# Capitalism and inequalities: Why is Thomas Piketty's "Capital in the Twenty First Century" so popular?

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Notes on Thomas Piketty's *Capital in the Twenty First Century.*

## Why the Popularity

**1.** Addresses a real problem of rising inequalities of income and especially wealth, certainly between the top and bottom deciles and even between the top deciles and the 'rising middle classes'. Even leftists and Marxists with legitimate criticisms of Piketty's work must welcome the fact that this has helped put the issue of such inequalities onto the agenda of international public discourse as the single most important *political* consequence of his work.

**2.** TP was greatly welcomed especially in the US by the liberal and more Keynesian wing of mainstream economists and his work pushed by them as a 'pathbreaking' study for a number of reasons. a) The remarkable scale of empirical data put together by TP and collaborators to show levels and changing patterns of inequalities over nearly two centuries and for such a large range of countries. b) While there is a canonical theory of income distribution in mainstream economics – marginal productivity which along with marginal utility constitutes the theoretical heart of the discipline – there is no canonical theory of wealth distribution, so TP's formulations are seen as an original theoretical contribution having powerful empirical validation. c) Liberal-Keynesian explanations for the Great Recession of 2007-09 have centred on some variant or other of 'underconsumptionism' which can then be connected to inequalities between richer and poorer who have a higher propensity to consume and spend. His book came out at an opportune time to support those who saw the main cause of the Great Recession as lying in such inequalities. d) TP's thinking does *not break* from the mainstream broadly neoclassical framework of economic thinking. If inequality is the main cause of capitalist crises then it is curable within capitalism – reduce such inequalities.

**3.** Other reasons for acceptability: a) TP does not challenge either free trade theory or the need for capital mobility as international public goods. He doesn't oppose globalization as such but wants a globalised form of social democratic capitalism. b) He therefore rejects the notion of exploitative imperialism as *inherent* in capitalist expansion. c) He believes the Marxist understanding of capitalism is fundamentally flawed and that Marx's explanation for crises being linked to the 'tendency of the average rate of profit to fall' as empirically disproved by his data that shows remarkable stability of a high average rate of return over the long run.

**4.** TP has shown that it is not true that lowering taxes on the rich, very rich and super rich i.e. top 10%, 1%, 0.1% produces necessary incentives for obtaining high growth rates. Among advanced countries less unequal countries with relatively higher tax rates for the rich as in Germany and Denmark have as good and better growth rates than those countries with lower tax rates and greater inequalities.

**5.** Within the mainstream, TP is certainly the first to point, at least on the basis of such analytical and empirical depth, to a very disturbing trend carrying on into the future – namely the thrust to 'patrimonial capitalism' where rentier and inherited wealth becomes more and more significant compared to 'meritorious' and 'deserved' income and wealth distribution which a properly managed capitalism can provide.

**6.** He proposes a steeper progressive income tax, inheritance taxes nationally, and because of capital mobility, the need for a global tax on wealth. To start with he advocates making the EU a much more social democratic bloc through a "European Budget Parliament" where the majority of national representatives decide on taxing and spending for the whole bloc.

**7.** He warns that to preserve *capitalist democracy* (for him the only kind conceivable) we must seriously reverse this trend towards patrimonial capitalism.

**8.** For him history has shown that any socialist attempt to transcend capitalism only begets 'totalitarianism'. So forget socialism and Marxism – not to be taken seriously, even if Marx did, to his credit emphasize, as the classical tradition did, the importance of 'political economy'.

## What he Says

After the emergence of industrial capitalism there are longer term tendencies for inequalities of income and wealth to grow but capitalism also provides mechanisms for convergence and not just divergence in these respects. The four parts of his book are 1) his theoretical framework and definitions of basic economic concepts; 2) and 3) empirical validation; 4) policy recommendations.

His *convergence* mechanisms:

Main ones: a) knowledge diffusion, b) investment in skill training.

Weaker ones: c) laws of supply and demand which shift production and investment into more valued and desired areas.

Yes, advantages of 'late-comers' through technological leapfrogging can help 'catch up'. But market forces do not ensure such diffusion. While technological diffusion does not ensure skill diffusion i.e., what some call raising 'human capital' (TP hates the phrase 'human capital' which he sees as wrong and misleading given his definition of capital).

As for *divergence*:

One reason, but not the main one, is because of 'excessive' salaries to 'super-managers' and 'top-earners' who can fix their 'prices' of employment.

But the main mechanism of divergence is the operation of what TP calls his "fundamental contradiction” of capitalism which is r>g or the ‘annual average rate of return on capital’ in one country or in the comity of nations being greater than the average annual growth rate over a given territorial space.

There are those who get their incomes from work mostly or totally, and there are those who get their share of annual income mostly or totally from the capital they own. If the *rate* at which this capital accumulates or grows is higher than the rate at which output i.e., incomes grow, then obviously the gap between capital owners and those who have little or no income from capital assets will increase i.e., inequalities of wealth and *therefore* of income will have grown.

TP’s argument here is backed by his empirical data which is that over the last 180 or so years, except for the period, between say, 1914 to 1975, r was rising relative to g. Moreover as economies mature, g falls.

