A Lonergan Institute Seminar St Anselm’s Abbey

THOMAS PICKETTY

CAPITAL IN THE TWENTY-FIRST CENTURY

DISCUSSION: SATURDAY, 12/05/2020

Chapter 1: Income and Output

Discussion Questions:

"The first two parts of this book focus on the respective shares of global income going to labor and capital and on how those shares have changed since the eighteenth century."

Picketty states that "the question of what share of output should go to wages and what share to profits—in other words, how should the income from production be divided between labor and capital?—has always been at the heart of distributional conflict."

"Does this kind of violent clash between labor and capital belong to the past, or will it be an integral part of twenty-first-century history?"

Question: Where does your income originate from? And have you received a fair share relative to the work (output) you contribute?

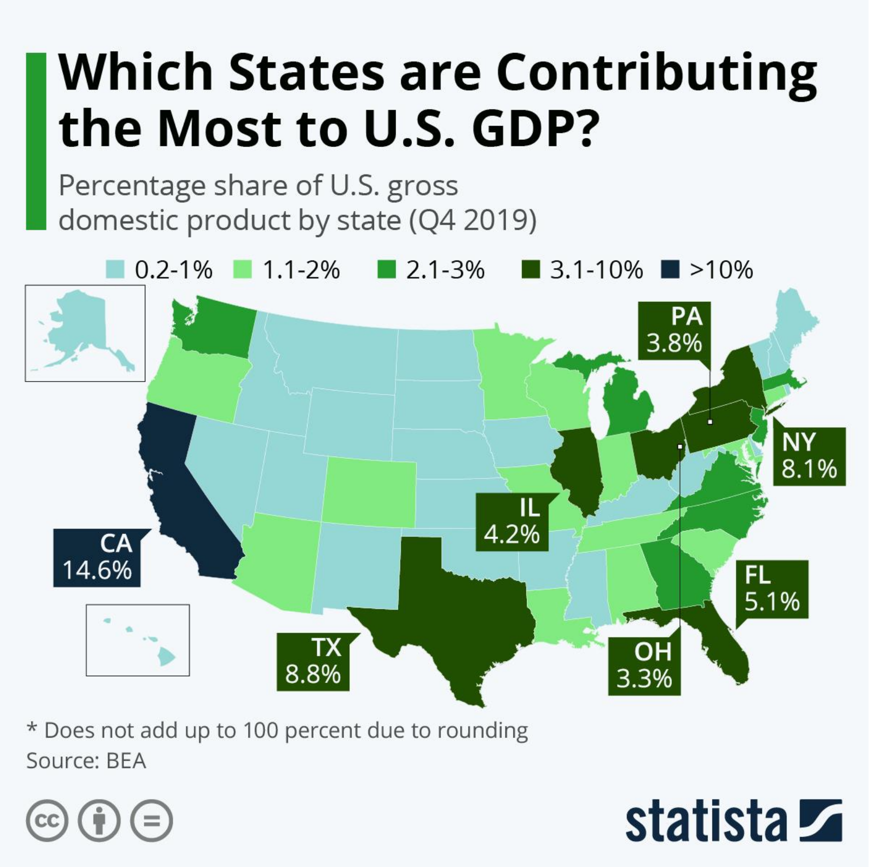
William Clarke; Slaves Fell the Ripe Sugar, 1823

Definitions of Economic Jargon

National income is defined as the sum of all income available to the residents of a given country in a given year, regardless of the legal classification of that income.

Gross Domestic Product (GDP) is defined as the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country's economic health. ** US GDP 2019 $21.44 trillion*

"There are, however, two important differences between GDP and national income. GDP measures the total of goods and services produced in a given year within the borders of a given country. In order to calculate national income, one must first subtract from GDP the depreciation of the capital that made this production possible: in other words, one must deduct wear and tear on buildings, infrastructure, machinery, vehicles, computers, and other items during the year in question."

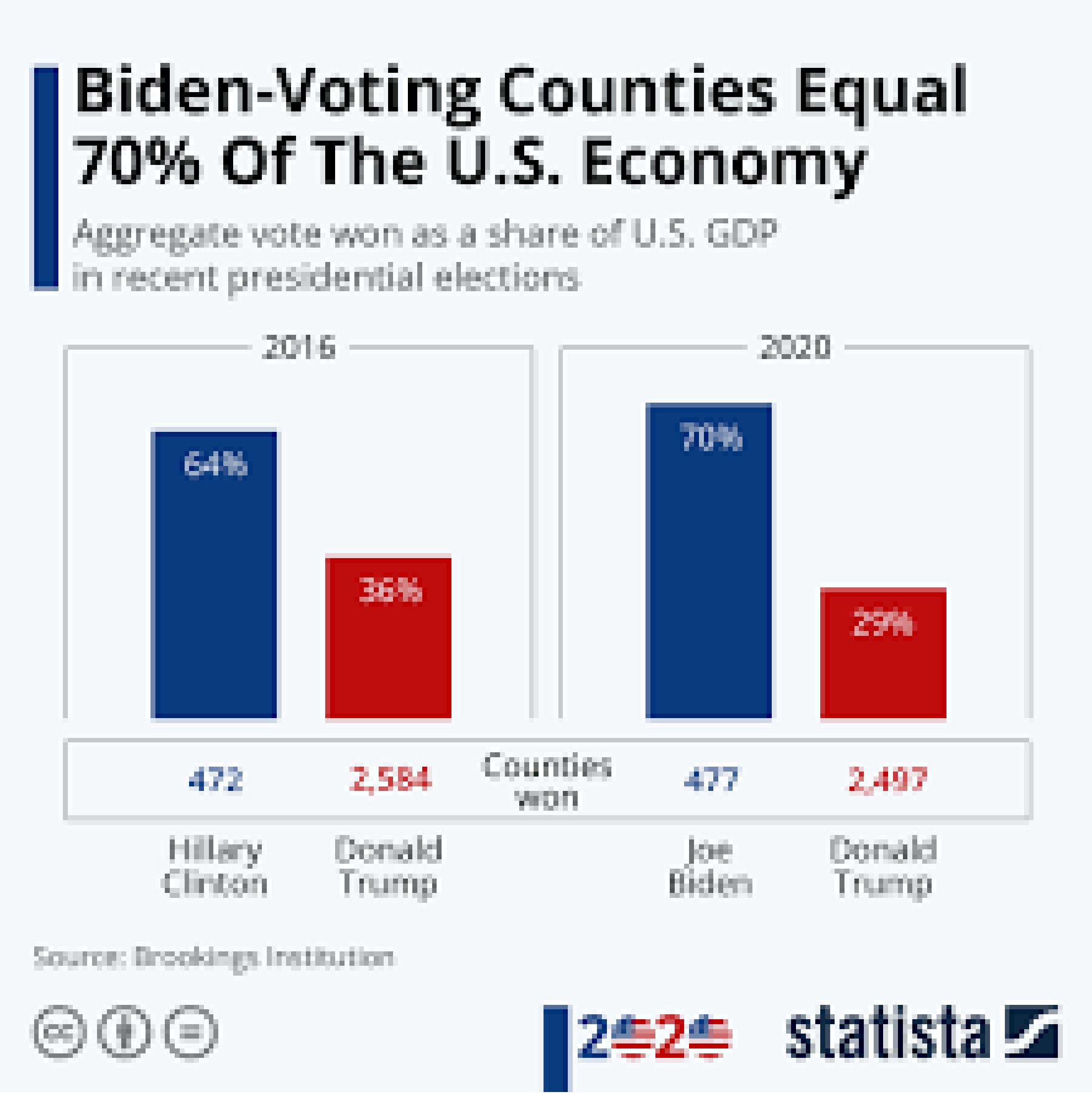


Impact of Inequity on Politics

According to Brookings:

“Biden’s winning base in 477 counties encompasses fully 70% of America’s economic activity, while Trump’s losing base of 2,497 counties represents just 29% of the economy.”

[Biden-voting counties equal 70% of America’s economy. What does this mean for the nation’s political-economic divide? (brookings.edu)]



“In short, 2020’s map continues to reflect a striking split between the large, dense, metropolitan counties that voted Democratic and the mostly exurban, small-town, or rural counties that voted Republican. Blue and red America reflect two very different economies: one oriented to diverse, often college-educated workers in professional and digital services occupations, and the other whiter, less-educated, and more dependent on “traditional” industries”

Policy Matters Ohio

“Ohio’s largest employers paid CEOs $14.6 million on average”

https://www.policymattersohio.org/research-policy/fair-economy/work-wages/big-ohio-ceos-306-median-employee-1

“Today, many Ohioans performing critical jobs aren’t paid enough to make ends meet, but the CEOs of the companies they work for are paid more than ever. Both of the most recent downturns have hit low and middle-income people harder and likely for much longer, exacerbating a decades-long trend that has separated the economic fortunes of the wealthiest from those of everyone else. The stock market rebounded from the COVID-19 recession in record time. “

Discussion Question:
Is it “just” to pay a CEO $14.6 MILLION?

