Appendix II
Comparison of Golden Age and Market Capitalism

This appendix contains the statistical basis for the summaries contained in Chapter Two. It also contains a little more detail on the oil price shocks of the 1970s and the Global Financial Crisis of 2007-8.

1945 – 1980: The Golden Age of Capitalism

After the end of the Second World War in 1945, both among the victors and in the defeated countries, there was a clear need to rebuild national economies and a determination that the rebuilding should result in a better world. Economically, the Great Depression was still a living memory, and those in power were determined not to make the same mistakes again. Many countries duly experienced an economic miracle: Germany had its *Wirtschaftswunder*; France enjoyed *Les Trente Glorieuses*; Italy experienced *Il Miracolo Economico*; and Japan and many other countries used similar language to describe similar phenomena. In the US and the UK, this period was termed the *Golden Age of Capitalism*.

There is some debate about the duration of this Golden Age: the late 70s were a period in which many economies slowed down and began to experience inflation. The results were far less golden. This has led some to date the end of the Golden Age to the early 1970s. I have taken a different approach: since the dominant ethos – the way societies ran their economies – remained essentially the same until the end of the 1970s, I have credited these results to the Golden Age, which reduces the shine a little. In the same way, and for the same reasons, I have credited the results of the Global Financial Crisis to the Age of Market Capitalism. This seems a fairer way of comparing the effects of these two eras, both of which conveniently last for 35 years.

The economic historian Lord Skidelsky describes[11] the Golden Age (which he dates from 1951 to the early 1970s) in the following terms:

> *"For roughly a quarter of a century after the Second World War, Keynesian economics ruled triumphantly. No one wanted to go back to the 1930s. Nationally, governments accepted responsibility for maintaining high and stable levels of employment. Internationally, institutions, collectively known as*

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11 (Skidelsky, Keynes: the return of the master, 2009)

the Bretton Woods system, were set up to prevent depressive forces from being transmitted through the international payments and trading system."

In practice, this period also saw governments funding large infrastructure projects, creating strong social security systems, creating healthcare systems, and investing in education for their populations. During this period, US government spending initially fell sharply from wartime levels to about 20% of GDP, and then gradually rose to about 33% in 1980.

Generally speaking, this system seemed to work well until the early 1970s. From 1971 until 1973, a succession of unanticipated shocks caused serious problems for the developed economies world and resulted in what was then known as stagflation (the combination of stagnation in economic growth with price inflation).

First, the Bretton Woods system, in place since 1947, collapsed when it became progressively harder to maintain exchange rates between different currencies and between gold and the dollar at their target levels. In August 1971, the US abandoned the gold standard and allowed the dollar to float[12]. Britain then floated the pound sterling. In February 1973 Japan and the members of the EEC decided to allow their currencies to float.

Because oil is priced in dollars, the depreciation of the dollar caused the income of the oil producing countries to fall. In September 1971, the Organisation of Petroleum Exporting Countries (OPEC) announced that from then on, its members would price oil in terms of a fixed amount of gold[13].

When America supported Israel during the October 1973 Yom Kippur War, OPEC initially responded by raising the price of oil by 70%, and then by imposing an embargo and a series of monthly cuts in oil production of 5%. The price of oil rose by a factor of four, from \$3 per barrel to \$12 per barrel, during this time. This was the first oil shock.

The collapse of the Bretton Woods system and the oil shock caused a global stock market crash[14] – a bear market which lasted from January 1973 to December 1974. In real terms, US stocks lost over 55% of their value, and UK stocks lost over 70% of their value during this time.

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12 (Ghizoni, 1971)
13 (Wikipedia, 2016)
14 (Davies, 2003)

Both the US and the UK entered recessions. In 1976, economist Nicholas Kaldor[15], concluded that the oil shock had caused inflation and that the government reaction to inflation in the US and later in other countries caused recession.

Later in the 1970s, a Second Oil Shock – caused partly by the Iranian revolution – brought further economic turmoil, including widespread speculative hoarding[16]. This second shock both depressed economic activity and provided an environment in which inflation could take hold – and by the end of the 1970s, inflation had become a serious problem in both the US and the UK.

1980 – 2015: The Age of Market Capitalism

In 1979, in the UK, Margaret Thatcher was elected as Prime Minister; and in 1981, in the US, Ronald Reagan was elected as president. These two leaders were influential in ushering in a different form of capitalism - Market Capitalism.

As Lord Skidelsky describes it[17]:

"… by the 1980s both theory and policy had swung back to pre-Keynesian ideas. Government was seen once more as part of the problem, not the solution. Expansionary government policies were accused of fuelling inflation and crowding out better-informed private investment without reducing unemployment in the long run."

The principles of Market Capitalism were codified in the 10 points of the so-called 'Washington consensus', which described the standard economic reform package recommended by Washington-based institutions such as the International Monetary Fund (IMF), World Bank, and the US Treasury Department, as set out by John Williamson in 1990[18]:

1. Fiscal Deficits – governments should run at least a balanced budget, if not a surplus
2. Public Expenditure Priorities – it is better to reduce spending than increase taxes
3. Tax Reform – reduce taxes where possible, make them broad-based where not possible
4. Interest Rates – maintain positive real rates, but not too high
5. The Exchange Rate – competitive

15 (Kaldor, 1976)
16 (Graefe, 2016)
17 (Skidelsky, Keynes: the return of the master, 2009)
18 (Williamson, 1990)

6. Trade Policy – free
7. Foreign Direct Investment – encouraged
8. Privatization – encouraged
9. Deregulation – encouraged
10. Property Rights – to be legally secured.

These 10 principles are the basis of what in Washington – and far beyond – was meant by the word 'reform' of the economy. They have two main thrusts: to free up the private sector; and to shrink the role of the state.

True to these principles, since 1980 in both the US and the UK (as well as many other countries), the direction of policy has been to deregulate wherever possible – and in particular to impose 'light-touch' regulation of Financial Services; to privatise wherever possible and to contract-out where full privatisation is not possible; to reduce rates of income tax; to contain public spending; and to reduce the power of the union movement. By and large, in other words, the government has been trying simply to get out of the way.

