

Some Comments to the Discussion on the Euthanasia of the Rentier

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Abstract

This paper concerns the Keynesian topic of the Euthanasia of the Rentier. We summarize discussions appearing throughout the second half of the 20th century and concentrate on recent reflections on this topic. We develop a microeconomical foundation of the accumulation of capital indicating important linkages between the concepts of abstinence loss, varying levels of rentier consumption and slow convergence of the abstinence loss curve to zero. The outcome of the model offers an explanation of the capital accumulation process in the course of reducing interest rates and supports the feasibility of the reduction of interest rate to zero. However, recent studies on the rentier income share give no evidence about the rate of capital accumulation reaching the Euthanasia of the Rentier.

Keywords: *Euthanasia of the Rentier, capital, accumulation, concentration, interest rate, level of rentier consumption, abstinence loss curve*

JEL Classification: E12, E22, E43

Introduction

In the last chapter of the *General Theory* (Keynes, 1936), there is a vision about capitalism without exploiting the scarcity-value of capital fore-seeing the ultimate fall of the rate of profit on capital to zero. Keynes calls this situation the *Euthanasia of the Rentier*. According to Keynes “*the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital up to a point where its marginal efficiency had fallen to a very low figure*”. This remark is widely referenced in the economic literature.

Dudley Dillard mentioned already in 1946 in *The Pragmatic Basis of Keynes's Political Economy*, that “*Keynes gives no adequate explanation of the process*

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by which the *Euthanasia of the Rentier is to be accomplished*" (Dillard, 1946). Dillard speaks about a resistance to fall in the interest rate below a basic minimum, where liquidity preference becomes almost absolute (Dillard, 1946). Dillard concludes that "*some technique other than conventional bank controls must be found to lower the interest rate from 2 per cent to zero*".¹

Silvio Gesell highlights the Keynes's term "socialization of investment" and suggests stamped money, incurring carrying costs on currency in order to discourage storing wealth in the form of money (Dillard, 1942). The relevance to Keynesian "socialization of investment" is in fact limited. The idea of Keynes did not mean any violent social revolution, rather a gradual process lasting for decades. The term "socialization of investment" stands for the final stage of this process, not for the means. On the other hand, Keynes remarks, that the idea of stamped money may contain the essence of what is needed, however is not workable in the proposed form. One can also find similarities between Gesell's "Board of Public Investment" and the government-spending concept of Keynes.

The theoretical problem of accomplishment of the zero rate of profit on capital remains obscure as well in 1956, when Joan Robinson publishes *The Accumulation of Capital* (Robinson, 1956). The model of Robinson requires no consumption of rentiers to allow infinite accumulation of capital, which is not a realistic condition. Especially, if the ownership of wealth is "functionless",² rentiers cannot be expected to defer the consumption. Robinson concentrates on the relation between population growth and the accumulation of capital, disregarding the obstacles of an infinite accumulation. The essential argument is that with fixed coefficients the additional workers require the same tool per head as the others. They can therefore be absorbed only if accumulation is sufficient to provide these tools. A slightly greater rate of accumulation would make tools a free good, the worker would get the whole product, and the capitalist would get euthanasia. Conversely a rate of accumulation slightly less than that required for a Golden Age³ would reduce the real wage to zero (or to subsistence level). Robinson just remarks that "*we must be content with the conclusion that over the long run, the rate of accumulation is likely to be whatever it is likely to be*" (Robinson, 1956). Abba P. Lerner comments in 1957, that "*reading this book does not alter one's previous feeling that there is not really very much that economics can tell us about the accumulation of capital*" (Lerner, 1957).

¹ There is quite interesting remark concerning the basic minimal rate of interest, which Dillard estimates somewhere at 2% rate. Until 1946 the interest rates were rarely if ever at such a low level and from the current viewpoint this estimate was very accurate.

² „The functionless investor“ is a term of Keynes.

³ Golden age stands for period of balanced growth of the capital and population.

Fourteen years later, in 1970, Robinson admits, that “*there may be some ultimate bottom-stop to the rate of interest so that it might get stuck at too high a level and bar the entry to paradise regained. This argument certainly flatters the monetary system, not so much because of the notion that liquidity preference might ultimately check accumulation, as because of the tacit assumption that successive reductions in the rate of interest could keep accumulation going in face of a falling rate of profit*” (Robinson, 1970). Robinson adds an interesting comment, that when she came to the Chapter 17, reading the proofs of the *General Theory*, she wrote to Keynes that for the first time she was finding the argument difficult to follow. Keynes should have replied that he was not surprised for he found it difficult himself.

