

Lecture 4

The Great Transformation of the 20 th century: from proprietary to social-democratic societies

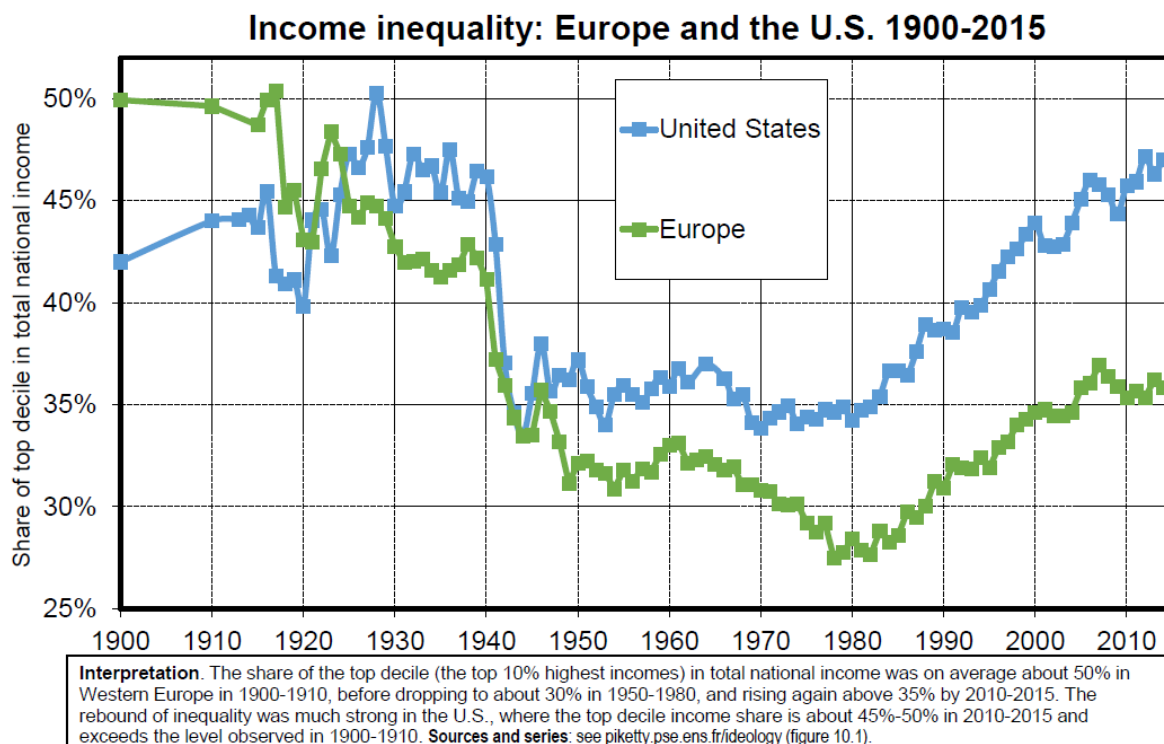
K. Polanyi and the « Great Transformation » (1944)

- **K. Polanyi, The Great Transformation: The Political and Economic Origins of our Time (1944):** the 19 c capitalist system was inherently unstable; this finally led to the self-destruction of European societies in 1914-1945 & the death of 19c economic liberalism and laissez-faire ideology
- Hungarian economic historian, took refuge in London 1933 & NYC 1940-1944
- 19c regime: sacralisation of market system and private property + generalized competition between individuals and between European nations-states
 - very unequal & unstable system, both within and between countries
 - wars, revolutions, monetary chaos, fascism
- Key pb = **myth of self-regulated markets for labor, land and money** The solution is democratic socialism, i.e. the “social embeddedness of markets” (market economy with democratic regulation of the markets for labor, land and money/capital) (but the book focuses mostly on historical analysis) (+over-optimistic view of pre-industrial restrictions on labor mobility?)
- **H. Arendt, The Origins of Totalitarianism 1951:**
same basic premises as Polanyi 1944: generalized market competition 1815-1914 led to self-destruction of European nation-states in 1914-1945
- Arendt stresses **the need for post-national federations to regulate globalized capitalism** = what colonial British & French empires did in a hierarchical way; what Bolsheviks and Nazis did in a totalitarian manner; what the US do in a constitutional & relatively democratic manner
- **European social-democratic nation-states were too small to control & regulate global economic forces.** European social-democratic parties (SPD, Labour, French socialists, etc.) were internationalist in their discourse but not in their political project (nation-centered, lack of federalist dimension).
- This 1951 analysis seems quite relevant for 2019-2020
- O. Rosenboim, **The Emergence of Globalism. Visions of World Order in Britain and the United States 1939-1950.** Princeton UP 2017
- Between colonial empires and the cold war: new federal visions of world orders emerge (UN 1945: less ambitious version of these discussions)
- **UK movement Federal Union:** very active in 1938-1940
- April 1940 meeting in Paris between British & French economists to prepare a possible federal union between Britain, France and beyond
- **But wide disagreements about the economic content of federal union:**
- Beveridge, Wooton: social insurance, federal progressive tax on high incomes and inheritance (Socialism and Federation, 1941)

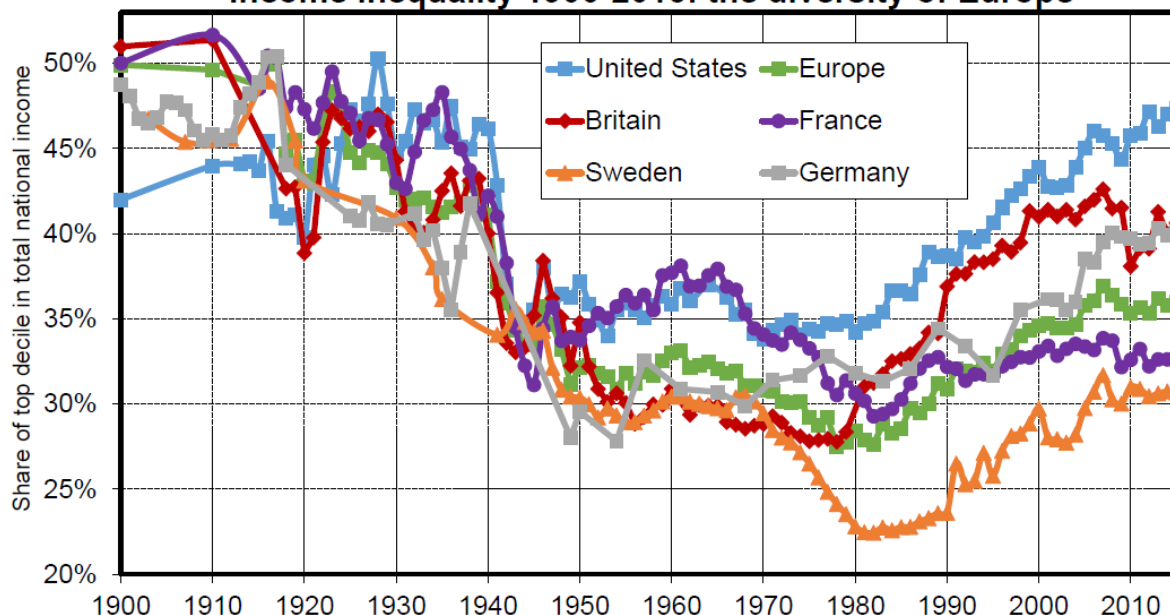
- Robbins: ok for federal progressive taxation in case the free movement of labour and trade within the federation is not sufficient to reduce inequality
- Hayek: the only objective of the federation must be to constitutionalize property rights & prevent redistribution (The Road to Serfdom, 1944; Law, legislation and liberty, 1982; pro-Pinochet in 1973-1990)

The fall of inequality and private property (1914-1950)

- **Fall of top income shares 1914-1950, particularly in Europe**
- Rebound of inequality since 1980, especially in the US
- But inequality levels in Europe in 2010s are still much below pre-WW1 levels
- **The decline in income inequality during the 20c is largely due to the fall of top capital incomes**
- In contrast, the inequality of labour income has been relatively stable in the long-run, particularly in Europe (\neq sharp rise in US since 1980s)
- Basic orders of magnitude. **Top 10% income share declined from 50% to 30- 35% of total income. Top 10% wealth share declined from 90% to 50-60% of total wealth.** Bottom & middle incomes are made of labour income, top incomes are made of capital income. Bottom wealth = liquidities, middle wealth = housing, top wealth = financial & business assets.

