A General Without an Army

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By
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For all Piketty's mainstream respectability, it is only the radical left and the labor movement — not treasuries and central banks — that can push his program.

Mike Beggs is an editor at Jacobin and a lecturer in political economy at the University of Sydney.

Capital is back." That's the title of the long paper that first presented the core data and many of the concepts for Piketty's book — the *Grundrisse* for his *Capital*, coauthored with Gabriel Zucman. The title captures perfectly what is so striking about Piketty's approach to inequality. Conventional treatments have for years focused mainly on inequalities of income from work. The book returns the discussion to capital and labor.

But Piketty doesn't only focus on the labor-capital distribution of income, since the distribution of capital itself obviously matters. If ownership of capital were spread evenly across the population, these functional shares would hardly matter. In fact, however, capital ownership is highly concentrated, and likely to become more so, since capital breeds capital.

The conventional economic wisdom has long been that the labor-capital split doesn't matter much because labor and profit shares are constant. According to the Cobb-Douglas aggregate production function, which has been the textbook standard since the 1950s, the parameters are such that an increase in the quantity of one factor relative to the other affects their marginal productivities in just the right way to keep their shares stable. This is extremely convenient, because it keeps the analysis simple, and by coincidence it also seemed to fit the data.

The notion was also an ideologically comforting one, since it suggested there was not much point in worrying about inter-factor distribution, and no point fighting it. This "stylized fact" was often wheeled out to persuade the labor movement that if nominal wages grew faster than labor productivity, it would still never make inroads into profits, but only drive inflation.

But Piketty's long-range data shows that this stability was limited to the postwar decades and is not an eternal law. For much of the nineteenth century in Britain, capital took more than forty percent of total income; its share collapsed around the time of the

First World War, and fluctuated between twenty and thirty percent for the rest of the twentieth. France saw a similar, though more volatile, trajectory.

More recently, the capital share in rich countries has been rising: from fifteen to twenty percent in 1970 to twenty-five to thirty percent in the 2000s. Average labor income has not kept up with average labor productivity growth.

Piketty interprets this within the framework of the aggregate production function. He accepts the standard neoclassical argument that, at least in the long run, the rate of return on capital equals — and is explained by — its marginal productivity, i.e. the value produced by an additional unit of capital, with a given labor force and level of technology. He also accepts that there are decreasing returns to capital: again, holding the labor supply and level of technology steady, the more capital, the lower its marginal productivity will be.

Piketty departs from the standard story only in his estimate of the parameters of the production function relating inputs to outputs. For him, the key is that these parameters must be subject to change. In the agricultural societies of the eighteenth and nineteenth centuries, capital was mostly agricultural land. It was good for a limited range of production processes: growing crops, grazing livestock. In such conditions, rent would be sensitive enough to the relative abundance of land so that the more there was in a geographic area, the lower the income share of landowners would be.

Now, however, capital can augment production in many different physical ways, so that it is not as subject to diminishing returns. Increasing capital intensity will still, he predicts, reduce its marginal productivity, and thus the rate of return on capital, but not by as much as the Cobb-Douglas parameters suggest. If the capital-output ratio rises, capital's share of income also rises. And Piketty projects that it is indeed due to rise.

This part of the argument is framed by one of Piketty's "fundamental laws of capitalism": over the long run, the ratio of capital to income will tend towards the proportion of national income saved, divided by the rate of income growth. The reason is simple arithmetic. If the capital-income ratio is lower than that, capital grows faster than income; if it is higher, capital grows more slowly than income. Only at that point do capital and income grow at the same rate and so maintain a steady ratio.

Much in Piketty's analysis turns on the contrast between the long run and the short run. The approach of the actual capital-income ratio to its stable ratio is very slow: a modest shift in the saving rate or growth rate could take years or decades for the ratio to fully adjust to.

The "law" is meant to describe "long-term evolutions, fundamental trends that in many cases cannot be appreciated on time scales of less than thirty to forty years or even longer." Of course, the capital-income ratio could move for other, "short run" reasons: a stock market or real estate boom or bust, or the widespread destruction of capital in war. But to focus attention as Piketty does on the very long-run point of attraction is to treat such events as ephemeral, however massive their impact.

All this means that though capital and labor are back in the center of the distributional question, there is not much class struggle — at least not at the level of "long-term evolutions" and "fundamental trends."

For the labor movement, the message of Piketty's "fundamental laws" is not much different from that of the old "stylized facts." The wage and the profit rate are still determined by the marginalist parameters of the production function, presumed to be essentially technological in nature. The growth rate depends on demographics and technological advance. The savings rate depends ultimately on private decisions, and mostly those of corporations and people with high incomes and wealth.