A very different approach we can find at Arthur Dahlberg. In 1961 in *Money in Motion* (Dahlberg, 1961), Dahlberg expresses arguments for the liquidity preference as a mean of competition. His arguments are rooted in the theory of endogenous money. According to Dahlberg, “Nothing that money results from the creation of demand deposits based on bank loans” and the collateral securing such loans is worth far more than the loans. If holders of money decide to play a waiting game (that is, if liquidity preference increases), it may be advantageous to participate in this exercise because of the collateral to which money ultimately has access. Borrowers are in effect gambling, that income recipients will reuse money fast enough that prices will not fall or real property values decline. From this point of view, the falling of the interest rate is only a temporary effect of the hostile money hoarding. After the physical assets of the borrowers are liquidated, there is no more motivation for deferring the consumption and keeping the profitless capital.

In 1975, B. J. Moore attracts attention to the concentration of capital. In his *Equities, Gains, and the Role of Finance in Accumulation* (Moore, 1975), Moore expresses two crucial ideas. First, the concentration of capital reduces the disadvantage of deferring the consumption by concentrating the abstinence loss at a smaller group of capital holders. Second, holders of large capitals have a higher average propensity to accumulation, because the decision about the accumulation intensity is largely not done by them, but by the hired managers of their possessed businesses. This conclusion is supported by a comprehensive survey of wealth distribution among income groups: “*Lower wealth holders own primarily homes, consumer durables, automobiles, and some liquid assets. Top wealth owners hold the bulk of their wealth in the form of business and investment assets, primarily listed and unlisted corporate stock and equity in business and professions.*” (Moore, 1975) Moore remarks, that by saving a large proportion of property income, concentration of wealth paradoxically serves in part to condone the institution of private property itself. Moore recalls the

famous Keynesian double bluff passage observing that the capitalists, though they do no work, “were allowed to call the best part of the cake theirs, and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice”.

Among the recent literature, there is the ‘*Socialization of Investment*’ and ‘*Euthanasia of the Rentier*’: *the Relevance of Keynesian policy ideas for the contemporary US Economy* by Robert Pollin from 1996 (Pollin, 1996). Pollin points out at the experience of financial system instability, which is the counter-power to the process of reducing the interest rates. Pollin puts similar arguments forth again in 2007 in “Resurrecting the Rentier” (Pollin, 2007).

On the very opposite side we find papers concerning the technical feasibility of the interest rate reduction even to negative figures. Marvin Goodfriend concentrates on this idea in 2000 in *Overcoming the Zero Bound on Interest Rate Policy* (Goodfriend, 2000).

Considering the concept of the *Euthanasia of the Rentier*, we should also regard a comprehensive survey of the distribution of the rentier income in *Trends in the Rentier Income Share in OECD Countries, 1960 – 2000* (Power, 2003) by Dorothy Power, Gerald Epstein and Matthew Abrena. Instead of the euthanasia, rentiers experience an increase in the rentier income share in average in the second half of the 20th century in developed countries.

The existing economic theory describes most of phenomenon connected with the accumulation of capital and interest rate reduction. There is a clear understanding of the accumulation by saving, of the abstinence theory, of the theory of interest, liquidity-preference and of capital market behavior. The purpose of this paper is to find new linkages among these concepts.

To find out how the reduction of the interest rate checks the accumulation of capital, we investigate first the process of capital accumulation. We develop a microeconomic foundation of the capital accumulation and identify important features of the model: varying *abstinence loss*, varying levels of rentier consumption and shifts of the *abstinence loss* curve. Then we analyze the capital accumulation process in combination with reducing interest rates and investigate the effect of capital concentration.