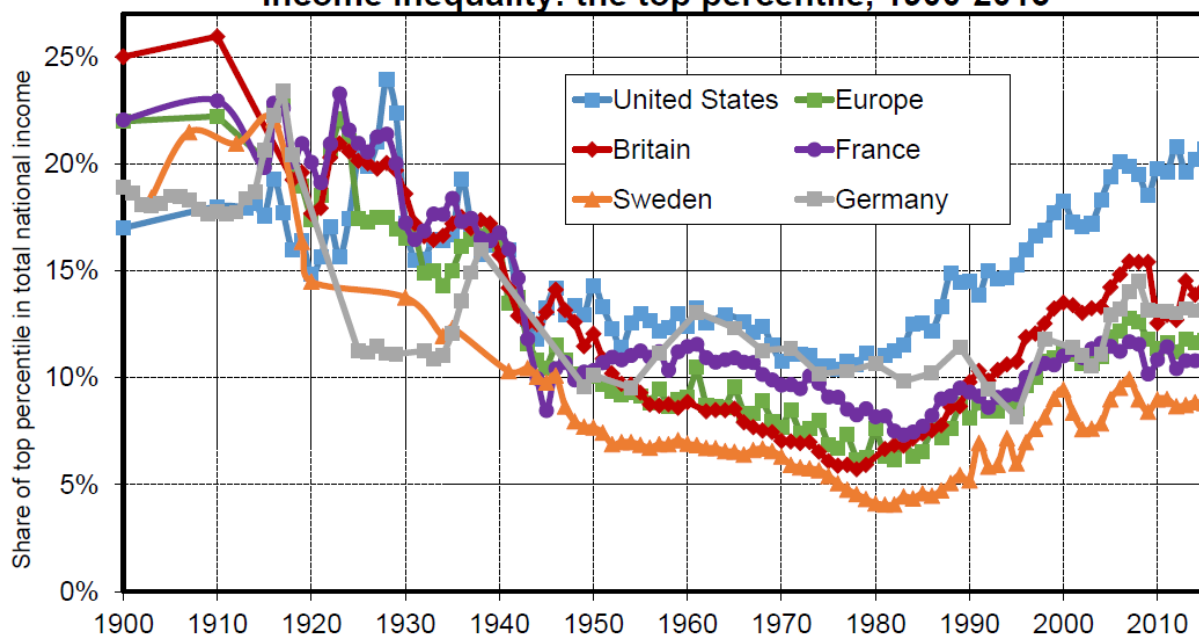


Income inequality 1900-2015: the diversity of Europe

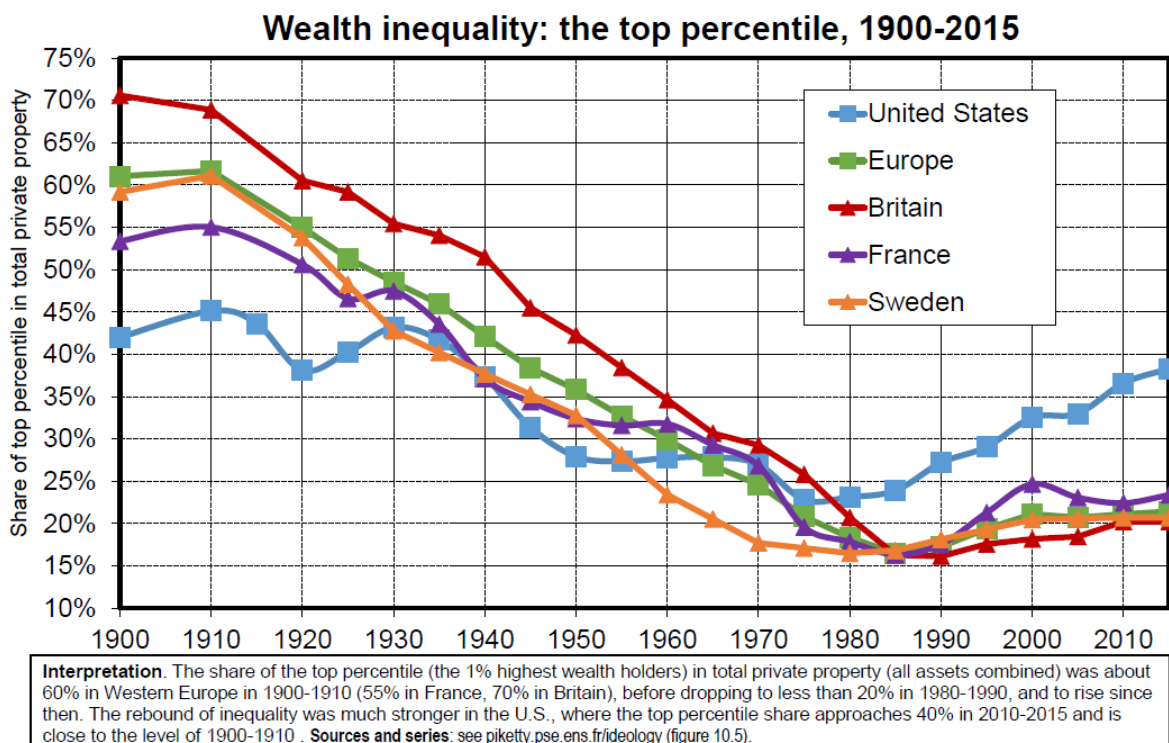
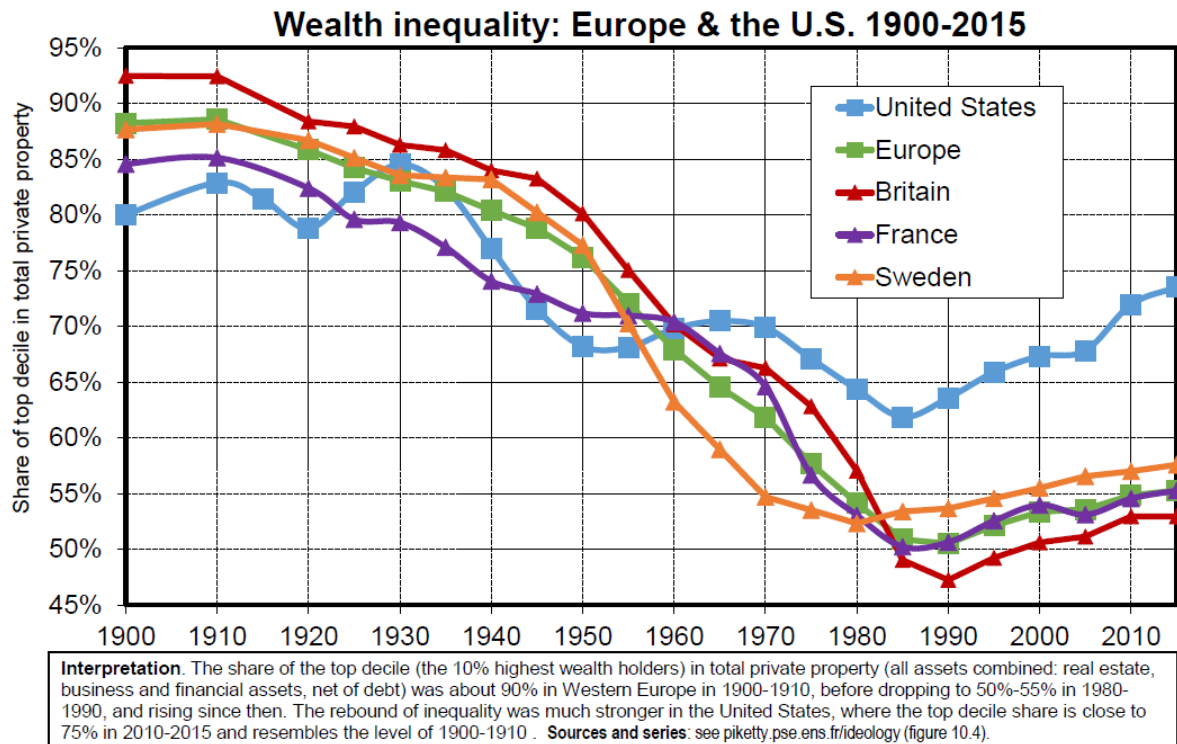


Interpretation. The share of the top decile (the top 10% highest incomes) in total national income was on average about 50% in Western Europe in 1900-1910, before dropping to about 30% in 1950-1980 (or even below 25% in Sweden), and rising again above 35% by 2010-2015 (or even above 40% in Britain). In 2015, Britain and Germany appear to be above European average, while France and Sweden are below average. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 10.2).

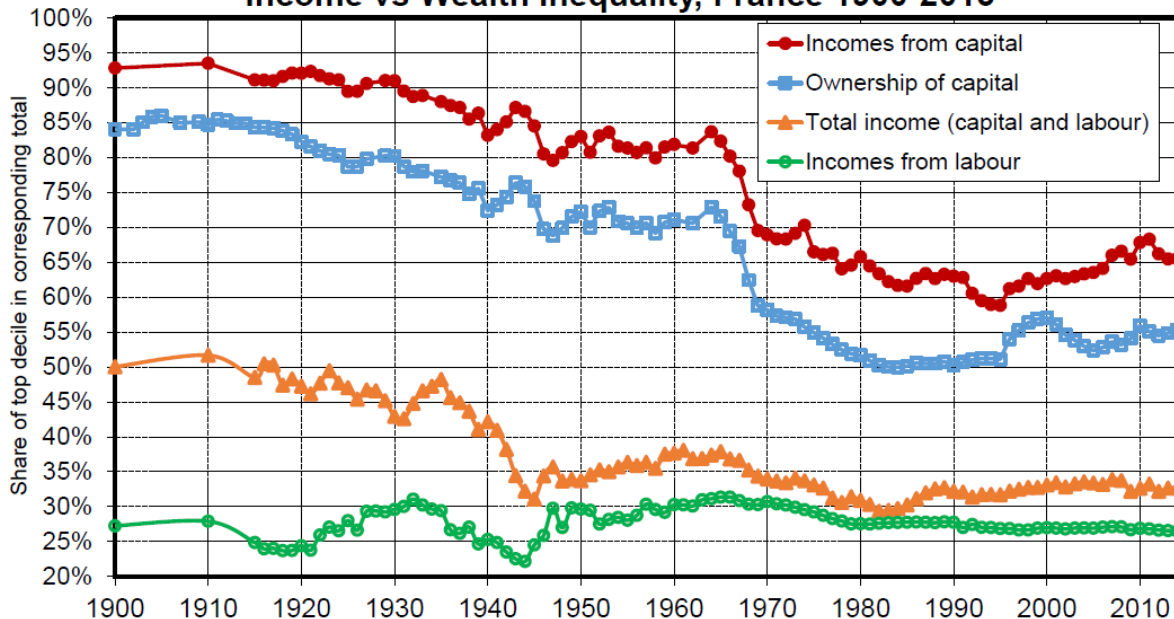
Income inequality: the top percentile, 1900-2015



Interpretation. The share of the top percentile (the 1% highest incomes) in total national income was about 20%-25% in Western Europe in 1900-1910, before dropping to 5%-10% in 1950-1980 (or even less than 5% in Sweden), and rising again around 10%-15% in 2010-2015. The rebound of inequality was much stronger in the U.S., where the top percentile share reaches 20% in 2010-2015 and exceeds the level of 1900-1910. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 10.3).