WPA Federal Art ProjectMichigan artist Alfred Castagne sketching WPA construction workers, 1939. (Image Number: 69-AG-410)
National Archives and Records Administration, Washington, D.C

“Ohio’s largest employers paid CEOs $14.6 million on average

Discussion Question: Is it “just” to pay a CEO $14.6 MILLION?

“Likewise, in the aftermath of the Great Recession, the wealthiest were the first to recover: Three years into the recovery, the top one-percent had captured 71.9% of all new Ohio income growth in the recovery. The post-recession growth was characterized as a “jobless recovery” that took eight years, until October 2015, to restore the number of jobs shed by Ohio employers after June 2007. Ohio has never recovered all those lost in the 2001 recession.”

Parable of the Rich Fool

From Luke 12:16-21

16 Then he told them a parable. “There was a rich man whose land produced a bountiful harvest.

17 He asked himself, ‘What shall I do, for I do not have space to store my harvest?’

18 And he said, ‘This is what I shall do: I shall tear down my barns and build larger ones. There I shall store all my grain and other goods

19[i] and I shall say to myself, “Now as for you, you have so many good things stored up for many years, rest, eat, drink, be merry!”’

20 But God said to him, ‘You fool, this night your life will be demanded of you; and the things you have prepared, to whom will they belong?’

21 Thus will it be for the one who stores up treasure for himself but is not rich in what matters to God.”[*]

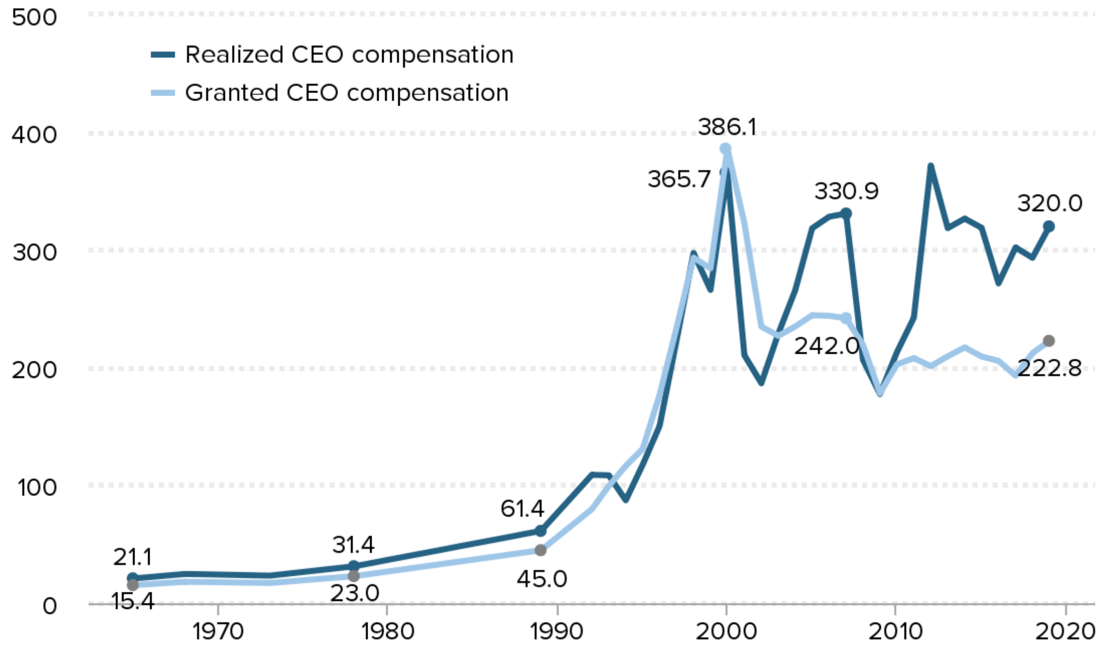
“Ohio’s largest employers paid CEOs $14.6 million on average

Discussion Question: Is it “just” to pay a CEO $14.6 MILLION?

“The CEOs of America’s largest firms are among the few who have benefitted from this growing fissure between the rich and the rest of us. For the past several decades, corporate boards have increased pay for CEOs faster than the economy has grown, while income for most Americans and Ohioans has been held down. This trend illustrates that growth in CEO pay does not reflect productivity growth in CEO performance or growth of their skills, but instead is largely the result of CEOs’ ability to set their own pay. It is a leading cause of growth in inequality. ”

CEOs make 320 times as much as typical workers

CEO-to-worker compensation ratio, 1965–2019



Notes: Average annual compensation for CEOs at the top 350 U.S. firms ranked by sales is measured in two ways. Both include salary, bonus, and long-term incentive payouts, but the “granted” measure includes the value of stock options and stock awards when they were granted, whereas the “realized” measure captures the value of stock-related components that accrues after options or stock awards are granted by including “stock options exercised” and “vested stock awards.” Projected value for 2019 is based on the percent change in CEO pay in the samples available in June 2018 and in June 2019 applied to the full-year 2018 value. “Typical worker” compensation is the average annual compensation (wages and benefits of a full-time, full-year worker) of production/nonsupervisory workers in the industries that the top 350 firms operate in.

Source: Authors’ analysis of data from Compustat’s ExecuComp database, the Bureau of Labor Statistics’ Current Employment Statistics data series, and the Bureau of Economic Analysis NIPA tables.

Economic Policy Institute

Policy Matters Ohio

"Ohio's largest employers paid CEOs $14.6 million on average

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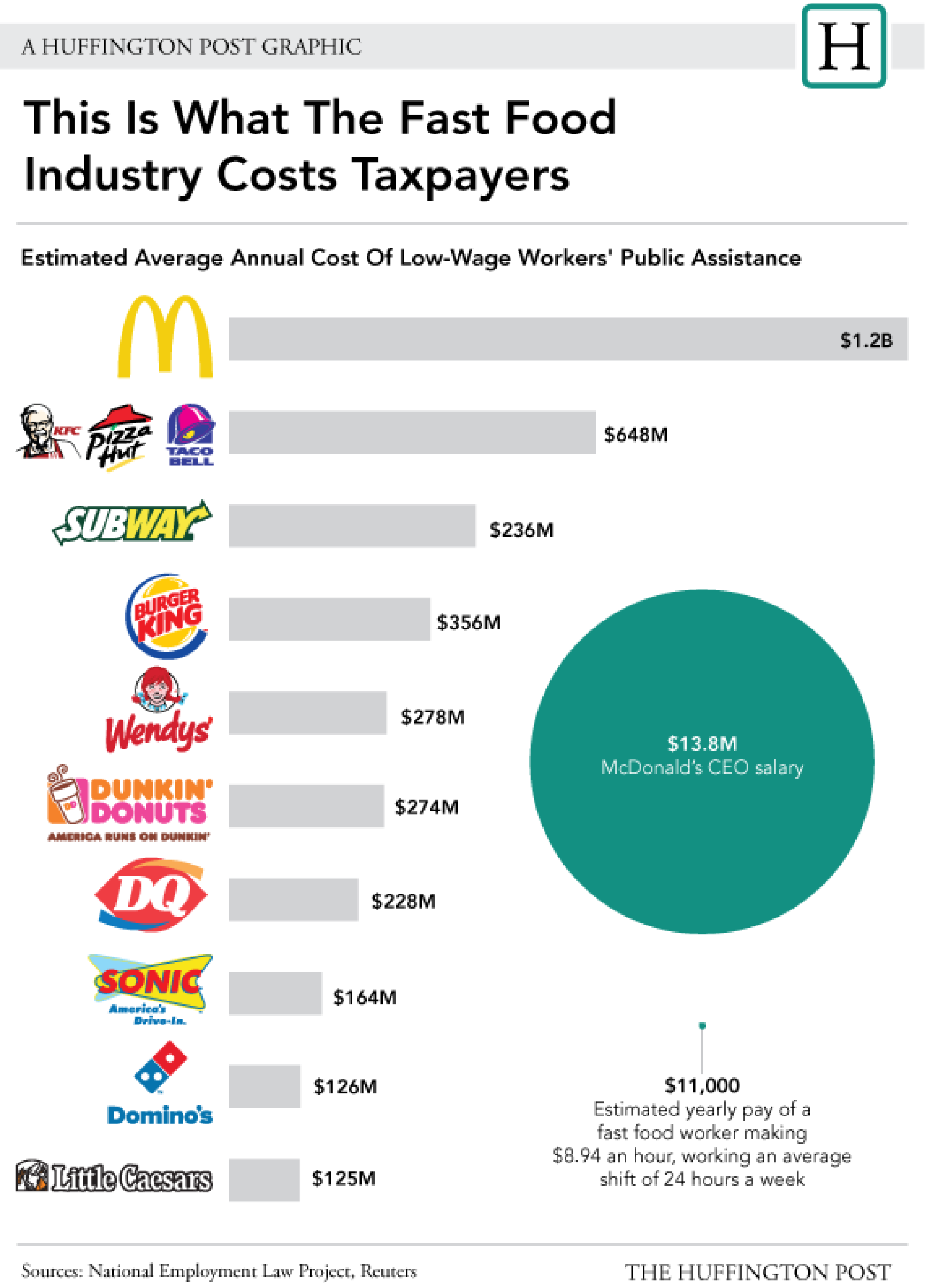
WPA Mural. By Charles Klauder

Policy Matters Ohio

"Ohio's largest employers paid CEOs $14.6 million on average

Discussion Question:
Is it "just" to pay a CEO $14.6 MILLION?