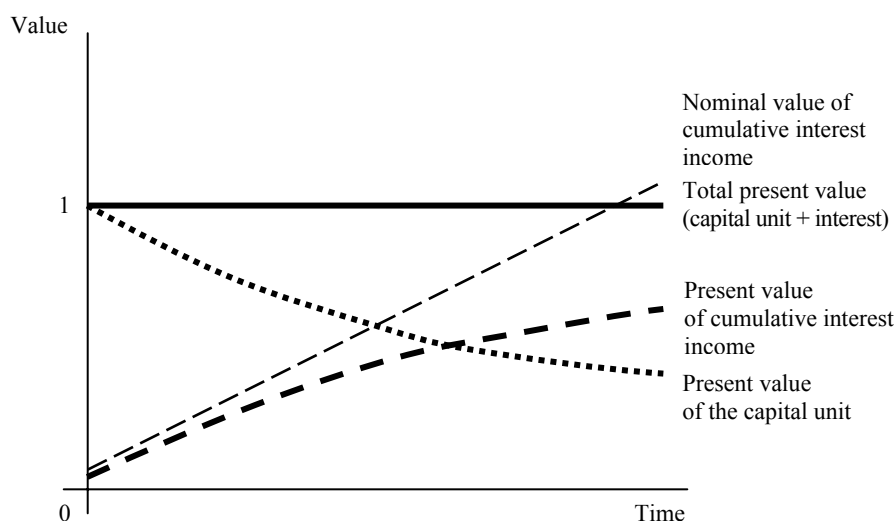
1. Microeconomical Foundation of the Accumulation of Capital

Any individual process of the capital accumulation is preceded by an individual decision between saving and spending. The individual is deciding about each unit of capital⁴ by comparing the profit from spending it with the profit of saving it. The profit of spending the capital unit just equals its value; let’s say

equals 1. The profit of saving is more complicated concept and includes a time dimension. By saving the capital unit the individual gets a choice of spending it in future, i.e. a discounted value of the capital unit, and the interest. This rate of discounting follows the emotional loss⁵ caused by abstaining from immediate consumption. The value of interest is identified by the existing level of interest rate and future interest incomes are emotionally discounted in the same way as the profit of future consumption. The process of saving can be interrupted any time by the decision to consume, or last infinitely. The Chart 1 describes the concept of the profit of saving a particular capital unit and in this particular case we choose the rate of emotional discounting to equal the interest rate.

Chart 1

The Profit of Saving a Particular Capital Unit



Source: Own research.

The horizontal axis measures time, while the vertical axis measures value. The degressively decreasing curve of capital unit value starts from the current value and expresses the emotional discounting in time. The degressively

⁴ The term 'capital' is usually understood as an investment-designated property. However, regarding the focus of this paper in investigating the individual saving-spending decision, we must understand the capital more broadly, covering the whole individual property (simplified as money stock) before the saving-spending decision is taken. Afterwards, some part of this property is spent for consumption, while the rest is retained (invested) in the form of the usually understood term 'capital'. This paper does not regard the recurrence of this process.

⁵ We define the emotional loss as the difference in utility between the immediate consumption and the future consumption.

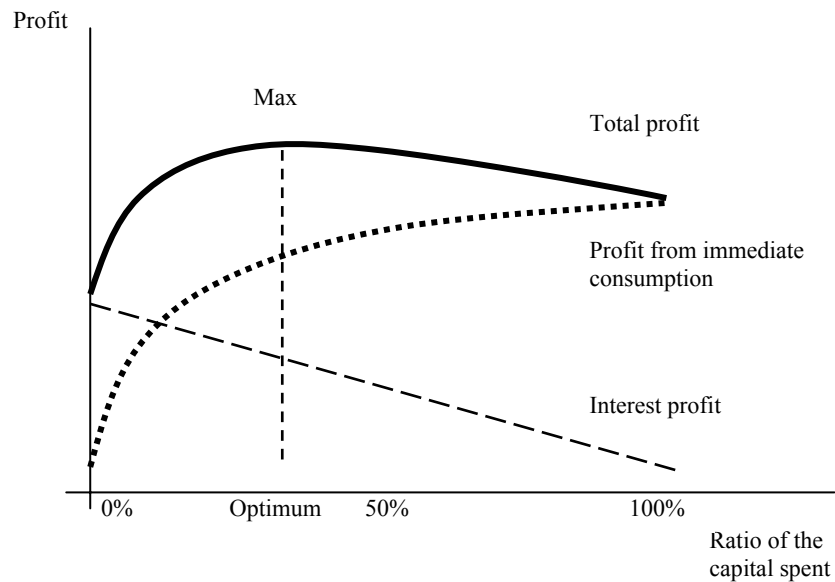
increasing curve of the present value of cumulative interest income expresses the discounting of the linear cumulative interest income in nominal values. The flat line of present value (capital unit + interest) represents the summarization of the former two curves and in this particular case is constant because the rate of interest equals the emotional discount rate.

