“CAPITAL IN THE TWENTY-FIRST CENTURY”

CRITICAL REVIEW FROM A HETERODOX PERSPECTIVE

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I

Introduction

The purpose of this lecture is to perform a critique of the book *Capital in the Twenty-First Century* from a heterodox perspective, that is, from a position which, at the same time, disagrees with mainstream economic theory, neoclassical theory.

Well, it is of utmost importance to make a critical analysis of this book because it has become extremely popular not only in academic circles but also among the general public. Indeed, *Capital in the Twenty-First Century* is undoubtedly a very unique book because it has achieved almost since its appearance something truly unusual: constitute itself as a real sales boom although it is a work of economics which has about 700 pages (a little more or a little less depending on the edition). This book, written by the French economist Thomas Piketty and first published in 2013, has as its main theme the analysis of inequality in the evolution of capitalism from a historical perspective reaching the conclusion that capitalism necessarily leads to more inequality because, in the long run, the rate of return on capital (r) exceeds the rate of economic growth (g).

Such is the popularity of the book and its proposals that it has come to speak of a “Piketty effect” and even of a “fever Piketty”. Thus, we have to Paul Krugman, famous American economist and Nobel Prize in Economics in 2008, who has written the following in his column in the *New York Times*: “It seems safe to say that *Capital in the Twenty-First Century*, the magnum opus of the French economist Thomas Piketty, will be the most important economics book of the year — and maybe of the decade"[1]. In turn, the French historian and political scientist Emmanuel Todd has praised the book saying it is "a masterpiece (…) a seminal book on the economic and social evolution of the planet"[2]; and the British historian Andrew Hussey has referred to the book as "epic" and "groundbreaking" because it has proven "scientifically" that "capitalism is not working"[3].

It is in this context that the media has talked about Piketty as "the new Marx" and about his book *Capital in the Twenty-First Century* as the "substitute" for *Capital* of the nineteenth century (namely, the book written by Marx). Therefore, it is extremely important to know the ideas of this book and analyze them in depth. But prior to making the critique we must first make at least a summary of its main arguments.

II

Chapter by chapter summary

I will use the edition: *Capital in the Twenty-First Century*, Harvard University Press, 2014, translated by Arthur Goldhammer.

<u>Chapter 1: *Income and Output*</u>*:* Here the starting point must be evidently the definition of 'capital'. In this regard, Piketty says: "Throughout this book, when I speak of ´capital´ without further qualification, I always exclude what economists often call (unfortunately, to my mind) ´human capital´ (…). In this book, capital is defined as the sum total of nonhuman assets that can be owned and exchanged on some market. Capital includes all forms of real property (including residential real estate) as well as financial and professional capital (plants, infrastructure, machinery, patents, and so on) used by firms and government agencies" (p. 46).

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[1] Paul Krugman, "Wealth Over Work", *The New York Times*, March 23, 2014.
[2] Emmanuel Todd, "Piketty décrypte le come-back des héritiers", *Marianne*, September 14, 2013.
[3] Andrew Hussey, "Occupy was right: Capitalism has failed the world", *The Guardian*, April 12, 2014.

After that Piketty formulates his "First Fundamental Law of Capitalism", which is denoted as:

$$\alpha = r \times \beta$$

Where: α = share of capital in national income, β = capital / income ratio, and r = rate of return on capital.

Chapter 2: *Growth: Illusions and Realities*: This chapter provides a more detailed analysis of how population growth rate and growth rate of output have evolved after the First Industrial Revolution. In particular, Piketty argues that, if we examine the long-term issue, the population growth rate should not be conceptualized as an increasing or static rate but rather as a bell curve in which we would be in the descent phase. Also we find interesting analysis of the phenomenon of inflation which, as reported by Piketty, "is largely a twentieth-century phenomenon. Before that, up to World War I, inflation was zero or close to it" (p. 103); but immediately came a context of continuous turbulence in which the "attempts to reintroduce the gold standard in the 1920s did not survive the crisis of the 1930s" and after the Second World War the system "would prove to be barely more robust: established in 1946, it ended in 1971 when the dollar ceased to be convertible into gold" (p. 107).