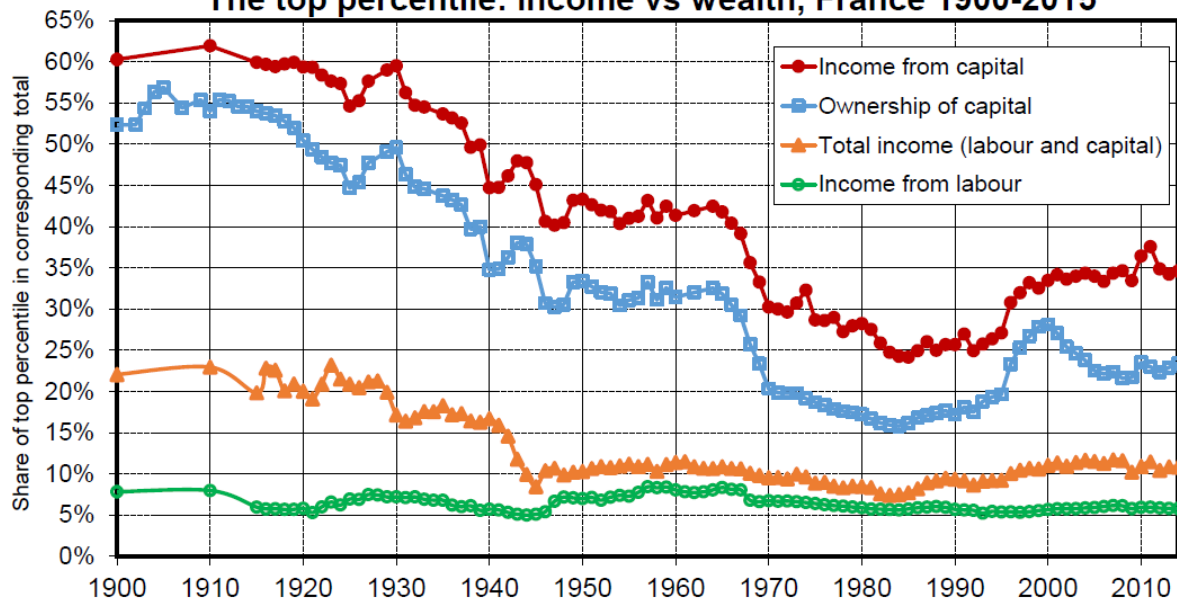


Income vs Wealth Inequality, France 1900-2015

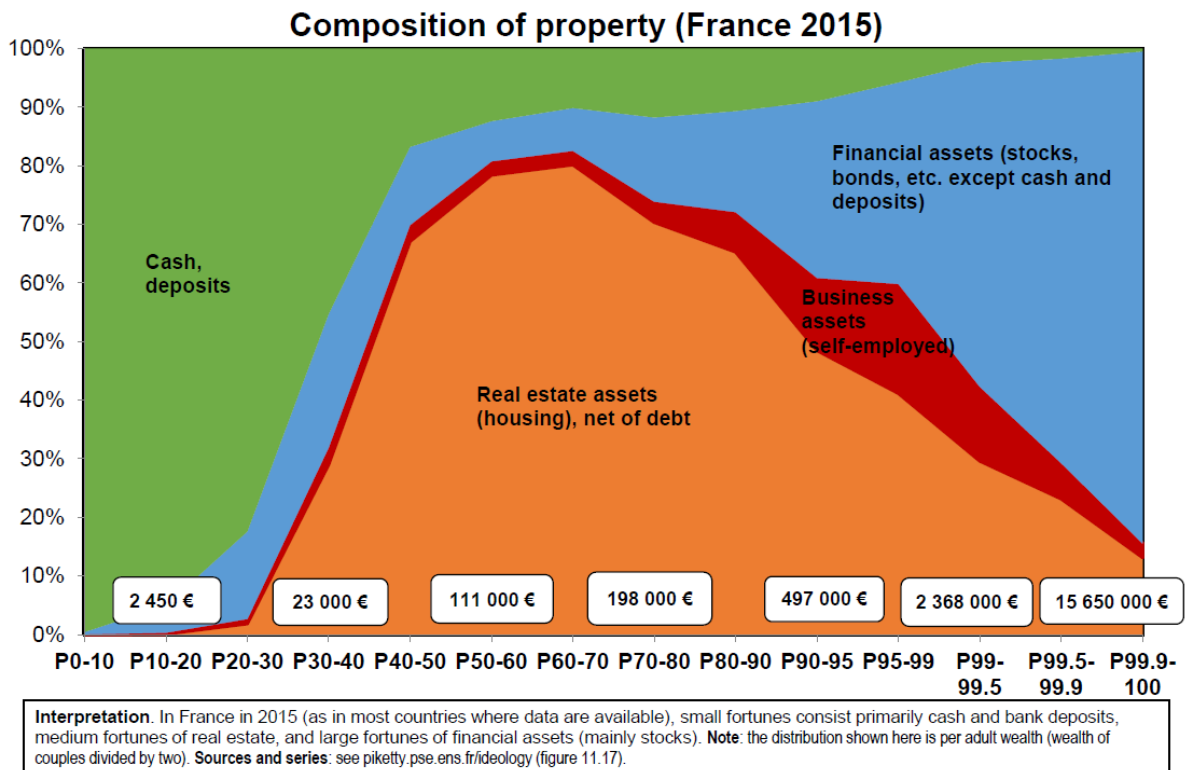
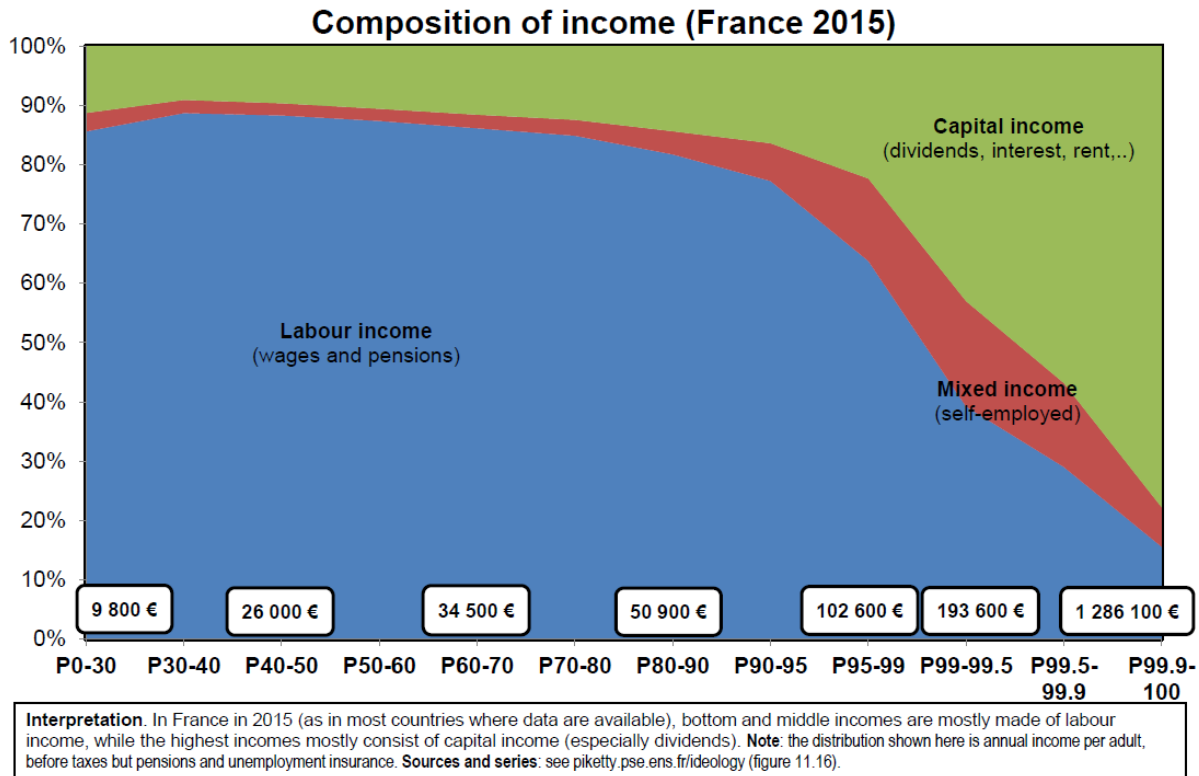


Interpretation. In 1900-1910, the 10% highest capital incomes (rent, profit, dividend, interest, etc.) received about 90%-95% of total capital incomes; the 10% highest labour incomes (wages, self-employment income, pensions) received about 25%-30% of total labour incomes. The reduction of inequalities during the 20th century came entirely from the fall in the concentration of property, while the inequality of labour incomes changed little. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 10.6).

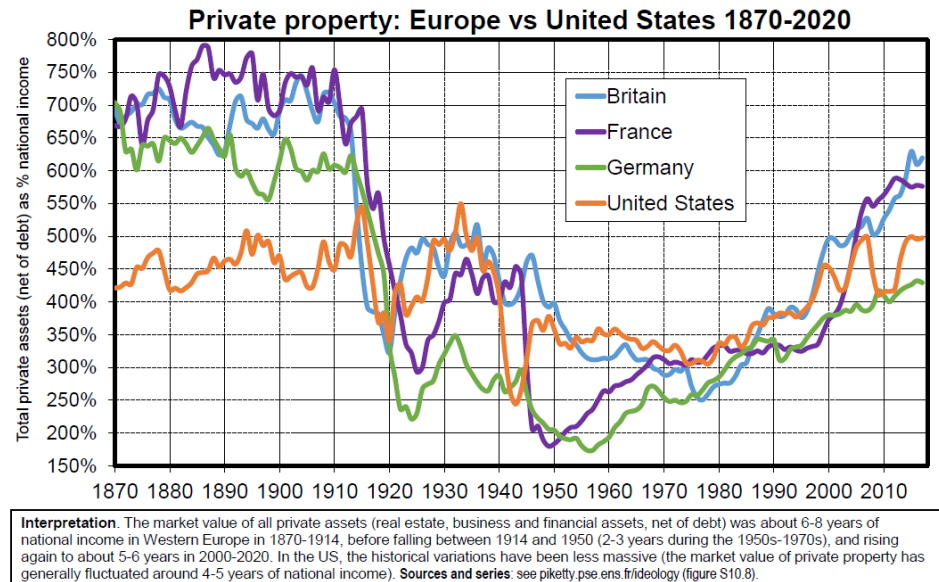
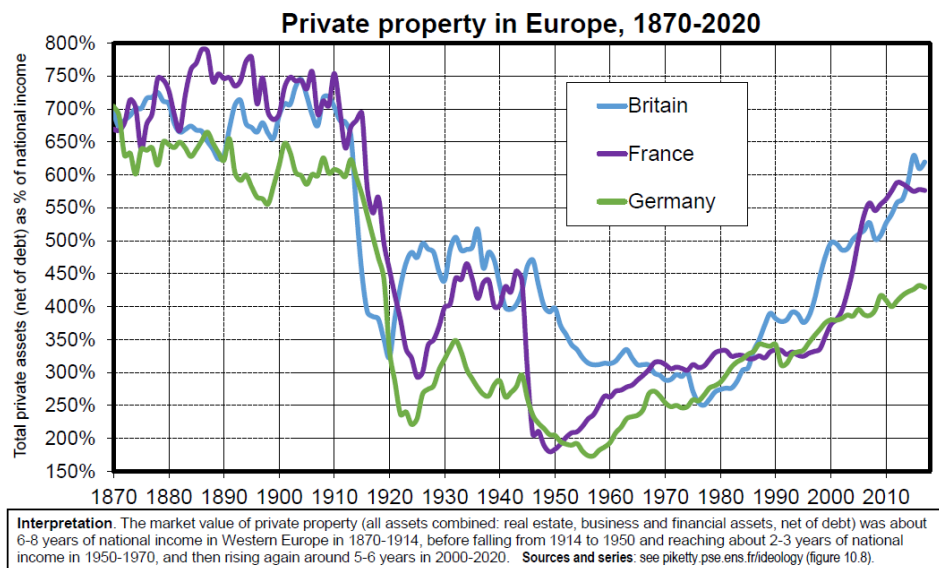
The top percentile: income vs wealth, France 1900-2015

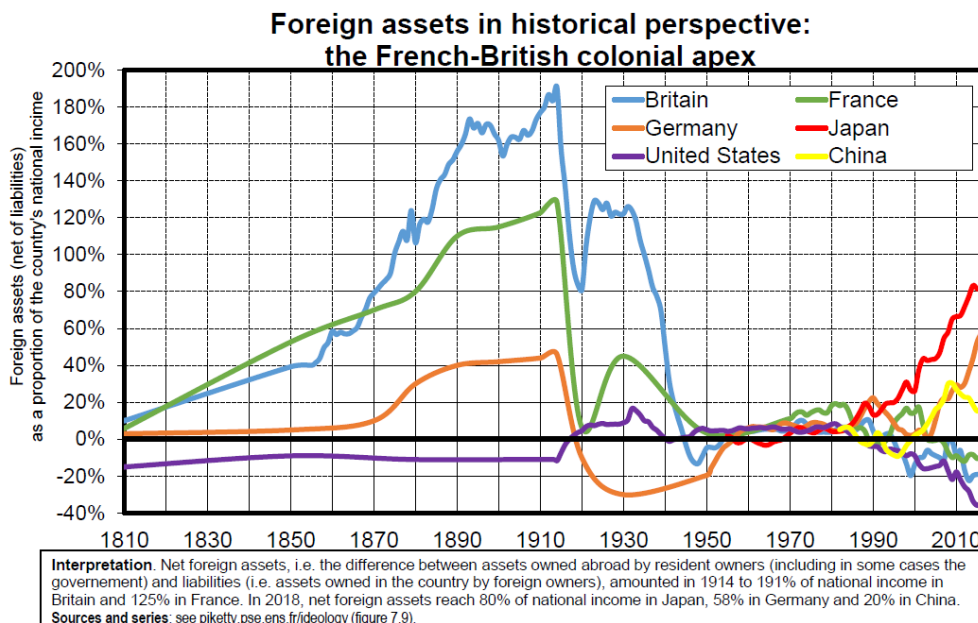


Interpretation. In 1900-1910, the 1% highest capital incomes (rent, profit, dividend, interest, etc.) received about 60% of total capital incomes; the 1% highest capital owners (real estate, business and financial assets, net of debt) owned about 55% of total private property; the 1% highest total incomes (labour and capital) received about 20%-25% of total income; the 1% highest labour incomes (wages, self-employment income, pensions) received about 5%-10% of total labour incomes. In the long-run, the fall of inequality is entirely due to the fall in the concentration of property and incomes from capital. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 10.7).



- In order to understand the fall in top capital incomes during 20c, two mechanisms to distinguish:
1. The fall (& recovery) in aggregate private property. From 600%-800% of national income in 1880-1914, down to 200%-300% in 1950-1970, back up to 500%-600% by 2000-2020. But wealth concentration did not recover (yet).
 2. The fall (& incomplete recovery) of the concentration of private property. In principle, the fall in aggregate private property could have affected all wealth levels in the same proportion, with unchanged wealth shares by decile. But:
 - Assets held at the top (e.g. foreign wealth) were particularly affected.
 - Top wealth holders need their capital income to finance their savings & living standards; 20c shocks led to a collapse of their saving capacity; some even started to sell some of their assets so as maintain their living standards.
 - Progressive taxation of top income and top inheritance made it virtually impossible to return to the previous concentration.

