Varieties of Capitalism, Increasing Income Inequality, and the Sustainability of Long-Run Growth

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Paper builds on (Setterfield and Kim, 2016; Setterfield et al., 2016)

Previous work investigates effects of rising inequality, in the presence of emulation effects and fundamental uncertainty about consequences of debt accumulation, on rate of growth and its sustainability

This paper explores two important extensions of this earlier work
Outline of Presentation

- Previous research and results
- Extensions
  - theory: borrowing and the decline of the social wage
  - application: varieties of capitalism (Germany vs US)
Previous Research: Model

- Stock-flow consistent Kaleckian model
- Banks: passive intermediaries
- Firms:
  - Produce output using capital, managers, and production workers
  - Price according to standard mark up over direct (labour) costs
  - Invest in direct relation to the profit rate and “animal spirits”
Rentier households consume conventional fraction of their income (profit, managerial salaries, interest income)

Worker households consume conventional fraction of their wage income and consume by borrowing from rentiers

Workers’ total consumption influenced by propensity to emulate consumption of rentiers
Main findings:

- Increased income inequality that spurs household borrowing can boost growth ("consumption-driven, profit-led growth" (Kapeller and Schütz, 2015))
- ... but undermine financial sustainability of the growth regime
- Potentially positive impact of debt servicing (not just borrowing) on growth
- Precise form of debt servicing behavior has qualitative effect on debt dynamics
Extensions: 1. Borrowing and the Decline of the Social Wage

- As social wage diminishes, households forced to increase private consumption expenditures merely to *maintain* established consumption standards.
- So not just emulation effects ("keeping up with the Joneses") driving borrowing.
- Write:
  \[ C_W = W_r L - iD_W + C^T \]
  
  where:
  \[ C^T = \beta C_R - \omega_s \]

  and \( \omega_s \) denotes the social wage.
Assume that:

\[ \omega_S = t\Pi \]

(social wage entirely funded by tax on profits)

Substituting into expression for \( C_W \):

\[ C_W = W_r L - iD_W + \beta C_R - t\Pi \]
Now consider workers’ budget constraint:

\[ W_r L + \dot{D}_W = C_W + iD_W \]

so:

\[ \dot{D}_W = C_W + iD_W - W_r L \]

Substituting expression for \( C_W \):

\[ \dot{D}_W = \beta C_R - t\Pi \]
Capitalist consumption net of tax:

\[ C_R = (1 - s_R)([1 - t]\Pi + iD_W) \]

Substituting into expression for \( \dot{D}_W \):

\[ \dot{D}_W = \beta(1 - s_R)([1 - t]\Pi + iD_W) - t\Pi \]

Simplifying and standardizing by \( K \):

\[ \dot{d}_W = \beta(1 - s_R)(\pi u + id_W) - (1 - \beta[1 - s_R])t\pi u \]
Now have new distributional variable, $t$, that indirectly affects rate at which workers borrow

This is for two reasons:

- decrease in $t$ results in lower social wage which stimulates more borrowing, as workers try to make up for the loss of publicly-provided consumption goods by increasing private expenditures
- decrease in $t$ raises capitalist consumption, which stimulates worker borrowing and spending through emulation effects

Question: what is marginal contribution of observed decline in taxes on profit to household debt dynamics and financial fragility of neoliberal growth regime?
## Extensions: 2. Varieties of Capitalism and Sustainability

Results of previous research based on numerical simulations:

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Value</th>
<th>Source</th>
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<tbody>
<tr>
<td>$c_W$</td>
<td>0.94</td>
<td>Author’s calculations based on Bunting (1998)</td>
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<tr>
<td>$c_\pi$</td>
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<td>Setterfield and Budd (2011)</td>
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<td>$\delta$</td>
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<td>Author’s calculations based on Mishel and Sabadish (2012)</td>
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<td>$\phi$</td>
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<td>Author’s calculations based on Mishel et al. (2007)</td>
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<td>$\alpha$</td>
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<td>Author’s calculations based on (Mishel et al., 2007, p.118)</td>
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<td>$\omega_p$</td>
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<td>Author’s calculations based on Mohun (2006), Figure 7</td>
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<td>$\pi$</td>
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<td>Setterfield and Budd (2011)</td>
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<tr>
<td>$\kappa_0$</td>
<td>0.095 or 0.045</td>
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<td>Lavoie and Godley (1 02), Skott and Ryoo (2008)</td>
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Future work:

- Re-calibrate key distributional parameters to economies other than US (e.g., Germany)
- Sustainability of varieties of capitalism:
  - are there different “distributional regimes” across different varieties of capitalism during the neoliberal era?
  - do these affect debt dynamics and sustainability of growth?
  - e.g., how would US capitalism have fared with a German neoliberal distributional regime?