Chapter 3: *The Metamorphoses of Capital*: In this case Piketty focuses on the evolution of capital / income ratio (β) in Britain and France. Interestingly, he finds that while the population growth rate and growth rate of output have a dynamic of "bell" which increases significantly at the beginning of XXI century, the capital / income ratio has the opposite pattern, falling sharply until the beginning of Second World War after which it begins to recover, behaving as "an impressive U-shaped curve" (p. 118). He also finds that "net public wealth in both countries is quite small and certainly insignificant compared with total private wealth" (p. 125).

Chapter 4: *From Old Europe to the New World*: Here the above analysis is expanded to Germany and the United States. In the case of Germany (pp. 140-146) the evolution of capital / income ratio shows many similarities with France and Britain but also there are important differences because Germany did not have a colonial empire and had a traumatic experience of hyperinflation in the 20's, among other factors. In turn, in the case of the United States (pp. 150-

156, 158-163) is also found that the evolution of capital / income ratio is adjusted to a "U-shaped curve" but clearly attenuated, what Piketty attributed to geographic isolation from capital destruction in World War II and the fact that nationalization policies have not been implemented in this country, among other factors.

Chapter 5: *The Capital / Income Ratio over the Long Run*: This chapter focuses on the Piketty´s "Second Fundamental Law of Capitalism", which is expressed as:

$$\beta = s / g$$

Where: β = capital / income ratio, s = saving rate, and g = growth rate. Thereby, this "law" tell us that in the long-term the capital / income ratio (β) is the quotient of the saving rate (s) and the growth rate (g). Piketty writes: "This formula (…) reflects an obvious but important point: a country that saves a lot and grows slowly will over the long run accumulate an enormous stock of capital (relative to its income), which can in turn have a significant effect on the social structure and distribution of wealth. Let me put it another way: in a quasi-stagnant society, wealth accumulated in the past will inevitably acquire disproportionate importance" (p. 166).

Chapter 6: *The Capital - Labor Split in the Twenty-First Century*: Here Piketty investigates the evolution of the shares of capital and labor in income based on his formula about the "First Fundamental Law of Capitalism". It also refers briefly to the "Two Cambridges debate" (pp. 230-232) which, according to him, happened because the economists of Cambridge, England, headed by Joan Robinson, "saw in Solow's model a claim that growth is always perfectly balanced, thus negating the importance Keynes had attributed to short-term fluctuations" and "it was not until the 1970s that Solow's so-called neoclassical growth model definitively carried the day" (p. 231).

Chapter 7: *Inequality and Concentration: Preliminary Bearings*: In this chapter, Piketty distinguishes labor income of inherited wealth and identifies two main ways to generate inequality. The first is called "hyper-patrimonial society" in which "the total income hierarchy is dominated by very high incomes from capital, especially inherited capital. This is the pattern we see in Ancien Regime France and in Europe during the *Belle Époque*" (p. 264). On the other hand, we have the scheme of "hyper-meritocratic society" largely generated in the United States in recent decades. This type of society is characterized by "supermanagers" and "superstars" so that "the peak of the income hierarchy is dominated by very high incomes from labor rather than by inherited wealth" (p.- 265).

Chapter 8: *Two Worlds*: At this point Piketty argues that the living conditions of the richest 1 percent are well above even the next 9 percent. In the case of France he finds that "the reduction of inequality (…) during the twentieth century is largely explained by the fall of the rentier and the collapse of very high incomes from capital" (p. 274). The US case is more complex and we found that "United States has become noticeably more inegalitarian than France (and Europe as a whole) from the turn of the twentieth century until now, even though the United States was more egalitarian at the beginning of this period" (p. 292).

Chapter 9: *Inequality of Labor Income*: The analysis focuses on the dynamics of inequality which comes from labor income and it is found that "in all the English-speaking countries, the primary reason for increased income inequality in recent decades is the rise of the supermanager in both the financial and nonfinancial sectors" (p. 315).

Chapter 10: *Inequality of Capital Ownership*: This chapter focuses on the analysis of inequality in the distribution of wealth in France and the United States. In turn Piketty, although he does not insist that is a logical necessity that the rate of return on capital is higher than the growth rate, predicts that in the XXI century, if there is no a change in policy, greater inequality is unavoidable because "global growth is likely to be around 1.5 percent a year between 2050 and 2100" and therefore "the gap between r and g would then return to a level comparable to that which existed during the Industrial Revolution" (p. 355).