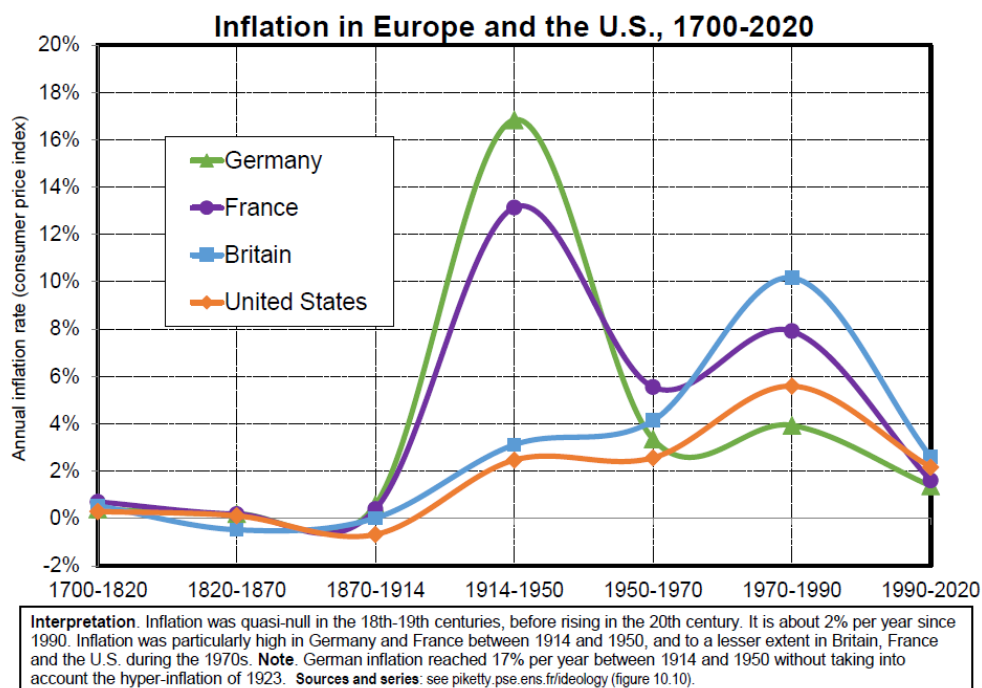
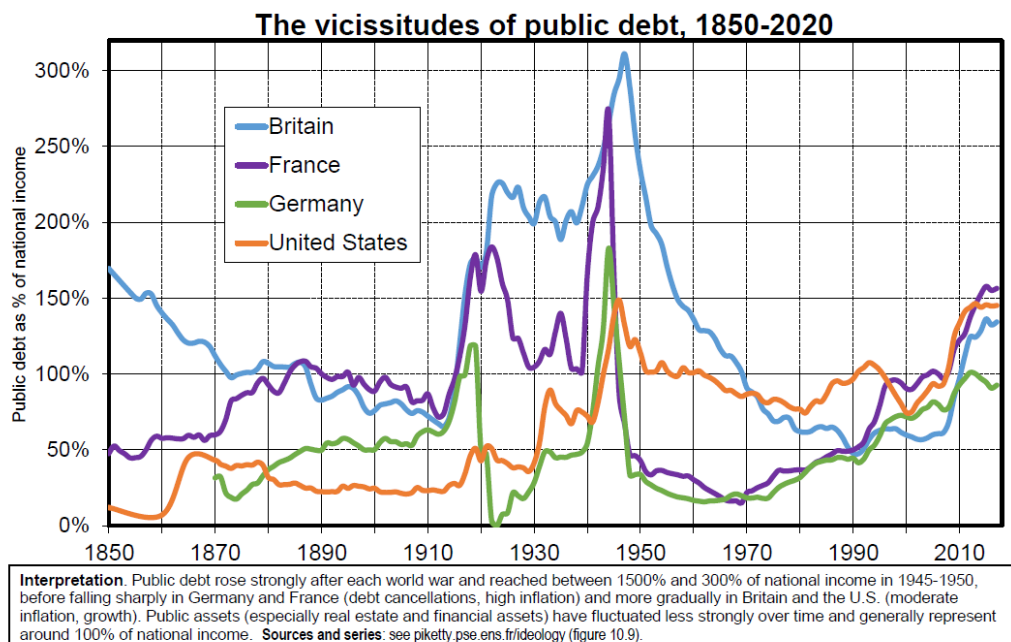




- For detailed decompositions of the fall in aggregate private property between 1914 and 1945, see Piketty-Zucman, *Capital is Back: Wealth- Income Ratios in Rich Countries, 1700-2010*, QJE 2014 (database) (and *Capital in the 21 st century*, chapters 3-5)
- **Physical destructions** of capital: 25-30% of the 1914-1945 fall in France and German, <5% in Britain
- Other two main components explaining the fall (about 50-50):
- **Lack of investment** (low private savings, most of which were absorbed to finance the public debt used to pay for the war)
- **Change in legal property regime:** nationalization, financial regulation, codetermination (power sharing between shareholders and workerrepresentative in companies), rent control, etc. → decline in the market value of assets (companies, real estate) for property owners, but not necessarily of the real economic value of capital

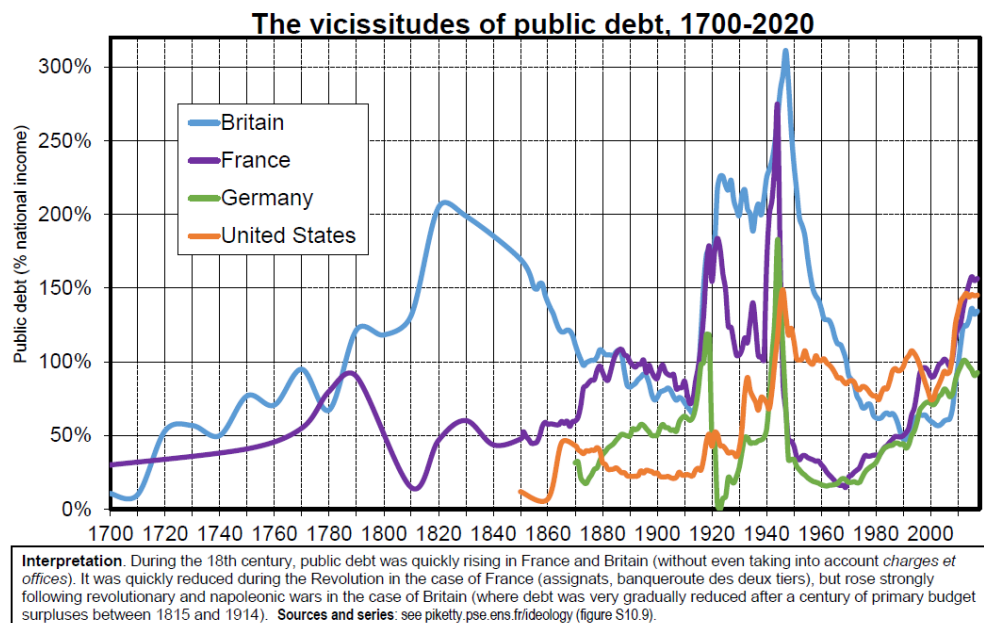
The removal of 20c public debt: inflation & exceptional wealth taxes

- In 1945-1950, public debt was about 200%-300% of national income in Britain, France and Germany. In effect, between 1914 and 1945, private wealth holders have put a large part of their assets into public debt in order to finance the war.
- This large public debt was never repaid to bond holders
- **Britain: gradual erosion by inflation 1945-1980**
- **France: very fast erosion by inflation in 1945-1950**
- **Germany: exceptionnal progressive taxes of large private wealth** (real estate + financial, incl. public debt) were put in place in 1949-1952
→ **very fast reduction of public debt (<20% national income in 1950s- 1960s)**, without the negative distributional consequences of inflation (≠ regressive wealth tax)



- **Germany's public debt removal 1949-1953:** mixture of inflation (much more moderate than Germany 1920s or France 1945-1949), **exceptionnal wealth taxes**, and **foreign debt cancellation** (London 1953, final cancellation 1991)
- See L. Hughes, *Shouldering the Burdens of Defeat: West Germany and the Reconstruction of Social Justice*, U. N.Carolina Press 1999
- See Galogre-Vila et al, « The economic consequences of the 1953 London Debt Agreement », EREH 2018

- **Large levies (one-off taxes) on private capital** (up to 90% on top wealth) **were also used in Japan 1946-1947** in order to reduce large public debt
- See Eichengreen, « The Capital levy in theory and practice », in Dornbush- Draghi, Public debt management: theory and history, CUP 1990
→ **the fast removal of public debt following WW2 was a big success in Germany, Japan, France, etc.: it facilitated post-war growth by giving more fiscal capacity for investment in public infrastructure, education, health, etc.**
- **A very different historical experiment with large public debt: Britain 1815-1914.** Over 200% of national income in public debt in 1815. Gradually repaid by primary budget surplus during 1815-1914 period. Possible but slow.
- Did not prevent industrial investment and development (Ricardo, 1817)
- See R. Barro, “Are government bonds net wealth?”, JPE 1974 : in a representative agent model, rational agents should anticipate that they will pay more taxes in the future if today’s public deficit increase, so they save more in order to make reserves (for themselves or their successors) so as to pay these taxes in the future → the timing of taxes is irrelevant, « debt neutrality » (« Ricardian equivalence »)
- See also R. Barro « Government spending, interest rates, prices and budget deficits in the UK 1701-1918 », JME 1987 ; G. Clark, «Debt, deficits and crowding out: England 1727-1840”, EREH 2001
- Pb: these works neglect the fact that public debt also has huge distributional consequences (whether it is repaid or not), and that this matters for accumulation and growth. I.e. **full debt repayment in 19c Britain was highly beneficial to top wealth holders** (see Amoureux 2014), **while debt cancellation in mid-20c Europe and Japan contributed to the emergence of a more inclusive development model.**

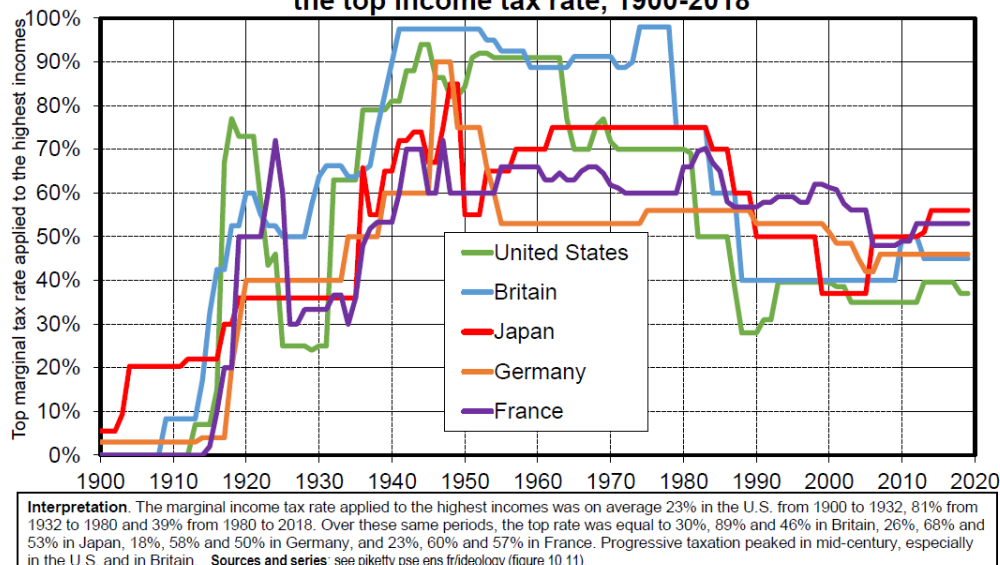


Progressive taxation & the deconcentration of property

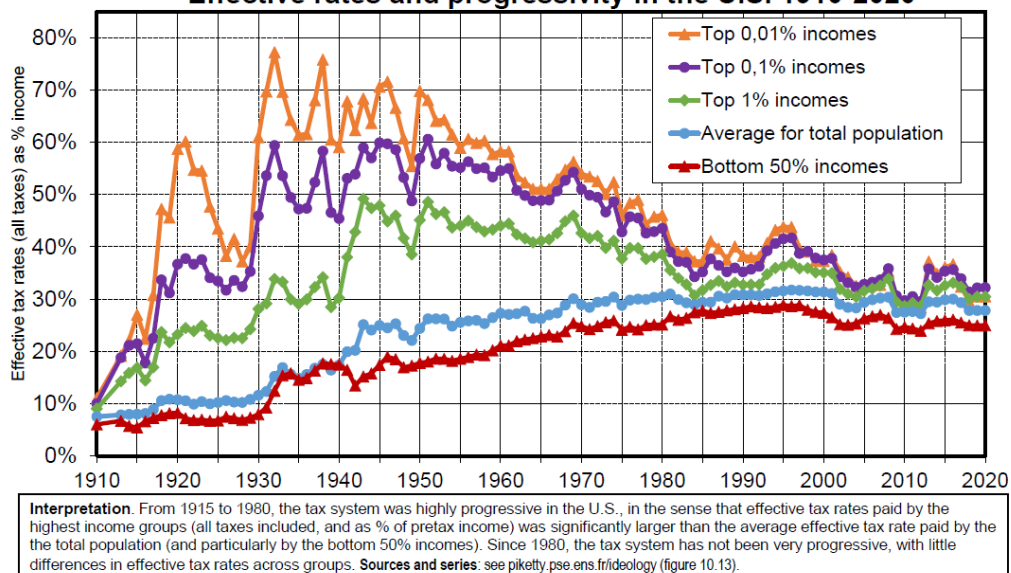
- **Progressive taxation of top income and inheritance contributed to reduce the long-run concentration of property** (less accumulation at the top, but more accumulation within middle class) (see e.g. The End of Rentiers: Paris 1842- 1957) (with G. Postel-Vinay, J.L. Rosenthal, WID.world WP)

