

Review of Thomas Piketty, Capital in the Twenty-first century, Belnap, Harvard, 2014.

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Several commentators have observed that their impressions of the value and meaning of Piketty's work changed many times, especially if they read it at different times, in different geographies and in different contexts. Some were initially struck by the brilliance of its ambition and rhetoric, by the impressive use of long-run historical data, by the significance of its focus on growing global inequality, by its ability to appeal to scholars ranging from mathematical economists, to political economists, historians and sociologists, and by the way it captured the attention of politicians and policy-makers of both the left and the right all over the world, including even US republicans, who were forced publicly to engage with his ideas. In the reviews I have read a few of these same commentators saw in later readings only the banal and the obvious, and pointed to the limitations of his arguments, methodology and techniques. They noted its lack of any real explanatory power as compared to Marx, or Polanyi (who fails to get even a mention), and a lack of any economic policy relevance as compared say to Keynes, in the context of the current crisis of capitalism. This has been my experience too. My review article based on Piketty and Sampie Terreblanche's new book, *Western Empires*, written last year and to be published in London later this year, is also somewhat more positive about Piketty and for all the above reasons, compared to these comments tonight, made after a second skim through. But let me start by a few comments on Piketty, then his main arguments. Remember it is a 685 page book, and I have 10 minutes, so I am going to stick to my text to prevent me from waffling and to save time.

Thomas Piketty is not a Western Marxist of the early post-war variety yet he has a quintessentially modern left- of -centre European outlook. By his own admission, he confirms that "I belong to a generation that turned eighteen in 1989, which was not only the bicentenary of the French Revolution, but also the year when the Berlin Wall fell. I belong to a generation that came of age listening to the news of the collapse of the communist dictatorships and never felt the slightest affection or nostalgia for those regimes or for the Soviet Union. I was vaccinated for life against the conventional but lazy rhetoric of anti-Capitalism, 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" (p.31).

Piketty may have been schooled amongst neo-classical economists, but his models, underpinned by intimidatingly impressive data sets, mined from tax records going back three

hundred years in some cases, goes some way to reclaim mathematics from the grip of neo-classical economics. But he chooses to be really, really rude about the place and value of mathematics and econometrics in modern economic analyses, something guaranteed to make him popular among the left, in and out of academia, most of whom are neither willing or able or content to play this numbers game. George Cooper, an economist who has worked for Goldman Sachs, JP Morgan, and Deutsche Bank, makes the point that to his mind the best quote from *Capital in the Twenty-First Century* is: “*To put it bluntly, the discipline of economics has yet to get over its childish passion for mathematics...*” p32.

To my mind, having studied but not much practiced a lot of maths and econometrics in my own economics, I find Piketty’s rudeness somewhat puzzling and contradictory given his own mastery and proficiency in this approach. He may well be right about the obscene degree to which economics has been driven by mathematical modelling and econometrics, to the exclusion of all other traditions or methodologies. But whether understood as a form of philosophy of reason or as a neat set of constructs (equations) to explain complex real world economic phenomena, maths employed critically in the service of economics, not as its master, has been and remains useful.

Now to Piketty’s analysis.

To date, economic data from the relatively short post- World War II period up until the end of the twentieth century, has been read mostly in sympathy with a neo-classical interpretation. In this period the hypothesis behind the Kuznets Curve was the dominant thinking about development and income inequality. AS Bhandari et al put it:

“The relationship between inequality and economic development has continued to fascinate economists ever since Nobel Laureate Simon Kuznets (1955) suggested that such a relationship may take the form of an inverted-U. This hypothesis predicts that inequality first increases in the early stages of development, reaches a maximum at an intermediate level of income, and then declines as the country achieves a high level of per capita income. As a poor country embarks on growth, the process of industrialization leads to greater inequality as a result of a shift of labor force from low-productivity agriculture to sectors of higher productivity.” (Bhandari, Pradhan and Upadhyay 2010:7).

Piketty shows that patrimonial capital is the largest contingent of total capital, more so even than Schumpeter’s “heroes of enterprise”. That central to understanding capitalists drive to accumulate is increasing economies of scale. Whereas Marx focussed on the increasing economies of scale of industry, Piketty shows how the same benefits of scale apply to the

investment performance of capital. Large fortunes enjoy better returns than smaller ones. His two fundamental laws of capital are worth noting. I express this in Chris Gregory's neat non-mathematical summary, as follows:

"The first reveals that profit's share of national income is equal to the rate of return on capital multiplied by the capital/income ratio. The second states that the capital/income ratio is equal to the savings rate divided by the growth rate in national income. His principal finding is that forces of income divergence have outweighed the forces of convergence since the 1970s as the rate of return on capital (r) has exceeded the growth rate (g). In other words $r > g$ means that the rich are getting richer and the poor are getting poorer. This thesis has a Marxist ring to it but Piketty argues that Marx's apocalyptic vision of capitalism was wrong: the rate of profit has not tended to fall as Marx predicted because the long term trends in the statistical data reveal that $r > g > 0$, not $r = 0$ as in Marx's extreme worst case scenario."

So centuries of capitalist development are reduced to three accounting identities, in the process the richer, more sophisticated and less ephemeral analyses of this same subject, such as those by Marx, Schumpeter and Polanyi are simply ignored.

