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Rethinking Piketty: critique of the critiques (a work in progress)

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In *Capital in the 21st Century* and companion works, Piketty and his colleagues have clearly embarked on an important new research program, reviving classical concerns about the course of capitalist development. I was intrigued by the title, obviously reminiscent of Marx. How was the author going to study the dynamics of capital and capitalist development for the 21st century and what of substance would he reveal?

Like many others I was extraordinarily impressed by the book. Piketty demonstrates in statistical detail the course of capital accumulation and increasing income and wealth concentration among the very rich in developed capitalist economies since the 18th century and into the 21st century, while designating the period from 1914-1980 an aberration. What does the author argue that we have to fear or look forward to about capital in the 21st century? And how is Piketty's work related to that of Marx?

Studying the book reviews I was reminded that economists assess the work of others based on their own discipline training and ideological world view. In this case neoclassical economists tended to concentrate on and critique Piketty's definition of capital which he equates with wealth, his use of neoclassical growth models, Solow's in particular, and the unwarranted assumption that the elasticity of substitution of capital for labor that his analysis depends on is greater than 1. Marxists tended to take issue with Piketty's inadequate definition of capital and his misinterpretation of Marxian analysis. Keynesians and Institutionalists were enthusiastic about his work and his conclusions about the dangerous concentration of wealth and income which has long concerned them, but critical of Piketty's policy recommendations.

Given his focus on income and wealth distribution, it is appropriate for Piketty to define capital as the market value of "the sum total of nonhuman assets that can be owned and exchanged in a market" (p. 46). These are assets *private individuals* can own and sell. Connecting with the classical tradition of Smith, Ricardo and Marx, Piketty traces capitalist development and distribution as it has evolved into the 21st century. And there is more than a little that Piketty's work shares with that of Marx. However, the fact that Piketty seems to tie his theoretical analysis to neoclassical growth theory diverts attention and adds confusion. Of course, his mainstream orientation allowed him to reach a wide audience of economists and lay readers. However, his disregard of Marx's analysis of capital, as we shall see, weakens his analysis of the nature and dynamics of capital in the 21st century.

In this paper I concentrate on a few reviews I found most helpful in assessing the importance and limitations of *Capital in the 21st Century*. These authors share my gratitude to Piketty and colleagues for their work, but also my concerns. And I relate Piketty's work to arguments from Marx on capitalist development.

Branko Milanovic presents Piketty's theoretical argument in his superb and revealing review in *the Journal of Economic Literature* as a return to the method of the classics of building "a simple machine that captures the key features of a capitalist economy".[1] In this case Piketty employs one definitional relationship, two fundamental economic laws of capitalism, and one inequality relationship:

- The capital/income ratio K/Y = β links the stock of capital K (all forms of explicit or implicit return bearing assets) to the flow of income Y.
- The process of increasing β, over time characterizes all advanced capitalist economies.
- The significance of increasing β becomes clear when combined with the *first fundamental law of capitalism,* capital's share, α = rβ where r = rate of return on capital. In contrast to other reviewers Milanovic argues "we can consider this definition a "law" of capitalism in the sense that in a private capital economy the returns on capital are income of capital owners." If, for instance, capital is state owned then capital's share in national income has no influence on personal income distribution, so the "law" defines the distribution of income in terms of shares going to capital and labor.
- The inequality r>g indicates that capital's share of national income increases over time.
- This plus an increasing β over time drives the share of capital income arbitrarily close to one. (Milanovic describes the positive feedback loop at work. As capital's share increases and owners save some of their income, they reinvest more. "The increased saving in turn makes the growth rate of capital exceed further the growth rate of national income and increases β. Thus the higher β implies an increase in capital's share that leads to a higher β, etc., etc.)
- This process produces a changing functional distribution of income between capital and labor in favor of capital, and since capital income is more concentrated than income from labor, personal income distribution becomes more and more unequal.
- The *second fundamental law* gives the long-run equilibrium condition. Taken from basic growth theory, β= K/Y = s/g, where s = percent of annual income saved and g = annual growth rate of Y. (In response to criticism levied at Piketty, Milanovic notes, "the second law plays a rather subsidiary role in Piketty's analysis and he resorts to it only when he considers where eventually β may settle in some (perhaps mythical) steady state. … If g declines close to 0, then in the long run β approaches infinity" and "however small r, the share of capital in total income will be high." p. 522)
- Piketty considers low growth inevitable once countries achieve a high level of income, reach the technological frontier and experience slow population growth.
- The "stickiness" of r is the weak point in Piketty's argument, which Piketty buttresses, arguing that increasing financial sophistication and international competition for capital will help keep r>g. Nevertheless, Piketty's long-run prediction rests on an empirical rather than a theoretical argument.