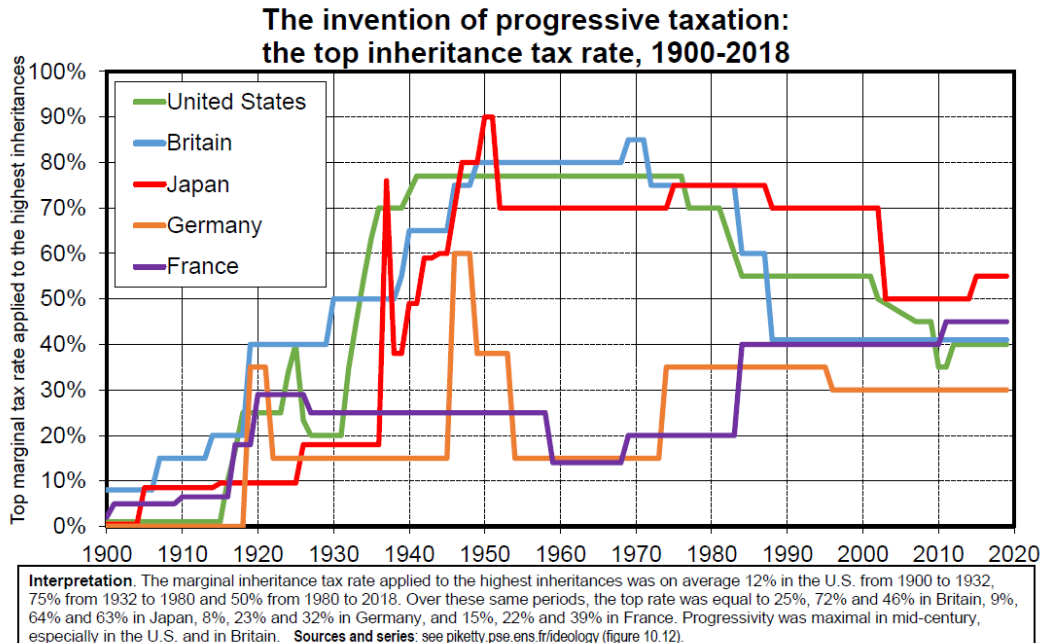
- **Rise of progressive taxation was accelerated by WW1 & WW2**, but also by other events, including Bolshevik revolution (huge impact on European politics), the Great depression (major impact in the US). The role of wars as such should not be exaggerated (& wars were themselves partly due to inequality).
- **Key role of long-run ideological changes and socio-political mobilization:**
 - 1909-1910 People's Budget in Britain (fall of House of Lords)
 - 1911 constitutional change in Sweden (end of hyper-censitary regime)
 - 1913 constitutional amendment in the US (rising demand for redistribution) Rise of progressive taxation in Japan also started much before WW1, etc.

**The invention of progressive taxation:
the top income tax rate, 1900-2018**



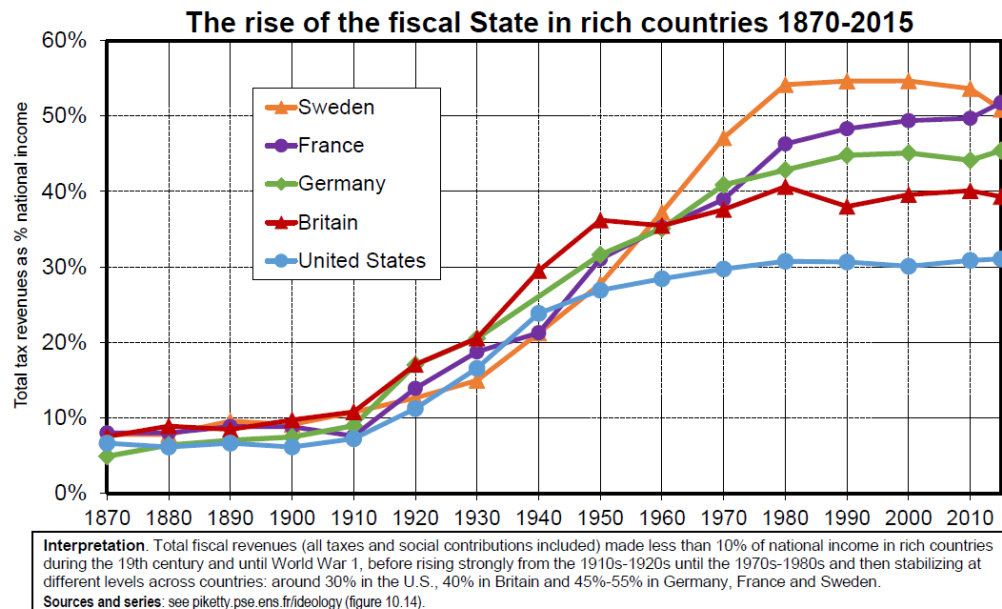
Effective rates and progressivity in the U.S. 1910-2020

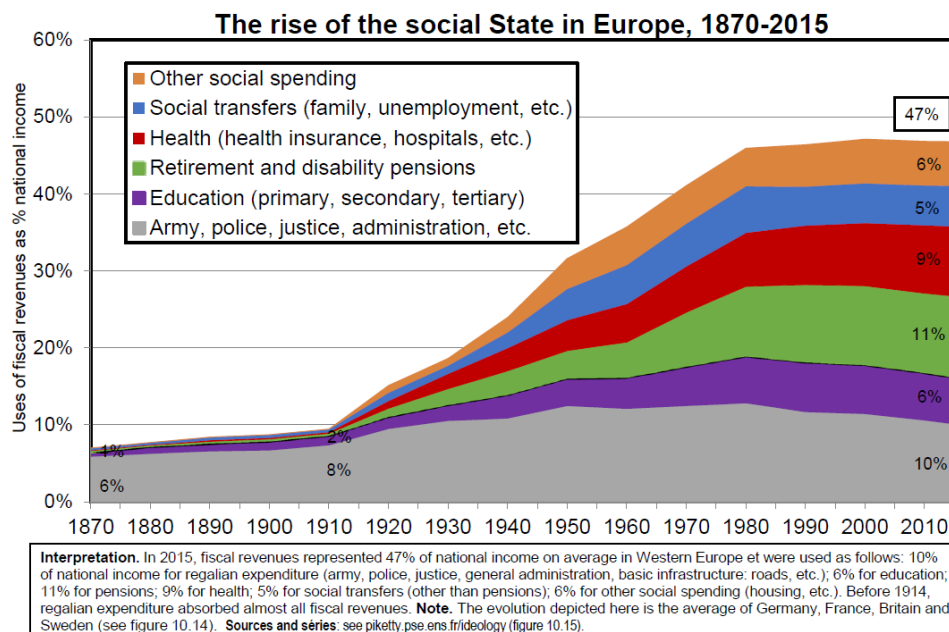




The rise of the social and fiscal state

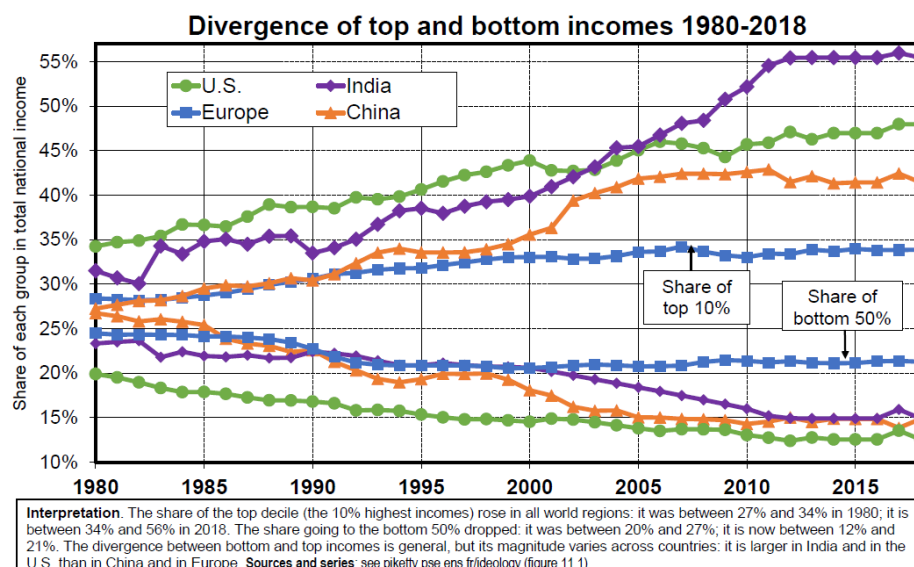
- Tax progressivity at the top played an important role for reducing top-end inequality and for making the rise of the social and fiscal state acceptable for the average taxpayer
- But what was even more important was the overall rise of total fiscal capacity, which was used to finance pro-equality and pro-growth spending (education, health, public infrastructures, etc.)
- Rise of educational investment in Europe & the US : <1% national income until 1910s, 5%-6% since 1980s



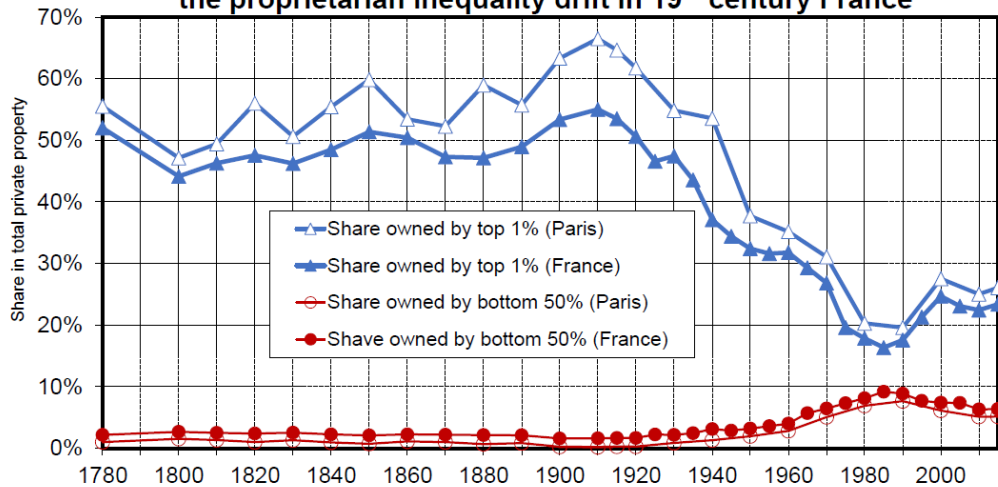


Social-democratic societies (1950-1980): incomplete equality

- Despite their many achievements, social-democratic societies (1950-1980) were unable to prevent the **global rise of inequality since 1980-1990**
- **Also, the magnitude of the decline of inequality achieved during 20c in social-democratic societies should not be exaggerated:**
the bottom 50% wealth share has always remained very small (5% or less): **very limited diffusion of property and economic democracy**
the bottom 50% income share has increased (from 10% to 20%) but remained below top 10% share
- **In the US, rising inequality since 1980s has taken enormous proportions (bottom 50% income share back to 10%).** Strong anti-globalization feeling, rise of nationalist movements, Trump, Brexit, etc. Is this the common future?

