Economic history:
Final Exam

December 15, 2015 - 15h45-17h45. No document allowed.

Exam Guidelines:
Each answer should not exceed **one page**. The evaluation will be based on the ability to write a short but clear and concise answer to each question. The structure of the answers as well as the illustration of the arguments based on empirical evidence will also be taken into account.
The exam can be done either in French or in English.

1) In 1825, France imposed to Haïti financial compensation for loss of slave property, in the form of large public debt. Assume for simplicity that until Haïti's independance half of Haïti's net domestic output Y was paid to slave owners (and the other half was used to sustain the population). Assume the average rate of return to capital was 5 % at the time. How big should have been the public debt, as a fraction of Haïti's annual output Y, in order to fully compensate the slave owners? How does this compare to the observed levels observed for private and public wealth since the Industrial revolution across the world? Comment. (5 points)

Answer:
$Y_k = 0.5Y$, $r = 0.05$ and $Y_k = W * r \Rightarrow W = \frac{Y_k}{r} = 10Y$
The public debt should have been equal to 10 years of Haiti's net domestic output in order to fully compensate the slave owners.
Evolution of private and public wealth:
Private wealth during 19c: 7Y (UK, France), 3 to 5 Y for the US excluding slavery or 4.5 with slavery (US) ; Public debt during 19c: 50%-200% (UK), $<$ 100% (France), less than 40% (US) ; Public wealth during 19c: -100%-0% (UK), 0%-50% (France), 0% (US)
Link with Haiti public debt and comment:

A public debt of 10Y is gigantic. Public debt never exceed more than 2Y in history (UK during Napoleonic war) and UK takes more than a century to reduce it below 50%. More over, such a level is widely above historical levels of private wealth. A public debt of 10Y should be seen as a perpetual debt that is impossible to pay back and would have reflected an extreme sacralization of private property. The yearly compensation could have led to explosive and unsustainable level of foreign claims limiting the development path of Haiti. In this particular case, the debt repudiation through inflation or default is difficult to implement because of the the coercive power of France through military invasion.
Comment on the high market value of slaves in this example:
In south US, market value of slaves around 3Y instead of 10Y because the rate of return is more important 8-10% against 5%, the impact of slavery on the economy is smaller ($\alpha = 30\%$ of Y instead of 50%). Even in this case, a full compensation is still important.
Historically, France imposed to Haiti a compensation corresponding to 100%-150% of Haiti national income that was repaid until the end of WW2. The high debt repaid by Haiti have had a negative impact on its development.

2) Describe the main determinants of labor income inequality, and the extent to which they can explain observed historical changes in inequality. (5 points)

Answer:
Since 1970, huge increase of labor income inequality in the US. Top wage decile goes from 25% in 1970 to 35% today. Goldin-Katz(2010) explains that phenomenon by the race btwn education and technology. If the growth rate of skill increases less than the demand for high skill workers (due to technical change), then labor inequality increases. But that story does not fit perfectly with continental Europe countries in which labor inequality have remained stable and PISA report show that inequality in educational achievement among 15-yr-old (math tests) is as large in France as in the US. According to this theory, the difference between France and the US should be explained by a differential access to higher education (tuition fees). Even in that case, the theory can not explain why most of the top decile increase is due to the top 1% .

Other forces can also play and fit the differential trends between the US and continental Europe.

- Labor market institution: salary scale, minimum/maximum wage. (See evolution of minimum wage between France and the US.), differences in legal systems (stakeholder vs shareholder rights) (see McGaughey (2015), Schuster (2015))
- Imperfect competition: CEO bargaining power and top tax rate (Piketty-Saez-Stantcheva (2014)), rent extraction in finance (Philippon(2012, 2015))

3) Great Depression vs Great Recession. Explain the similarities and differences. (5 points)

Answer:

Causes of both crisis are somehow related. In both cases, declining labor share and rising inequality. But for GR, imbalance btwn demand and supply while for GD, rising household debt and financial deregulation. Impact of both crisis on GDP and unemployment: GDP fall of about 5% for GD against 20%-30% for GR. because different policy responses: during GD, central banks decided to led bank collapse (liquidationist view) and absence of automatic stabilizers. during GR, central banks are lender of last resorts and QE policy and automatic stabilizers. Political consequences of the crisis : After GD, protectionism and rise of nazism. Markets were accused leading to new economic thinking with Keynesian policies, rise of social state and new role of central banks. After GR, both markets and govt were accused. Need to rethink regulation of financial markets and coordination of states.

4) Analyze the historical interaction between the rise of democracy and the decrease of inequality. (5 points)

Answer:

Implicit idea that democracy is associated with lower inequality because political leaders are elected by the entire population. Need to think about the distinction between status-based rights and real rights. Development of democracy have led to an increase of formal rights (universal suffrage and abolition of slavery) even if it was not immediate (suffrage for women implemented in 1945 in France, in the US abolition of slavery in 1865 and end of legal racial discrimination in 1960's . . .). But formal rights do not mean real equality of opportunities and redistribution. Example: Europe's experience 1870-1914: huge inequality, universal suffrage, but strong and largely successful resistance to fiscal-social reforms by the economic and political elites until the 1914-1945 shocks. Decrease of inequality due to exogenous shocks (crisis and world wars).

Why doesn't democracy always lead to declining inequality?

- Capture of the political process by the wealthy (Bonica and Rosenthal (2013)) : Political contributions by the wealthy
- Political attitude toward inequality: Political acceptance of inequality in the US according to extreme meritocratic ideal.
- Political polarization
- Lack of information and mistrust in government (Saez and Stantcheva (2015))