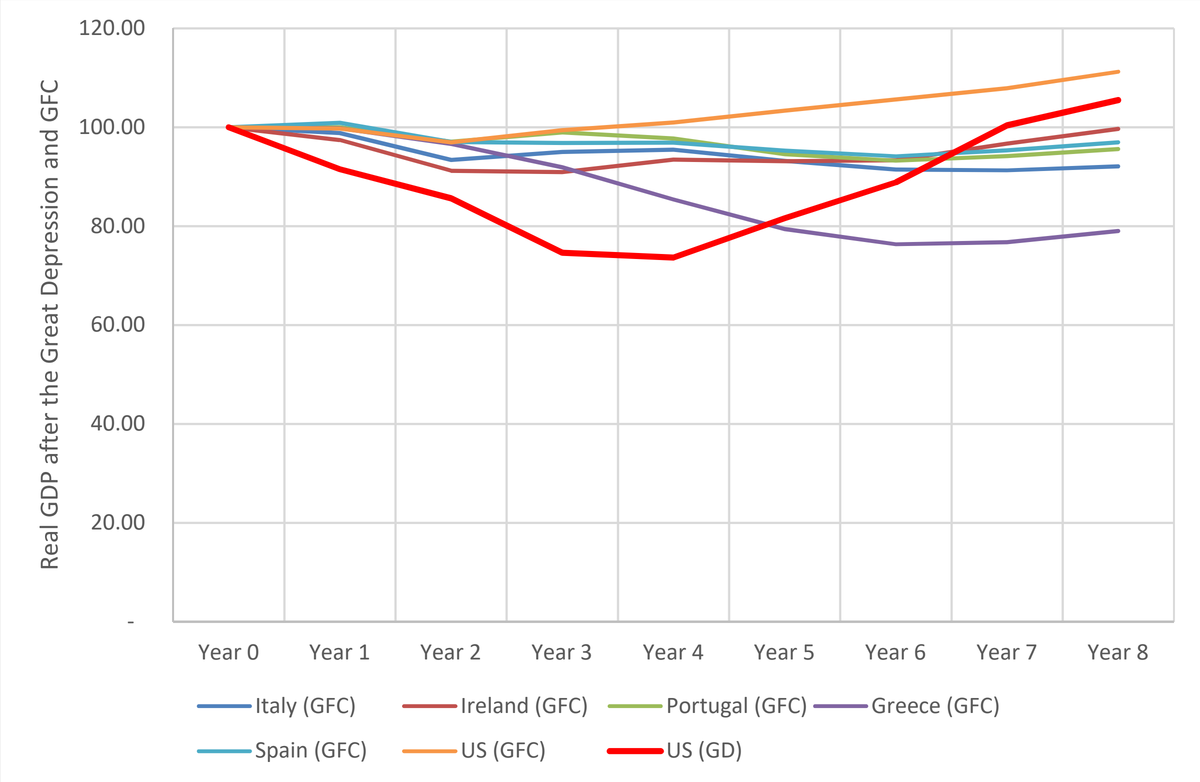
Like the Golden Age – in fact rather more so – the Age of Market Capitalism has been punctuated by crises, of which the most recent, and the most serious, was the Global Financial Crisis which became manifest in 2007 and reached its crisis point in September 2008.

The Global Financial Crisis was described by Charles Bean, the Deputy Governor of the Bank of England as[19], *"... a once in a lifetime crisis, and possibly the largest financial crisis of its kind in human history.*"

The deep recession which followed the Global Financial Crisis (GFC) has been dubbed 'the Great Recession' and, in some countries its impact has been more serious than that of the Great Depression in America. The chart below shows real GDP for the peripheral countries in Europe after the GFC and compares those trends with the changes in real GDP for the US after the Great Depression (GD). To make the numbers comparable, they have all been indexed to 100 in Year 0 which, for the Great Depression, was taken as 1929 and for the GFC as 2007.

19 (BBC, 2009)

Figure 6: Comparing the aftermath of the GFC with the Great Depression



Source: BEA[20] and WEO database[21]

The cumulative impact of the Global Financial Crisis on the peripheral countries of Europe has been disastrous. The solid red line shows the dramatic fall in US GDP during the Great Depression, and the sharp recovery after Year 4 when the New Deal kicked in. Although the Great Recession was initially much less dramatic, there has been little to no recovery in these peripheral countries and they are now far behind where they would have been had they followed a similar path to that of the US during the Great Depression.

We have therefore had two 35-year periods with two different dominant philosophies, each ending in a crisis. The crisis at the end of the Golden Age of Capitalism brought radical change and ushered in the Age of Market Capitalism. It is not yet clear whether the Global Financial Crisis and the subsequent Great Recession will also bring about substantial change.

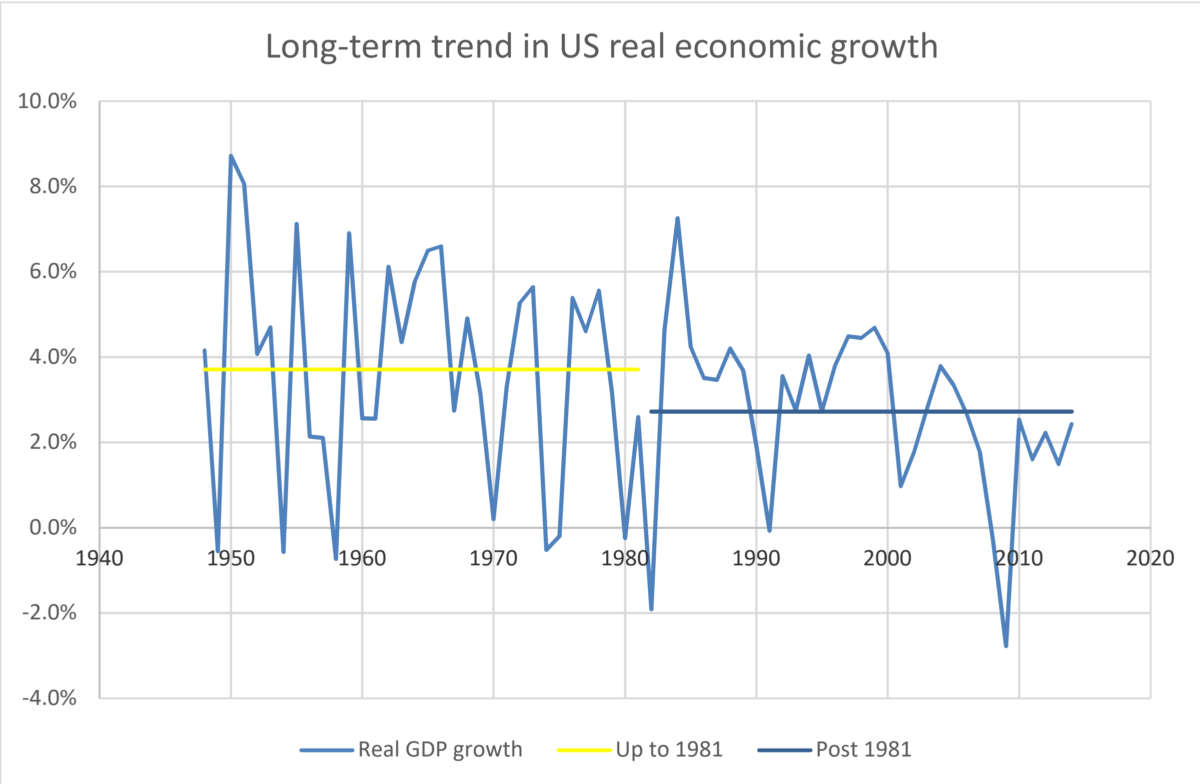
20 (Bureau of Economic Analysis, 2015)
21 (IMF, 2015)

On most measures, the results were better during the Golden Age of Capitalism

Using real GDP (i.e. adjusted for inflation) we can measure the total value of economic activity over the 70-year timeframe. To understand the results in terms of their impact on individuals, we must also look at real GDP *per capita,* at real median income (the inflation-adjusted income of the typical family) and at the unemployment rate.

We can start with real GDP in the US and in the UK - the extent to which the size of the pie grew during the Golden Age and during the Age of Market Capitalism.