"The typical person working at one of Ohio's biggest employers makes more than the typical worker statewide, but many workers at Ohio's largest employers are paid wages below the poverty level. Today many CEOs bank windfalls as they preside over corporations that offer no paid sick time or hazard pay in the middle of a pandemic."



Policy Matters Ohio

"Ohio's largest employers paid CEOs $14.6 million on average

"Key Findings

The median CEO at Ohio's largest employers who report to the SEC made 306 times as much as the median worker at the same firm. 72% had pay ratios of at least 200-to-1.

Average pay among CEOs at Ohio's 54 largest employers that file reports with the SEC was $14.6 million.

30% of the top reporting employers paid their median worker less than $25,000 per year. The median worker could be part time, and not based in Ohio. Retail companies dominated low-pay employers among top firms.

Corporations have increased pay for CEOs faster than most workers' pay over the past four decades: Ohio's 306-to-1, and 320-to-1 for the nation, compares with national figures of 21-to-1 in 1965 and 61-to-1 in 1989.[1] Median pay for Ohio workers grew 3.9%, and 15.1% nationally since 1979. Median pay at top Ohio employers exceeds the statewide median by about a third"

Discussion Question:
Is it "just" to pay a CEO $14.6 MILLION?

Diego Rivera Mural (Panel) -1932. Depicting workers at the infamous Ford Motor Company's River Rouge plan

Discussion Question:
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"Communism forgets that life is individual. Capitalism forgets that life is social, and the kingdom of brotherhood is found neither in the thesis of communism nor the antithesis of capitalism but in a higher synthesis. It is found in a higher synthesis that combines the truths of both."
— Martin Luther King

Table 1

CEO/Median Employee Pay 2019

Ohio's Major Employers That Reported Ratios

Company	Ohio Employment Rank	Ohioans Employed	CEO Name	Total CEO Comp.	Median Comp.	Ratio
Wal-Mart Stores, Inc.	2	49,330	Doug McMillon	$22,105,350	$22,484	983
Kroger Co.	3	45,340	Rodney McMullen	$21,129,648	$26,790	789
JPMorgan Chase & Co.	10	21,000	Jamie Dimon	$31,619,266	$80,431	393
United Parcel Service, Inc.	15	14,425	David Abney	$18,040,841	$74,395	243
Lowe's Companies, Inc.	18	13,400	Marvin Ellison	$11,621,369	$22,748	511
Home Depot, Inc.	20	12,350	Craig Menear	$10,889,833	$22,652	481
General Electric Company	21	12,000	H. Lawrence Culp Jr.	$24,553,788	$50,471	486
Berkshire Hathaway, Inc.	24	11,800	Warren Buffet	$374,773	$65,740	5.7
Amazon.com, Inc.	25	11,500	Jeff Bezos	$1,681,840	$28,848	58
Procter & Gamble Company	26	11,000	David Taylor	$20,498,812	$66,326	309
Progressive Corporation	26	11,000	Tricia Griffith	$14,041,272	$66,285	212
Huntington Bancshares Incorporated	31	10,600	Stephen Steinour	$7,488,685	$61,717	121.3
Cedar Fair, L.P.	32	10,500	Richard Zimmerman	$4,585,920	$8,748	524
L Brands, Inc.	33	10,300	Les Wexner	$3,783,221	$13,490	280
Whirlpool Corporation	34	9,350	Marc Bitzer	$14,011,663	$20,765	675
Marathon Petroleum Corporation	35	9,300	Gary Heminger	$24,129,164	$27,507	877

Discussion Question:
Is it "just" to pay a CEO $14.6 MILLION?

We need to ask the moral questions: Do I have a right to be rich? And do I have a right to be content living in a world with so much poverty and inequality? These questions motivate us to view the issue of inequality as central to human living.
- Amartya Sen

Corporation						
CVS Health Corporation	36	8,800	Larry Merlo	$36,466,470	$46,140	790
Fifth Third Bancorp	36	8,800	Greg Carmichael	$8,999,237	$68,103	132
Target Corporation	39	8,600	Brian Cornell	$18,938,363	$23,080	821
Dollar Tree, Inc.	40	8,200	Gary M. Philbin	$10,604,621	$15,375	690
Kohl's Corporation	40	8,200	Michelle Gass	$8,983,392	$9,738	923
Charter Communications, Inc. / Spectrum Management Holding Company, LLC	42	7,930	Thomas Rutledge	$8,743,601	$57,625	151.7
Dollar General Corporation	44	7,000	Todd J. Vasos	$12,008,059	$14,571	824
FirstEnergy Corp.	44	7,000	Charles Jones	$14,684,659	$149,550	98
PNC Financial Services Group, Inc.	44	7,000	William S. Demchak	$16,555,752	$76,131	217
AT&T Inc.	49	6,900	Randall Stephenson	$32,032,925	$98,630	325
Cardinal Health, Inc.	51	6,700	Mike Kaufmann	$15,584,454	$57,261	272
KeyCorp	54	6,400	Beth E. Mooney	$9,663,988	$63,748	152
Macy's, Inc.	56	6,200	Jeffrey Gennette	$10,308,820	$22,353	461
Ford Motor Company	57	6,150	James Hackett	$17,355,505	$110,706	157
Sherwin-Williams Company	59	6,100	John G. Morikis	$14,854,731	$42,590	349
Walgreens Boots Alliance, Inc.	60	6,060	Stefano Pessina	$19,156,202	$34,074	562
American Electric Power Company, Inc.	61	6,000	Nick Akins	$14,492,436	$132,611	109
TJX Companies Inc.	61	6,000	Ernie Herrman	$19,083,676	$12,006	1590
U.S. Bancorp	65	5,300	Andrew Cecere	$18,801,847	$69,775	269

Discussion Question:
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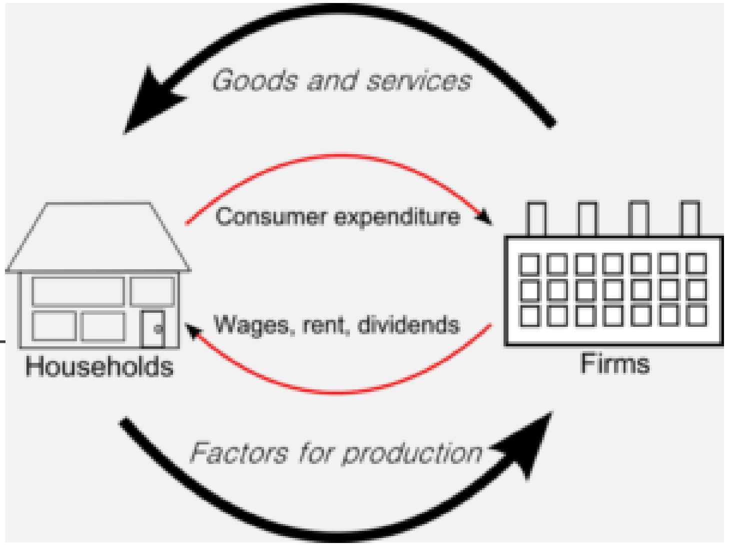
“Some people continue to defend trickle-down theories which assume that economic growth, encouraged by a free market, will inevitably succeed in bringing about greater justice and inclusiveness in the world. This opinion, which has never been confirmed by the facts, expresses a crude and naive trust in the goodness of those wielding economic power and in the sacralized workings of the prevailing economic system.”
- Pope Francis