Milanovic disregards the debate by many mainstream economists over Piketty's definition of capital by basically ignoring Piketty's introduction of growth theory in chapters 5 and 6 where capital necessarily represents a factor of production. Piketty, Milanovic concludes, has given

[1] Branko Milanovic, "The Return of 'Patrimonial Capitalism': A Review of Thomas Piketty's *Capital in the Twenty-first Century*". *Journal of Economic Literature* 2014, 52(2), 519-34.

us a framework that forces us to think of recent increases in income and wealth concentration, not as a diversion from normal convergence of the distribution of income and wealth due to diffusion of knowledge and skills, "but to see rising inequality as part of a changing nature of modern capitalism" (p. 533).

Specifically, Piketty states "In the long run the β or K/Y is related in a *simple and transparent* way to the savings rate *s* and to the growth rate *g* according to the following formula β = *s/g" that* "reflects an obvious but important point: a country that saves a lot and grows slowly accumulates an enormous stock of capital (relative to its income) which can in turn have a significant effect on the social structure and the distribution of wealth" (p. 166).

Fundamentally, it is important to recognize that Piketty's accomplishment is empirical. He has amassed the data necessary to make his argument, buttressed by useful descriptive detail. He makes no theoretical claims. Given all the criticism levelled by mainstream economists on this point, it is useful to note that in the 700 pages of the book, only two-and-a-half pages in chapter 6 are devoted to "growth theory".

Edward Fullbrook, in "Capital and Capital: the Second Most Fundamental Confusion,"[2] distinguishes between capital as an *object* or some set of objects (which he calls capital-1), and some *property* of the objects, in this case their *value (*which he calls capital-2*)*. Piketty's "national wealth" or "national capital", "the total market value of everything owned by the residents and government of a given country at a given point in time, provided that it can be traded on some market" is capital-2. Similarly, income, can be considered a set of objects or a flow of value over time. Fullbrook designates the objects as income-1 and the flow of value as income-2.

He notes that *market-value* represents relations between a pair of objects, it is a relative phenomenon although this is not clear at the micro level of consumerism or business where we can speak of individual prices, and can add them up, *et cetera*. However, market-value as a relative phenomenon becomes clear when one considers market values at the meso level, as with inflation, or in considering distributions of wealth and income. Then, market value's Boolean structure comes "strategically into play." Fullbrook states:

> "Piketty's capital-2/income-2 ratio, β, is one way of comparing two quantities of market-value. But given that market-values only exist relative to other market-values, these two quantities, capital-2 and income-2, when considered together have a special metrical property that remains hidden when they are expressed as a ratio. Capital-2 + income-2 … comprise *all* the market value that exists in the economy. Therefore, metrically capital-2 + income-2 is the equivalent of certainty with respect to theoretical probability. As is the convention with probability's certain event, we can assign (capital-2 + income-2) or K + Y the value of 1. … For example, if β = 8, then K + Y = 8/9 + 1/9 = 1."
>
> "K + Y = 1 is the fundamental relation that underlies the market economy. [Fullbrook notes that the Bo*olean discovery reveals that value and distribution are the same thing.*] It is the relation that intriguingly lies behind

[2] Edward Fullbrook, "Capital and capital: The second Most Fundamental Confusion," *Real-World Economics Review*, #69.

