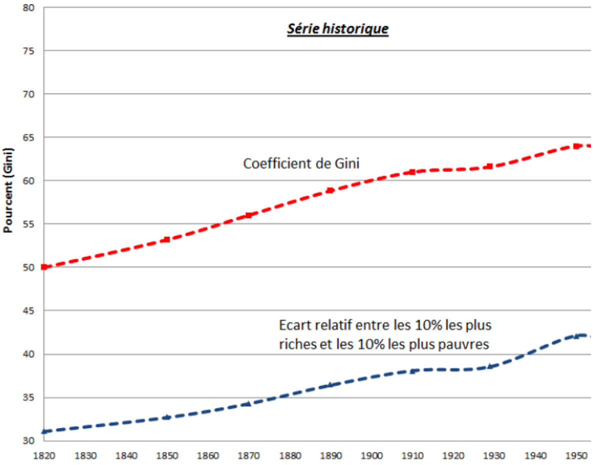
General Laws of Capitalism

Evolution of the Inequalities in the World between 1820 and 1950[1], Gini index



[1] F. Bourguignon and C. Morrisson, "*Inequality among World Citizens: 1820-1992*", AER 2002 (Data OECD and WB)

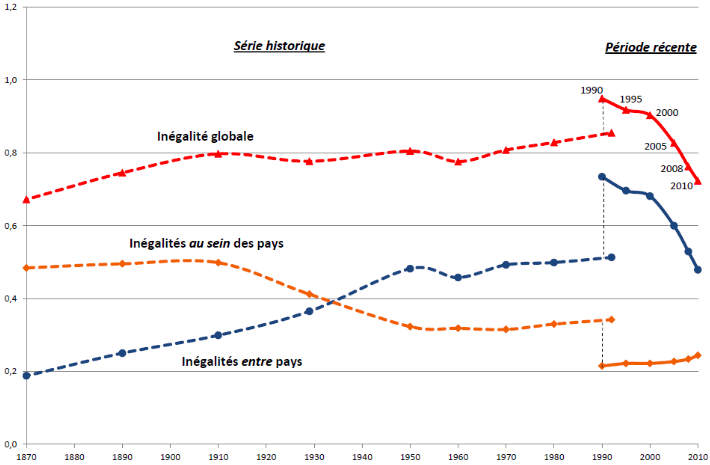
General Laws of Capitalism

What have been the main laws of capitalism:

- D. Ricardo (1815): Capital accumulation would end in economic stagnation and inequality, as **an increasing share of national income accrued to landowners**.
- K. Marx (1850): **Historical materialism** and the inevitable immersion of the proletariat: "The hand-mill gives you society with the feudal lord; the steam-mill society with the industrial capitalist"
- T. Piketty (2014): The widening of inequalities has been driven by rising inequality of labor incomes and an **increasing prevalence of capital income, inherited wealth and rentier billionaires (Top 1%)**.

Evolution of the Inequalities between 1870 and 2010

Theil index: Worldwide, Between and Within countries inequality levels[2]



[2] F. Bourguignon and C. Morrisson, "*Inequality among World Citizens: 1820-1992*", AER 2002 (Data OECD and WB)

Acemoglu and Robinson's Critic

General Laws of Capitalism have failed to come true:

- D. Ricardo:
  - 1870s started 2nd Industrial Revolution $\Rightarrow$ **Rapid fall of Land Prices!**
- K. Marx:
  - Interstate Commerce Act (1887), Sherman Anti-Trust (1890), Federal Trade Commission (1914) **curtailed monopolies**.
  - The Income tax (1913) launches the **welfare state** era.
  - Post-W.W. II **economic and profits expansion** (e.g.).
- T. Piketty:
  - **No direct correlation** or causal effect between $r - g$ and changes in inequalities.
  - Focus on the share of GDP going to the top 1% gives a **distorted view**, as it ignores the middle and the bottom of the income distribution.