Chapter 11: *Merit and Inheritance in the Long Run*: In this part is studied the evolution of the importance of inherited wealth in the long run being found the very interesting result that "over the course of the twentieth century, following the collapse of inheritance flows" reaching the lowest point in the 70s where "after several decades of small inheritances and accumulation of new wealth, inherited capital accounted for just over 40 percent of total private capital. For the first time in history (except in new countries), wealth accumulated in the life time of the living constituted the majority of all wealth: nearly 60 percent" (p. 401).

Chapter 12: *Global Inequality of Wealth in the Twenty-First Century*: Here Piketty analyzes the prospects for the global distribution of wealth to the first decades of the XX century noting the need to improve our statistical information in this regard moving from "rankings of billionaires" to "global wealth reports". Also, he calls into question the "moral status of wealth" saying that "the inequality $r > g$, combined with the inequality of returns on capital as a function of initial wealth, can lead to excessive and lasting concentration of capital: no matter how justified inequalities of wealth may be initially, fortunes can grow and perpetuate themselves beyond all reasonable limits and beyond any possible rational justification in terms of social utility" (p. 443).

Chapter 13: *A Social State for the Twenty-First Century*: Piketty begins reflecting on how, after the dominance of neoliberalism, the 2008 crisis has meant a "return of the State". Thus, he advocates an improvement and modernization of the "Social State" with special emphasis on two aspects: "first, the question of equal access to education, and especially higher education, and second, the future of pay-as-you-go retirement systems in a world of low growth" (p. 483).

Chapter 14: *Rethinking the Progressive Income Tax*: In this chapter Piketty performs an analysis of various historical experiences with progressive income taxes with special attention to the US case of the "confiscatory taxation of excessive incomes" and finally reaching the interesting result that "the evidence suggests that a rate on the order of 80 percent on incomes over $500,000 or $1 million a year not only would not reduce the growth of the US economy but would in fact distribute the fruits of growth more widely while imposing reasonable limits on economically useless (or even harmful) behavior" (p. 513).

Chapter 15: *A Global Tax on Capital*: Here Piketty explains his famous proposal for a global tax on capital which he admits as a "utopian idea" because "it is hard to imagine the nations of the world agreeing on any such thing anytime soon" but that he still considers as an "useful utopia" (p. 515) and could be considered its implementation "step by step" based on "financial transparency" through a system of "automatic transmission of banking information" in a democratic and cooperative environment at the international level.

Chapter 16: *The Question of the Public Debt*: In this final chapter Piketty analyzes the pressing issue of impasse generated by high levels of public debt in the current context and also the question of the optimal level of public capital accumulation in an environment where the "natural capital" is deteriorating due to the ecological crisis and the global warming. Finally, he refers to the importance of institutions, concluding that: "If democracy is someday to regain control of capitalism, it must start by recognizing that the concrete institutions in which democracy and capitalism are embodied need to be reinvented again and again" (p. 570).

Well, this is the chapter by chapter summary of the entire Piketty's work. Now I will begin my critique of the book.

III

Critique from a heterodox perspective

Evidently the book *Capital in the Twenty-First Century* is an extremely valuable contribution because explains the problem of inequality in capitalism in a very clear and persuasive way, makes empirical analysis with an extraordinarily wide data which in some cases starts since the eighteenth century, and proposes interesting measures to reduce the concentration of wealth such as inheritance taxes, progressive income taxes and even a global tax on wealth. Also, as we have seen, the book has received much applause in academia. Given this context, and given that I am a heterodox economist, I find most useful, convenient and necessary to make a critical assessment of the book from a heterodox perspective rather than simply join to the litany of applause.

Well, you can begin questioning the title of the book itself. Even though its author does not explicitly say it and even pretend deny it later, it is quite clear that with the title "*Capital* in the Twenty-First Century" he wants to emulate the "Capital" of the nineteenth century, written by Karl Marx. However, there is a big difference between the Marx's work and the Piketty's work because while the first one is a work of tremendous theoretical depth, the second one does not reach that level. You don´t need to be a Marxist to accept the pertinence of this critique. Whether one agrees or not with the theories of Marx (and in particular I do not agree with the theory of Marx, that is, I am a non-Marxist heterodox economist), it is clear that the level of theoretical depth that seeks his work is such that at times borders philosophical issues. At most Piketty reaches to border political issues and he does not raises major epistemological discussions. Rather the merit of Piketty´s work is in its extraordinarily wide empirical analysis which, even if it is susceptible of certain methodological criticisms, gives us quite interesting and useful results. But definitely it is not a book of theoretical depth.