Figure 7: Comparison of US real GDP growth rates during the two eras



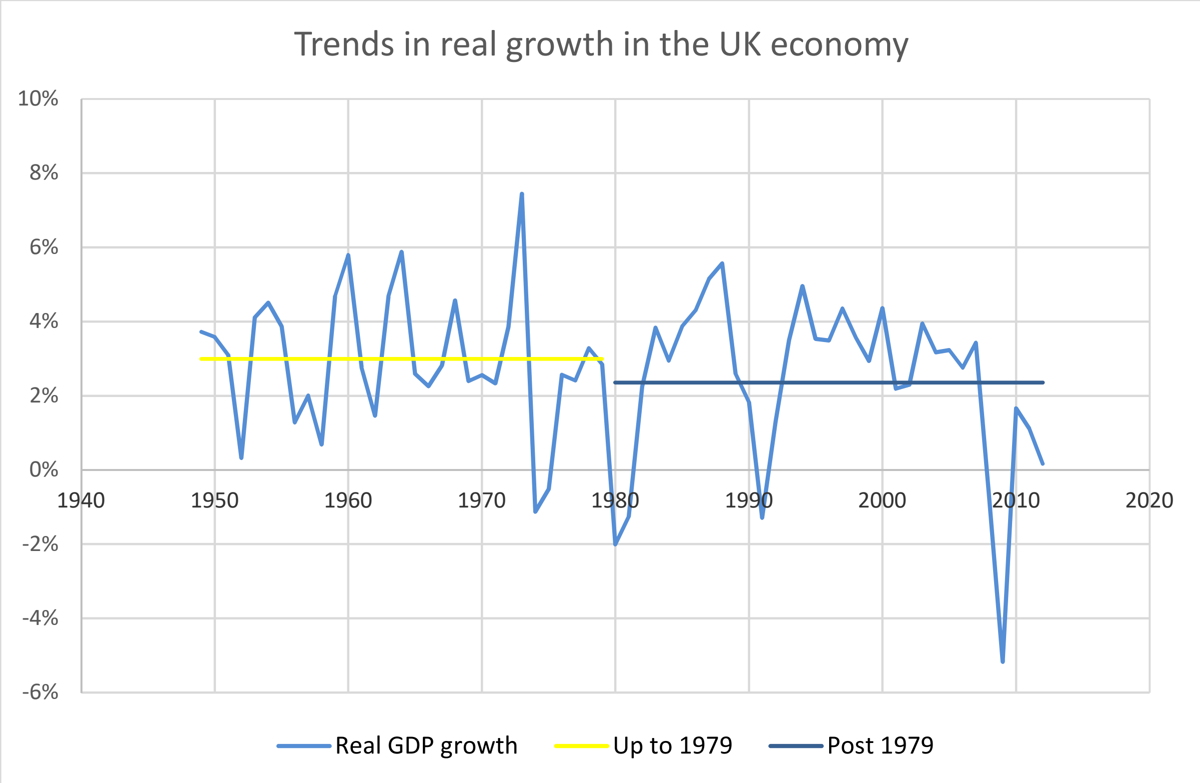
Source: BEA[22]

During the first of the two eras, the average annual growth rate of real GDP in the United States was 3.7%; during the second era, the average growth rate of real GDP was only 2.7%.

The chart below shows the equivalent data for the UK.

22 (Bureau of Economic Analysis, 2015)

Figure 8: Comparison of UK real GDP growth rates during the two eras



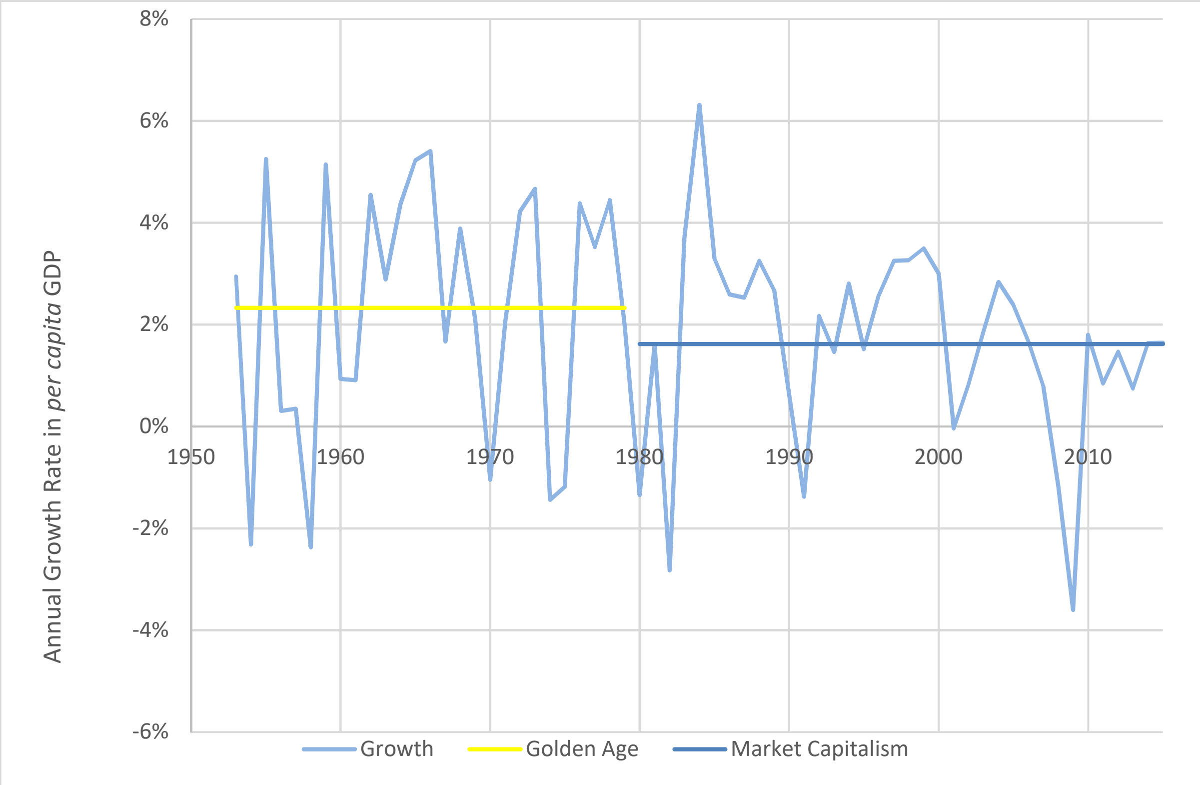
Source: ONS[23]

Again, the data show no evidence of an improvement in growth rate following the introduction of the Thatcher reforms: during the Golden Age, UK growth averaged 3% *per annum*; during the era of Market Capitalism, it has averaged only 2.4% *per annum*.

In terms of growing the pie, the Golden Age philosophy was more successful than Market Capitalism. But growing the pie in total may or may not be reflected in the experience of individual members of society. To explore the impact on individuals, we must look at real GDP *per capita*.