Alliance Data Systems Corporation	68	4,800	Edward J. Heffernan	$7,599,100	$60,219	126
General Motors Corporation	72	4,600	Mary Barra	$21,630,867	$106,715	203
Starbucks Corporation	73	4,400	Kevin Johnson	$19,241,950	$11,489	1675
Rite Aid Corporation*	74	4,300	Heyward R. Donigan	$9,657,799	$38,394	252
FedEx Corporation	76	4,200	Frederick Smith	$15,973,884	$52,718	303
J. C. Penney Corporation, Inc.	77	4,100	Jill Soltau	$9,735,604	$11,482	848
Verizon Communications Inc.	82	3,800	Hans Vestberg	$18,111,823	$119,873	151
Norfolk Southern Corporation	83	3,730	James Squires	$16,655,786	$108,348	154
Anthem, Inc.	84	3,700	Gail Boudreaux	$15,473,139	$62,686	247
Big Lots, Inc.	86	3,600	Bruce K. Thorn	$6,547,830	$9,871	663
Cintas Corporation	86	3,600	Scott D. Farmer	$8,621,245	$52,302	165
Worthington Industries, Inc.	89	3,570	John P. McConnell	$3,738,834	$64,725	58
Unitedhealth Group Incorporated	90	3,500	David S. Wichmann	$18,907,522	$54,322	348
Cincinnati Financial Corp.	92	3,350	Steven J. Johnston	$5,528,654	$96,112	57.5
Goodyear Tire & Rubber Company	93	3,300	Richard J. Kramer	$16,970,655	$52,623	316
Abercrombie & Fitch Co.	94	3,250	Fran Horowitz	$8,389,027	$1,954	4293
Emerson Electric Co.	96	3,100	David Farr	$20,310,575	$47,415	428
Signet Jewelers Limited / Sterling Jewelers, Inc.	96	3,100	Virginia Drosos	$9,222,270	$34,600	267
Honeywell International Inc.	100	3,000	Darius Adamczyk	$20,525,104	$69,513	295

More Economic Jargon



National income = capital income + labor income

National income = domestic output + net income from abroad

At the global level, income received from abroad and paid abroad must balance, by definition:

Global income = **global output**

This equality between two annual flows, income and output, is an accounting identity, yet it reflects an important reality. In any given year, it is impossible for total income to exceed the amount of new wealth that is produced (globally speaking; a single country may of course borrow from abroad).

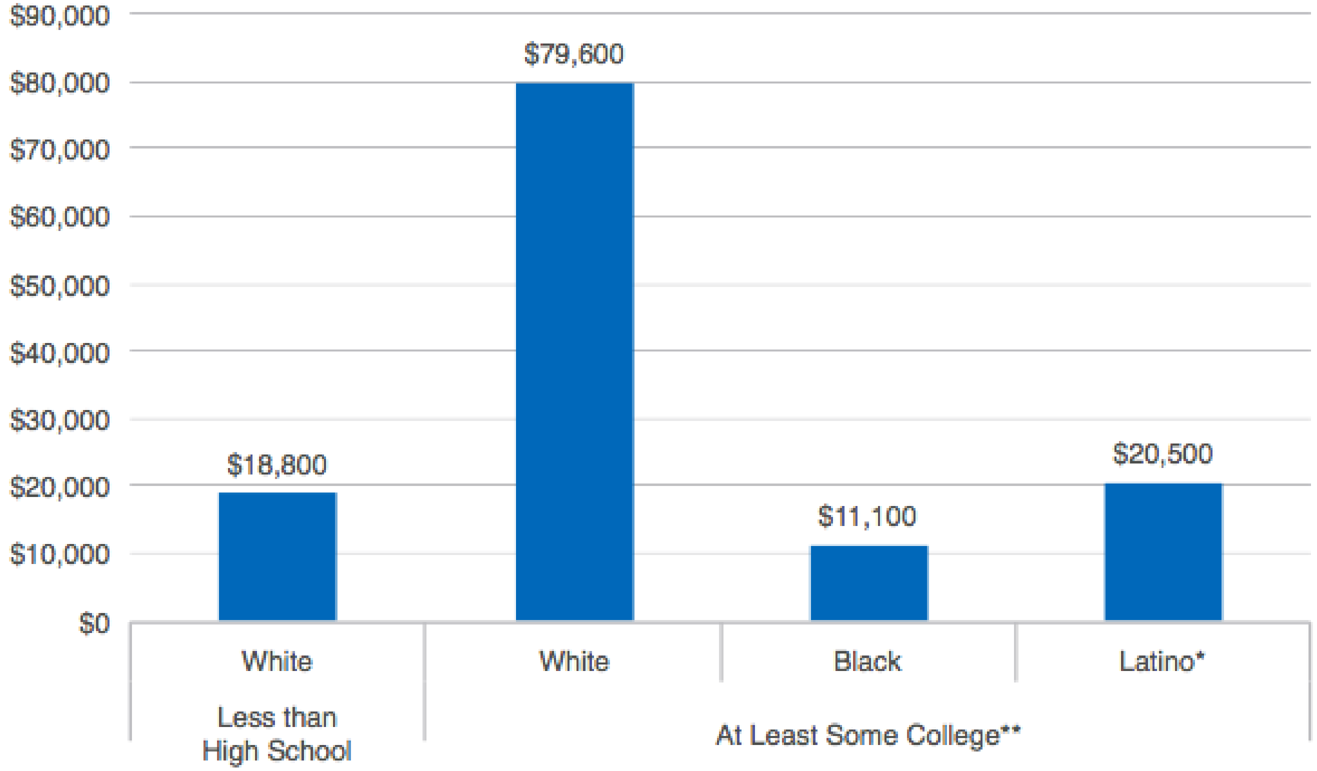
Conversely, all production must be distributed as income in one form or another, to either labor or capital: whether as wages, salaries, honoraria, bonuses, and so on (that is, as payments to workers and others who contributed labor to the process of production) or else as profits, dividends, interest, rents, royalties, and so on (that is, as payments to the owners of capital used in the process of production).

More Economic Jargon

"To summarize, I define "**national wealth**" or "**national capital**" as the total market value of everything owned by the residents and government of a given country at a given point in time, provided that it can be traded on some market."

"It consists of the sum total of **nonfinancial assets** (land, dwellings, commercial inventory, other buildings, machinery, infrastructure, patents, and other directly owned professional assets) and **financial assets** (bank accounts, mutual funds, bonds, stocks, financial investments of all kinds, insurance policies, pension funds, etc.), less the total amount of financial liabilities (debt)."

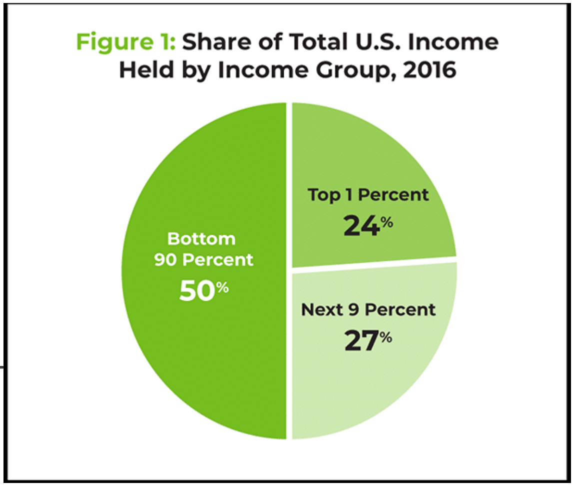
Figure 1. Median Wealth by Educational Attainment for Working Households under Age 55



Source: Authors' calculations of the Survey of Consumer Finances, 2013

* Latino refers to anyone who identified as Hispanic or Latino on the Survey of Consumer Finances and may be of any race.
** This group includes households who attended college but attained no degree as well as those with associate's or bachelor's degrees. Households with graduate and professional degrees are not included.

More Economic Jargon



"**National wealth** = private wealth + public wealth

As I will show, private wealth accounts for nearly all of national wealth almost everywhere

(land, buildings, infrastructure, and other material goods).

Include **"immaterial" capital** such as patents and other intellectual property, which are counted either as nonfinancial assets (if individuals hold patents directly) or as financial assets (when an individual owns shares of a corporation that holds patents, as is more commonly the case).