The decision about saving or spending the particular capital unit follows the slope of the total present value curve.⁶ We are simply asking if the emotional discounting of the capital unit is compensated enough by the interest profit or not. Of course, this question is not the same for all capital units. Only the profit from interest is constant, but the rate of the emotional discounting is higher for the first capital units than for the last one. The reason is the decreasing inevitability of consumption of the additional capital units.

The individual maximizes its profit by consuming up to the capital unit, of which the rate of emotional discounting equals the rate of interest.⁷ Additional capital units will be saved, because the rate of loss from abstaining from their consumption is less than the rate of interest.

Chart 2

The Optimal Saving-spending Combination



Source: Own research.

⁶ A positive slope suggests saving, otherwise spending.

⁷ In other words, we find the amount of capital, of which the marginal rate of emotional discounting equals the marginal rate of interest profit.

The Chart 2 indicates the optimal combination of saving and spending. The horizontal axis covers all saving-spending combinations, while the vertical axis expresses the profit of spending, saving, or its combination.

2. Abstinence Loss Curve

The important phenomenon visible on the charts above is the variable emotional discount rate of the capital unit value, which we define as the *abstinence loss*. Under this term *abstinence loss* we understand the emotional loss⁸ caused by abstaining from consumption. Its measure is the rate of loss, which applies on the extent of retained capital. In a graphical sense, the *abstinence loss* curve is an inverted curve of profit from immediate consumption.⁹

In a short-run the *abstinence loss* curve does intercept the money-axis, because there is some ultimate amount of money, which, if spent, is covering all demands of the individual so that there is no demand for additional spending. This is caused by the fact that the individual demands are definitive in short-run. They are inherited from recent demands, which reflect the recent resource constraints, and do not reflect their changes. In a long-run the individual is able to adjust its demands and the accumulation of capital causes the *abstinence loss* curve to shift to higher level as indicated on Chart 3.

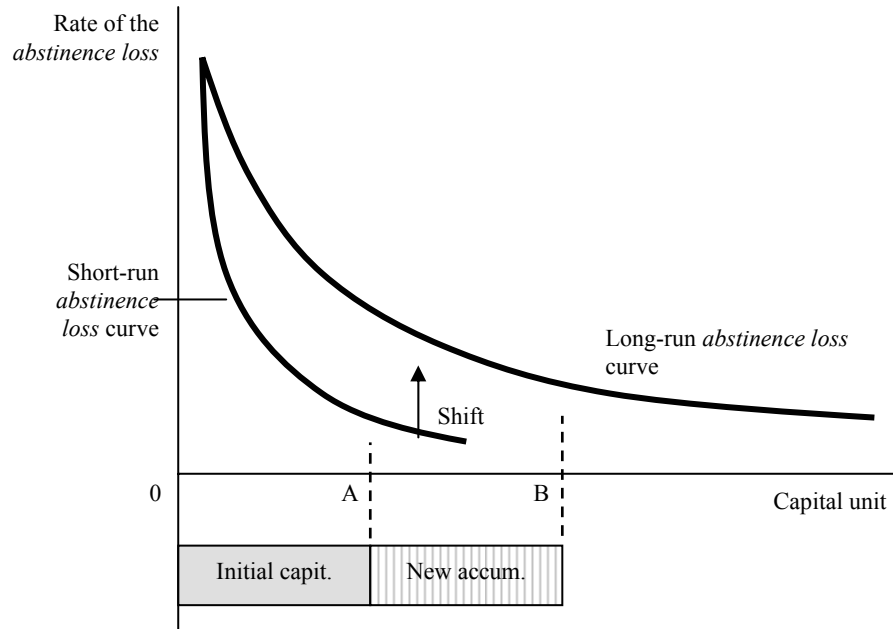
The horizontal axis indicates the capital units, while the vertical axis shows the rate of the *abstinence loss* from not consuming the respective unit of capital. The short-run *abstinence loss* curve intercepts the horizontal axis beyond the available extent of the initial capital (interval $[0, A]$) indicating the insufficiency of covering all demands of the individual. If an additional capital is accumulated (in the extent of interval $[A, B]$), so that it would cover all recent demands and even leaving a rest for producing the rent, the *abstinence loss* curve shifts to a higher level.

