Afterthoughts on Piketty's Capital

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Thomas Piketty has written a book called *Capital* that has caused quite a stir. He advocates progressive taxation and a global wealth tax as the only way to counter the trend towards the creation of a "patrimonial" form of capitalism marked by what he dubs "terrifying" inequalities of wealth and income. He also documents in excruciating and hard to rebut detail how social inequality of both wealth and income has evolved over the last two centuries, with particular emphasis on the role of wealth. He demolishes the widely-held view that free market capitalism spreads the wealth around and that it is the great bulwark for the defense of individual liberties and freedoms. Free-market capitalism, in the absence of any major redistributive interventions on the part of the state, Piketty shows, produces anti-democratic oligarchies. This demonstration has given sustenance to liberal outrage as it drives the Wall Street Journal apoplectic.

The book has often been presented as a twenty-first century substitute for Karl Marx's nineteenth century work of the same title. Piketty actually denies this was his intention, which is just as well since his is not a book about capital at all. It does not tell us why the crash of 2008 occurred and why it is taking so long for so many people to get out from under the dual burdens of prolonged unemployment and millions of houses lost to foreclosure. It does not help us understand why growth is currently so sluggish in the US as opposed to China and why Europe is locked down in a politics of austerity and an economy of stagnation. What Piketty does show statistically (and we should be indebted to him and his colleagues for this) is that capital has tended throughout its history to produce ever-greater levels of inequality. This is, for many of us, hardly news. It was, moreover, exactly Marx's theoretical conclusion in Volume One of his version of *Capital*. Piketty fails to note this, which is not surprising since he has since claimed, in the face of accusations in the right wing press that he is a Marxist in disguise, not to have read Marx's *Capital*.

Piketty assembles a lot of data to support his arguments. His account of the differences between income and wealth is persuasive and helpful. And he gives a thoughtful defense of inheritance taxes, progressive taxation and a global wealth tax as possible (though almost certainly not politically viable) antidotes to the further concentration of wealth and power.

But why does this trend towards greater inequality over time occur? From his data (spiced up with some neat literary allusions to Jane Austen and Balzac) he derives a mathematical law to explain what happens: the ever-increasing accumulation of wealth on the part of the famous one percent (a term popularized thanks of course to the "Occupy" movement) is due to the simple fact that the rate of return on capital (r) always exceeds the rate of growth of income (g). This, says Piketty, is and always has been "the central contradiction" of capital.

But a statistical regularity of this sort hardly constitutes an adequate explanation let alone a law. So what forces produce and sustain such a contradiction? Piketty does not say. The law is the law and that is that. Marx would obviously have attributed the existence of such a law to the imbalance of power between capital and labor. And that explanation still holds water. The steady decline in labor's share of national income since the 1970s derived from the declining political and economic power of labor as capital mobilized technologies, unemployment, off-shoring and anti-labor politics (such as those of Margaret Thatcher and Ronald Reagan) to crush all opposition. As Alan Budd, an economic advisor to Margaret Thatcher confessed in an unguarded moment, anti-inflation policies of the 1980s turned out to be "a very good way to raise unemployment, and raising unemployment was an extremely desirable way of reducing the strength of the working classes…what was engineered there in Marxist terms was a crisis of capitalism which recreated a reserve army of labour and has allowed capitalists to make high profits ever since." The disparity in remuneration between average workers and CEO's stood at around thirty to one in 1970. It now is well above three hundred to one and in the case of MacDonalds about 1200 to one.

But in Volume 2 of Marx's *Capital* (which Piketty also has not read even as he cheerfully dismisses it) Marx pointed out that capital's penchant for driving wages down would at some point restrict the capacity of the market to absorb capital's product. Henry Ford recognized this dilemma long ago when he mandated the $5 eight-hour day for his workers in order, he said, to boost consumer demand. Many thought that lack of effective demand underpinned the Great Depression of the 1930s. This inspired Keynesian expansionary policies after World War Two and resulted in some reductions in inequalities of incomes (though not so much of wealth) in the midst of strong demand led growth. But this solution rested on the relative empowerment of labor and the construction of the "social state" (Piketty's term) funded by progressive taxation. "All told," he writes, "over the period 1932-1980, nearly half a century, the top federal income tax in the United States averaged 81 percent." And this did not in any way dampen growth (another piece of Piketty's evidence that rebuts right wing beliefs).