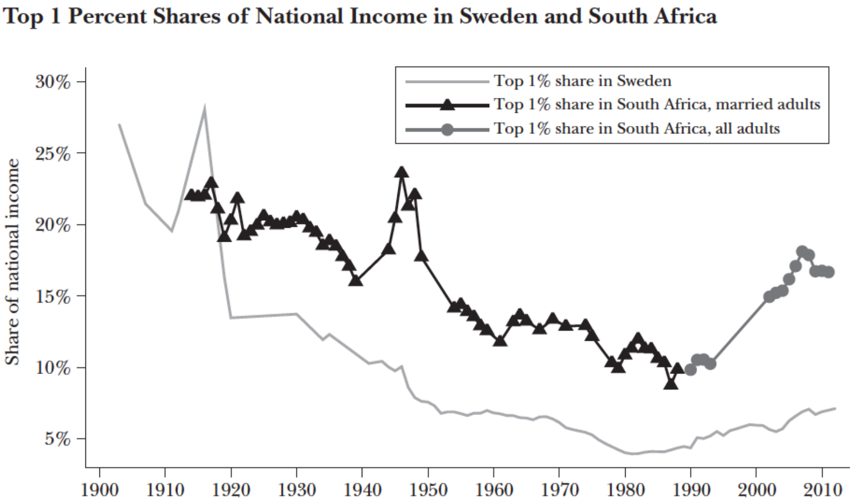
Acemoglu and Robinson's Critic

General Laws of Capitalism are misleading, because they ignore the key forces shaping how an economy functions and path dependency:

- **Endogenous evolution of technology and of the institutions**
- **Political equilibrium** that influence how markets function,
- Heterogeneity of economic arrangements leading to different **redistributions scheme**.

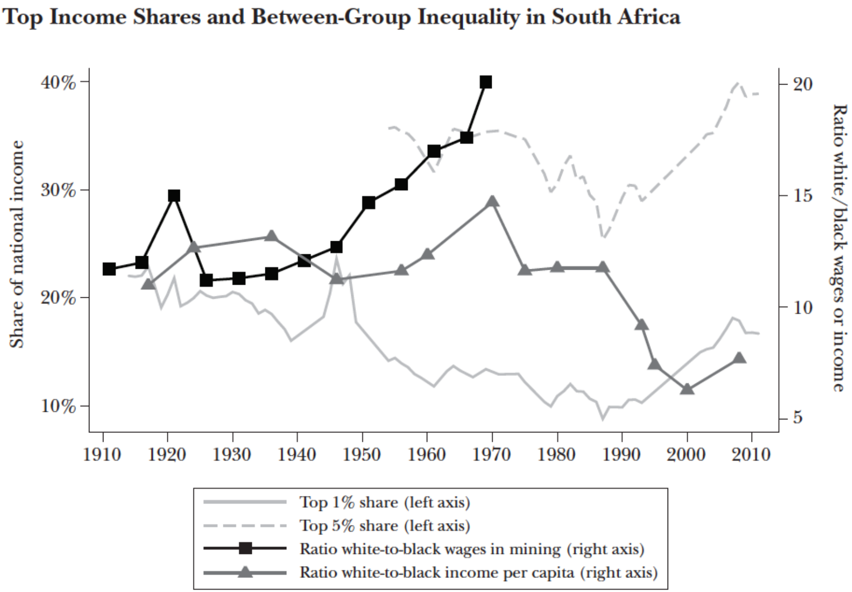
$\Rightarrow$ **A Tale of Two Inequalities**: South Africa and Sweden

A Tale of Two Inequalities



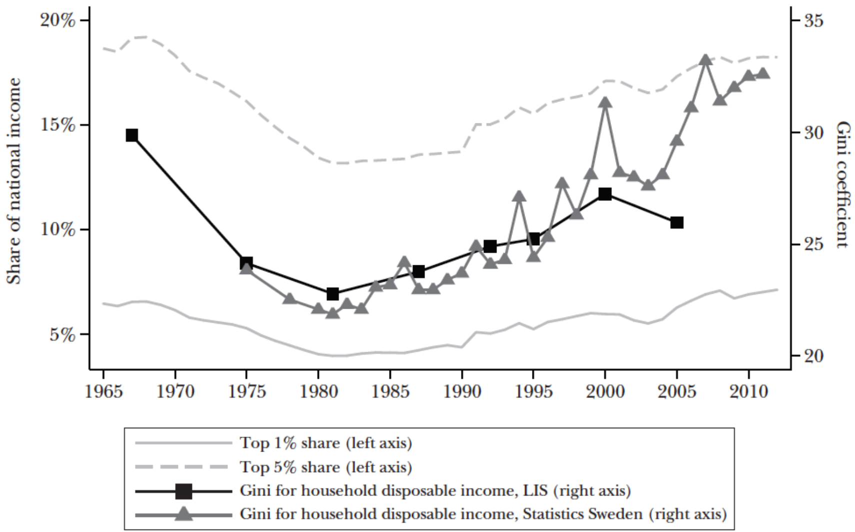
Sources: The data series for South Africa is from Alvaredo and Atkinson (2010). The data series for Sweden is from Roine and Waldenström (2009).