That is not to say Piketty completely ignores what he takes to be ephemeral. The ups and downs of financial markets, the back and forth of politics, are bound up with shorter trends "of ten to fifteen years or even longer," he writes. These are "often counterbalanced in the end, but for the people who live through them they often appear, quite legitimately, to be the most significant realities of the age." Some of these short-term deviations involve movements of income shares that seem to have nothing to do with shifts in marginal productivity.

Piketty devotes a few pages to the class struggle in France and the US since World War II. The basic trends and episodes will be very familiar to readers of political-economic histories. In France, there is a wage explosion after May 1968, a diminishing of capital's share in the 1970s amid political-economic turmoil, and a reversal under Miterrand in the 1980s. In the US, a moderation of income inequality in the 1950s and 1960s, and then an explosion of high incomes since the Reagan era.

But the labour movement is oddly and strikingly missing from Piketty's narrative: he tells us that May 1968 was about "cultural and social issues that had little to do with the question of wages," but then that de Gaulle ended the crisis with a twenty percent increase in the minimum wage. The rest of the story is mostly concerned with further political adjustments of the minimum wage.

For a book telling the story of distribution under centuries of capitalism, and with nearly 700 pages to tell it, it is amazing to see only three references to trade unions: they are mentioned twice on consecutive pages, for their importance in establishing minimum wages in Germany and Sweden; and then, on the last page, their activists are exhorted to pay attention to economic statistics, however dull they may seem. There is nothing on the rise, plateau and decline of the Western labor movement.

At one point Piketty does raise the possibility that the shift in the production function parameters he estimates from the data could be interpreted in terms of bargaining power instead of — or as well as — technological change. But it is left to others to explore that possibility.

Throughout the book, Piketty fights a number of skirmishes with aspects of conventional theory: time preference as an explanation of the interest rate, the life-cycle model of saving, marginal productivity as an explanation of high mangerial incomes. It is not at all his aim to set up an alternative set of models. His weapon is always "the data," and his stance is that of the empiricist, distrustful of theory, preferring instead to deal pragmatically with the ocean of facts by mapping it, finding ingenious ways to represent its structures. Piketty is brilliant at this, and it is the source of everything that is great about *Capital*.

But it also means a somewhat ad hoc treatment of all the phenomena he dismisses as "short term" and transitory.

In the book's introduction, he explains that he quit an enviable position in an American economics department at age twenty-five because he was repelled by the abstraction and inattention to data, arguing that "economics should never have sought to divorce itself from the other social sciences and can advance only in conjunction with them." In the conclusion, he pulls no punches, claiming that high-level economics has come to "rely on an immoderate use of mathematical models, which are frequently no more than an excuse for occupying the terrain and masking the vacuity of the content." It is unfortunate that Piketty does not engage more with those economic traditions that have for many years been working along the lines he lays out.

The sense of a missed opportunity is most painful in Piketty's summary dismissal of the "Cambridge capital controversies," which played out in the journals especially in the 1960s. This debate was about the validity of explaining the return on capital with the device of an aggregate production function. The main point of Joan Robinson and her Cambridge, England, fellows was that aggregate capital could not be quantified independently of distribution. Capital could be measured, as Piketty does, by adding up the market value of assets at some point in time. But this value would itself depend on the going real wage and rate of profit, among other things. It could not legitimately be used as an independent quantity to *explain* distribution.

As James Galbraith has already pointed out, Piketty seems to have completely misunderstood the debate. In his telling, it was all about whether the capital-income ratio was flexible enough to make for relatively smooth growth. To back up his claim that the controversy involved "a good deal of confusion" all round, he claims that the Cambridge UK side had set up an anti-Keynesian MIT straw man, and assures the reader that the Massachusetts side of the debate "were fully convinced that the growth process is unstable in the short run and that macroeconomic stabilization requires Keynesian policies." But this is a non sequitur. The debate had little to do with the value of macroeconomic stabilization.

Piketty characteristically concludes that the controversy could have been avoided if only both sides had access to "the historical data needed to clarify the terms of the debate." This misses the point entirely, since the actual historical data on the value of capital will always reflect the distributional conditions of the their time.

Frankly, it is hard to believe Piketty has had much exposure to the debates at all. A search of the footnotes and appendices finds no references to the original papers to substantiate his interpretation. (The same can be said of his repeated, preposterous claim that Marx did not consider the possibility of technological change in his treatment of growth and distribution.)