In line with the above, I find that another great deficiency Piketty's work is that he abuses of extrapolation and calls "fundamental laws" to mere empirical regularities. Is fine that these regularities occur in a wide stretch of time, but call them "laws" is go beyond what is epistemologically justified, more so considering that Piketty focuses more on the historical analysis than in the theoretical structure. We can check that this critique is pertinent especially if we analyze when Piketty makes "predictions": although his retrospective explanations are pretty good because history "already happened", his predictions are quite fragile and uncertain because his theoretical scheme is not strong enough (besides, of course, the fact that it is always difficult to make predictions.... especially about the future).

Now, the interesting thing is that Piketty formulates "laws" but does not reach properly to explain them but rather that he only illustrate them with historical examples and gives some grounds of plausibility. Piketty fails to understand the underlying structure behind the empirical regularities that he finds. And what is this underlying structure? The power relations involved in the social organization of the capitalist production. Piketty simply does not reach to think in depth this point. This can be seen in his very definition of capital because he conceptualizes it merely as an object rather than as the manifestation of a social process (that is to say, Piketty falls into a "fetishism of capital"). In turn, this type of approach leads him to see the "capital-labor division" from a primarily instrumental perspective, in terms of "statistical changes" and "historical events" but without going to the heart of the matter: the social relations of production. Nor is it necessary to be a Marxist to accept this point because, without assuming that this is structured in terms of the famous "class struggle" of dialectical materialism, it is clear that the power relations between groups and individuals are constitutive of the economic process itself.

In the same context, we find that although Piketty speaks against the growing concentration of wealth from the seventies, says virtually nothing about the deep global restructuring carried out by means of neoliberalism in that time with the privatization process. He simply does not criticize privatization. And that's a major flaw because as a result of this privatization, many of the things that were expected to be public services have become monopolies which generate extraordinary profits for those who were already the richest. Furthermore, the regulation to the big monopolies and oligopolies finds no place in the Piketty´s approach, nor the problem of the management of licenses and patents. And not only that: Piketty does not analyze thoroughly, but merely mentions, a so fundamental issue as the economic power groups which can control the political power groups for ensuring its wealth and expand it. Corruption on Wall Street, mortgage fraud, lobbies, pressure from banking deregulation, the role of rating agencies, lack of sanctions on those who were involved in generating the crisis: none of this has enough space in the Piketty´s work.

Despite the above, the media have labeled to Piketty as "the greatest heterodox economist of our time". But that is simply false because although Piketty makes a critique of capitalism, the theoretical framework from which he makes it, is compatible or at least does not contradict the orthodox economic theory. The definitions and terms used are basically those of mainstream economics. Piketty is a great critic of capitalism but not a heterodox economist in the full sense. The clearest example of this is found when he speaks of the "Two Cambridges Controversy". This is maybe the most important theoretical debate which has occurred between orthodox and heterodox economists in the last century, but we find that Piketty devotes it only three pages throughout the entire book. But that's not the worst. The worst is that Piketty is not even well informed about what was the cause of the dispute. He believes that the point of contention was whether the Solow model had a stable growth path or not and he even says that the debate was finally won by the orthodox economists, with Solow among them. But it shows a tremendous ignorance about it. The point of contention between the two Cambridges was precisely about an absolutely central notion in the Piketty´s theory: capital. The question raised by the heterodox economist Joan Robinson is that there is no consistent way of measuring capital in the neoclassical approach and at the end the orthodox economists themselves accepted the defeat (see Solow and his reduction of neoclassical theory to mere "parables"). How is it possible that "the greatest heterodox economist of our time" ignores that?

But is not the purpose of this lecture rejecting all the Piketty's work. Obviously his book is a great contribution, as I have already said. But the "Piketty bubble" has been inflated so much that to deflate it a little is "right and necessary". If we think that his critique of capitalism is "the greatest possible", we will be depriving ourselves of making a broader and fundamental critique. And I think a deeper critique is still needed.