By the end of the 1960s it became clear to many capitalists that they needed to do something about the excessive power of labor. Hence the demotion of Keynes from the pantheon of respectable economists, the switch to the supply side thinking of Milton Friedman, the crusade to stabilize if not reduce taxation, to deconstruct the social state and to discipline the forces of labor. After 1980 top tax rates came down and capital gains – a major source of income for the ultra-wealthy – were taxed at a much lower rate in the US, hugely boosting the flow of wealth to the top one percent. But the impact on growth, Piketty shows, was negligible. So "trickle down" of benefits from the rich to the rest (another right wing favorite belief) does not work. None of this was dictated by any mathematical law. It was all about politics.

But then the wheel turned full circle and the more pressing question became: where is the demand? Piketty systematically ignores this question. The 1990s fudged the answer by a vast expansion of credit, including the extension of mortgage finance into sub-prime markets. But the resultant asset bubble was bound to go pop as it did in 2007-8 bringing down Lehman Brothers and the credit system with it. However, profit rates and the further concentration of private wealth recovered very quickly after 2009 while everything and everyone else did badly. Profit rates of businesses are now as high as they have ever been in the US. Businesses are sitting on oodles of cash and refuse to spend it because market conditions are not robust.

Piketty's formulation of the mathematical law disguises more than it reveals about the class politics involved. As Warren Buffett has noted, "sure there is class war, and it is my class, the rich, who are making it and we are winning." One key measure of their victory is the growing disparities in wealth and income of the top one percent relative to everyone else.

There is, however, a central difficulty with Piketty's argument. It rests on a mistaken definition of capital. Capital is a process not a thing. It is a process of circulation in which money is used to make more money often, but not exclusively through the exploitation of labor power. Piketty defines capital as the stock of all assets held by private individuals, corporations and governments that can be traded in the market no matter whether these assets are being used or not. This includes land, real estate and intellectual property rights as well as my art and jewelry collection. How to determine the value of all of these things is a difficult technical problem that has no agreed upon solution. In order to calculate a meaningful rate of return, r, we have to have some way of valuing the initial capital. Unfortunately there is no way to value it independently of the value of the goods and services it is used to produce or how much it can be sold for in the market. The whole of neo-classical economic thought (which is the basis of Piketty's thinking) is founded on a tautology. The rate of return on capital depends crucially on the rate of growth because capital is valued by way of that which it produces and not by what went into its production. Its value is heavily influenced by speculative conditions and can be seriously warped by the famous "irrational exuberance" that Greenspan spotted as characteristic of stock and housing markets. If we subtract housing and real estate – to say nothing of the value of the art collections of the hedge funders – from the definition of capital (and the rationale for their inclusion is rather weak) then Piketty's explanation for increasing disparities in wealth and income would fall flat on its face, though his descriptions of the state of past and present inequalities would still stand.

Money, land, real estate and plant and equipment that are not being used productively are not capital. If the rate of return on the capital that is being used is high then this is because a part of capital is withdrawn from circulation and in effect goes on strike. Restricting the supply of capital to new investment (a phenomena we are now witnessing) ensures a high rate of return on that capital which is in circulation. The creation of such artificial scarcity is not only what the oil companies do to ensure their high rate of return: it is what all capital does when given the chance. This is what underpins the tendency for the rate of return on capital (no matter how it is defined and measured) to always exceed the rate of growth of income. This is how capital ensures its own reproduction, no matter how uncomfortable the consequences are for the rest of us. And this is how the capitalist class lives.

There is much that is valuable in Piketty's data sets. But his explanation as to why the inequalities and oligarchic tendencies arise is seriously flawed. His proposals as to the remedies for the inequalities are naïve if not utopian. And he has certainly not produced a working model for capital of the twenty-first century. For that we still need Marx or his modern-day equivalent.

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