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Income shares, wealth and growth☆

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Abstract

The paper analyzes the relationship between income shares, wealth and growth in an environment where positional goods are taken into account and rent is generated. This hypothesis, which is a macro engine for inequality, creates a gap between profit share and property share and implies a clear-cut distinction between capital and wealth.

The interactions between these aspects are studied in a medium-run growth model led by aggregate demand, where monetary aspects also matter. The results of the dynamic analysis, obtained by means of simulations, are in keeping with some recent stylized facts. Furthermore, the model generates bounded dynamics, where the co-movements between variables are more complex than those obtained in the recent literature. At the same time the disequilibrium processes can create a link between medium-run considerations and a more long-run perspective.

JEL classification: D31; E; E2; 04

Keywords: Property and profit share; Positional goods; Private wealth; Inequality; Demand-led growth; Limit cycles

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1. Introduction

If one considers the performance of advanced economies in recent times, there are three stylized facts worth mentioning: (i) a falling labour share; (ii) an increasing wealth output ratio and (iii) stagnating growth that produces negative repercussions on the labour market.

These patterns are in strong contrast with the Kaldorian "stylized facts" that any growth theory was supposed to mimic. While the first one violates the hypothesis of constant share, which, given a constant capital/output ratio, implies also a stationary rate of profit, the second one was not even mentioned as a macro theme.

In fact, wealth has mainly been a subject of microeconomics, welfare theory or fiscal policy, where the personal distribution of income matters. One of Piketty's (2014) main contributions has been to cast the two themes, i.e. income

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share and wealth distribution, into a macro dimension, where inequality provides the profound links between the two aspects. These relationships are studied in a very long time horizon and within a steady state environment.

With respect to this analysis, the paper introduces three substantial changes. First, positional goods and rents are introduced into the analysis. Even though from an empirical point of view they are not the major vehicle of capital gains, they seem to represent the "*zeitgeist*" of the present economic situation, dominated by bubbles and their aftermath. Furthermore, from an analytical point if view, they oblige to draw a clear-cut distinction between capital and wealth and to deal with profits and rents, as far as income shares are concerned. Second, the time horizon of the present paper is shorter because it refers to a medium-run perspective (see also Ferri, 2011) which is better suited to capture the events of the "Great Recession" (see also Cynamon et al., 2013). Third, the model put forward is characterized by the following features: its dynamics are driven by aggregate demand, where investment plays a fundamental role. Furthermore, the model operates in a monetary economy, as defined by Keynes. Finally, steady state considerations are supplemented by a dynamic process of interdependence, where the feedbacks between variables make the co-movements between them more complex. In this context, one must possibly consider how instability can affect inequality and how the latter can feedback on the former.

The results of the dynamic analysis are obtained by means of simulations. They not only can mimic the stylized facts before mentioned, but they generate bounded dynamics where accelerating expansions are endogenously followed by opposite movements. At the same time they indicate that the relationship between income share, wealth and growth can assume different features depending on the nature of the model, the type of hypotheses put forward and the quantitative value of the parameters.

The structure of the paper is the following. Section 2 reviews the recent literature. Section 3 introduces rents and positional goods, and identifies the proper income share. Section 4 deals with capital and wealth ratios and defines technology. Section 5 presents a demand-led growth model, discusses steady state relationships and uses simulations in order to carry out a disequilibrium analysis. Section 6 discusses the robustness of a linearized version of the model, it also considers an extension of the model and discusses the implications of different growth scenarios. Section 7 concludes. Appendices A and B includes mathematical details.

2. A review of the recent literature

The main contribution of Piketty's (2014) analysis is to have studied the macro conditions that favour inequality (see Milanovic, 2014 and the Special issue of Real-World Economics Review, 2014 for a review of the book).

These macro conditions are determined by two laws: the "first fundamental law" is initially derived from an identity, i.e. the definition of profit share (α):

$$\alpha \equiv r\beta \tag{2.1}$$

If r, the average return of capital, is assumed to be given and stationary, then the identity becomes an equation and turns itself in the "first fundamental law", which states that an increase in β, which is both the wealth/output ratio and the capital/output ratio, is accompanied by a surge in the profit share α. Since capital is more unequally distributed than labour, it follows that profit share can be used as a macro proxy of inequality, which ultimately depends on wealth distribution.

The second fundamental law of capitalism is given by:

$$g = \frac{s}{\beta} \tag{2.2}$$

where s is the (net) exogenous propensity to save and g the rate of growth. This formula is in keeping with the long-run steady state relationship à la Harrod-Domar (see also Fazzari et al., 2013; Dutt, 2006). Suppose that g is determined à la Solow, i.e. by the supply side of the economy and therefore is equal to the rate of growth of productivity and labour force. It then follows that, for a given s, a fall of g implies an increase in β. Stagnation induces an increase in wealth. Since a stagnation period is in front of us, a higher wealth/ratio and therefore increasing inequalities are expected. The forecast is based upon the following causal scheme:

$$g \downarrow \rightarrow \beta \uparrow \alpha \uparrow$$

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