23 (ONS, long-term profile of GDP UK, 2015)

Figure 9: Real GDP per capita in US

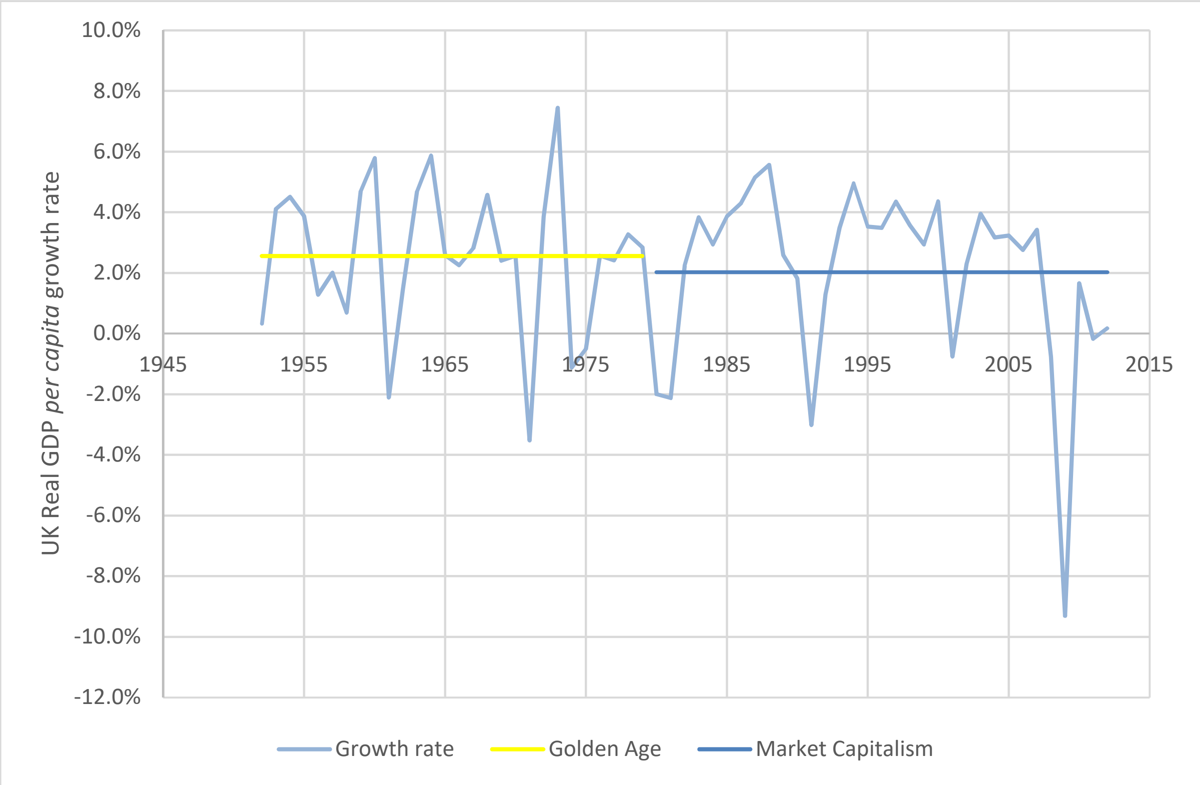


Source: Federal Reserve Bank of St Louis[24]

The average growth of real GDP *per capita* in the United States was 2.3% during the Golden age of Capitalism. During the era of Market Capitalism, however, it grew at only 1.6%. Even though the difference is slightly less than the difference in growth of total GDP (because population growth has slowed), it remains a very significant difference, enough to have a profound impact on the experience of individuals in society.

24 (St Louis Federal Reserve Bank, 2015)

Figure 10: Real per capita GDP for UK



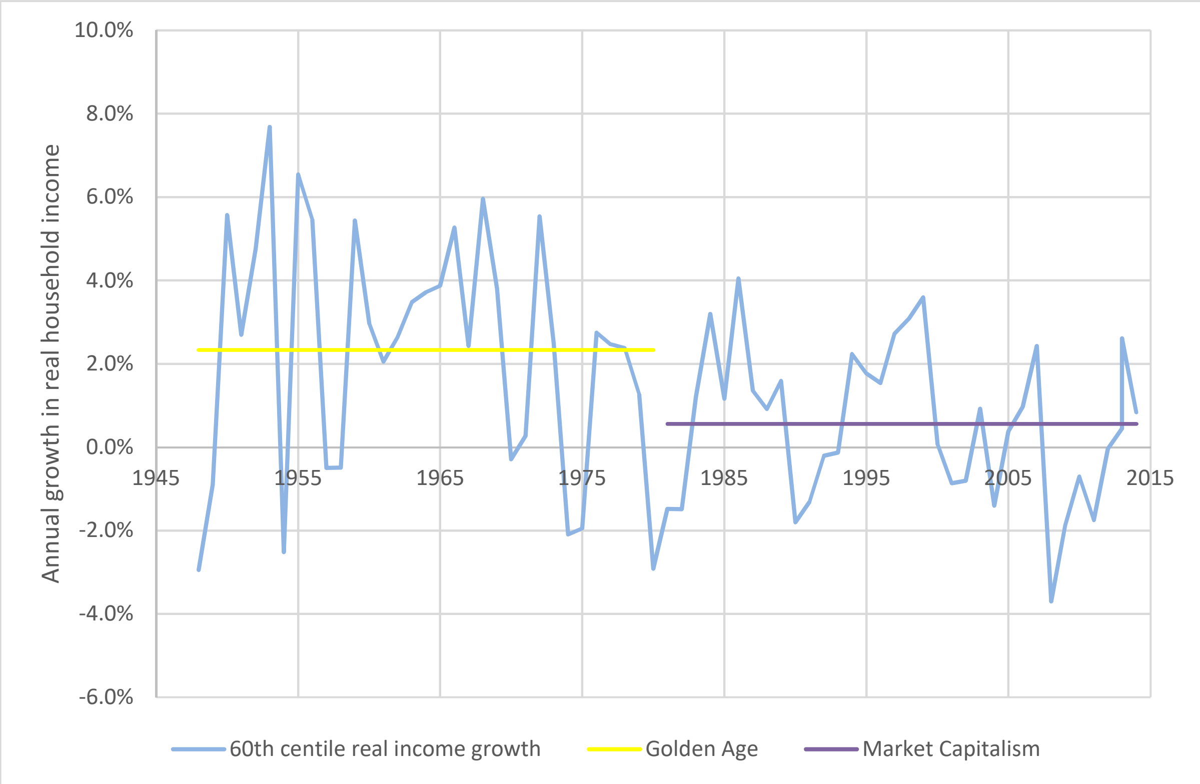
Source: ONS[25]

The picture in the UK is similar. During the Golden Age of Capitalism, the average annual growth rate in real GDP per capita was 2.6%. During the Age of Market Capitalism, it has been only 2%.

The next issue is median income. For somebody in the middle of the income range, changes in real median income represent whether they are better or worse off. Unfortunately, official statistics for median income do not go back to 1945, so we cannot present these results. The US Census Bureau does, however, provide a long-term dataset for the 60th percentile of the population, which we can expect to show a very similar picture.