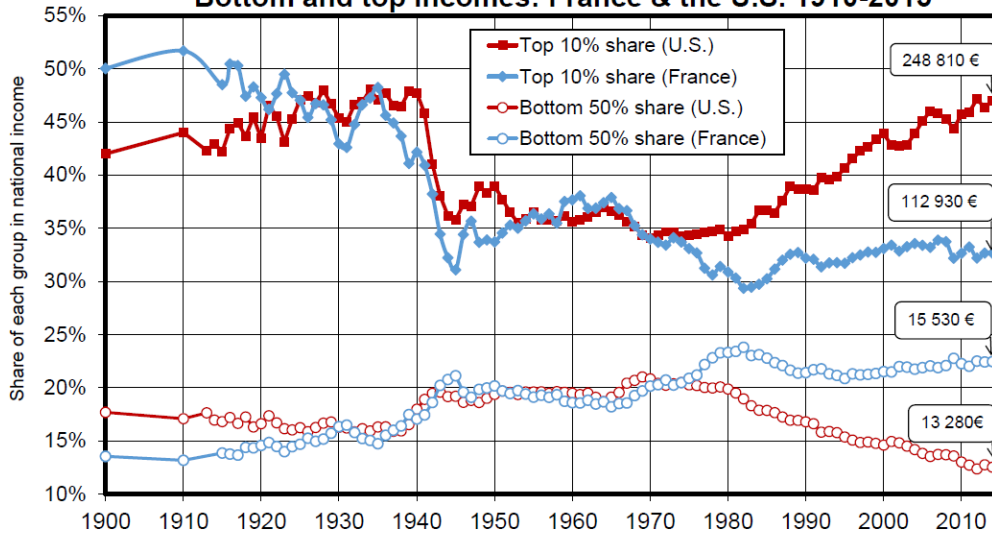


The failure of the French Revolution: the proprietarian inequality drift in 19th century France



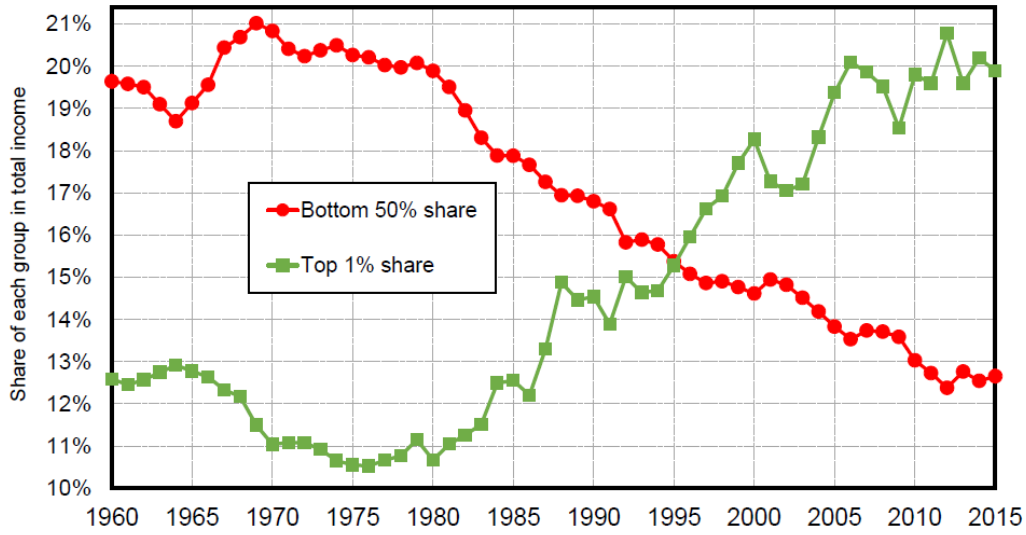
Interpretation. In Paris, the richest 1% owned about 67% of total private property in 1910 (all assets combined: real, financial, business, etc.), vs. 49% in 1810 and 55% in 1780. After a small drop during the French Revolution, the concentration of property rose in France (and particularly in Paris) during the 19th century and until World War I. In the long run, the fall in inequality occurred following the world wars (1914-1945), rather than following the Revolution of 1789. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 4.1).

Bottom and top incomes: France & the U.S. 1910-2015



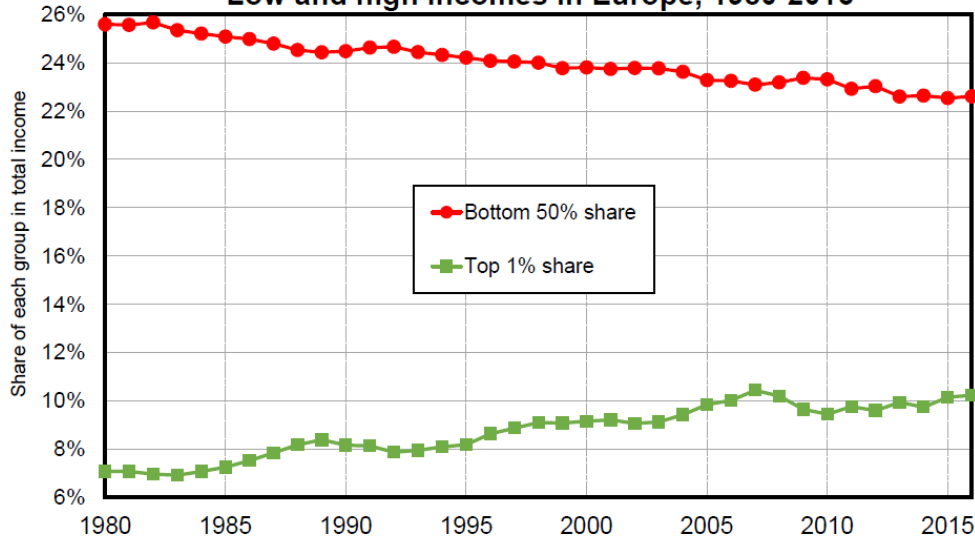
Interpretation. Income inequality in the U.S. in 2010-2015 exceeded its level in 1900-1910, whereas it was reduced in France (and Europe). In both cases, however, inequality remains high: the top decile, one-fifth the size of the bottom 50 percent, still receives a much larger income share. The income levels reported here are the average annual incomes of each group in 2015 (at purchasing power parity). **Sources and series:** see piketty.pse.ens.fr/ideology (figure 11.2).

The fall of the bottom 50% share: U.S. 1960-2015

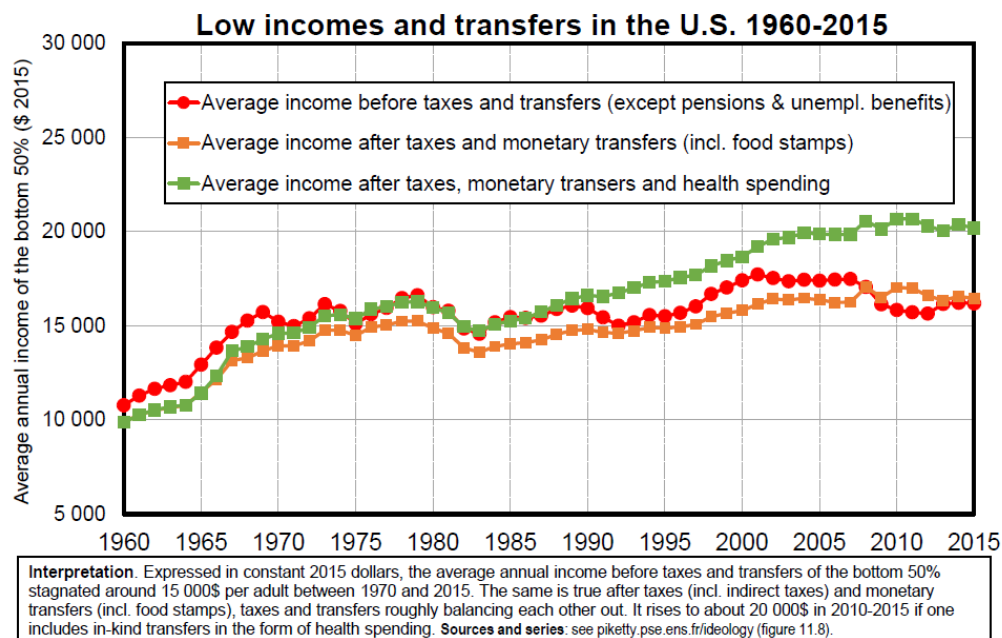
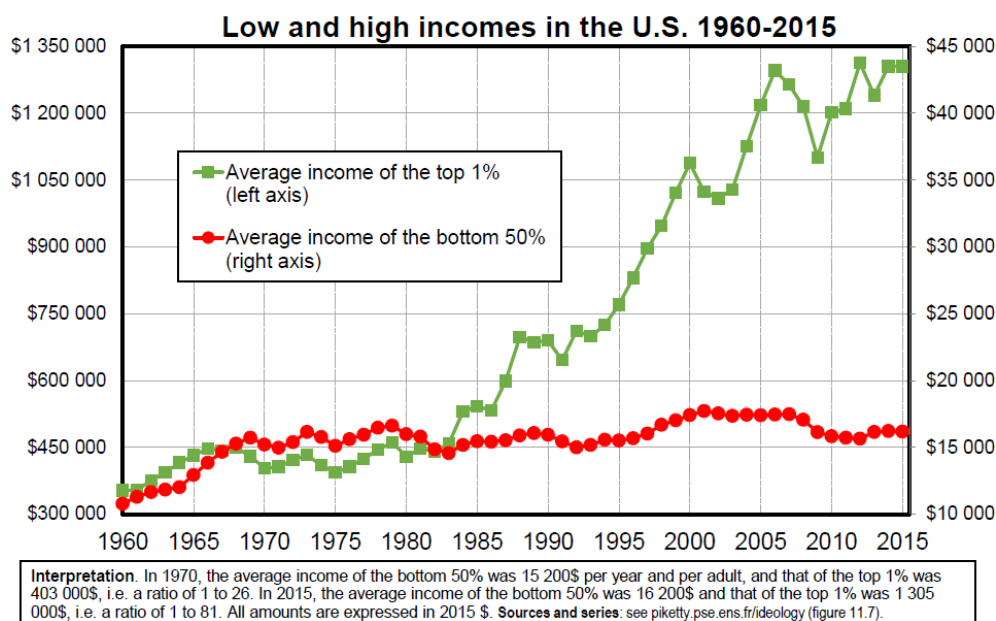


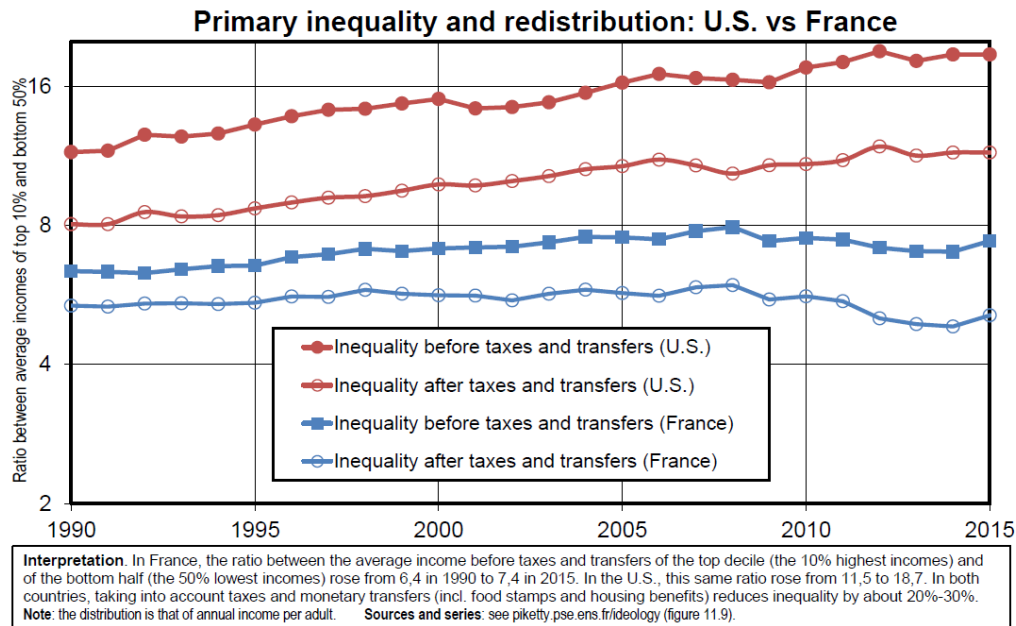
Interpretation. The share of the bottom 50% lowest incomes in the U.S. dropped from about 20% of total income in the 1970s to about 12%-13% in the 2010s. Over the same period, the share going to the top 1% highest incomes rose from 11% of total income to 20%-21%. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 11.5).