National wealth = national capital = domestic capital + net foreign capital

Domestic capital is the value of the capital stock (buildings, firms, etc.) located within the borders of the country in question

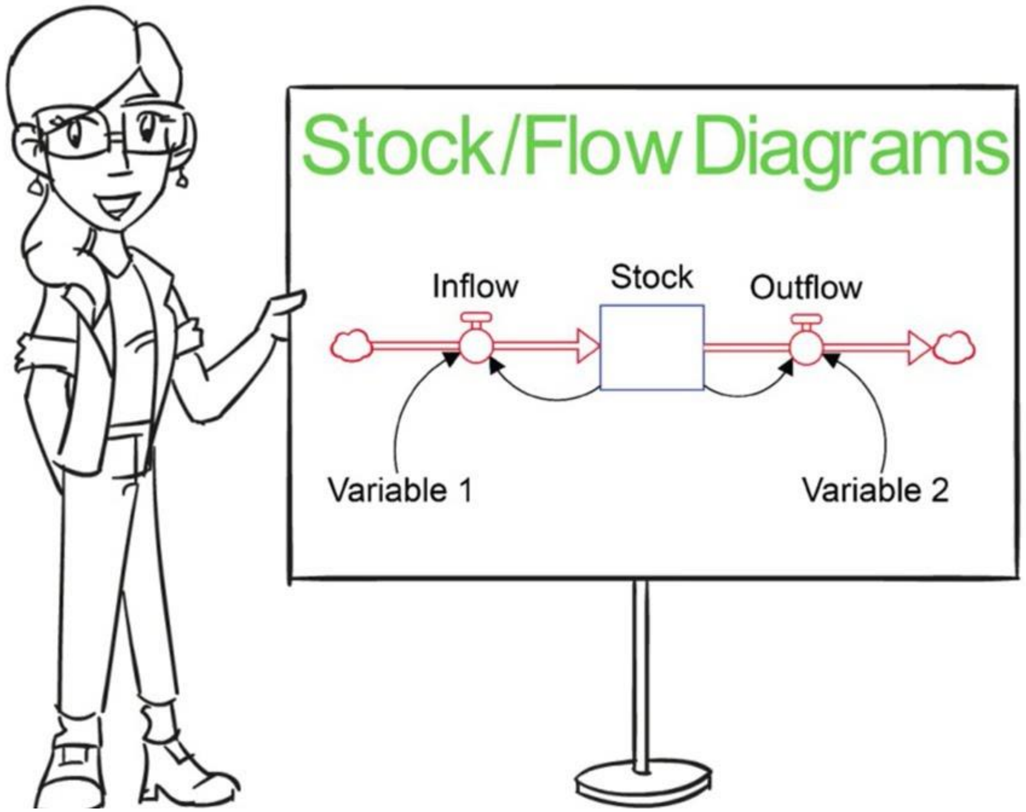
Net foreign capital—or **net foreign assets**—measures the country's position vis-à-vis the rest of the world: more specifically, it is the difference between assets owned by the country's citizens in the rest of the world and assets of the country owned by citizens of other countries."

Now, Moving Toward Intelligibility

“[We] begin by defining the capital / income ratio:”

“Income is a flow. It corresponds to the quantity of goods produced and distributed in a given period (which we generally take to be a year).”

“Capital is a stock. It corresponds to the total wealth owned at a given point in time. This stock comes from the wealth appropriated or accumulated in all prior years combined.”



Understanding Capital/Income Ratio

"The most natural and useful way to measure the capital stock in a particular country is to divide that stock by the annual flow of income. This gives us the capital / income ratio, which I denote by the Greek letter β."

"For example, if a country's total capital stock is the equivalent of six years of national income, we write β = 6 (or β = 600%). In the developed countries today, the capital / income ratio generally varies between 5 and 6, and the capital stock consists almost entirely of private capital."

"The capital / income ratio for the country as a whole tells us nothing about inequalities within the country."

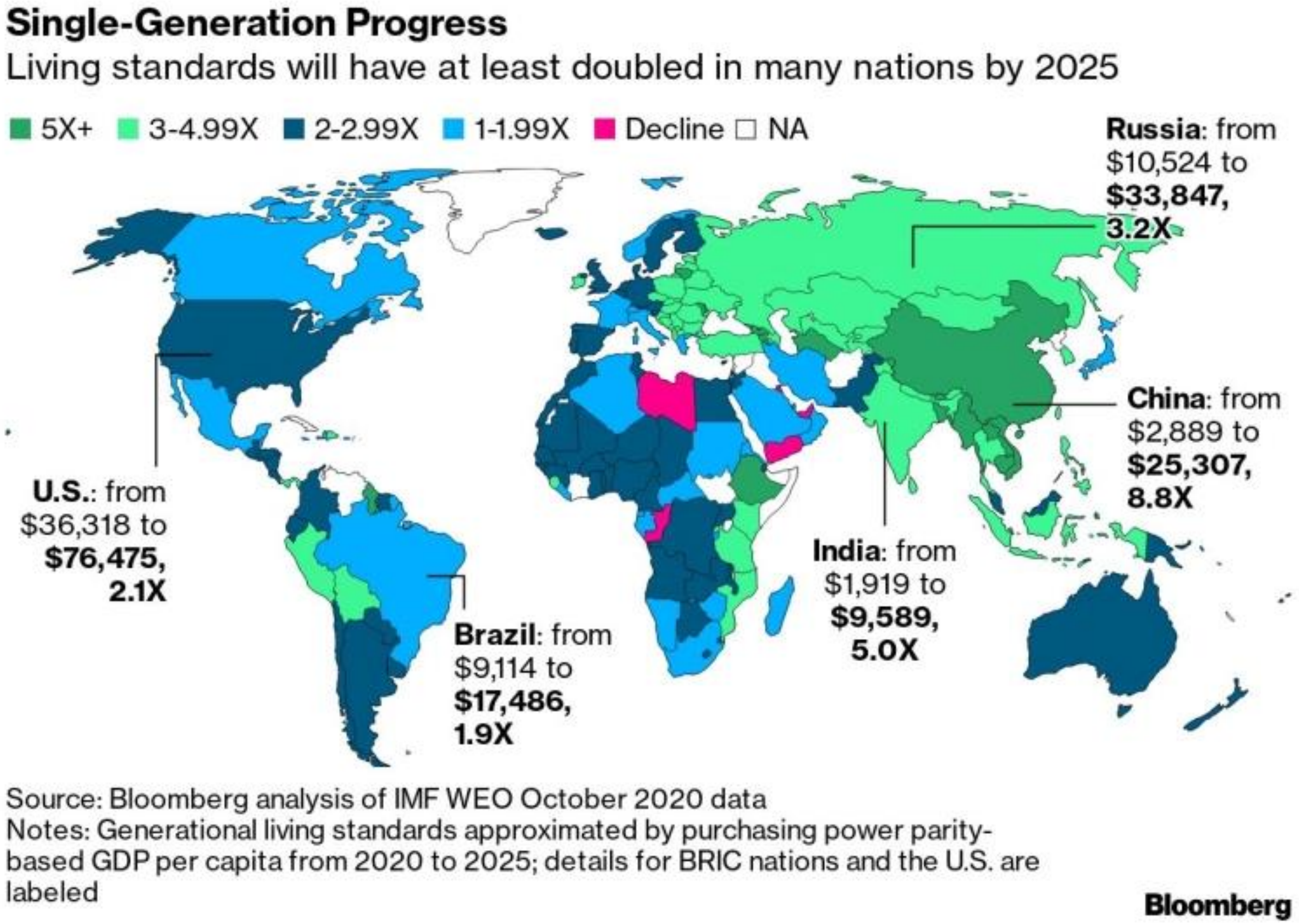
Vincent Van Gogh. The Poor And Money.

Poor "souls" lining up outside to buy lottery tickets.

Understanding Capital/Income Ratio

“In France and Britain, Germany and Italy, the United States and Japan, national income was roughly 30,000–35,000 euros [or $36,358 to $42,417] per capita in 2010, whereas total private wealth (net of debt) was typically on the order of 150,000–200,000 euros [or $181,719 to $242,385] per capita, or five to six times annual national income.”

“It is useful to note that the capital stock in the developed countries currently consists of two roughly equal shares: residential capital and professional capital used by firms and government. To sum up, each citizen of one of the wealthy countries earned an average of 30,000 euros [$36,358] per year in 2010, owned approximately 180,000 euros [$218,046] of capital, 90,000 [$109,073] in the form of a dwelling and another 90,000 [$109,073] in stocks, bonds, savings, or other investments.”



Why Care About Capital/Income Ratio?

The First Fundamental Law of Capitalism: $\alpha = r \times \beta$

Move One, consider this:

$\alpha = r \times \beta$

Where α = capital's share of national income

B = the capital to income ratio

r = the pure rate of return on capital

Return on Capital

Essentially measures the earnings as a proportion of debt+equity required by a business to continue normal operations. In the long run, this ratio should be higher than the investments made through debt and shareholders' equity. Otherwise diminishing returns shall render the business unsustainable.

= (Earnings from operations - interest and liabilities) / (Shareholders equity + debt)

This is saying that you can expect those who own or possess capital to get a percentage, or a return, every year from that capital.

Think along the terms of your boss or landlord, their take home income per year, based on their return on capital.

Why Care About Capital/Income Ratio?

Move Two, consider this:

Picketty's Second Law of Capitalism: $\beta = s/g$

Where β = Capital (all productive assets)

s = the savings rate

g = GDP growth

What is Capital
MONEY or assets put to economic use, the life-blood of CAPITALISM. Economists describe capital as one of the four essential ingredients of economic activity, the FACTORS OF PRODUCTION, along with LAND, LABOUR and ENTERPRISE.

What is Savings?
Savings is the money a person has left over when they subtract their CONSUMER SPENDING from their DISPOSABLE INCOME over a given time period. Savings can be used to increase income through INVESTING.