> Piketty's data but which he, blinded by Euclidian preconceptions, fails to unveil. In the Piketty context, the most profound revelation of this unveiling is that *any increase in the market-value of either K or Y decreases by an equal amount the market-value of the other and vice versa.* That is why it is a profound error to speak as does Piketty, of accumulating or of the macro accumulation of capital-2, i.e. of K… It is not an accumulation that takes place when capital-2 increases, but rather an appropriation…"

In discussing the saving rate, **s**, and growth rate, **r**, Fullbrook points out that Piketty's "***s*** refers to a *portion* of the *market-value* of a country's output. His **g** on the other hand refers to *two levels of real output* compared on the basis of what their market-values would be if the market-value of money remained constant." If all the saving goes into investing in existing assets there will be asset inflation and **K/Y** will increase. If the saving goes into investing in new real assets, in new capital-1, there would probably be a decrease in **K/Y** and an increase in **g**. In other words, **g**, **s**, and **β**= **K/Y** are interconnected.

Fullbrook comments, "…it's nice to increase the size of the pie, but some people find it even nicer to increase the size of their slice." Fullbrook gives expression to my own hunches about the long-run increase in β, particularly in recent times of relatively slow growth. How do owners of capital (wealth) find profitable outlets for their savings and does this explain the increasing percent the financial sector takes up in the U.S. economy in the past few decades? After all, owners of capital who are rentiers seek to maximize their *monetary* return and this may have little to do with investing in productive capital. Fullbrook ends his paper on what he labels Plutonomy Economics: for instance, strategies that involve manipulating the capital-2 inflation rate relative to the income-2 inflation rate. In the aftermath of the 2008 financial crisis "unprecedented extensions of credit were almost exclusively directed toward the inflation of capital-2 rather than toward income-2 or toward increasing capital-1 or income-1." U.S. policy favored monetary policy over fiscal policy expansion of aggregate demand.

It is useful, now, to consider how Marx provides insight to this discussion of *Capital in the 21st century* through his analysis of the dynamics of capital over (and in) time, and in particular, the development of the special sphere of financial capital, a major concern for Piketty. Marx calls *capital* self-valorizing value, the creation of value by value (or capitalization). In Volume II of *Capital* Marx describes the circulation of commodities as capital through his reproduction schemes to identify the preconditions of growth in capitalism. Growth means accumulation of capital, which is partial capitalization of profit into additional capital through the control of the production process and the surplus value produced.

Marx describes the circuit of capital for an individual owner of capital – it's metamorphosis from money capital that the capitalist invests in productive capital and labor that is transformed in the process of production into commodity capital that must be further transformed through market transactions back into ***more*** money, the realization of the surplus value embodied in the commodities created by labor in production. The time element in the valorization process is crucial, "Capital can be considered only as motion, not as a thing at rest." The rate of return for the capitalist depends on his control of the production and distribution processes and in particular, the turnover time, the speed of production and circulation of capital. This involves increasing exploitation of labor through the creation of both absolute and relative surplus value.

Productive capital represents the commodities and labor time used in the productive process. Circulation capital represents capital advanced unproductively, the expenditure of necessary social costs that do not create value and surplus value, but costs that originate in the change in form of value.

Marx emphasizes that capitalist development depends on increasing competition that decreases rates of return in developed markets requiring expansion into newer more profitable sectors and regions. This is the short-run aspect of the tendency for a falling rate of return as part of capitalist competition, a process involving capitalist crises of demand (which destroy some capital and lead to both centralization and concentration of capital), but also eventuating in a world market promoted by and promoting a speed up in the circulation of capital, what Marx described as the eventual "annihilation of space by time".