The renowned American Marxist philosopher, Bob Woolf makes this point: "Piketty's central discovery, if we may call it that, is that contemporary capitalism is over the long run steadily transferring huge quantities of wealth from the poor to the rich, reconstituting thereby the inherited or patrimonial privilege and power characteristic of Europe in the eighteenth and nineteenth centuries. This fact may come as a surprise to professional economists, but it does not particularly startle those of us who have squandered our youth and idled away our maturity reading Karl Marx. *All societies exist for the purpose of transferring wealth from those who create it -- the poor -- to those who do not -- the rich. The academic professions exist for the purpose of rationalizing this transfer, the churches exist for the purpose of blessing it, and the arts exist for the purpose of decorating the transfer so as to make it as charming as possible [even though this often comes to nothing more than putting lipstick on a pig.]*" (<http://www.box.net/shared/n72u3p7pyj>).

Piketty's argument is built around a definition of capital as income or assets of various forms, not as Marxists would have it as a social relation of domination and exploitation. But on the technical point of definitions of capital, income, assets, capital-output ratios and the like, Bob Rowthorn has argued in the Cambridge Journal of Economics that Piketty is in fact wrong on some matters. For Piketty the increases in the income of wealth-holders arises from ever higher capital-output ratios, driven on by increased capital accumulation ie by investment. But Rowthorn's evidence using data from Canada, the US and France, shows that capital-output ratios have either been flat (Europe) or falling (as in the US). What Piketty's is seeing,

he argues, is the valuation effect on wealth-holder incomes flowing from disproportionate rises in the prices of certain asset classes, such as real estate over the last 40-50 years. In fact, real capital investment in most economies may have fallen steadily over time. (Rowthorn, 2014:1282).

All that said, and despite my reservations, I believe that Piketty does convey an important and timely message combining a grasp of western economic history and an analysis of long run historical data, and that is to point to the nature, form and variety that western capitalism has assumed over an extended time, of which sharply widening inequalities of income and wealth between rich and poor, is the most blatant. To the corporates and the ever richer elites, the beneficiaries of this variety of capitalism, and to many in aspirant and new middle classes in countries including South Africa and India, who praise and parrot this model and its values, Piketty does indeed have something to say and he does this elegantly, despite a certain caution. For, he achieves this objective without denouncing inequality or capitalism per se – especially since (quote) “social inequalities are not in themselves a problem as long as they are justified” (p.31).

On the “what to do” about it all question, Piketty is right to point to the need for a robust debate about the kind of state (social state, he calls it) that is required at the beginning of the 21st century to regulate a rampant in-egalitarian capitalism. New institutions and instruments are indeed needed to regain control over globalized financial capitalism, and ‘to achieve a just social order’ (p31), but when it comes to specifics, Piketty’s economic policy prescriptions are not very convincing, and in my view do not take progressive macroeconomic policy any further, if anything it sets back thinking in this crucial policy arena, both at national and global level. His policy response to the crisis he correctly analyses, as Chris Gregory notes, is constructed “in the narrowest apolitical, mathematical tradition of 20th century mainstream economics”. An international tax on capital is not likely to be implementable under current national or regional political models. Action is more likely to originate at a national, not international level, including in my view a serious relook at old and new forms of control over currency, capital mobility and banking regulation, and he has little to say about all this, apart from noting (on the basis of China’s admittedly opaque and unstable system of capital regulation) that ‘capital controls are one way of regulating and containing the dynamics of wealth inequality’. (p.536). Indeed; but how would this work in more democratic, transparent and liberal regimes than the China of today?

The three major 20th century revolutions in macroeconomic policy to my mind are those of John Maynard Keynes, and the rather different, right of centre, but still powerful interventions of Milton Friedman and the monetarists, and the related arguments of Robert Lucas and the

rational expectation theorists. Nothing in Piketty's policy prescriptions comes close to the incisiveness, power and influence of these earlier ideas, whether we agree with them or not.

In short, I would suggest that while Piketty's intervention is timely, ambitious and sparkling, it is not the radical or subversive treatise that some would hope to believe, and I would suggest too that there are much more useful tasks that progressive macroeconomists can busy themselves with, than pouring over Piketty line by line for some policy prescription fit for current purpose. This is especially true in respect of policy in developing countries on which issue Piketty sadly has little to say, apart from viewing emerging market economies as part of a catching up story. (p.21). This is also a strange absence for he appears to have supervised a number of theses on developing countries since the mid-1990s, including one that I found on South African equality (Morival, 2011).

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Acemoglu and Robinson (2014), themselves highly respected institutionalist economic historians fault Piketty for formulating "general laws" for the economy. These general laws, Acemoglu and Robinson claim, all fail because of a failure to appreciate the institutional environment in which economic history plays itself out. They undertake an impressive summary of the long twentieth century trajectory of the economies of Sweden and South Africa to show that it was the institutional framework of these two very different countries, rather than Piketty's or Marx's general laws of capital, that best explain performance, distribution and inequality. There is something of value in this. But beyond Piketty's general laws, and Acemoglu and Robinson's focus on the role of institutions or even Marx's attention to class forces, it has to be pointed out that many other factors and forces including most notably technological and communications changes, as well as matters such as climate change, war and conflict make economic progress within modern capitalism both irregular and unpredictable.

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