In this moment we come to important comment on the *Euthanasia of the Rentier*. The term 'rentier' is always connected with some particular level of rentier consumption. Everyone possessing a financial capital of any positive value is a rentier on some specific level of rentier consumption. To be a rentier is therefore somehow a matter of choice. One chooses his own *abstinence loss* curve by specifying his demands and their inevitability. Just the fact, that the *abstinence loss* curve intercepts the capital-axis soon enough to retain such an amount of capital, that it produces a rent sufficient to cover the demanded consumption, constitutes the rentier.

⁸ As defined in the previous section.

⁹ The curve of profit from immediate consumption is indicated on Chart 2.

Chart 3

Abstinence Loss Curve

Source: Own research.

The fact, that individuals prefer higher level of consumption and their *abstinence loss* curve is able to adjust to changing constraints in a long-run, creates a counter-power to the increase of rentier income, which would normally be the effect of capital accumulation. These shifts of the individual *abstinence loss* curve as an impact of the capital accumulation are the reason of the slow convergence of the long-run *abstinence loss* curve to zero.

If we construct an aggregate *abstinence loss* curve as a summarization of many individual curves, we should refer the long-run individual *abstinence loss* curve, because the aggregate curve includes individual curves in different decision moments, similarly like if the individuals would have enough time to shift their *abstinence loss* curves to higher levels. This implies the same slow convergence of the aggregate *abstinence loss* curve to zero.

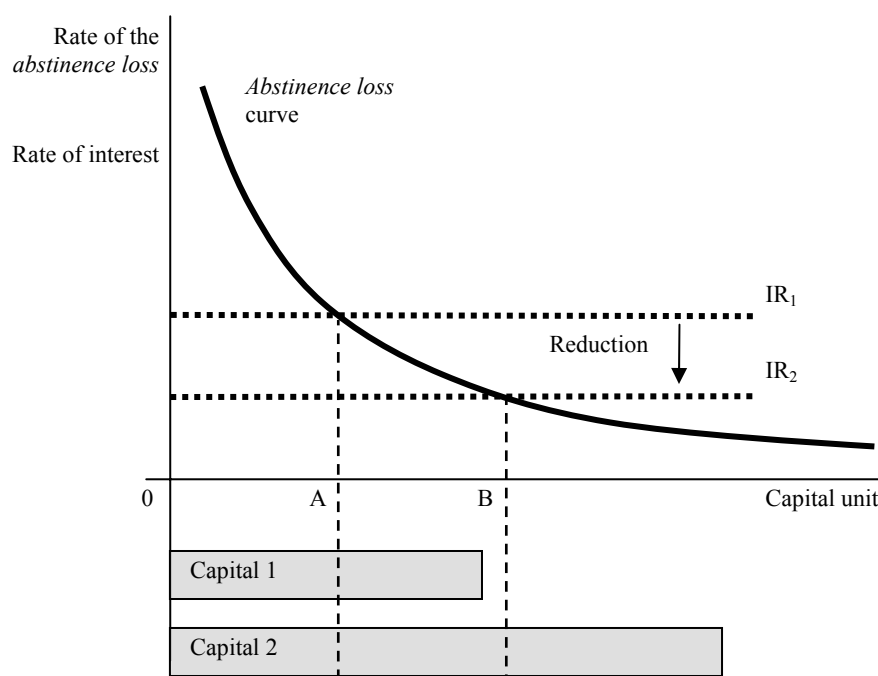
3. Accumulation of Capital in the Course of Reducing Interest Rates

Having identified the aggregate *abstinence loss* curve, we can analyze the process of capital accumulation in the course of reducing interest rate.

The Chart 4 describes the process of saving-spending decision of two individuals with the same *abstinence loss* curve, but with a different size of capital. The interest rate starts at the level IR_1 . Because of the same *abstinence loss* curve, both individuals prefer the same amount of consumption identified by the interval $[0, A]$ and waive the rent that would be produced by this extent of capital at the rate IR_1 if it would not be spent. Both individuals are able to cover this extent with part of their capital and the rest is retained for producing the rent.

Chart 4

Reduction of Interest Rates and abandoning of capital



Source: Own research.