In other words, we are measuring the stock or the total wealth of society over the total amount of income of the society, going back to our stock versus flow diagram above.

Also, β typically ranges between 4 and 7 times the national income (just file that away in your mind for now)

We are saying then that the amount of wealth that exists in society tends to be worth between 4 to 7 times the annual income everyone earns in society in a given year

Why Care About Capital/Income Ratio?

Move Three, **putting things together…**

$\alpha = r \times \beta$

$\beta = s/g$

Therefore, just like in algebra class, way back when…

$\alpha = r\,(s/g)$

Where α = capital share of national income

β = the capital/income ratio (between 4 and 6)

r = pure rate of return on capital

s = savings rate

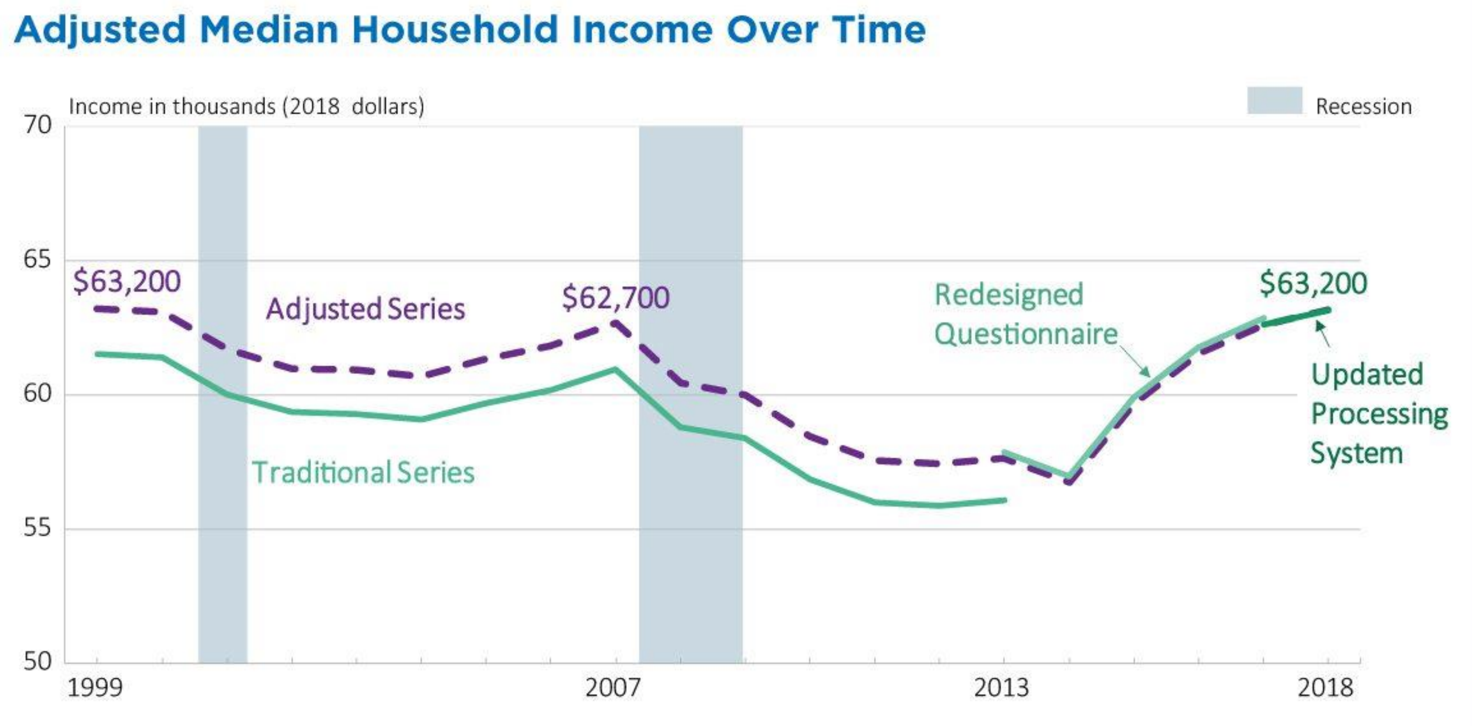
g = GDP growth

So, Why Should I Care?

The amount of wealth that people pull home in society from owning capital, is equal to the amount of capital, relative to the society, multiplied by how much on average they can pull from it. Picketty is drawing a relationship between the store of previously accumulated wealth and the amount that those who have wealth pull from society. In other words, if say alpha is 40%, then that means 4 out of 10 dollars earned in the society as income (output) is earmarked, or destined, to go back to those who possess, own, or have wealth.
*Remember from our previous side (16) - all production must be distributed as income in one form or another, to either labor or capital

Understanding Capital/Income Ratio

"Concretely, this means that the current per capita national income of 30,000 euros [$36,358) per year in rich countries breaks down as 21,000 euros [$25,350] per year income from labor (70 percent) and 9,000 euros [$10,907] income from capital (30 percent). Each citizen owns an average of 180,000 euros [$218,146] of capital, and the 9,000 euros [$10,907] of income from capital thus corresponds to an average annual return on capital of 5 percent."



Note: The data for 2017 and beyond reflect the implementation of an updated CPS ASEC processing system. The data for 2013 and beyond reflect the implementation of the redesigned income questions. The adjusted series accounts for the impact of these recent improvements over the entire data series. This adjustment is not made in our official publications and table packages because it requires the assumption that the impact of the data improvements would have been identical in all years, an assumption that is less likely to be accurate in years further away from these methodology changes.
Source: U.S. Census Bureau, Current Population Survey, 1966 to 2019 Annual Social and Economic Supplements.

Understanding Capital/Income Ratio

"For example, in 2010, a large apartment in Paris, valued at 1 million euros [$1,212,100], typically rents for slightly more than 2,500 euros [$3,030] per month, or annual rent of 30,000 euros [$36,363], which corresponds to a return on capital of only 3 percent per year from the landlord's point of view. Such a rent is nevertheless quite high for a tenant living solely on income from labor (one hopes he or she is paid well) while it represents a significant income for the landlord. The bad news (or good news, depending on your point of view) is that things have always been like this."

"Capital invested in businesses is of course at greater risk, so the average return is often higher. The stock-market capitalization of listed companies in various countries generally represents 12 to 15 years of annual profits, which corresponds to an annual return on investment of 6–8 percent (before taxes)."

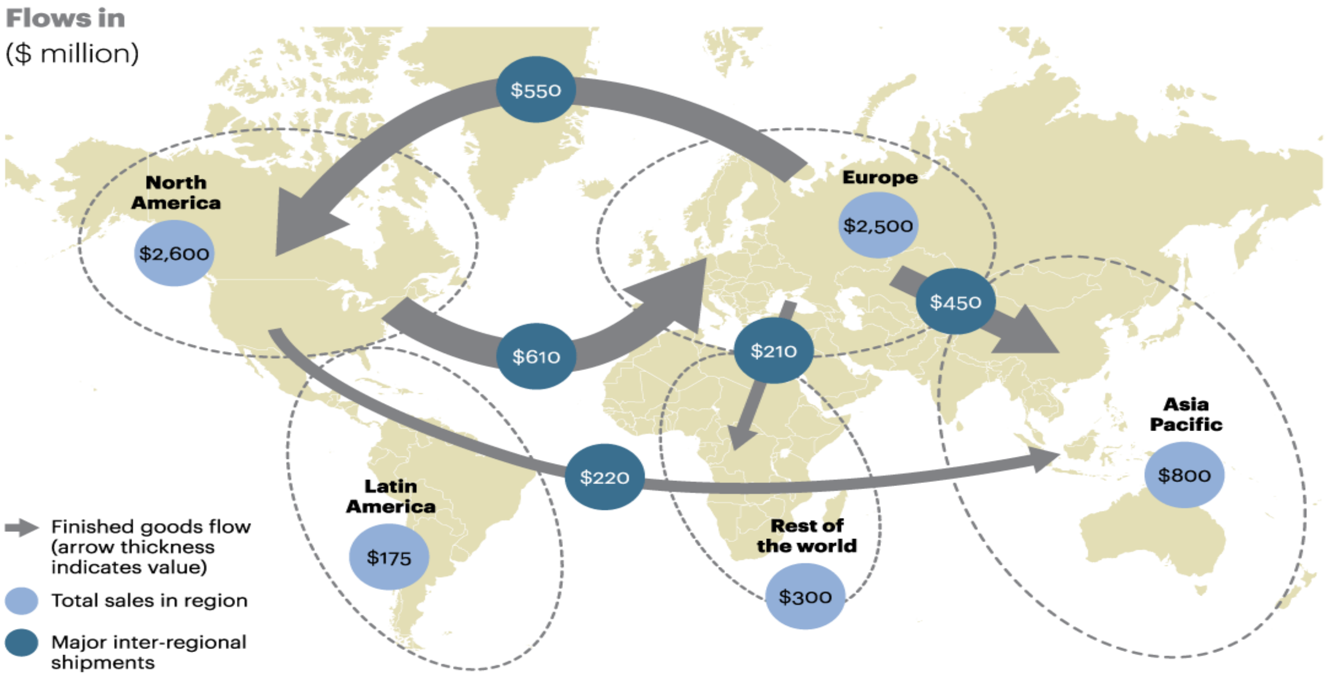
Looking Around the World

The Global Distribution of Production

"From 1900 to 1980, 70–80 percent of the global production of goods and services was concentrated in Europe and America, which incontestably dominated the rest of the world."

