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# **Piketty's fallacious view that globalisation makes the rich richer and the poor poorer : a mis- interpretation of Solow's model**

**Paris –Dauphine-BBC Conference  
with Thomas Piketty as keynote speaker  
19th June 2014**

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# Introduction Piketty illustrated

*Piketty's thesis : demagogic but definitely at odds with statistical evidence!*



## Executive summary

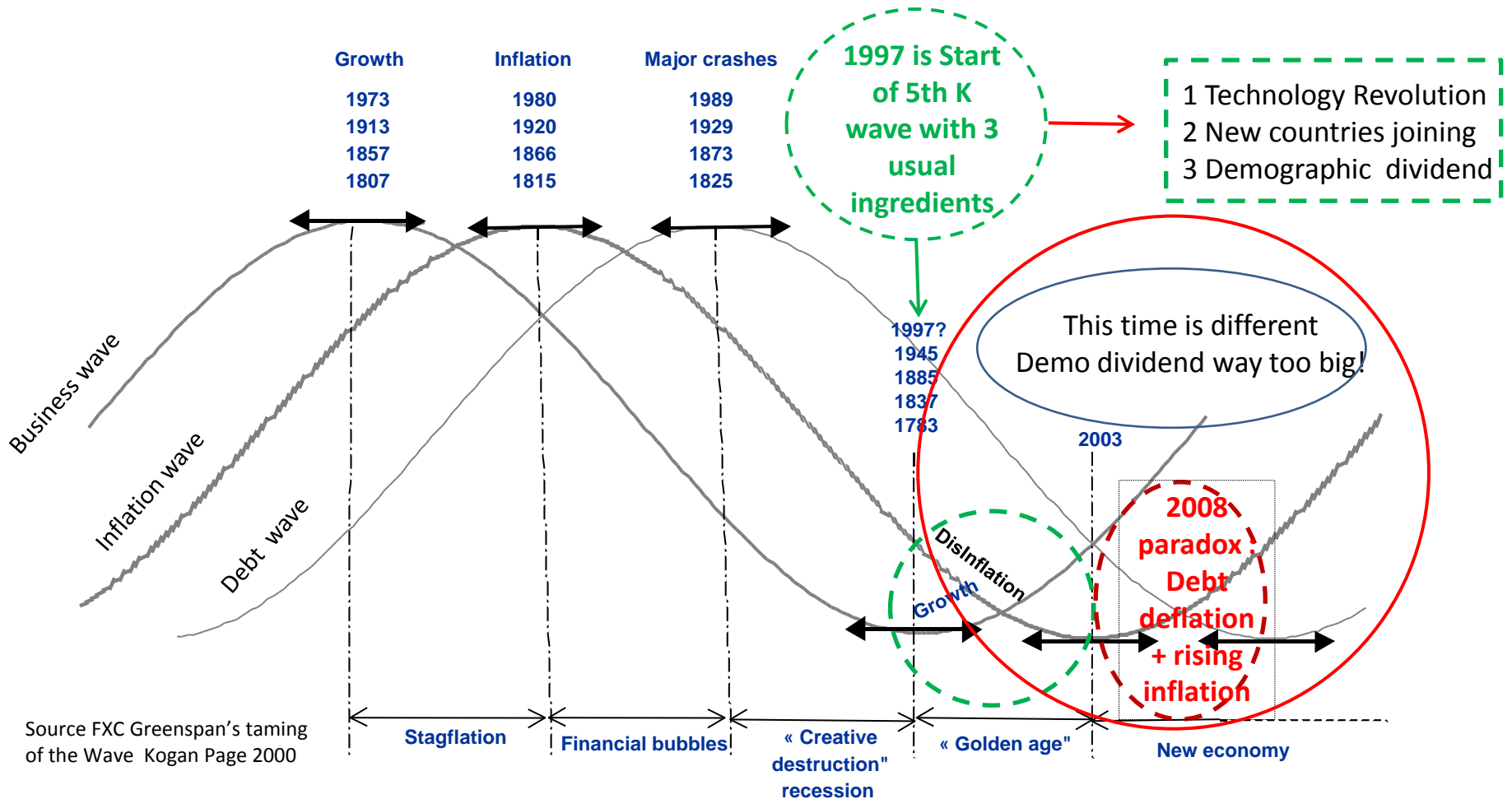
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*The recent collapse of the K/L ratio makes the Emerging countries get richer whilst forcing the Advanced economies into overconsumption and overindebtness*