It is unfortunate that Piketty got the wrong impression of the view from Cambridge, England, because it could have been well-suited to his overall argument. Contrary to what many now seem to believe, the intent of Robinson, Pasinetti, and others, was never to deny the meaningfulness or even quantifiability of capital at the level of the whole economy. Nor was it about a mere aggregation problem. It was simply to establish that the quantity of capital was not independent of income distribution and thus could not be treated as an exogenous variable in a model purporting to explain distribution over the long run.

For the Cambridge, England, tradition, distribution is something to be studied historically because there is no single long-run equilibrium position. The real wage and profit rate evolve over time, influenced by a range of institutional and market forces. Macroeconomic factors — which Piketty ignores as transitory— are critical in the short-run, but the long-run is no more than an accumulation of short-runs.

This is not to abandon explanation, but simply to admit the limits of abstraction and a need for real historical analysis. Piketty, too, calls for history and rails against purely abstract models. But in his core argument, he pits the long-run against the merely transitory, and the choice of which factors to treat as independent in the long run comes straight from standard Solow-Swan growth models.

I have got this far without explaining exactly what Piketty means by "capital." He means wealth, or net worth, and not simply "means of production":

> I use the words 'capital' and 'wealth' interchangeably, as if they were perfectly synonymous . . . It includes the sum total of nonfinancial assets (land, dwellings, commercial inventory, other buildings, machinery, infrastructure, patents, and other directly owned professional assets) and financial assets (bank accounts, mutual funds, bonds, stocks, financial investments of all kinds, insurance policies, pension funds, etc.), less the total amount of financial liabilities (debt).

This definition is crystal clear, but Piketty does not give the reader much sense of how unusual it is. It follows from this definition that the means of production owned by firms are not counted directly as part of a country's aggregate capital. Rather, their shares and debts are presumed to reflect the value of the means of production (along with the value of intangibles like intellectual property and “goodwill”), so it is these financial assets, owned by households, that are counted instead. As he explains in the online appendices, this allows him to evade the difficult problems of valuing firms’ capital stock.

This definition of capital makes it even odder that Piketty is comfortable to use it as a variable in an aggregate production function, as if this financial capital were a simple “input.” He is of course well aware that these financial values ride up and down with the fluctuations of financial and real estate markets. He acknowledges that the long upward trend in stock and real estate prices over the last few decades have increased the aggregate value of capital quite apart from from has happened to net savings. But he once again resorts to the long-run/short-run divide, arguing that “price effects” are transitory and that “volume effects” — i.e., the accumulation of capital by net savings — dominate in the long-run.

In many countries, the market value of corporate equities and debt has risen substantially relative to the values of firms’ net assets since the 1980s. But Piketty argues that this simply reflects a recovery from the declines of the Great Depression and the world wars. The long bull market we lived though was just a return to normality! This is a very casual way to deal with something that makes a big difference to his central variable. Pure capital gains (i.e. adjusted for the accumulation of real assets by corporations) account for a substantial proportion of the rise in the capital-income ratio since 1970 in many countries: about a quarter in the US, Japan and France; more than half in the UK, more than a third in Australia.

There are also big differences between countries at a given point in time. In the 2000s, the ratio of market to book value of corporations in Germany and Japan was only around half that of the US and UK — and this makes a substantial difference to the recorded value of capital.

On the other hand, there are things to be said for Piketty’s definition of capital. He puts all forms of wealth on the same footing, and in a major sense, they are. They are all vehicles for carrying purchasing power into the future, and all are expected to generate returns for their owner. Because wealth owners are free to adjust their portfolios as they see fit, their prices should adjust so as to roughly equalise expected rates of return, adjusted for risk and liquidity. Any asset gives its holder a share in society’s income, whether it be a share, a bond, a piece of factory equipment or a house. (The last makes clear that the return need not involve an actual monetary flow: living in a house you own saves you rent, and the national accounts deal with owner-occupied by ‘imputing’ a rental flow from resident to owner, even though they are the same person.)

So Piketty’s definition of capital as net wealth gives us a fuller picture in some respects than we get from one restricted to instruments of production. For that matter, it compares favorably with a narrow focus on the debtor-creditor relationship, which has been in vogue among radicals these past few years. Owners of all forms of wealth, not just creditors, enjoy unearned income simply by virtue of that wealth, and all of this income is derived from our collective production.

Geoffrey Hodgson has argued that Piketty's treatment is a return to an older, more useful, intrinsically monetary conception of capital. There is some truth to that — but there are important implications that Piketty barely discusses. A financial definition of capital calls for some explanation of the relationship between monetary interest rates and rates of return in production, and raises fundamental questions about the workings of capital markets. But this could be another potential point of contact between Piketty's framework and radical political economy.