25 (ONS, long-term profile of GDP UK, 2015)

Figure 11: Growth in real household incomes in the United States



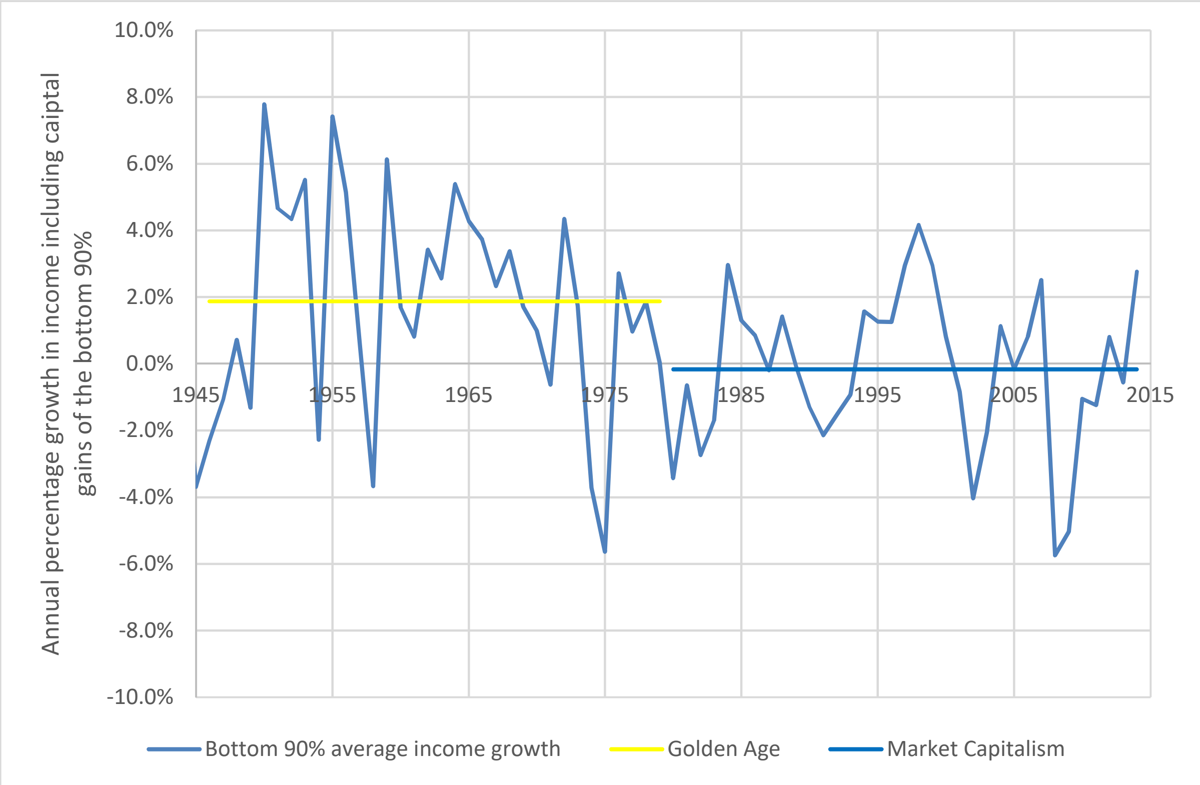
Source: US Census Bureau[26]

The chart shows that during the Golden Age, a typical American family could expect to see its income rising at 2.3% *per annum* in real terms. In the age of Market Capitalism, the rate of increase *per annum* has been just 0.6%. At the beginning of this chapter, we noted that a typical American family has seen a real-terms increase of 155% in earnings since 1947. The data above imply that 111% of this increase took place during the Golden Age and only 21% during the age of Market Capitalism – and as we shall see, almost all of that 21% is accounted for by an increase in the number of earners per household rather than by a change in individual earnings.

For the US, in addition, the economists Facundo Alvaredo, Sir Anthony B Atkinson, Thomas Piketty and others have compiled detailed historical information on the distribution of income – particularly at the upper end – which has been made available in the world top incomes database (WTID). This database does not have a figure for median income, but it does have data for the bottom 90% of society (as well as a detailed breakdown of the incomes of the top 10%) covering the entire period. One of these data series contains information on total income by households including any capital gains they may have enjoyed.

26 (US Census Bureau, 2016)

Figure 12: US real total income trends



Source: WTID[27]

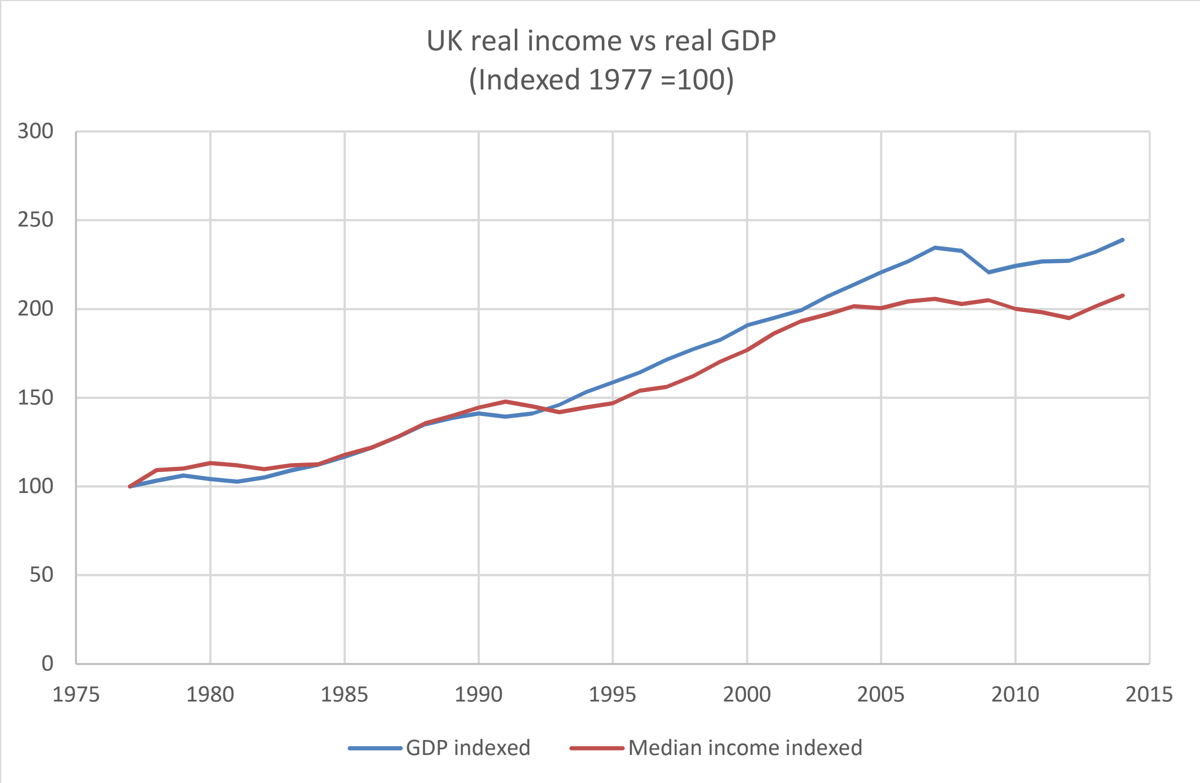
The chart shows that the bottom 90% of the population enjoyed an average annual increase in their total income – including capital gains – of just under 2% during the Golden Age. During the era of Market Capitalism, however, the bottom 90% of the population has seen a small decrease on average in their total income. The bottom 90% of the population are actually worse off than they were 35 years ago. This is particularly surprising result given that, although GDP per capita has grown less strongly than it did during the Golden Age, it has nevertheless been growing – at about 1.6% *per annum* – throughout this period.

The message from the two data sources is consistent: the pie has been growing, but much of the population has been getting smaller slices.