In Volume III Marx gives more detail about how different sectors of the ruling class participate in the total distribution of the total mass of surplus-value produced by productive wage labor.

> "The purely technical movements that money undergoes in the circulation process of industrial capital, and… commercial capital… these movements, having acquired autonomy as the function of a special capital which practices them, and them alone, as its specific operations, transform this capital into money-dealing capital. … A definite part of the total capital now separates off and becomes autonomous in the form of money capital, its capitalist function consisting exclusively in that it performs these operations for the entire class of industrial and commercial capitalists" (ch. 19, p. 431).

Activity in this financial sector is part of costs of circulation that do not create value. Marx quotes a banker in Yorkshire describing the great and possibly dangerous expansion of bills of exchange: "It is impossible to decide what part arises out of *real bona fide* transactions, such as actual bargain and sale, or what part is fictitious and mere accommodation paper… in order to raise a fictitious capital, by creating so much currency." Marx notes that the accumulation of money capital "is effected by various people who have feathered their nests and *withdrawn from the reproductive process*. The greater the profits made in the course of the industrial cycle, the more of these people there are." As material wealth increases "the class of money capitalists grows. On the one hand there is an increase in the number and wealth of the retired capitalists, the rentiers; and secondly the credit system must be further developed, which means an increase in the number of bankers, money-lenders, financiers, etc." (p. 642-3).

Piketty intentionally defines national capital or national wealth as the total market value of everything owned by the residents and government at a given point in time provided it can be traded on some market – the sum total of nonfinancial assets and financial assets. What roles does this wealth play, *visa vis productive capital* as the 21st century progresses? I believe Piketty gets side-tracked by trying to make the connection using neoclassical growth theory. But, clearly, Piketty is interested in the concentration of income and wealth among the very rich, how the distribution of income might affect 21st century capitalism and democracy as we know it. To me the most insightful comments come from writers thoroughly familiar with Marx who have a clearer understanding of the fundamentals of capitalism. I've chosen two in particular: Hans Despain, and Benjamin Kunkel to suggest the importance of broadeningeconomics discourse to include dissenting traditions not usually taken seriously here in the U.S.

Hans Despain[3] praises Piketty for demonstrating an enormously important point – there are no economic laws determining the distribution of income and wealth. For Despain, the big problem in Piketty is an undeveloped social theory and normative philosophy which, he comments, leads to anemic policy recommendations.

Despain points out that the book is not directly about capital in the Marxian sense. Rather it concerns the accumulation of wealth and financial assets, how this wealth becomes concentrated in fewer hands and is finally passed on through inheritance. Nonetheless, he recognizes that indirectly the book *is* about (Marxian) capital. When Piketty assumes a rate or return on capital, he is simply assuming what Marx called in Volume Two of *Capital* "value in process". Thus, the book is tacitly about the commodification of the ability to exploit and create passive income streams through financial markets."

While Piketty's strictly monetary and financial definition of capital is useful in demonstrating financial flows through history, Despain argues that it fails to "capture the deeper issues involved for "social being". Marx's notion of capital as *value* captures the moral, philosophical, psychological, political economic aspects as well. "Capital is a social relationship that establishes the *relations of production*. Piketty's definition leaves his argument in the sphere of distribution. As a consequence, Piketty's policy recommendations remain geared toward issues of *re*distribution, with no attention to productive relations."

Interestingly, Despain points out that Piketty never addresses the "principal-agent" problem of how capitalists get workers and managers to carry out capitals interests. He does assume that wealth distribution is determined by the relative power of agents and other institutional forces, but he does not say what determines the rate of return on capital. Despain notes that increases in productivity will be passed on to the managerial class if the working class does not challenge the relations of production.