Low and high incomes in Europe, 1980-2016

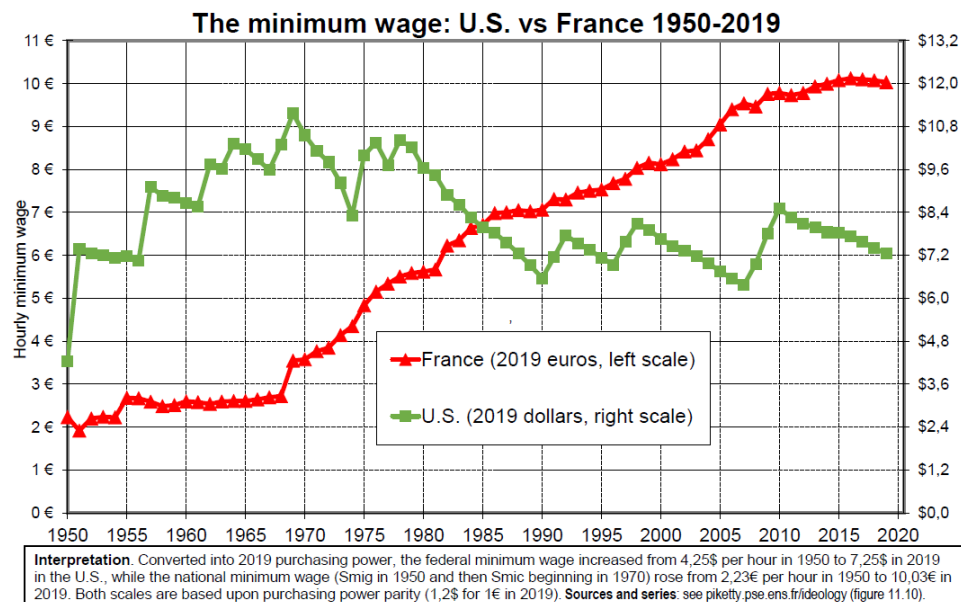


Interpretation. The share of the bottom 50% lowest incomes in Europe dropped from about 26% of total income in the early 1980s to 23% in the 2010s. Over the same period, the share going to the top 1% highest incomes rose from 7% of total income to 10%. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 11.6).





- More on **predistribution** (public policies affecting pretax income inequality: education, bargaining power, capital endowments, minimum wages, etc.) **vs redistribution** (public policies reducing disposable income inequality, for a given level of pretax income inequality: i.e. redistributive taxes and transfers):
- Inequality and Redistribution in France 1900-2018: Evidence from Post-tax Distributive National Accounts (DINA) (with Bozio, Garbinti, Goupille, Guillot, WID.world WP 2018/10)
- The lower inequality level in France vs US in 1990-2018 is entirely due to lower pretax inequality levels: more attention should be given to predistribution (including the impact of progressive income and wealth taxes on predistribution)



The limitations of social-democratic societies

- **Incomplete diffusion of property and power sharing.**
Bottom 50% wealth share has always remained very low.
German and Swedish laws on codetermination (workers voting rights vs shareholders voting rights) were not generalized (until recently).
- **Insufficient investment in education.** Challenges of tertiary education: it was easier to design an egalitarian platform with primary-secondary education.
- **Challenge of financial deregulation and tax competition.**
Reagan-Thatcher tax cuts put strong pressure on other countries.
Adoption of free capital flows treaties in the 1980s-1990s, with no common regulation, taxation, or automatic exchange of information.

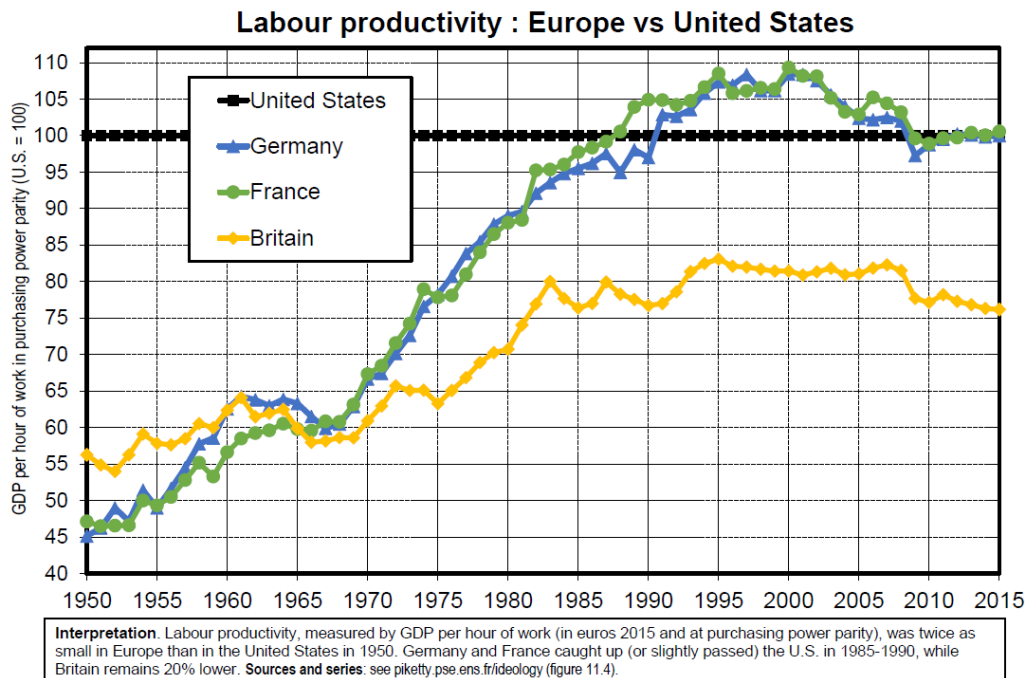
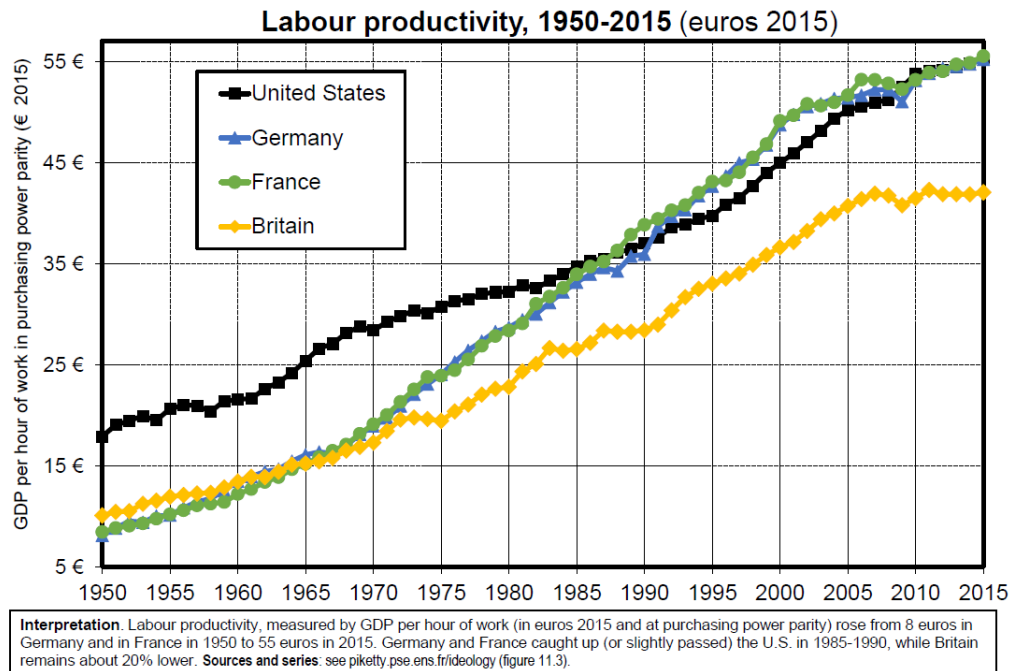
Codetermination & power sharing: success, limits & incomplete diffusion

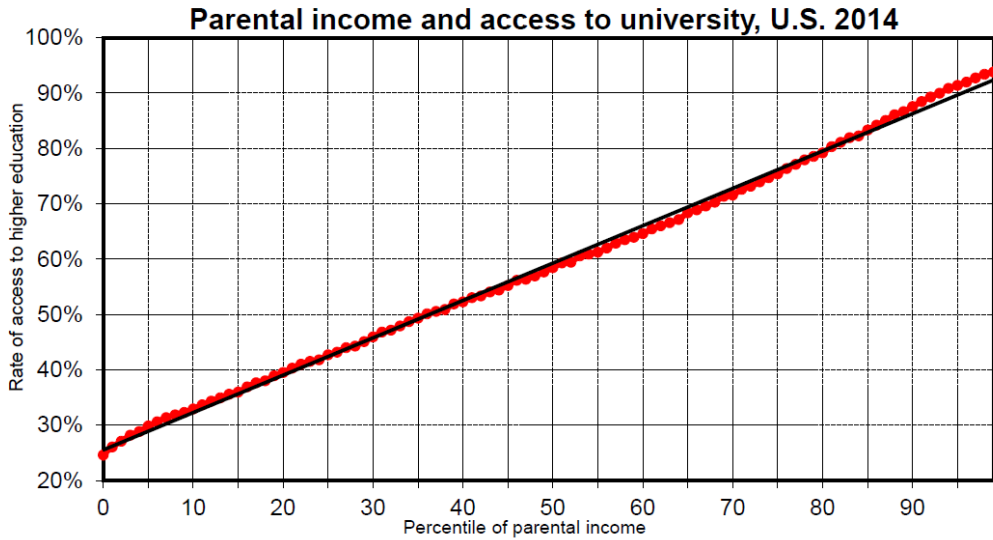
- German codetermination laws 1951-1952 (reinforced in 1976): half of the seats in board of large companies (>2000 employees) go to elected worker representatives (one third of the seats in companies with 500-2000 employees)
- This implies that with a minority capital stake (say 10%) employees can take control of the companies: **major challenge to the one-share one-vote principle and to the traditional notion of private property** (major innovation made by Weimar Constitution 1919 and German Fundamental Law in 1949)
- Sweden (1974 law extended in 1980-1987): one third of seats for workers in all companies with 25 employees or more
- **Codetermination/comanagement seems to have had a positive impact on overall productivity (while limiting the rise of inequality and very top pay)**
- E. McGaughey, The Codetermination Bargains: History of German Corporate and Labour Law, Columbia Journal of European Law 2017
- **Failed extensions 1970s-1980s:**
 - UK 1978: “2x+y” project, following Bullock commission
 - EC Company Law Directive project, multiple versions 1972-1988
- **New attempts 2010s:**
 - 2013 French law: one worker seat if board < 12 members (firms > 5000 employees) (extended in 2018)
 - UK Labour Law Manifesto 2018
 - US Accountable Capitalism Act 2018