- A 5th Kondratieff upwave started around 1997 based upon 3 ingredients : the O/N doubling of the world labor force, thus cutting the K/L ratio in half, the conversion to capitalism of both Russia and China, and the internet
- As a result, world growth got boosted as the BRICS became embroiled into a huge catch up wave. And this will last as long as the K/L ratio has not got back to its pre Berlin Wall fall (1989) level... **Hey! There is the rub !**
- The marginal productivity of capital (ROCE) or slope of Solow's production model  $y=f(K/L)$  initially steepens as long as the pool of available labor remains huge...
- However the picture is not that rosy for the advanced economies and capital :
  - As ROCEs go up the stock markets demand higher returns and risk premia
  - Jobs and investments focus on the BRICS which are pushed into oversaving whilst the mature countries are forced to overconsume and borrow...Hence the 2007 Debt crisis
  - China is becoming the largest economy in PP terms : the poor get richer as hundreds of millions of people have now escaped poverty status
- Icing on the cake : whenever the K/L ratio reaches its pre 1989 ratio, the wage earners will have their revenge : the process has already started in China ...

# A 5th Kondratieff upwave started in 1997 : history repeats itself

*But the demographic dividend is huge as the active population doubled O/N*

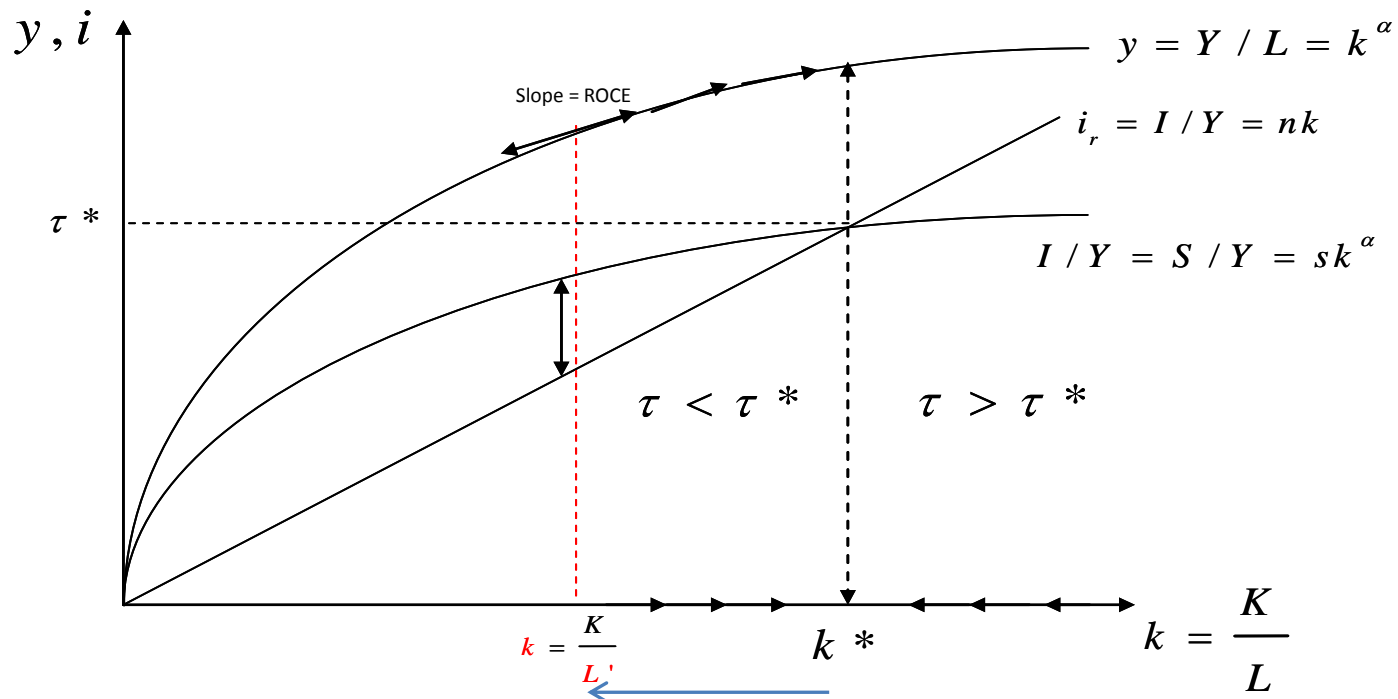


Source FXC Greenspan's taming of the Wave Kogan Page 2000

# 1997-2025 : Early win/win Benefits of the O/N doubling of the Labor Force

**With a K/L ratio cut in half and wages under pressure, world growth has been boosted**

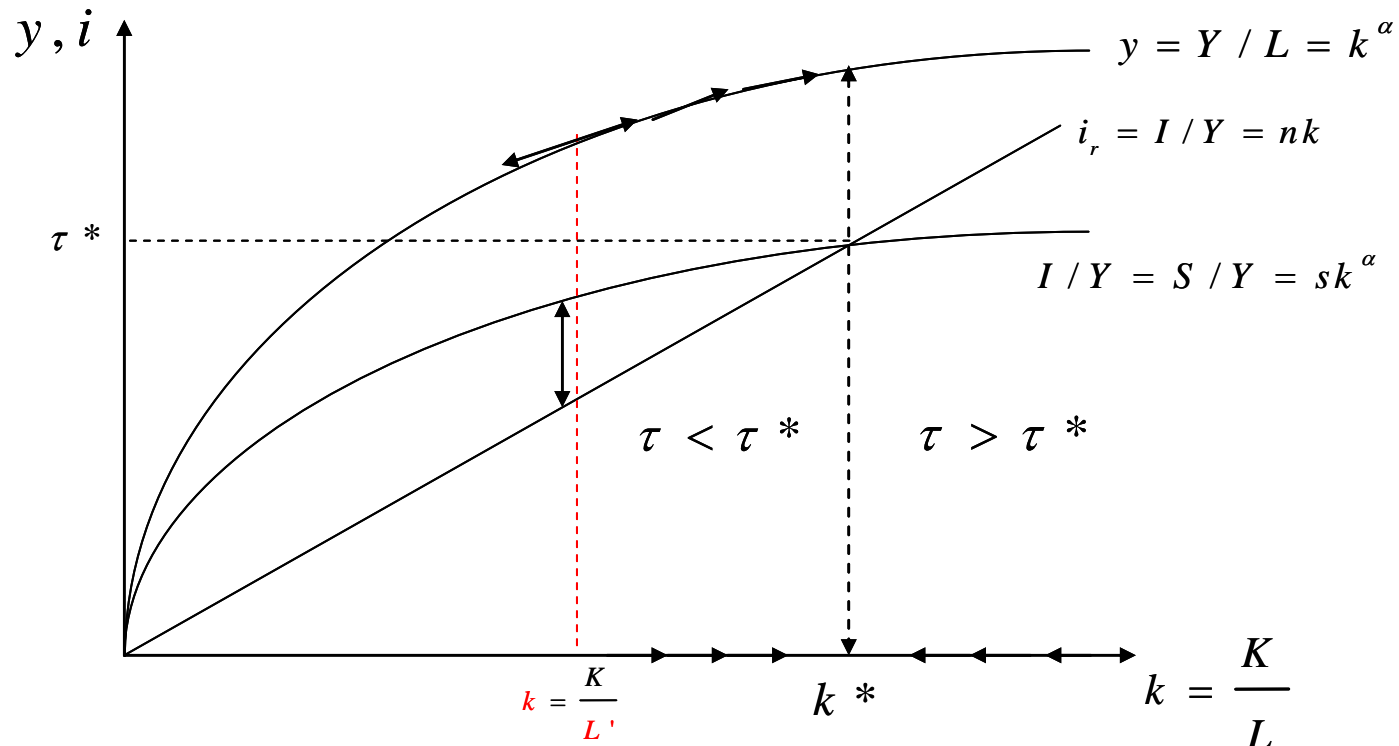
- Solow's model : K/L ratio urged to go back to its initial value, & the BRICs committed to catch up with the developed world
- As capital is scarce and labor is plentiful, a new worldwide growth wave is triggered by the appealing returns on capital invested, low wages and low interest rates.
- Marginal productivity of labor is low and marginal productivity of capital is high : a deflationary boom is ongoing
- Industrial price deflation (textiles, computers) benefits to the Western consumer
- As the BRICs over-save (S/Y-Ir) this pushes G3 interest rates lower