In discussing the *rentier class* today Despain argues that the key is the notion of *value in process*. Today, instead of making long-term loans, production relations are so stable that people with money hoards buy and sell financial assets. "For the buying and selling of financial assets to replace interest-bearing capital, the money holder must be very secure in the ability of functioning capitalists to exploit at will. I propose they can. As such Piketty's assumption of a 4-5% return on (*abstract*) capital is justified on the Marxian notion of *value-in-process*. Moreover, this helps explain the activity of central banks as institutions of mass *redistribution* (p. 550). As such there is urgency for all social scientists and citizens to begin to better understand money as a social institution and a power relation (p. 577). Note that in this discussion Despain does not speak of *saving* out of income but of *money hoards*.

Despain reflects on the rise of supermanagers, particularly in the financial sector, paid to keep the sector highly lucrative, noting that their earnings may in fact reflect their marginal productivity, their ability to maintain high rates of surplus value for their clients. And he remarks that the expansion of a large middle-patrimonial class of 20-50% of the population serves an important function in justifying increasingly high concentrations of wealth by giving

[3] Hans G. Despain, Review of *Capital in the Twenty-First Century*, *Marx & Philosophy Review of Books,* http://marxand philosophy.org.uk/reviewofbooks/reviews/2014/1005.

"the appearance of meritocracy as the ideological justification of inequality" because this wealth is achieved mainly through labor contribution to society.
Despain concludes, Piketty's "theory is highly incomplete, but nevertheless urgently important. His final plea is not policy oriented but to "all citizens" to "take a serious interest in money, its measurement, the facts surrounding it and its history" (p. 577). We need to begin to understand how the financial classes can "profit without producing" … and how previous accumulated wealth "devours the future".

Benjamin Kunkel, a novelist and public intellectual, provides a thoughtful lay person's reaction to the book, and on what he calls the twin crises we are facing today: in the economics discipline and in the economy where the maldistribution of income and wealth is so visible in all aspects of society.[4] Quoting Kunkel is useful as a way of hearing what articulate wordsmiths are saying about economists in public.

Kunkel praises Piketty as one of the few economists "eager to revive the old-fashioned spirit of political economy". He notes the migration of the field from political economy in the 19th century to the discipline of economics in the 20th dominated by the marginalist revolution and a "stricter methodological charter." "The marginalist picture of the free market as the vehicle for maximizing everyone's utility – better known around the house as satisfaction or happiness – has become the vision retailed by politicians, and the notion of economic life as a matter of individuals harmonizing their preferences, as opposed to classes wrestling for control of shop floor and government, has filtered into common sense."

Kunkel considers the biggest difference between marginalists and political economists concerns the question of value. "The substantive dispute over value also implied methodological differences. To argue value derives from labour is ultimately to consider the successive labours that make up history; conflict and change emerge as the essence of economics as they are of history. To focus instead on the instantaneous balance of one person's wish to sell with another's wish to buy is to abstract a moment of harmony from the ongoing clangour and flux." Piketty is caught in a dilemma, he wants to recover the scope of political economy without giving up the quantitative rigor of contemporary economics. However, Konkel observes, "he has hitched his orthodox training to a Marxian research program". This means that economics can't be explained in economic terms alone. And, in fact Piketty's book, much Like Keynes' *General Theory*, is intended to influence both the profession and the intelligent lay public with the goal of promoting political reform.

Kunkel summarizes Piketty's argument, concluding that the extremes of inequality existing in the 19th century are redeveloping and reflect the capitalist norm driven by the tendency for the rate of return to exceed the rate of growth. "…the liability of r to exceed g generally holds in societies obedient to this law. Capital incomes will account for an ever greater share of income while receipts to labour dwindle by comparison."