"By 2010, the European–American share had declined to roughly 50 percent, or approximately the same level as in 1860. In all probability, it will continue to fall and may go as low as 20–30 percent at some point in the twenty-first century."

Figure 1
Imbalance of finished goods flows among regions

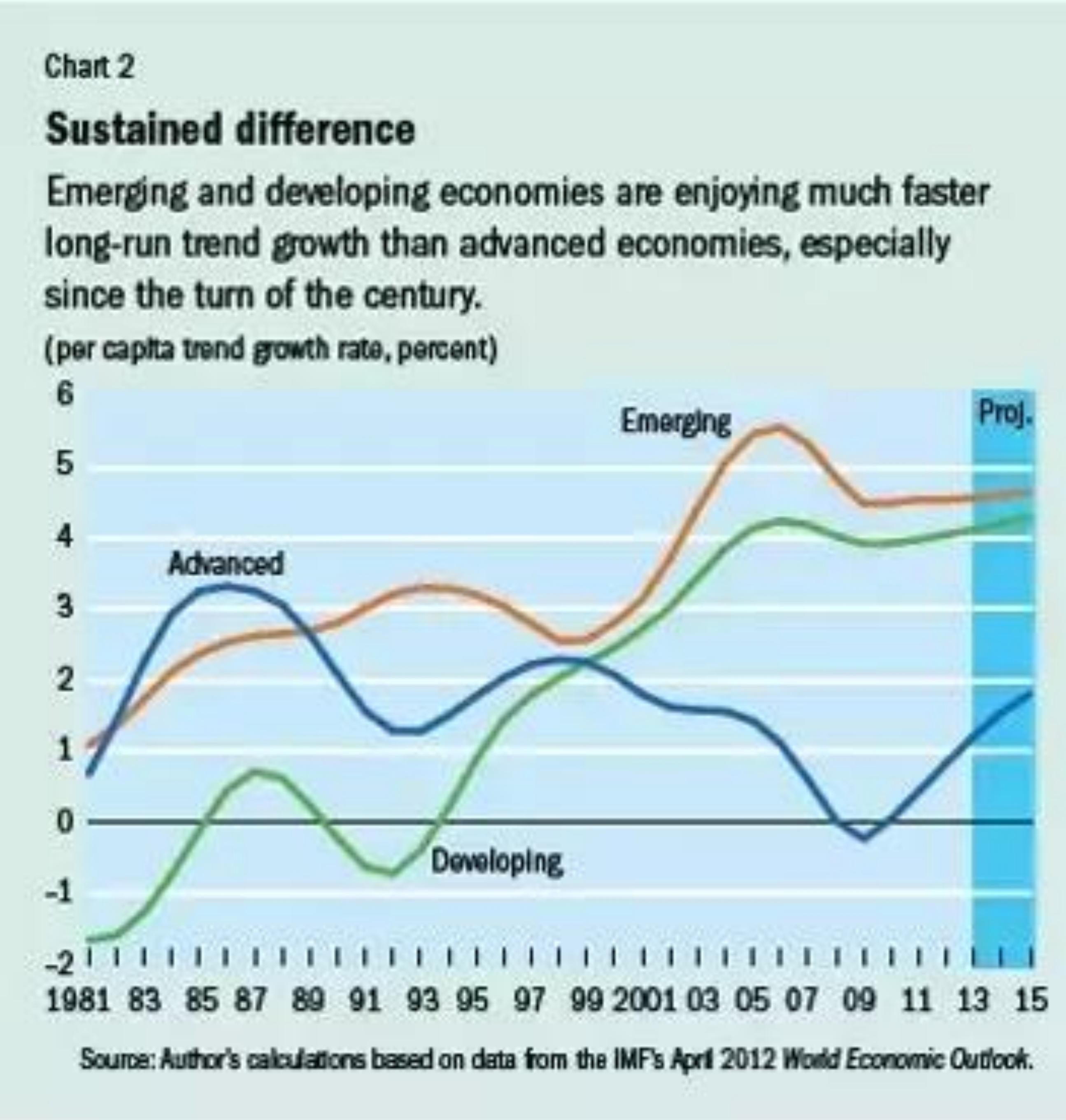


Note: Sanitized client example; only finished goods flows greater than US$100 million are shown
Source: A.T. Kearney analysis

Looking Around the World

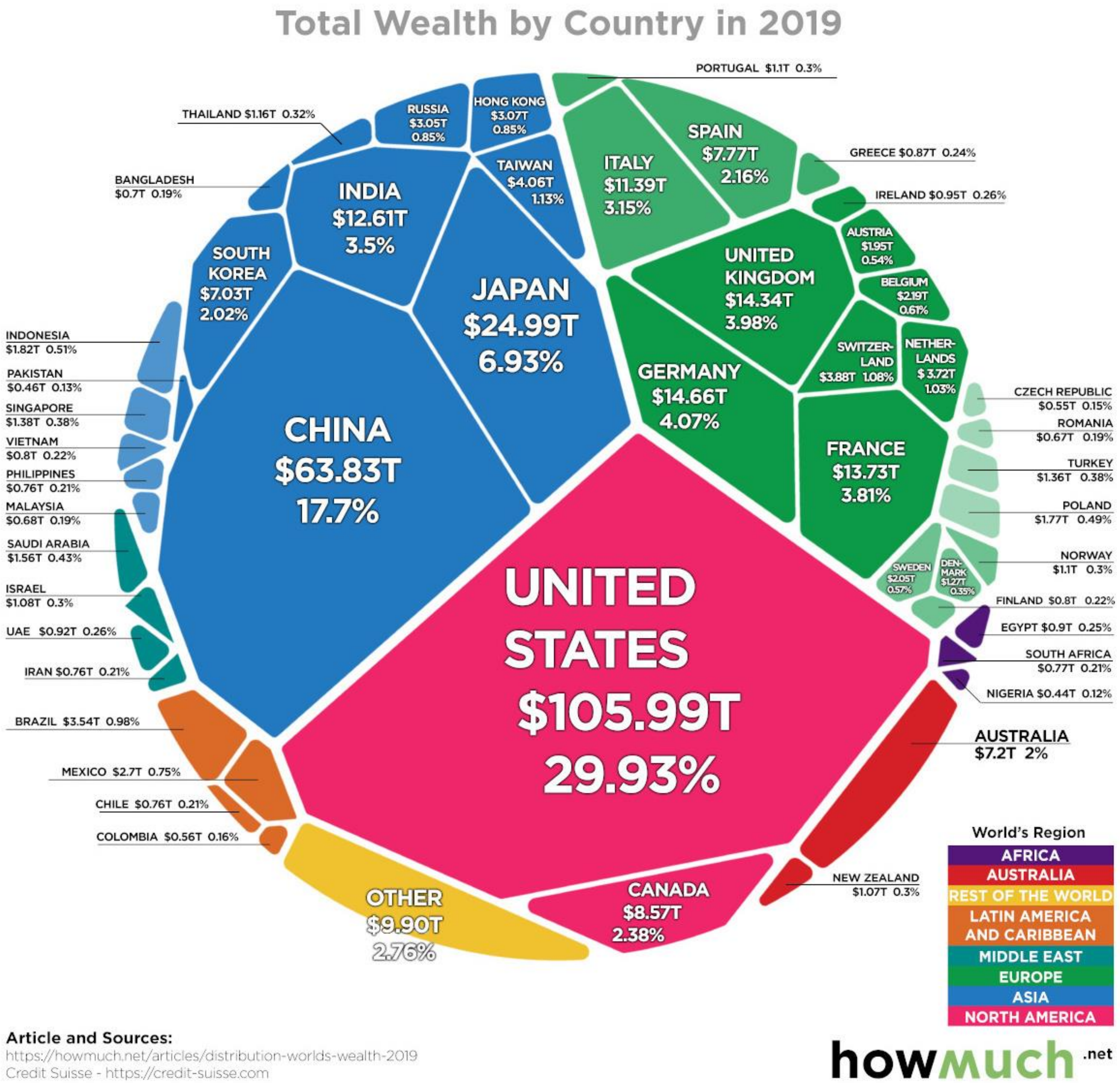
“In other words, the lead that Europe and America achieved during the Industrial Revolution allowed these two regions to claim a share of global output that was two to three times as large as their share of the world’s population simply because their output per capita was two to three times as large as the global average.”