A Tale of Two Inequalities: South Africa



A Tale of Two Inequalities: Sweden

Top Income Shares and Overall Inequality in Sweden



A Tale of Two Inequalities

South Africa:

- Institutionalization of **white dominance** in 1910 with 93% of the Land belong to whites, while blacks represent 59% of the population.
- 1948: **Apartheid** strengthening: social and educational segregation.
- 1994: Apartheid institutions **collapse** with Mandela's election.

Sweden:

- **Redistribution policies** started in the 1920s.
- **Top marginal tax rates** goes from 10% in 1910 $\rightarrow$ 60% in 1940.
- **Wage compression** created by labor market institutions (Unions).

$\Rightarrow$ **Inequality: Top 1% same trend; Divergence for surrounding pop**.

A Tale of Two Inequalities

Explanatory factors:

- Different **drivers of income distribution** (colonialism, social consciousness, solidarity, power's distribution)
- The impact of **institutions and the distribution of resources** (apartheid, welfare state, unions)
- **Endogenous technological progress and growth**. (who can contribute, innovate, choose?)

$\Rightarrow$ **Requires a new framework** taking into account political and economic institutions, as technologies, prices and economic performance.

Towards an Institutional Framework

Aim of the Framework:

$$\{\text{political institutions } (t);\ \text{inequality } (t)\}$$

$$\downarrow$$

$$\{\text{political institutions } (t+1);\ \text{inequality } (t+1);\ \text{economic performance } (t)\}$$

Towards an Institutional Framework

System of Votes, representatives, convergence of preference, electoral body:

{political institutions (t); inequality (t)}

$\Downarrow$

{*de jure* and *de facto* political power (t)}

Towards an Institutional Framework

Protestations, Riots, Votes, Laws:

$$\{\text{political institutions (t); inequality (t)}\}$$
$$\Downarrow$$
$$\{\textit{de jure} \text{ and } \textit{de facto} \text{ political power (t)}\}$$
$$\Downarrow\Downarrow$$
$$\{\text{economic institutions (t)}\}\ \{\text{political institutions (t+1)}\}$$

Towards an Institutional Framework: Economic Institutions

Access to knowledge, technology, freedom to innovate:

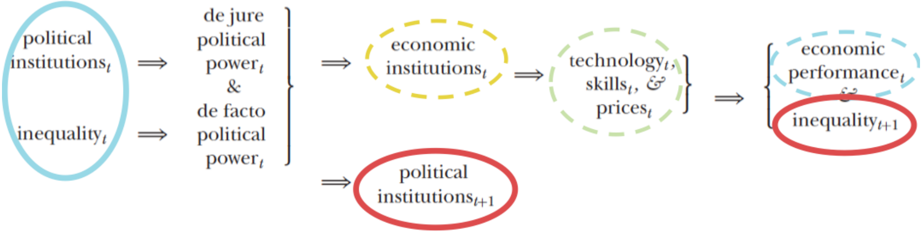
$$\{\text{economic institutions } (t)\}$$
$$\Downarrow$$
$$\{\text{technology } (t); \text{ skills } (t); \text{ prices } (t)\}$$

Towards an Institutional Framework: Economic Institutions

Productivity, Purchasing Power, self-governance:

$$\{\text{economic institutions } (t)\}$$
$$\Downarrow$$
$$\{\text{technology } (t); \text{ skills } (t); \text{ prices } (t)\}$$
$$\Downarrow\Downarrow$$
$$\{\text{inequality } (t+1); \text{ economic performance } (t)\}$$