The preferences change with reducing the interest rates. If the interest rate is reduced to level IR_2 , the interest profit becomes less valuable than the value of immediate consumption and both individuals decide for abandoning¹⁰ next part of their capital.¹¹ This additional extent is now identified by the interval $[A, B]$. In consequence the whole capital of the first individual is abandoned, while there is

¹⁰ We disregard the way of abandoning. A possible decision under these circumstances can be to invest this part of capital to securities with higher rate of interest. However, as this investment is not a result of the optimal risk rate acceptance, but rather a forced investment, we understand it as hazardous and therefore similar to spending for consumption.

still a rest of the capital of the second individual retained. Two events are happening now, which require attention: abandoning and concentrating of capital.

The abandoning of capital has an immediate result in growth of interest rates. The reason stands primarily in growth of prices forced by excessive investment activity¹² and secondarily the rate of profit on capital can increase with weaker competition on the capital market. On the other hand, abandoning of the capital of the first individual does not bring the situation back to the starting point, because there is still the second individual with its capital continuing in accumulation. The abandoning of capital slows down the accumulation, but does not stop it.

Discussing this paper, we identified three frequent counter-arguments to the idea of capital abandoning:

a) *Why the individual is not hoarding money disregarding the reduction of the interest rate?*

The hoarding is possible. The interest rate is reducing anyway because of the competition on the capital market, so that the hoarded money bearing a zero rate of interest or even not lent, becomes inert to the economy as well as to the holder. This situation equals disappearing of the capital.

b) *Why the individual is not abandoning the capital gradually for many years?*

A gradual abandoning is possible. This paper does not regard the time dimension of the capital abandoning process.

c) *Why the individual does not save the capital for further generations?*¹³

In this case the abandoning is only delayed or the capital is hoarded as explained in the points above.

The concentration of capital is another consequence of the interest rate reduction and is essentially connected with the accumulation at low interest rate. According to Moore (1975), the concentration of capital allows the *abstinence loss* to be concentrated on a smaller group of wealth holders, furthermore the concentration gathers enough capital to produce the rent, which is necessary for further accumulation even under low interest rate and finally it reduces the consequences of capital abandoning as an impact of the interest rate increase by limiting the number of individuals, whose capital would be abandoned after the next reduction of the interest rate.

¹¹ If the interest rate fluctuates and temporarily reaches lower level, the individual might not take the immediate decision of capital abandoning. This decision is taken rather in a long run, when the individual cannot realistically expect the interest rate to return to the previous level.

¹² We understand the investment activity as excessive for it would not be realized if the capital should not have been abandoned.

¹³ Overlapping generations model

Conclusion

The process of capital accumulation itself does not lead to reduction of the interest rate to zero because of the counter-power of abandoning capitals as a result of decreasing rate of profit on capital. On the other hand, the accumulation of capital in course of reducing interest rate is always connected with the capital concentration, which allows further accumulation even in situation of low interest rates. The process of capital concentration slows down the accumulation because of abandoning of smaller capitals, thus causing important reduction of the group of capital holders, necessary for diminishing the total abstinence loss (see Moore, 1975). However, the capital concentration process might be significantly disrupted by the increased instability of global financial system (see Pollin, 1996), which is another factor slowing down the capital accumulation. The recent surveys do not indicate that the accumulation of capital is reaching the level compatible with stagnation of the rentier income (see Power, Epstein and Abrena, 2003).

Based on the outcome of the microeconomical foundation of the accumulation of capital, of behavior of capital holders and its impact on capital concentration, we conclude that the concept of the *Euthanasia of the Rentier* is theoretically feasible. However, the process of capital accumulation in the course of reducing interest rates is decelerating in such a way, that it might be difficult to recognize the euthanasia, especially being disturbed by market volatilities (see Pollin, 1996). The current situation does not indicate symptoms of the *Euthanasia of the Rentier* and the current level of the capital accumulation is consistent with significant rate of profit on capital (see Pollin, 2007).

A Comment on the 2008 Subprime Crisis

The 2008 subprime crisis has severe impacts on the rentier income especially in two aspects: First, large parts of rentier capitals are diminished¹⁴ along with new market valuation of securities and second, the subsequent economic crisis largely reduces the business profit, which, according to Moore (1975), constitutes a substantial part of the top owners wealth. This development regresses the capital accumulation process, thus restraining the interest rate from falling to zero. Disregarding the theoretical feasibility of the *Euthanasia of the Rentier* in a long-run, the 2008 subprime crisis perfectly supports the idea of Robert Pollin (1996) that extending market instabilities constitute a considerable constraint for the fall of the interest rate to zero.

¹⁴ Instead of abandoned for consumption as suggested in section 3.

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