Kunkel identifies the major weakness of Piketty's analysis, the assumption that r and g are independent of each other, crediting both Marx and Keynes who argued that too much money in the hands of the rich can curtail demand for both consumer goods and capital goods and

[4] Benjamin Kunkel, "Paupers and Richlings," *London Review of Books,* Vol. 36, #13, 3 July 2014, pp. 17-20. Kunkel, a graduate of Harvard and Columbia, published the novel, Indecision in 2005 to considerable acclaim, has since written the play, *Buzz*, and most recently published a collection of essays, *Utopia or Bust*. He is part of a youngish set of left-leaning intellectuals.

thus growth. Kunkel invokes Marx's "coercive laws of competition" in which capitalists compete for money profits which are then profitably converted into ever larger masses of productive capital, "The systematic imperatives of satisfactory profits and endless accumulation may in the end be at odds."

Kunkel concludes that Piketty's "…concept of the rate of return on wealth may be too generic to ground any distinctive laws of capitalism. No theory of capitalist dynamics can do without the implacable logic of profitability and its effect on the interaction of distribution and production." Piketty promotes r>g to the central contradiction of capitalism, but Kunkel points out that it is not, in fact, a contradiction, since for Piketty this tendency could go on indefinitely, threatening democracy but not capitalism. Marx, by contrast proposes a genuine contradiction, a mechanism specific to capitalism in "the drive for profits through the exploitation of wage labor". Kunkel notes that capitalism can dispense with democracy more easily than with profits.

To conclude, clearly, Piketty has thrown down the gauntlet to the profession. We have a responsibility to study capitalism in the 21st century – to inform the public and public policy discourse. I doubt that this can be done responsibly without attention to Marxian insights.

The key problematic to Piketty's book is that implicitly Piketty should be arguing that there is no steady state toward which capitalist economies are moving, something Marx argued. The rate of return on capital, the saving rate, and the capital/output ratio are interdependent even though r does seem to be relatively stable over time. A key element in 21st century capitalism is rentier behavior of "retired capitalists" and the rich, including us in the middle patrimonial class who are not generally motivated to maximize growth, just our own wealth. Realized profits are not automatically reinvested to expand productive capacity. Instead some falls out of "capital as process" involved in expanded reproduction, and becomes money capital in the circulation process and generates fictitious capital. Increasing wealth disparities are *inherent* in capitalism. Capital in the 21st century seems to be characterized by continued globalization of capital through exploitation of new labor pools and the expansion of money capital that provides new sources of riches for the rentier class. This expansion of money capital might also explain the declining rate of growth in developed capitalist economies. Are we witnessing to some extent the euthanasia of the entrepreneur who produces real output?

Piketty's argument makes sense when neoclassical growth theory is jettisoned and some version of Marx's is substituted. This is just my hunch. But it seems reasonable when one recognizes the enormous growth of the financial sector in the U.S. economy – since 1948 the Finance, Insurance, and Real Estate (FIRE) sector has grown from 10% of GDP to more than 20%. A recent article, titled "Long Live the Reemergence of the FIRE Economy," reports that over the past decade GDP increased by 5.2 trillion dollars while the total credit market debt owed is up 24.5 trillion.[5] Meanwhile production jobs and increasingly service jobs are being offshored by U.S. companies eager to exploit labor pools earning lower wages and laboring under more unfavorable working conditions. And Americans suffering most from these changing work dynamics have a basic understanding of the problem, witness this year's presidential primaries focusing on Trump and Bernie.

[5] Mybudget360.com. www.mybudget360.com/fire-economy-comes-back-finance-profits-gdp-total-credit-market-debt-at-peak/ [9.06.2016]

What this seems to entail for the 21st century, as Piketty's data suggests, is more of the same. There is still a large untapped labor force in the world to exploit. Political movements or crises may and probably will intervene. Limits on natural resources or arable land as global warming heats up should continue to force more migration and political conflict. It's going to be a messy 21st century; we're already experiencing it. Economics needs a sabbatical to think, explore, and retool. I like Piketty's discovery of r>g. The profession should encourage diversity in world views, welcome the development of empirically based theory, and be less tied to yesterday's growth theories demonstrating a path to a steady state in the long run, where, as one famous economist pointed out, we are all dead.

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