Towards an Institutional Framework



Institutionnal Framework: South Africa

De jure

Initially (1910): Post-Colonial Institutions; Whites and Blacks Inequalities

$\Downarrow$

{Skewed distribution of lands (1914); "color bar" access to jobs (1920s)}

{Only white have the right to vote (1936); Apartheid (1948)}

Institutionnal Framework: South Africa

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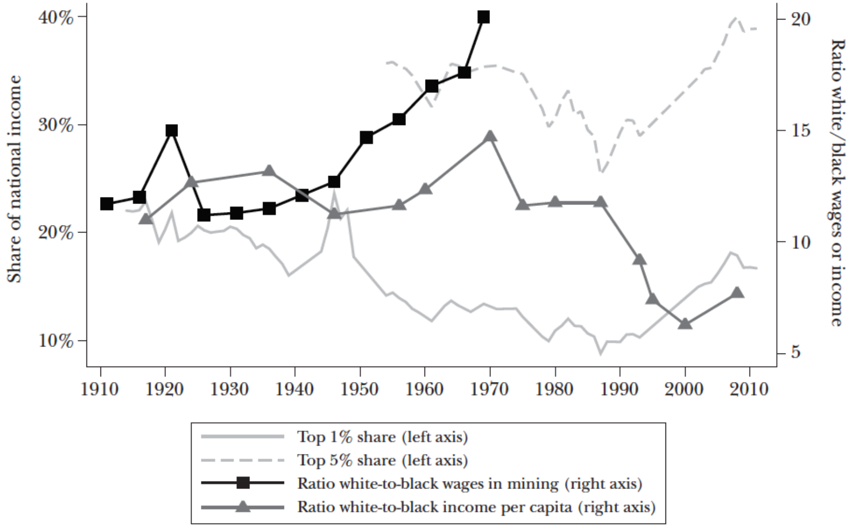
{Increase of white-to-black inequality ratio (1930-1970)}

{Economic deficiency}

A Tale of Two Inequalities: South Africa

Top Income Shares and Between-Group Inequality in South Africa



Institutionnal Framework: South Africa

De facto political institution: non monolithic blocs:

Whites represent a **heterogeneous coalitions** (41% of the pop.):
workers, farmers, mine-owners, industrials

$\Downarrow$

{Redistribution form the rich to the poor White}

{Same Political Rights}

Institutionnal Framework: South Africa

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{Same Political Rights}

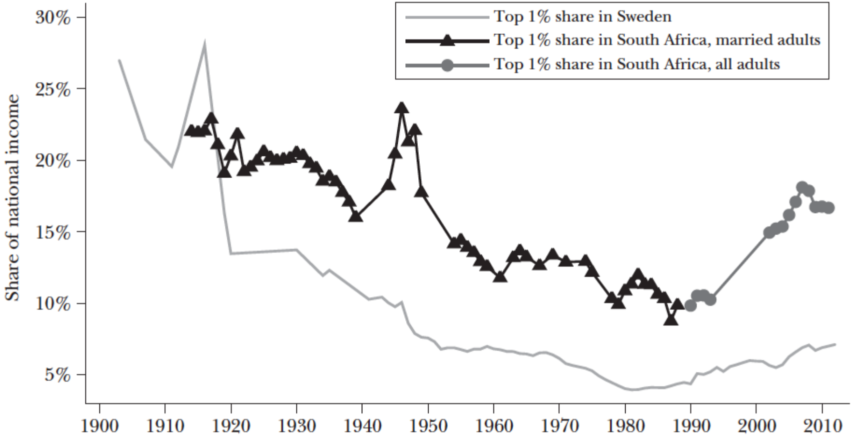
$\Downarrow\Downarrow$

{Reduction of Top 1% Share of National Income}

{Economic deficiency}

A Tale of Two Inequalities

Top 1 Percent Shares of National Income in Sweden and South Africa



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Institutionnal Framework: South Africa

In a second time

{Increase of white-to-black inequality ratio (1930-1970)}

{Reduction of Top 1% Share of National Income}

{Economic deficiency}

$\Downarrow$

{*De facto* power: Protest and Riots (1970s); Soweto uprising (1976)}

{Black Trade Unions; Lower workplace discriminations}

Institutionnal Framework: South Africa

{High inequality level; Economic deficiency (1930-1970)}

$\Downarrow$

{*De facto* power: Protest and Riots (1970s); Soweto uprising (1976)}

{Black Trade Unions; Lower workplace discriminations}

$\Downarrow\Downarrow$

{Increase of Labor savings Technologies by Whites mine-owners}

{Collapse of the Apartheid System}

Institutionnal Framework: South Africa

South African's example:
First, the South African context starting with:

- A *de jure* power: post-colonial institutions, Whites-Blacks inequalities.
- A *de facto* coalition of the whites

$\Rightarrow$ Higher White and Black Inequality and Economic deficiency

Leading in a **second time** to

- A *de facto* empowerment of blacks
- Economic deficiency

$\Rightarrow$ Collapse of the apartheid

Institutionnal Framework: Sweden

Sweden's context of democratization in the XXst century with a :

- Male adults suffrage (1909)
- Economic crisis (1918)

⇒ Coalition of the ends of the income distributions (businessmen and unskilled workers) against the middle class (skilled workers)
Democracy reform (1918) from democracy to more competitive elections

The Institutional Framework lead in a second time to

- Labor market institutions likely affecting the path of technology: new entry of rapid technology upgrading

⇒ One of a wealthiest country worldwide

Institutionnal Framework: Conclusion

Starting from **a given context of political institution and inequalities**, the institutional framework sheds light on the perpetrating or the collapse of an institutional system through the **evolution of Technologies, Skills, Prices** and finally:

Economic Performance and the **Dynamic of Inequality**.