# 1997-2025 : And now the pitfalls...

**But dividing the K/L ratio by 2 has structurally shifted growth and jobs towards the BRICs**

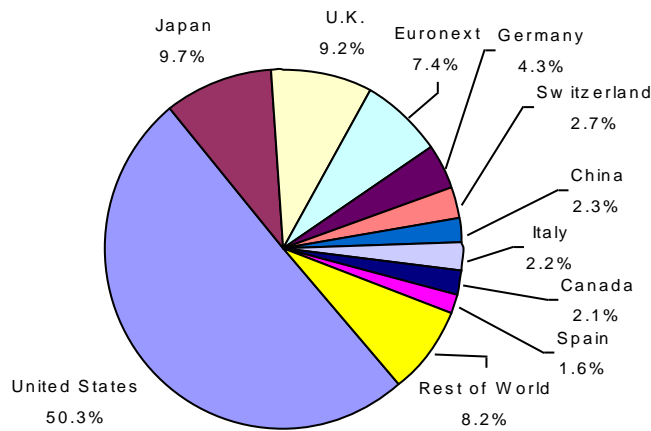
- The other side of Solow's apparatus where  $Ir$  stands for replacement Investment
- Over-saving ( $S/Y - Ir$ ) manifests itself primarily among emerging countries
- Which forces the developed world to over-consume and become their debtors...
- Whilst pushing for industrial transplants on a scale never heard of before
- Pushing the Western consumers into unemployment and overindebtedness (« subprimes »), and later the Western states themselves into financial strain
- Outcome : Free market stance shifting away from the developed world to the BRICS