Neither the Office for National Statistics nor the WTID provides an equivalent series for the UK going back as far as 1945, so a proper comparison of the two eras is difficult. We can however look at median income in the UK since 1977 when the official statistics become available. The chart below compares the growth in real GDP for the UK with the growth in real median incomes. To make the figures comparable, they have both been indexed so that the value for 1977 is 100.

27 (Alvaredo, Atkinson, & Piketty , The World Top Incomes Database, 2015)

Figure 13: UK real median income trends



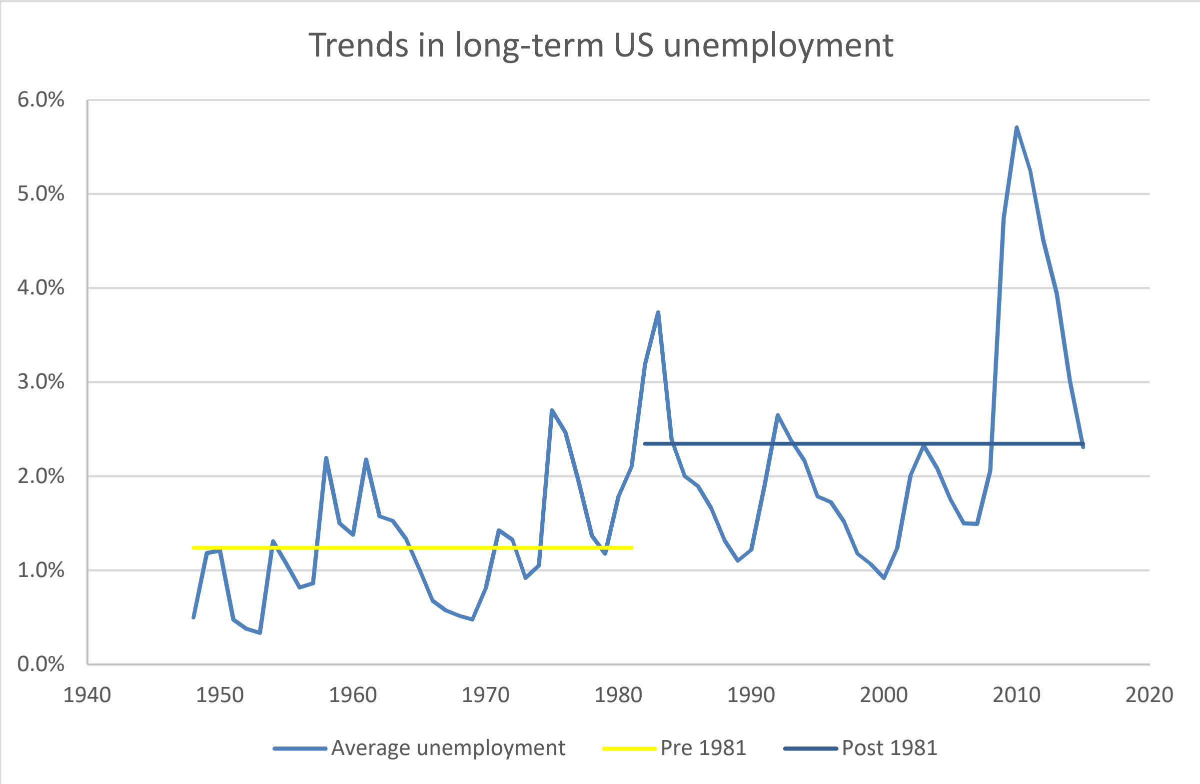
Source: *ONS*[28]

In the UK, we can see that the picture is a little different: GDP in total has grown less quickly, but up until the early 2000's, median household income more or less kept pace. Since about 2003, however, real incomes have stagnated. GDP is significantly higher now than it was in 2003, but real incomes are little changed, and in fact until 2012 they had been declining. Long-term decline in median income has not taken hold in the UK in the same way as in the United States – but neither is it a distant prospect.

The final factor that we shall consider, which has a huge impact on the experience of individuals, is the rate of unemployment. The charts below compare the rates of unemployment during the Golden Age with those during the age of Market Capitalism.

28 (ONS, 2015)

Figure 14: US unemployment rate



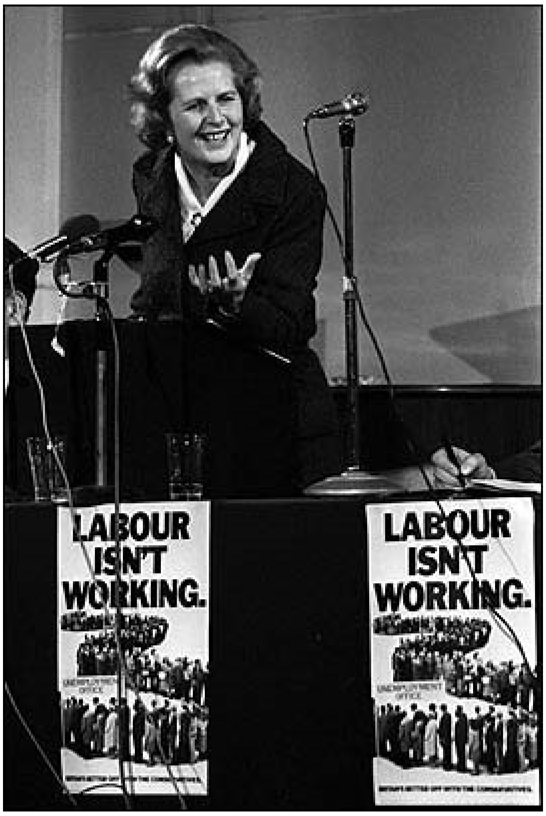
Source: BLS[29]

Clearly there has been a significant rise in the average unemployment rate since the introduction of the market reforms: long-term unemployment in the United States averaged only 1.2% during the Golden Age of Capitalism; during the Age of Market Capitalism, long-term unemployment has averaged 2.3%.

In the UK, the rising unemployment rate was a key source of dissatisfaction with the *status quo* at the end of the 1970s and a principal reason for the election of Margaret Thatcher – unemployment exceeded 1 million for the first time, which the Tories seized on as evidence of economic mismanagement with a highly successful, now iconic, poster saying, "*Labour isn't working*".