For all the problematic aspects of Piketty's central argument, the work is still of great value. It is a model of social science communication: clear and absorbing, readable by the general public, while providing the technical details for specialists online. The data he has assembled is tremendously useful, and freely available online to anyone who wants to use it to tell other stories, deepening or questioning his own account. This has already been happening — for example, earlier iterations of Piketty's statistics have been important to the Marxian analysis of fellow Frenchmen Gerard Duménil and Dominique Lévy.

Regardless of whether Piketty has *explained* what he describes, or whether he had justified his predictions, his description is very important. It is useful and fascinating to get details, for example, on exactly how the structure of wealth in the rich world today compares with that of the turn of the twentieth century. Then, around 90 percent of wealth was held by the top 10 percent. Now, in Europe and the United States, the next 40 percent have between a quarter and a third of it. Not much has changed for the bottom half of the population (with 5 percent of the wealth), but it is surely important politically that a substantial proportion of the population now have some limited degree of wealth.

The rise of a "partrimonial middle class" is hardly a new observation, but it is helpful to have it quantified and put in comparative perspective. And Piketty shows his real talent for excavating meaning from the data by considering exactly what it means for the life cycle experience of different generations. The rise of the capital-income ratio since the 1950s has been combined with this spread of some wealth to the upper-middle strata to create a new social configuration: what he calls "the society of petits rentiers."

As he shows with his long-run data on France, for much of the twentieth century the transmission of wealth from parents to children was unusually unimportant for most of the population. That is changing drastically. Among the parents of the baby boomers, only 2-4 percent inherited (or were gifted) amounts equal to the lifetime earnings of the bottom 50 percent of workers. Among the baby boomers, 5-8 percent received such windfalls.

For those born since 1970, Piketty projects that figure to rise to more than 12 percent. A larger group — though still a minority — will receive smaller but not insignificant inheritances. For all the importance of the 1 percent to overall distribution, their lives are alien for most of us. The pettier inequalities are perhaps just as important to everyday experience: among the people we know, some can buy a house or pay Ivy League tuitions; others cannot.

This is just one of a number of ingenious statistical set-pieces throughout the book, tangential to the main argument but insightful. There is an exploration of unequal returns among the wealthy, cleverly exploiting the records of private university endowments, since the accounts of wealthy households are not available. There is a discussion of the impact of slavery and emancipation on American capital, and another on the long decline of agricultural landed wealth and its replacement by urban residential real estate. There are riffs on attitudes to wealth in nineteenth-century novels and twenty-first-century police procedurals; on why the United States pioneered "confiscatory" high marginal income tax rates; on primogeniture, equipartition and the dynamics of dynasties.

Then there are Piketty's judgements and political proposals. Needless to say, there is no call for #fullcommunism. There is a rote recital of the things liberals feel they need to say to make sure serious people don't confuse them with communists: growing up in the 1980s left him "vaccinated for life against the conventional but lazy rhetoric of anticapitalism, some of which simply ignored the historic failure of Communism and much of which turned its back on the intellectual means necessary to push beyond it."

But let's be clear: there are conservatives calling Piketty a socialist, and conservatives calling Obama a socialist, and the former are a little closer to the truth. He is a true social democrat, and the positions he puts here are to the left of anything in mainstream politics for decades.

Paul Krugman recently took James Galbraith and Thomas Palley to task for bringing up the Cambridge capital controversy in their takes on Piketty (as if Piketty himself had not raised the subject himself). Krugman complained that there is "a long if bizarre tradition among some left-leaning economists that sees the notion that factors of production are paid their marginal products . . . as somehow implying an acceptance of the moral right of capitalists to keep their spoils." But this was never the point: there was no need to go to all the trouble of the Cambridge controversies for that. Joan Robinson always recognised — insisted — that even if you accepted the neoclassical framework as an explanation, it provided no justification for distribution. Capital goods can certainly be considered productive, but there is nothing productive about *owning* capital, and "the apparent rationality of the system of distribution of the product between the factors of production conceals the arbitrary nature of the distribution of the factors between the chaps."

It is one thing for Krugman and other 33rd degree Operating Thetans to understand and acknowledge that reality. But it is hard to deny that for the general population, the exoteric doctrine — what you might pick up from the op-ed pages or a semester or two of economics — is that marginal productivity means people generally get what they add to output, and what could be fairer than that?