How does TP define ‘capital’? For him there is no difference between capital and wealth! It is the *sum* of the value of all non-human non-financial assets including housing, jewellery, etc. plus net financial assets (assets minus liabilities); where a capital asset is anything that can be owned or exchanged on a permanent basis. This excludes the notion of ‘human capital’ except in times of slavery.

How does TP understand r? r is the average annual return that comes from *profits* (businesses), from *rent* (land), from *interest* (bonds), from *rent* (housing services). Out of these forms of annual income there are savings, not all of which is consumed but of which some part is used to increase asset values. Then if this increase — which is the rate of capital accumulation – is greater than the growth rate, this means that not only is the capital stock growing, it is making inequality of wealth greater. What is happening, he says, is that one time capitalist entrepreneurs, as they accumulate wealth/capital, are more and more becoming capitalist rentiers rather than entrepreneurial innovators.

According to TP, during and after WWI the state became basic to the capitalist economy. In advanced countries government spending from tax and other receipts are between one-third and one-half of GDP. This was a ‘great leap forward’ of the state. There will now be no great leap backwards, i.e., no retreat of the state — indeed, access to certain public goods, are now anchored in *rights* — but also no further leap forward either.

From a past when there were a few very wealthy rentiers, today and tomorrow there are and will be *many more* rentiers even though most of these new rentiers would be *less* wealthy than those of the past.

As inequalities rise the rich begin to pay a lower proportion of taxes on their incomes compared to what the poor pay. Taxation becomes increasingly regressive.

Oligarchic divergence is more important than international divergence. That is to say, the rich in poor countries are converging towards the rich in rich countries but the poor in poor countries are not converging towards the poor in rich countries.

Even so, in tax havens it is the rich of the rich countries who hold three-fourths of these financial assets.

## Good Things About the Book

**1.** Seeks to connect economics with history and other social sciences i.e., TP's concern with distribution echoes the concerns of classical political economy – of Marx, Ricardo, Smith.

**2.** He moves away from 'mathematized scientificity' of conventional economics to focus on bigger issues.

**3.** His book is lucid and clear and accessible to the intelligent general reader providing clear definitions and clarifications of a host of economic concepts from 'national income' to 'private wealth'.

**4.** His empirical data based on tax records is very impressive but he is also aware of the limitations of his data – it provides a much better and more accurate picture for richer countries especially Germany, France, UK, US, Japan. He is aware that in developing countries where the vast majority work in the informal sector, tax records alone cannot properly describe income distribution and the need for household surveys much greater.

**5.** He warns of rentier and inheritance wealth and income.

**6.** Like Keynes, he rejects the idea that capitalism is a self-equilibriating order or system.

**7.** He refutes the Kuznet's Curve which showed that inequalities rise with steady high growth at first but then declines as high growth and prosperity spreads.

**8.** He recognizes that the post-war 'golden age' was an exception not the norm of capitalism.

**9.** His policy recommendations would require having much greater transparency than exists today e.g., in regard to holdings in tax havens.

**10.** TP has helped put inequality on the international agenda of public political discourse, particularly because he is not an anti-capitalist leftist.

## Criticisms

**1.** Fiscal tax records are good for showing pre-tax concentrations of market incomes but household surveys give a better picture of disposable incomes since there are various government transfers – pensions, unemployment benefits, family allowances, guaranteed incomes, etc. – which go to the poor. This would tend to moderate somewhat income inequalities. So best to combine tax records with household surveys in developed countries.

**2.** His explanation for the relative decline in inequalities between 1914 and 1975 is inadequate. a) He puts it down in WWI mainly to physical destruction of capital (and therefore lowering of r) when there was not much physical destruction of capital in US, UK, France and even Germany. There was more physical destruction in WWII (but not in US); but in both cases it was the fall in the *financial* value of assets that was far more important. b) Since TP rejects the idea that imperialist competition was basic to the workings of capitalist countries of the West (and Japan) he has to claim that the world wars were *exogenous* factors rather than linked to the very pattern of capitalist development in the 19th and much of the 20th century. c) TP emphasizes the American New Deal but because he scants class struggle generally, he does not link the New Deal to TUs and to organized w/c pressure within the US of that time. Similarly, for Europe after WWII he neglects the importance of TUs, of w/c organization and of full employment wartime mobilizations as crucial pressures for creating the welfare state. d) Again, he does not connect the creation of the welfare state in the West to the systemic competition and 'aspirational ideal' provided by the growing Communist bloc, reinforced by the process of decolonization after WWII itself owing much to the existence of this bloc rivalry. e) TP notes the shift to neoliberalism and rising inequalities but doesn't explain, even in 'political economy' terms, why this shift.

**3.** TP uses r to show the share of income going to capital owners but he cannot explain where r or more precisely, *profit* comes from? This is an insuperable problem for him which he shares with all non-Marxists, non-Ricardian economists whether Keynesians or not, whether liberals or conservatives. Marginalism — which is the foundation for fundamental mainstream propositions such as obedient supply and demand curves, equilibrium, the aggregate production function — is theoretically incoherent. The most he allows for is that r is partly socio-politically constructed and so certain national rules/institutions (as in Germany where worker representatives sit on corporate boards) reduces the level of capitalization of firms' values and tends to raise worker share of profit incomes.