29 (Bureau of Labour Statistics, 2015)

Figure 15: Margaret Thatcher with the famous 'Labour isn't working' poster

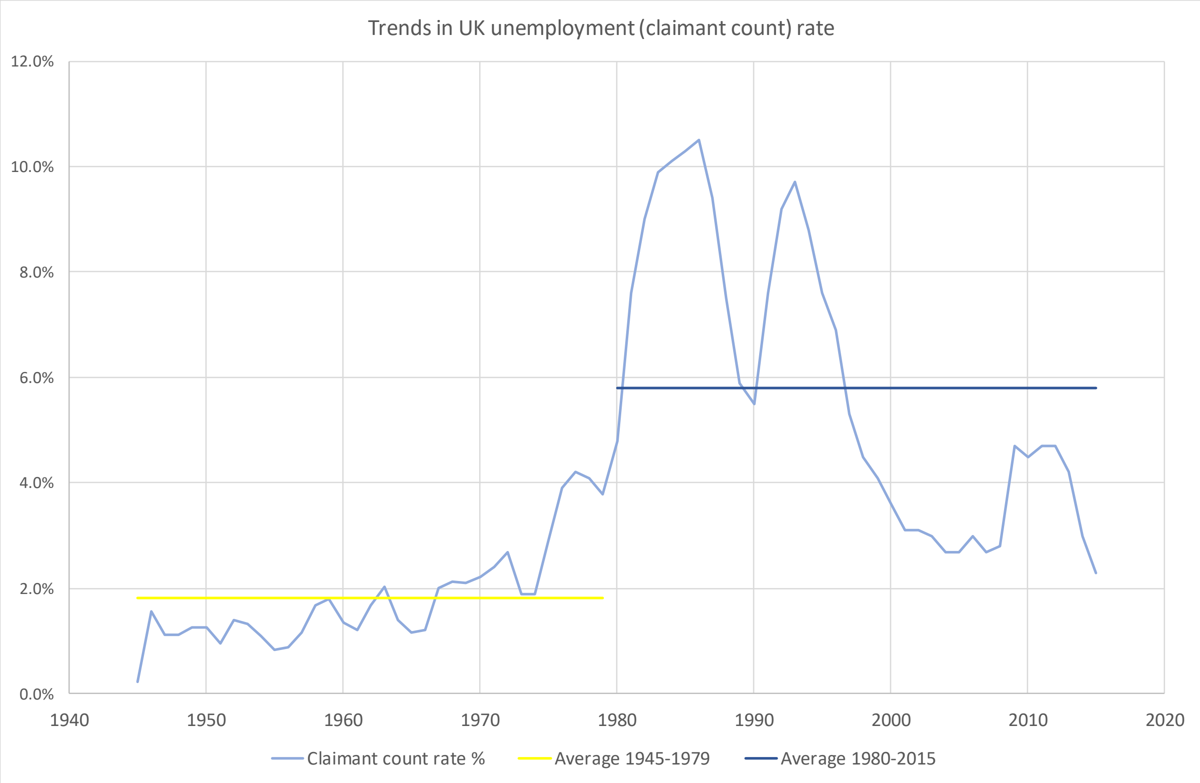


Source: John Preston, The Daily Telegraph[30]

The chart below shows the trends in UK unemployment since the late 1940s. It indicates that there was indeed a significant increase in unemployment under the Labour government preceding Margaret Thatcher's election: a sharp rise from around 2% up to about 4%.

30 (Preston, 2008)

Figure 16: UK unemployment rate



Source: ONS[31]

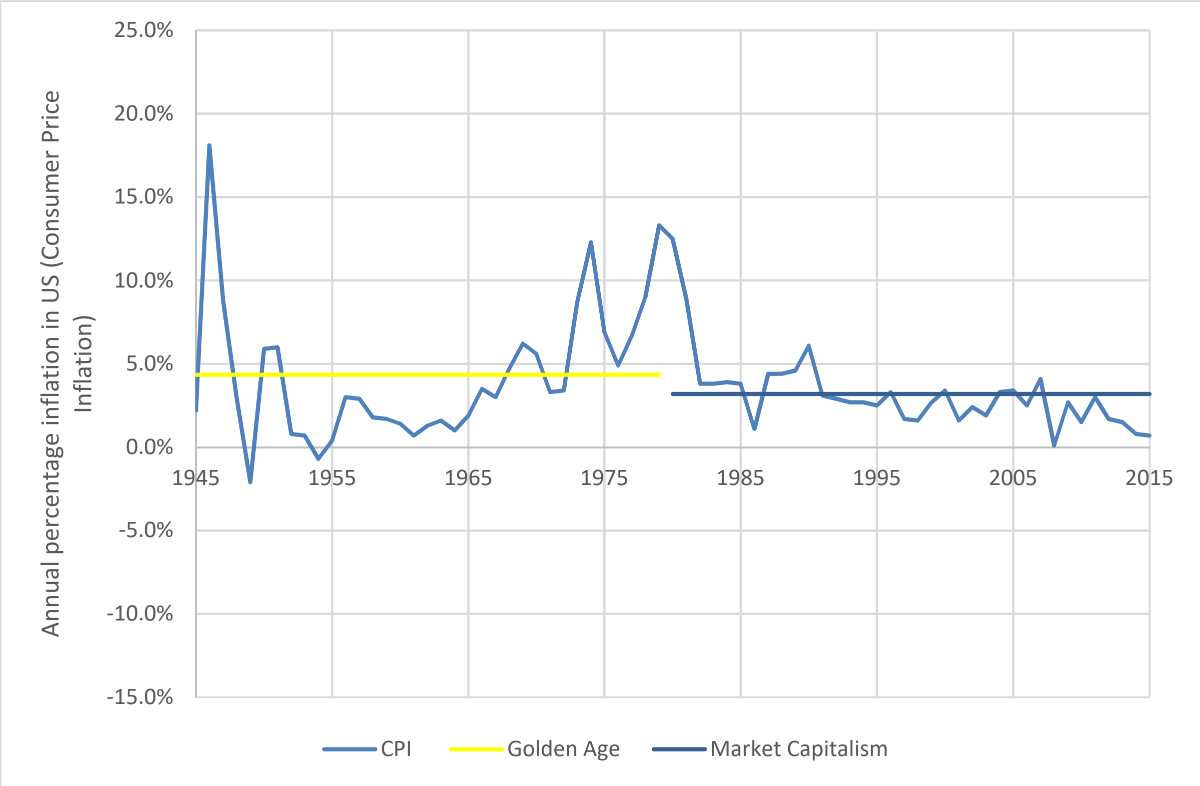
What is astonishing, however, is that after the election of Margaret Thatcher as Prime Minister, rather than falling as promised, unemployment shot up further – more than doubling – and peaked at over 10%, five times the previous norm. It was not until 1999 that UK unemployment again reached lower levels than those inherited by Margaret Thatcher in 1979. Given how central unemployment was to the election of Margaret Thatcher's government, it is surprising how little-known these facts are.

During the Golden Age, UK unemployment averaged 1.9%, whereas under Market Capitalism it has averaged 5.8%, slightly more than three times higher.

The Golden Age scored better on overall economic growth, growth in GDP *per capita*, growth in median incomes and unemployment rates. There was however one area in which performance during the age of Market Capitalism has been better: containing inflation.