Piketty is rather more reserved than Joan Robinson, but he politely undermines the idea that wealth-owners *deserve* their returns. He writes that our society seems unable to face honestly that much income has no connection to effort, and traces the changing connotations of the terms "rent" and "rentier." Once, they referred simply to the return on any asset and the owners who enjoyed them; but in the twentieth century, "rent" came to be associated with market imperfections, and "rent-seekers" were the parasites who exploited them. Yet capital income, writes Piketty,

> . . . is not an imperfection in the market: it is rather the consequence of a 'pure and perfect' market for capital . . . There is something in this notion that is an affront to common sense and that has in fact perturbed any number of civilisations, which have responded in various ways, not always benign . . . Nevertheless, rent is a reality in any market economy where capital is privately owned.

Someone once said that Marx and Marshall took the classical antipathy to land-rents in opposite directions. Marx showed that capital was much like land and so its owners just as parasitic. Marshall showed that land was very much like capital and so its owners were not so bad after all. Piketty leans back towards Marx in this respect at least. He tries to undermine any sense that modern society is meritocratic, at least where wealth accumulation is concerned. He estimates that in France, two-thirds of wealth is inherited, and projects that this will rise to 80-90 percent. American demographic growth has slowed this trend down somewhat, but he estimates that at least half of wealth is inherited.

He does not presume the deservedness of "earned fortunes" either: as he notes, "self-made" billionaires continue to accumulate long after their innovations. (In truth, he vacillates on this — Steve Jobs "fully deserves his fortune", but maybe not Bill Gates.)

Of course, Piketty is not calling for the expropriation of the expropriators. That falls under his category of responses "not always benign." This is largely the age-old liberal fear of Jacobinism: the rich might not deserve their positions, but levelling brings unpredictable social upheaval and potential catastrophe. It is mixed with a more serious (but still familiar) technocratic argument. The incomes of the wealthy and very-high earners are unfair and unjustifiable individually, but the rationality of the economic system depends on the pursuit of exceptional returns:

> [P]rivate property and the market economy do not serve solely to ensure the domination of capital over those who have nothing to sell but their labor power. They also play a useful role in coordinating the actions of millions of individuals, and it is not so easy to do without them.

It must be admitted that, after the Soviet experience, the burden of proof on this point still rests with socialists, and we need to take it seriously.

Meanwhile, Piketty's reform program is far from negligible. He endorses as a matter of course traditional social-democratic demands, such as steeply progressive income taxes. He is not much worried about inequalities of income from labor, except at the bottom and very top, and his proposals here are quite conventional — a minimum wage, a return to high top marginal income tax rates, and education. The call for the education palliative may induce yawns, but at least he goes beyond the platitudes and shows he means it — endorsing free publicly-funded higher education.

The book culminates in a "utopian" proposal for a progressive global wealth tax. In itself, this is anticlimactic after the dark picture painted over the previous 500 pages. He suggests a 1 percent tax on net wealth above 1 million euros; 2 percent above 5 million, and perhaps confiscatory 5-10 percent rates on fortunes above 1 billion euros. Given an average rate of return on capital of 5 percent, this is not nothing, but it seems mainly designed to stop things from getting worse rather than moving towards egalitarianism.

Ultimately, the real immediate practical difference Piketty's intervention could make is within struggles around the public sector and tax-system redistribution within individual rich countries. He is at his most radical in his critique of austerity and his proposed solution to the Eurozone debt quagmire. He argues that the debt could be effectively repudiated without default, by repaying it in a stroke by a large, one-off progressive capital tax, spreading the burden across the wealthy in general (not only bondholders), and abandoning austerity entirely.

This logic can be extended to budget "crises" everywhere — the risk of social security "going bust," of rising health costs, of just plain cramped, stretched, or inadequate public services and benefits. Or, if these things are already adequate, we may collectively decide we want them better than adequate because they are more important than the luxury cars and vacations of the fortunate. Piketty's framework can make it clear that it is never really about whether "the government" can afford this or that, but about how the output of our collective productive power is distributed.

The irony is that for all Piketty's reasonableness and respectableness, it is only the radical left and the labor movement that will push his program, if anyone is going to. However much his book has changed the conversation on inequality within economics and in the media — and it is really too soon to tell whether this is game-changer or flash-in-the-pan — his technocratic solutions are never going to come from the treasuries and central banks, or from the world's center-left parties.

Almost unanimously, reviews have highlighted the never-going-to-happen nature of the book's modest proposals. Piketty himself presents his global wealth tax only as "a utopian idea . . . a worthwhile reference point." Subtract the feel-good last couple of chapters from the book, and we are left with a dark and pessimistic picture.

If these moderate reforms are inconceivable, what does that say about capitalism and its future? Here, the burden of proof is with the liberals — are they going to take Piketty seriously and make a go of it?