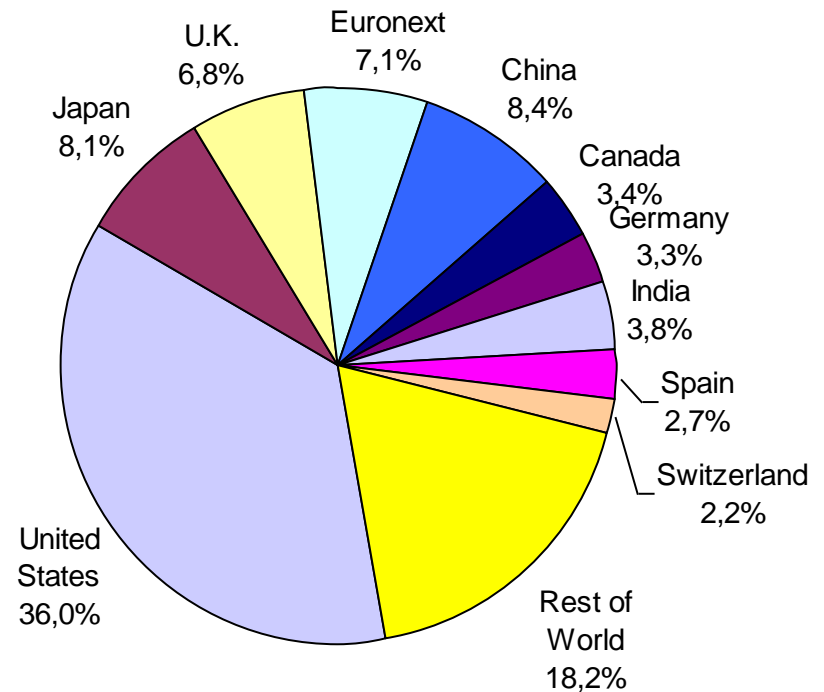


# The stock market boom of the first decade of the Kondratieff wave 1997-2007 mostly benefited the BRICS

**1998**  
**(Total \$25.683 trillion)**



**July 31, 2007**  
**(Total \$57.699 trillion)**

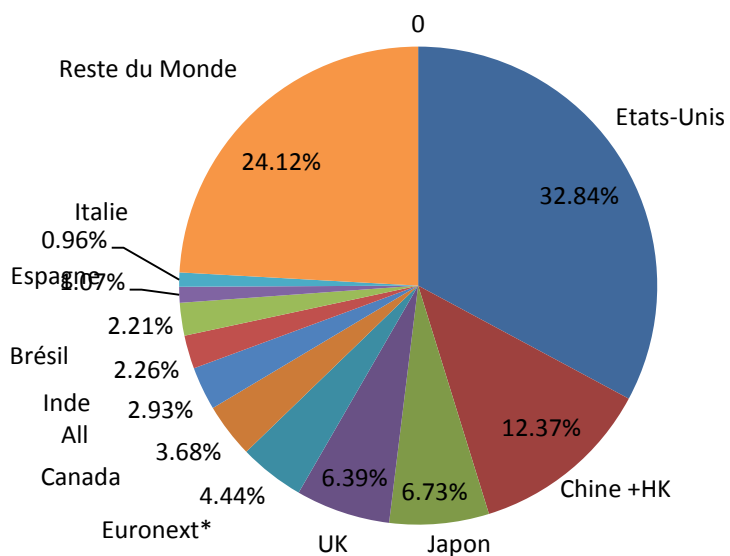




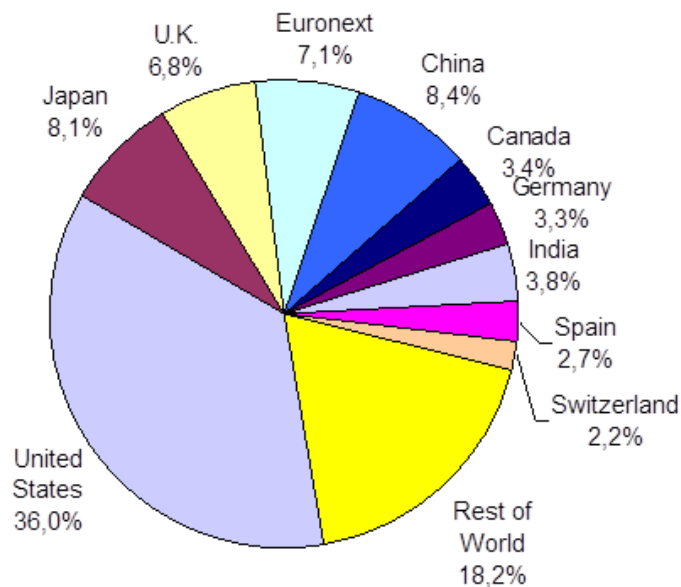
# All along the freeze affecting stock prices from 2007 to 2013

Advanced markets continued to loose weight against the BRICS

**15 février 2013**  
**(Total \$55.046 trillion)**



**31 juillet 2007**  
**(Total \$57.683 trillion)**





## Conclusion: The K/L ratio story is definitely two-handed!

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*Don't confuse higher ROCEs and low wages with higher market wealth and GDP*

- We are living through some new type of a Kondratieff upwave as this time the active labor force nearly doubled overnight (in fact over ten years from 1989 onward)
- The win/win benefits came first : through cheaper industrial goods produced in the BRICS, the latter got both the jobs and transplants, whilst advanced nations enjoyed a consumption spree
- With a K/L ratio cut in half, return on capital skyrockets and wages remain under pressure, but in the BRICS hundreds of millions of people are extracted from poverty. Apparently the rich should benefit most but higher risk premia freeze stock prices.
- In addition the developed countries soon became both addict clients and debtors of the BRICs which pushed them into over-consumption and over-indebtedness. As a result, in 2007-08 the subprime scandal and real estate deflation burst out triggering a banking crisis and ensuing recession of the advanced economies along the lines described by Irving Fisher 1933...
- Both in terms of stock market weights and PPP GDP, the poor have grown richer at the expense of the advanced economies