31 (ONS, 2015)

Figure 17: Consumer price inflation in the United States



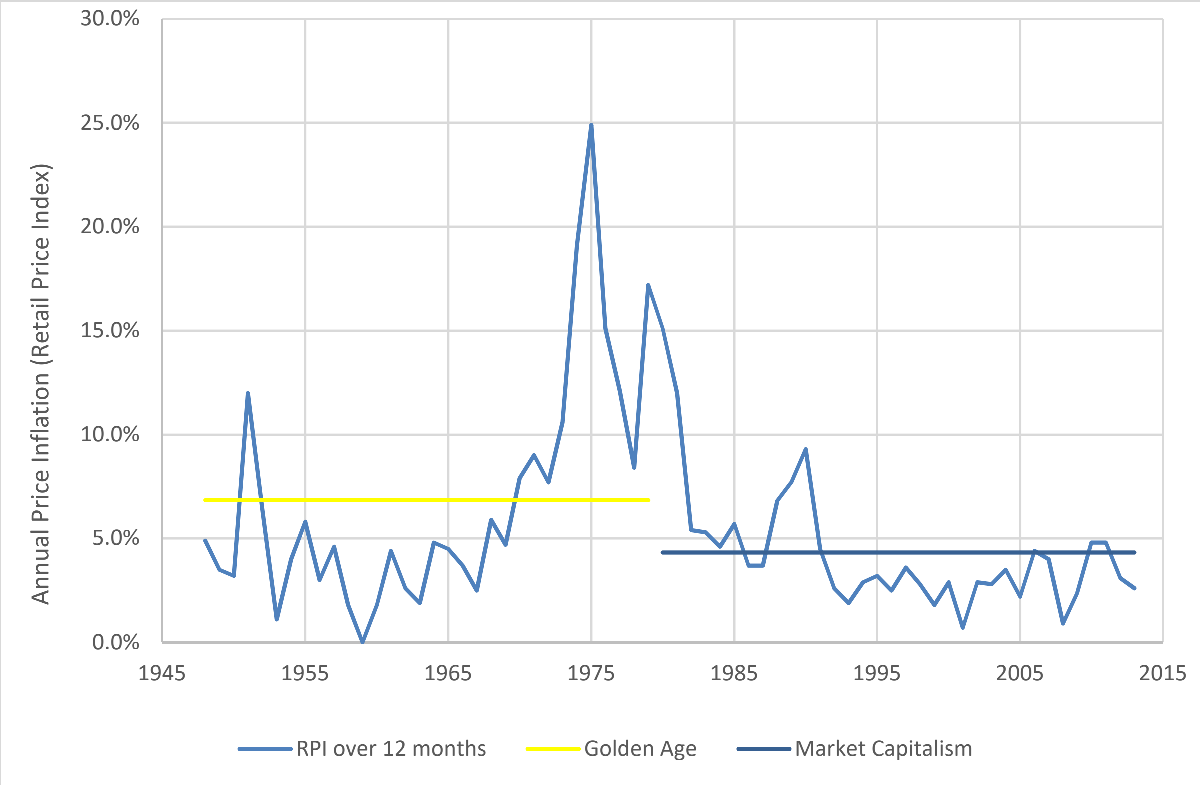
Source: US inflation calculator[32]

As the graph shows, not only has inflation on average been lower during the era of Market Capitalism (3.2% versus 4.3%) but it has generally been in decline during this second era. Indeed, we are now a point where many economists believe that deflation is the greater threat.

The picture is broadly similar in the United Kingdom as the graph below illustrates.

32 (US inflation calculator, 2016)

Figure 18: Retail price inflation in the United Kingdom



Source: ONS[33]

Inflation during the Golden Age of Capitalism averaged 6.8% in the UK; and it has been on average 4.3% during the age of Market Capitalism.

The data show that the period from 1945 up to about 1980 was indeed a Golden Age of Capitalism, but that it has been followed by 35 years of relatively poor results on almost every measure.

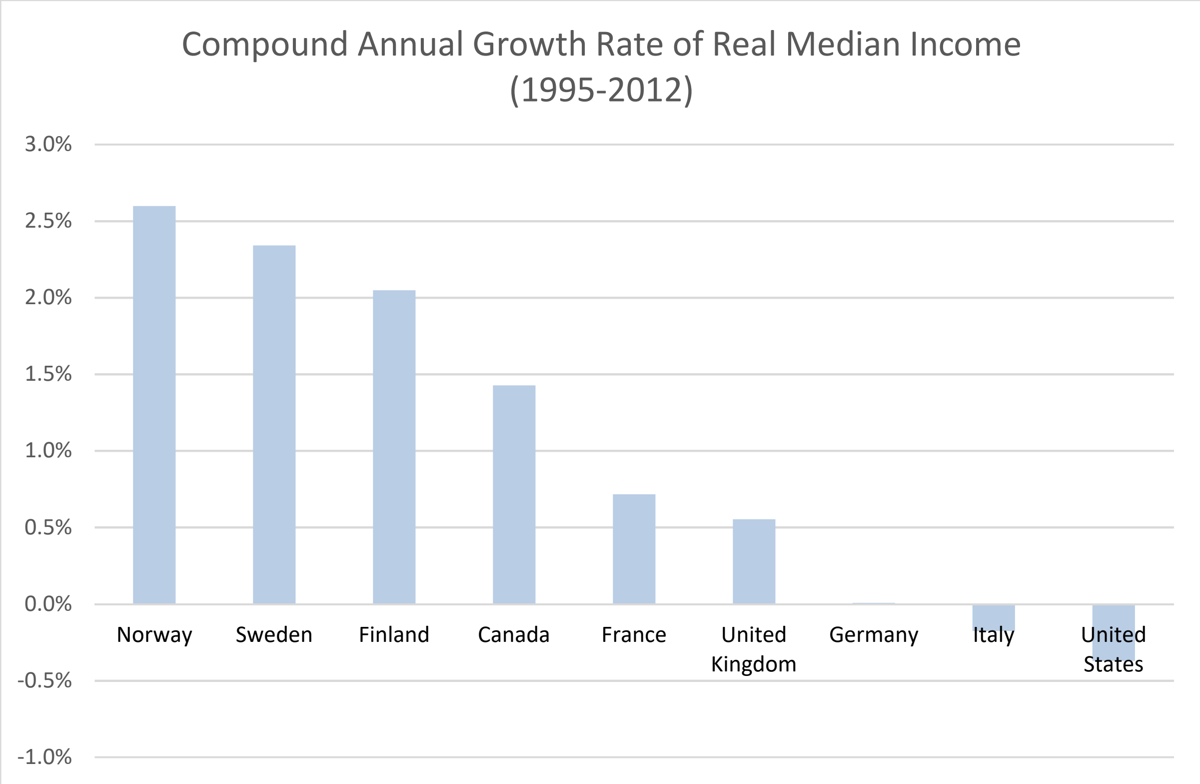
An unexpected phenomenon has emerged: Mass Impoverishment

Politicians and economists usually talk as though an increase in the size of the economy is all that really counts: if the pie grows, everyone will get a bigger slice. As the data presented above show, that was indeed the case during the Golden Age of Capitalism, but it has not been true in the United States during the era of Market Capitalism – not when total incomes are taken into account – and during the last few years, it has not been true in the UK.

In fact, as the chart below indicates there are several developed countries whose citizens are becoming poorer over time.

33 (Office for National Statistics, 2016)

Figure 19: Growth in real median income by country



Source: OECD[34]

The chart shows data from 1995 to 2012 – a 17-year period during which all the economies listed experienced considerable real growth. They are all significantly richer than they were 17 years earlier. The US shows a clear decline in the real median income of its population, and so does Italy; in Germany, there has been essentially no change in real median incomes over this 17-year period. (As noted above, this problem did not reach the UK until relatively recently).

This phenomenon is important for voters to understand and for policymakers to consider in formulating economic policy – it is demonstrably possible for the economy to grow at the same time as the mass of the population becomes poorer. In this book, I have called this process 'mass impoverishment.' It is not enough, therefore to argue that a certain policy is 'good for the economy,' we need to be sure that it is good for the *people* in that economy.

34 (OECD, 2015)