Focus on how the framework take into account **transition steps**:

- **Riot**: Soweto uprising, Sweden's 1918 protests
- **Votes**: Only for white in S.A, Every male adults in Sweden
- **Unions**: For White workers, then Black workers in S.A, Endogenous to Sweden's economic performances

Social Choice and Voting

Social choices through Riot, Votes or Unions ease economics and institutional transition through:

⇒ **More competitive political institutions** imply pressure for more redistribution.

⇒ Warning about **monopolization** of the choice: reduced economic performance and technological progress, prices and skills.

⇒ Contribute to explain **abstention** and **pivotal voting** due to institutions and economic context?

⇒ **How to explain current increase of within countries inequalities?**

Conclusion

General Laws of Capitalism are too General,
What is the **contribution** of the Institutional Framework?

- More Realistic
- Tractable
- Explains Cycles

Limits:

- No theory $\Rightarrow$ weak to predict long term dynamic
- No rigorous empirical evidence
- Lack of international interactions
- Too deterministic: only transition from rigid blocks and t to $t + 1$.

APPENDIX

General Laws of Capitalism

What is the goal of the general laws of Capitalism?

- Try to give a theory of history of economic thought and political changes
- Involve Economics, but also Sociology, History and Philosophy
- For the most it emphasizes on social organization of the production, income distributions and inequalities

Acemoglu and Robinson's Critic

General Laws of Capitalism are misleading

The Authors call the term **capitalism into question**, as it focuses on the ownership and accumulation of capital and distracts from the characteristics of societies which are more important in determining their economic development and the extent of inequality.

$\Rightarrow$ **A Tale of Two Inequalities**: South Africa and Sweden

Marx's Law: Historical Materialism

"The hand-mill gives you society with the feudal lord; the steam-mill society with the industrial capitalist"

in *The Poverty of Philosophy*, 1847

When production forces (technology) change, it destabilizes the relations of production and leads to contradictions and social institutional changes that have often been revolutionary in nature

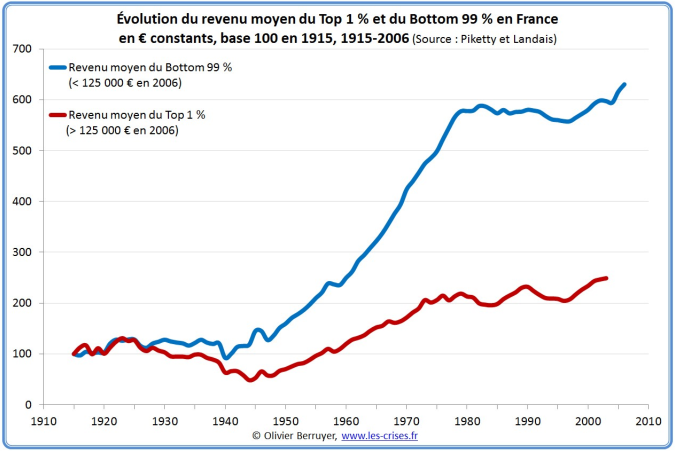
in *A Contribution to the Critique of Political Economy*, 1959

Capital state Marx's key predictions about inequalities:
His General Law of Capitalism leads to:

- Capitalist Accumulation
- Declining Profit
- Decreasing Competition

Piketty's Law: $r > g$

Top 1% vs. Bottom 99% average incomes over time (1915-2006)[3]



[3] C. Landais, T. Piketty and E. Saez in *Pour une revolution fiscale: un impot sur le revenu pour le 21 eme siecle*, 2011

Piketty's Law: $r > g$

Extract from Piketty's prominent book, *Capital in the Twenty-first Century*, 2014, macroeconomic results yield the fundamental laws[4]:

- Capital share of national income $= c = r\ (\frac{K}{Y})$
- $\frac{K}{Y} = \frac{s}{g} \Rightarrow c\ = r\ (\frac{s}{g})$
- Golden rule formula: $r = \theta + \gamma g => r > g$

[4] I denoted: r: interest rate; K: stock of capital; Y GDP (national income); s: saving rate; g: GDP's growth rate; θ: time preferences; γ curvature of the utility function.

Piketty's Law: $r > g$

Piety's third law is derived from the assumption of a high elasticity of substitution between capital and labor.

It yields that whenever $r > g$, there will be a tendency for inequality to rise.

Capital income will tend to increase at the rate of interest r, while national income (and income of non capitalist) increase at rate g.

Capital endowment is unequally distributed, this will translate into a ***capital-driven inequality****.*