“All signs are that this phase of divergence in per capita output is over and that we have embarked on a period of convergence.”



Looking Around the World

“To sum up, global inequality ranges from regions in which the per capita income is on the order of 150–250 euros [$182 to $303] per month (sub-Saharan Africa, India) to regions where it is as high as 2,500–3,000 euros [$3,030 to $3,636] per month (Western Europe, North America, Japan), that is, ten to twenty times higher. The global average, which is roughly equal to the Chinese average, is around 600–800 euros [$727 to $970] per month.”



Looking Around the World

The Global Distribution of Income Is More Unequal Than the Distribution of Output

“Generally speaking, the global income distribution is more unequal than the output distribution, because the countries with the highest per capita output are also more likely to own part of the capital of other countries and therefore to receive a positive flow of income from capital originating in countries with a lower level of per capita output.”

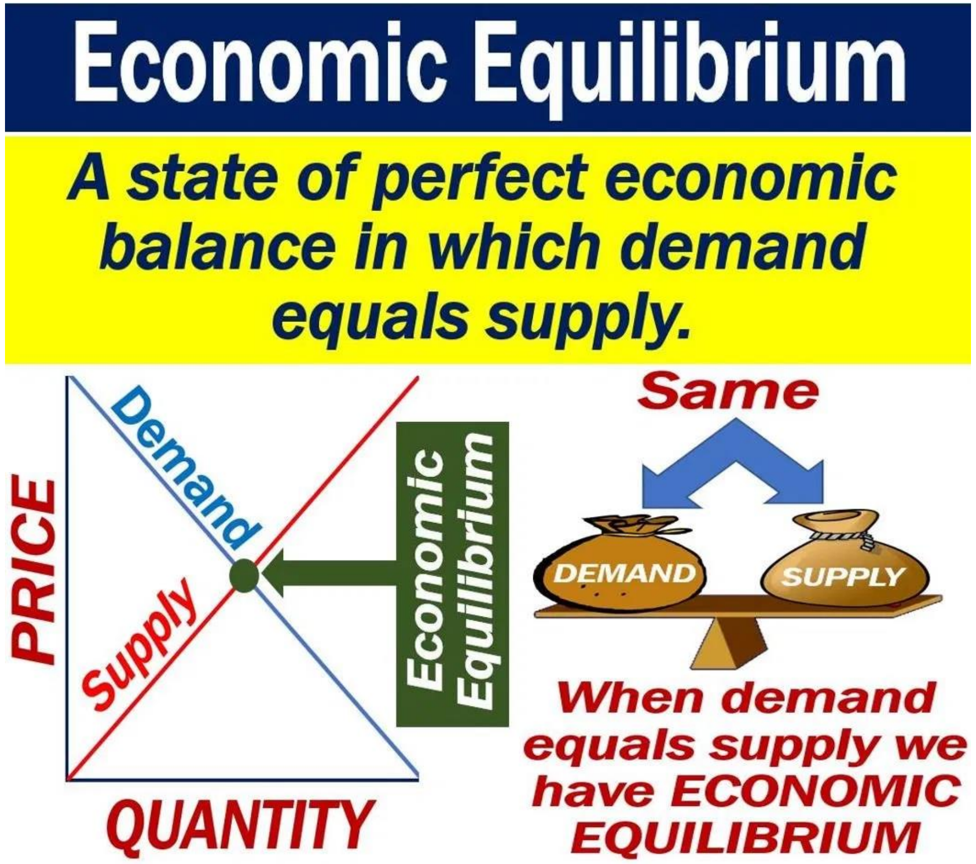
“In other words, the rich countries are doubly wealthy: they both produce more at home and invest more abroad, so that their national income per head is greater than their output per head. The opposite is true for poor countries.”

Map of Colonial Africa

Looking Around the World

"What we find in Europe, America, and Asia is something close to equilibrium: the wealthier countries in each bloc (generally in the north) receive a positive flow of income from capital, which is partly canceled by the flow out of other countries (generally in the south and east), so that at the continental level, total income is almost exactly equal to total output, generally within 0.5 percent."

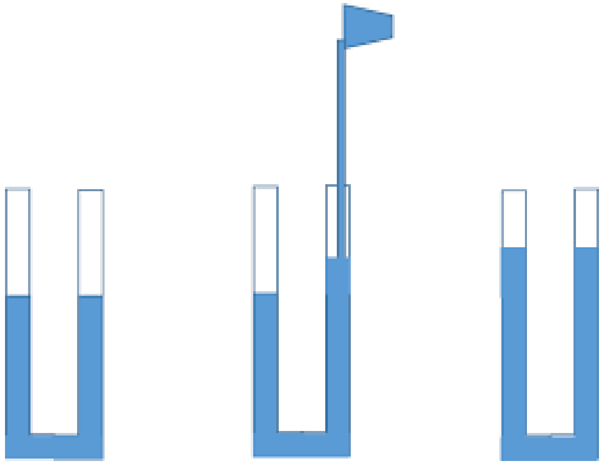
"The only continent not in equilibrium is Africa, where a substantial share of capital is owned by foreigners. According to the balance of payments data compiled since 1970 by the United Nations and other international organizations such as the World Bank and International Monetary Fund, the income of Africans is roughly 5 percent less than the continent's output (and as high as 10 percent lower in some individual countries). With capital's share of income at about 30 percent, this means that nearly 20 percent of African capital is owned by foreigners: think of the London stockholders of the Marikana platinum mine discussed at the beginning of this chapter."



What Forces Favor Convergence?

“In theory, the fact that the rich countries own part of the capital of poor countries can have virtuous effects by promoting convergence. If the rich countries are so flush with savings and capital that there is little reason to build new housing or add new machinery (in which case economists say that the “marginal productivity of capital,” that is, the additional output due to adding one new unit of capital “at the margin,” is very low), it can be collectively efficient to invest some part of domestic savings in poorer countries abroad.”

“Thus, the wealthy countries—or at any rate the residents of wealthy countries with capital to spare—will obtain a better return on their investment by investing abroad, and the poor countries will increase their productivity and thus close the gap between them and the rich countries. According to classical economic theory, this mechanism, based on the free flow of capital and equalization of the marginal productivity of capital at the global level, should lead to convergence of rich and poor countries and an eventual reduction of inequalities through market forces and competition.”



Another way to visualize equalization of the marginal productivity of capital and convergence in general is the old phrase “water seeks its own level.

What Forces Favor Convergence?

"This optimistic theory has two major defects, however. First, from a strictly logical point of view, the equalization mechanism does not guarantee global convergence of per capita income. At best it can give rise to convergence of per capita output, provided we assume perfect capital mobility and, even more important, total equality of skill levels and human capital across countries—no small assumption. In any case, the possible convergence of output per head does not imply convergence of income per head. After the wealthy countries have invested in their poorer neighbors, they may continue to own them indefinitely, and indeed their share of ownership may grow to massive proportions, so that the per capita national income of the wealthy countries remains permanently greater than that of the poorer countries, which must continue to pay to foreigners a substantial share of what their citizens produce (as African countries have done for decades)."

Kent Monkman, The Scream. History Painting for a Colonized Canada

What Forces Favor Convergence?

"If we look at the historical record, it does not appear that capital mobility has been the primary factor promoting convergence of rich and poor nations. None of the Asian countries that have moved closer to the developed countries of the West in recent years has benefited from large foreign investments, whether it be Japan, South Korea, or Taiwan and more recently China. In essence, all of these countries themselves financed the necessary investments in physical capital and, even more, in human capital, which the latest research holds to be the key to long-term growth."

What Forces Favor Convergence?

“When a country is largely owned by foreigners, there is a recurrent and almost irrepressible social demand for expropriation. Other political actors respond that investment and development are possible only if existing property rights are unconditionally protected. The country is thus caught in an endless alternation between revolutionary governments (whose success in improving actual living conditions for their citizens is often limited) and governments dedicated to the protection of existing property owners, thereby laying the groundwork for the next revolution or coup.”

John Keane. Art of The Troubles.

Final Thoughts from Picketty

"To sum up, historical experience suggests that the principal mechanism for convergence at the international as well as the domestic level is the diffusion of knowledge. In other words, the poor catch up with the rich to the extent that they achieve the same level of technological know-how, skill, and education, not by becoming the property of the wealthy."

"Above all, knowledge diffusion depends on a country's ability to mobilize financing as well as institutions that encourage large-scale investment in education and training of the population while guaranteeing a stable legal framework that various economic actors can reliably count on."

"It is therefore closely associated with the achievement of legitimate and efficient government. Concisely stated, these are the main lessons that history has to teach about global growth and international inequalities."

Washington Allston. The Poor Author and the Rich Bookseller

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