Social-democracy and the challenge of tertiary education

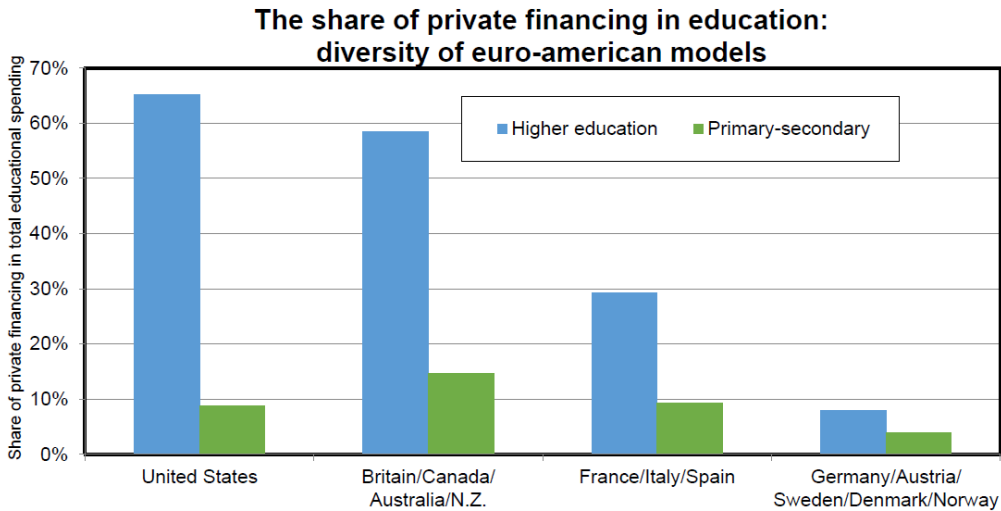
- US historical educational advance:
90% primary enrollment 1840s (vs 20%-30% Britain-France-Germany)
80% secondary enrollment 1950s (vs 20%-40% Britain-Fr-Germany)
→ key reason for US productivity advance
- Goldin, The Human Capital Century and American Leadership: Virtues of the Past, Journal of Economic History 2001
- **But since 1980s-1990s, all rich countries have reached quasi-universal primary & secondary enrollment and productivities converged**
- New challenge: access and funding of higher education.

- Major impact on rising inequality.
- Stagnation of total educational investment since 1980s-1990s: most natural explanation for growth slowdown (see also lecture 7 on reversal of electoral cleavages on education)

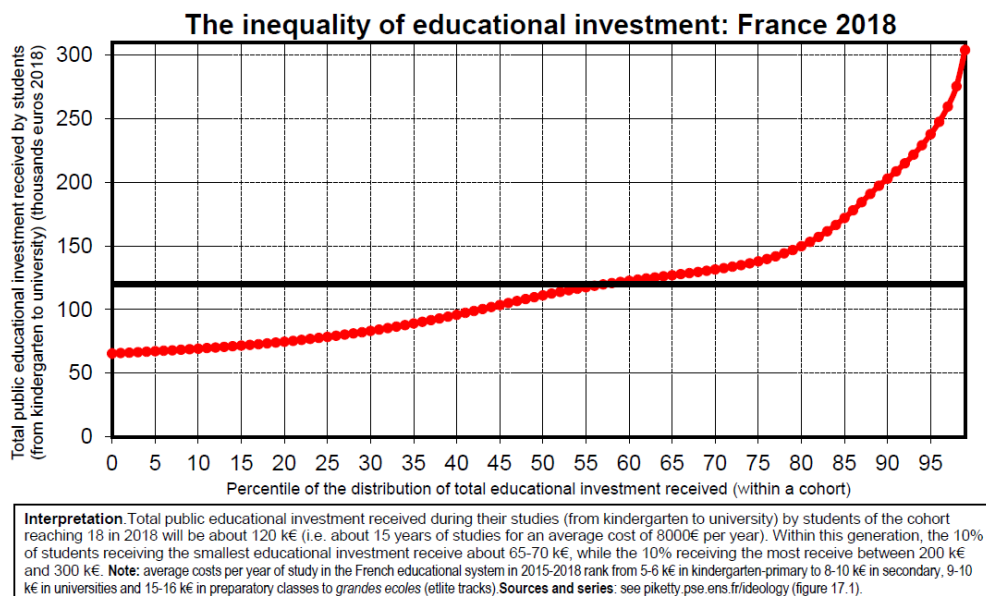




Interpretation. In 2014, the rate of access to higher education (percentage of individuals aged 19-21 enrolled in a university, college or any other institution of higher education) was barely 30% among the bottom 10% poorest children in the United States, and over 90% among the top 10% richest children. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 0.8).



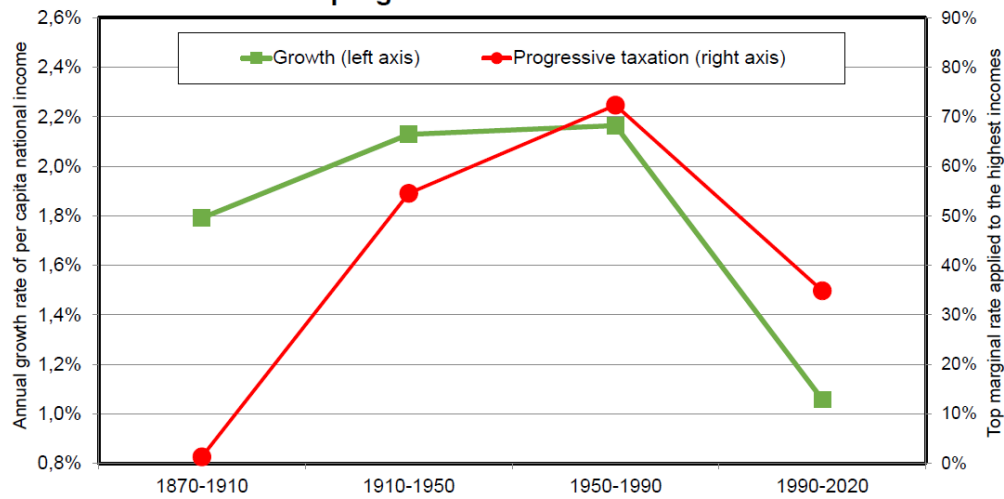
Interpretation. In the U.S., private financing make 65% of total financing (private and public) of higher education, and 9% of total financing of primary and secondary education. The share of private financing in higher education varies substantially across countries, with an anglo-american model, a south-european model and a north-european model. The share of private financing is everywhere relatively small regarding primary and secondary education (2014-2016 figures). **Sources and series:** see piketty.pse.ens.fr/ideology (figure 11.11).



The challenge of tax competition and financial deregulation

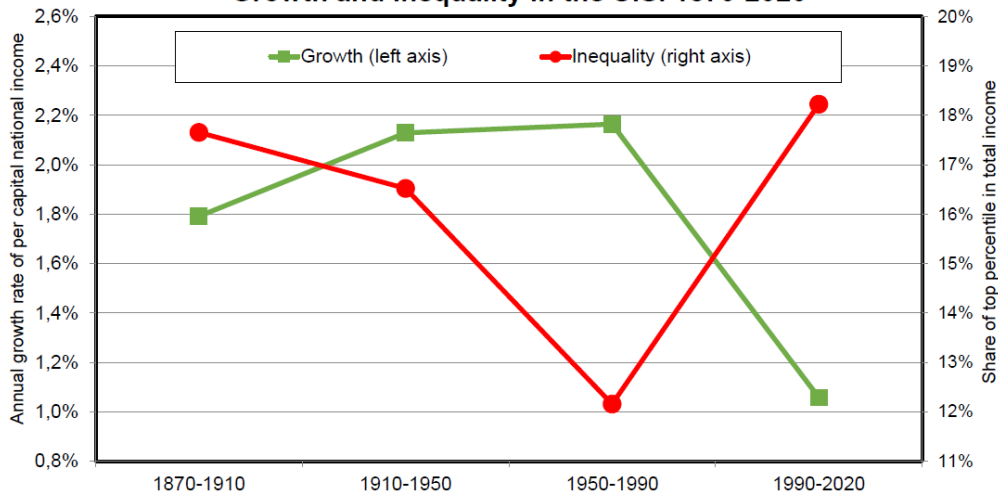
- **Reagan-Thatcher tax cuts of the 1980s and financial deregulation have put strong pressure on social-democratic fiscal compacts**
- R. Abdelal, *Capital Rules. The Construction of Global Finance*, HUP 2007. **The origins of unregulated capital flows are not only in US-UK, but also in France-Germany:** this was the deal made by the two countries in the 1980s in order to create a common currency (→ Maastricht Treaty 1992)
- Poor growth performance in rich countries since 1980s-1990s has raised strong doubts about the virtues of globalization and economic liberalism. At the same time collapse of communism (see lecture 6) has raised strong doubts about the possibility of an alternative economic system.
- This can contribute to explain the rise of nationalist-protectionist- xenophobic political movements in the 2000s-2010s: National Front, Trump, Brexit, etc. (see lectures 7-8)

Growth and progressive taxation in the U.S. 1870-2020



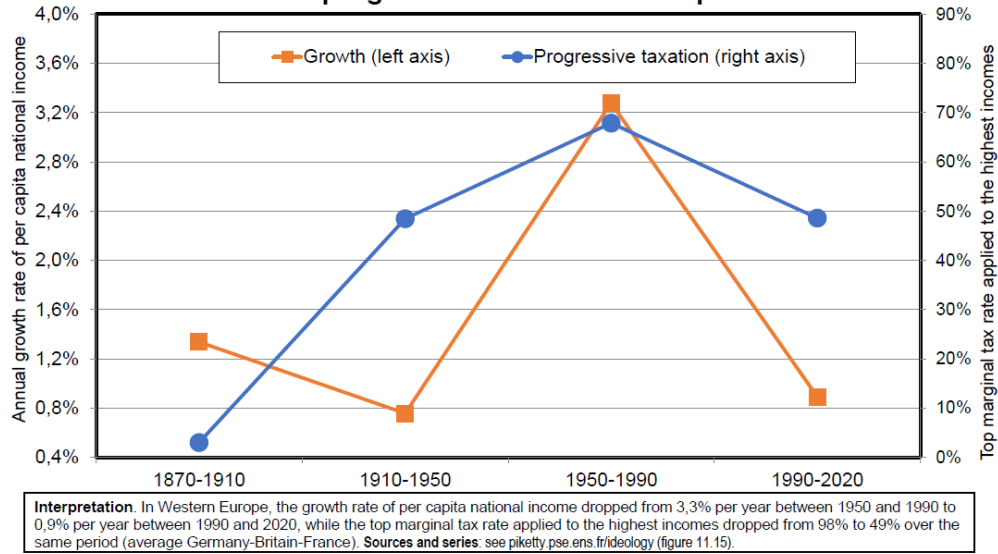
Interpretation. in the U.S., the growth rate of per capita national income dropped from 2.2% per year between 1950 and 1990 to 1.1% between 1990 and 2020, while the top marginal tax rate applied to the highest incomes dropped from 72% to 35% over the same period. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 11.13).

Growth and inequality in the U.S. 1870-2020



Interpretation. in the U.S., the growth rate of per capita national income dropped from 2.2% per year between 1950 and 1990 to 1.1% between 1990 and 2020, while the share of the top percentile (the 1% highest incomes) in national income rose from 12% to 18% over the same period. **Sources and series:** see piketty.pse.ens.fr/ideology (figure 11.12).

Growth and progressive taxation in Europe 1870-2020



Growth and inequality in Europe 1870-2020