**4.** Because he cannot explain the *internal dynamics* of capitalism he cannot explain capitalism's cyclical crises.

**5.** For TP as for all mainstream economists capital is a thing. For Marxists it is a social relationship, a social *process* of exploitation and it is this exploitation that is the principal source of profits. There is a distinction between 'productive' and 'non-productive' labour and therefore of capital which means one cannot equate capital with wealth. Even some non-Marxists reject TP's equation of capital with wealth. Much wealth comes from what 'productive' capital already produces i.e., it is not an *addition* to capital. Take out housing, real estate and financial assets from what is called 'capital' and then calculate the average rate of return to this, and you get a broad equivalent to Marx's notion of the 'average rate of profit'; and this category, on the basis of TP's *own data set*, goes up and down and is not as TP claims more or less continuously stable at a high level.

**6.** Inequality is inherent to capitalism but it is not its fundamental contradiction. Inequality is a feature of *all* pre-capitalist class societies which TP peculiarly (because of his equation of capital with wealth ) calls "capital-dominated societies" or wealth dominated societies which in contrast to capitalism did not have the latter's dynamism of growth but had very low growth or were stagnant for very prolonged periods and therefore more dominated by capital or wealth! That is to say, 'capital' was more important in non-capitalist societies! But if inequality was high and so persistent in all pre-capitalist societies why is inequality to be considered a "fundamental contradiction" in capitalism? In fact, even according to TP's own data for one-third of his 180 odd period, inequalities were significantly reduced. So while in pre-capitalist class societies r>g is remarkably stable and high, it is much less stable in capitalism. The fundamental contradiction of capitalism is obeyed *least* in capitalism!

**7.** TP's r>g formula does not work. To know r you must *first* value capital which being so heterogeneous can only be valued in monetary terms i.e., through market prices. But the value of so much of what is capital in capitalism i.e. what investors are willing to pay for it, depends on what output it produces from which profits can then be calculated again in monetary terms i.e., market prices. So you need to know g to calculate r to calculate capital to calculate r. You cannot simply calculate capital first so as to then calculate r – the whole logic is circular; and you cannot calculate r independently of g.

**8.** TP does not believe in imperialist exploitation. There are large reserve armies of labour in the South and disguised unemployment – contract, casual, part-time. This ensures depression of wages in the South and restrains wages in the North. So migration of capital to the South takes advantage of these huge reserves of labour and neither wages in the South, nor in the North keep up with increases in labour productivity. Thus profits and return to capitalists grow relative to wage incomes. This is another source of inequalities which TP ignores.

**9.** TP accepts standard neoclassical growth theory which assumes that markets ensure full or close to full employment so if there is unemployment this must be because wages are kept 'too high' because of market imperfections e.g., TUs are too strong. So weaken or break TUs; promote labour market flexibility. TP's framework of thinking does not rule this out at all but logically support this policy direction.

**10.** This kind of growth theory separates production from distribution or rather production determines distribution (and growth in production comes from the exogenous factors of a) technological advances that raise labour productivity, and b) from population growth) when in fact the manner/nature of distribution of incomes and wealth affects both the *pattern* and *volume* of production.

**11.** TP does not challenge free trade theory and its claims to benefit all players when it is actually a sub-set of the theory of competition in which there are always losers and winners. TP fears that rising inequalities could lead to protectionism which he does not want because he believes in the basic virtues of capital mobility.

**12.** TP does not call for raising minimum wages or for taxing corporate profits as ways to reduce inequalities.

**13.** TP does not favour debt cancellation though such cancellation, debt delay and rescheduling can provide money for public spending on health, education, etc. He does not believe that such debts have arisen from the very nature of a capitalist imperialism.

**14.** His proposal for a global tax on wealth would require a degree of popular mobilization that would be so great as to so dramatically shift the social and class relationship of forces as to put the transcendence of capitalism itself on the agenda. Such a global tax which assumes a global social democracy is simply not on; even national-level social democracy of the 'golden age' kind is not on.

**15.** For him popular mobilization is okay for putting pressure for the policies he believes in but not for pursuing an anti-capitalist globalization project or for the profound structural or radical changes that enormously powerful class struggle could bring about. Serious class struggle is a No-No.

**16.** TP does not come to terms with the Cambridge Controversy which he dismisses; and skirts around marginal productivity theory – he admits it does not explain the salaries of top managers but he believes that it is better for those much lower down in the wage and salary scale, and that its 'insights' and 'intuitions' remain valuable thereby suggesting that the theory needs to be moderated and qualified, not rejected.

**17.** He has nothing to say about capitalism's relationship to ecological despoliation apart from saying that we need to move towards sustainable energy sources and a greener capitalism.

**18.** He has nothing to say about inequalities of income, wealth in respect of gender, race or ethnicity. He does not recognize that structures of gender, race and ethnic discrimination are always part of a capitalist political economy and negatively affect (in varying degrees, times and places) the distribution of income and wealth.

**Achin Vanaik**