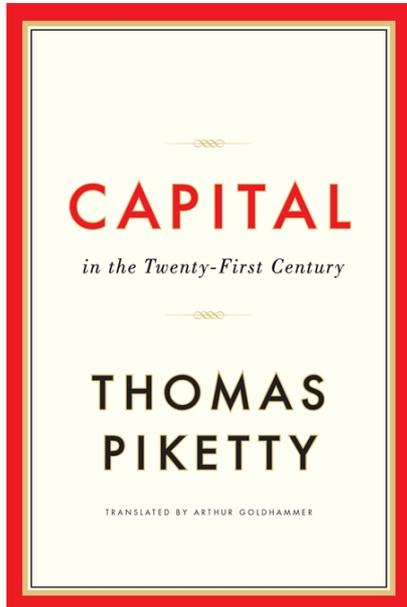


# Review: Thomas Piketty, *Capital in the Twenty First Century*

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Thomas Piketty, *Capital in the Twenty First Century* 2014  
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How often have you heard the term ‘fantasy economics’ thrown at someone who challenges austerity? Sinn Fein apparently suffers from this weakness’ ; so does Richard Boyd Barrett from People Before Profit and indeed everyone else who dares to oppose the endless cuts in public spending. There are some variations on the theme: ‘But do your figures add up?’ is probably the most common question any left-winger is asked on the Irish media. ‘Economically illiterate’ is the sniffy put down of those who suggest a tax on wealth.

This discourse assumes there is a technical discipline known as ‘Economics’ which only a few experts can master. The subject is supposed to be a science and the solutions advocated by its practitioners are devoid of any class or political bias. This expertise gives a peculiarly high status to economists in Ireland and elsewhere.

The pronouncements of Colm McCarthy in the Irish Independent or the many appearances of Jim Power on a host of radio and television outlets provide ready-made arguments for those who support austerity. Lesser-known names such as Seamus Coffey or John Fitzgerald of the ESRI do commentary based on statistical analysis and are treated with such reverence that they become arbitrators between varying political alternatives. This is all the more surprising since none of them predicted the crash of the Celtic Tiger or Great global Recession. In brief, in a more secular society, economists assume that role that priests used to have. Their pulpits may be the television studio rather than the altars but they talk of a mystical world unknown to the great mass of people. Whereas the priests spoke of heaven and hell, the economists surround themselves with the banal world of figures and jargon terminology. But they both dish out a same harsh message of punishment - for sin, in the case of the priests and for ‘excess’ in the case of the economists.

Thomas Piketty’s book, *Capital*, blasts a hole in the ill-deserved reputations of mainstream economists. This is despite the fact that Piketty comes out of the neo-classical school of economics - the dominant form taught in most Irish universities. Piketty’s personal biography gives a hint about the contradictory aspects of a book that has become a surprise bestseller. His parents belonged to the Trotskyist group, Lutte Ouvrier, but the young Piketty grew up in France where the intellectual Right were in the ascendancy where, he states, he became ‘vaccinated for life against... the

lazy rhetoric of anti-capitalism.’<sup>1</sup> After finishing his doctorate, he was hired by a university near Boston but then in his own words, ‘something strange happened’ as he became

only too aware of the fact that I knew nothing at all about the world’s economic problems. My thesis consisted of several relatively abstract mathematical theorems. Yet the profession liked my work. I quickly realised that there had been no significant effort to collect historical data on the dynamics of inequality (since the 1950s), yet the profession continued to churn out purely theoretical results without even knowing what facts needed to be explained. And it expected me to do the same.<sup>2</sup>

After this realisation, Piketty set about an analysis of longer term historical trends of inequality within capitalism. He collaborated with a group of economists including figures such as Anthony Atkinson and Emmanuel Saez whose work inspired the Occupy movement who focused on the fortunes and power of the ‘1 percent’. Yet despite the very radical implications of his research, Piketty remains trapped within a framework of conventional bourgeois economics and is, politically, a critical supporter of capitalism. However, far from undermining a Marxist reading of his data and methodology, these contradictions make his work all the more interesting.

Take, for example, his debunking of conventional economics. The standard

format of academic articles in ‘peer reviewed’ economic journals is a brief, readable preamble which sets up the research problem. There then follows a series of mathematical models, often based on regression analysis, to establish which ‘factors’ have most influenced on the phenomenon under discussion. The models are based on highly abstract and dubious assumptions about the behaviour of atomised individuals and the supposedly immutable laws about supply and demand. All science needs some degree of abstraction but the assumptions that mainstream economists use are biased. They typically rest on the ‘rational expectations’ of isolated individuals who pursue their own self-interest and on ‘factors of production’ which are divorced from any social relations. The more sophisticated the model, the more hidden and distorting is the original assumptions that underlay it.

Piketty’s work represents a partial break from this approach in two ways. Firstly, it is based on a mass of statistical data rather than any mathematical modelling. Moreover, unlike other economists who use this type of data, he readily acknowledges the limitations of the material that is drawn from official sources. He accepts that this data can only yield a partial and somewhat distorted picture of social reality but must be used because it is the only material that is available. ‘National accounts’ he states ‘are a social construct in perpetual evolution. They always reflect the preoccupations of the era they were conceived.’<sup>3</sup> He even notes the distinct class bias that lies behind the ‘chaste veil of official publications’.<sup>4</sup> The states and organisations that gather data do so

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<sup>1</sup>Thomas Piketty, *Capital in the Twentieth First Century*. Harvard University Press: Cambridge Massachusetts, 2014, p. 31.

<sup>2</sup>Ibid.

<sup>3</sup>Ibid. p.58.

<sup>4</sup>Ibid. p.267.

for particular purposes and, in a class society, they have reasons to conceal as well as reveal. Piketty notes, for example, that the data collected from the OECD ‘deliberately ignores the top end of the distribution’ by failing to provide data on the distribution within the top ten of society:

It is as if an official government report on inequalities in France in 1789 deliberately ignored everything about the ninetieth percentile (top 10%) - a group 5 to 10 times larger than the entire aristocracy of the day - on the grounds that it is too complex to say anything about.<sup>5</sup>

Now this sensitivity to the class bias and, consequently, limitations of official statistics is entirely absent from mainstream economics precisely because they ignore social processes and pretend to be engaged in a purely technical procedure. Can you imagine an ESRI economist, for example, warning their reader about the limitations of data on wealth and acknowledging that they probably underestimated its concentration?

Secondly, Piketty adopts an historical perspective. His data on inequality draws on material - limited as it is - from the 18th century to the 21st century. He illuminates and makes this concrete by comparing the lifestyles of the wealthy and poor across the different eras. He draws on the literature of nineteenth century writers such as Jane Austen and Honor de Balzac because both these writers had an acute awareness of social class. Through this approach, he can point to general trends rather than snapshots of particular issues at single junctures. This also allows Piketty to develop a more critical perspective on capitalism. Most economists adopt

an ahistorical approach and, therefore, implicitly assume that capitalism has no beginning and no end. If they are pressed, they will make absurd - and often quite ignorant claims - that trade and capitalism are one and the same thing. The mere existence of trading in Ancient Greece, for example, is used to claim that capitalism existed there, in embryonic form. Moreover, when an economist examines a problem thrown up by the present society, he or she seeks solutions which never question the hierarchy of wealth and privilege. They promote ‘realistic’ solutions that do not tamper with existing structures. When an Irish economist looks at the shortfall in government revenue, for example, he or she will propose solutions that will give confidence to foreign bondholders and capitalists to invest here. They will not take adopt a wider historical perspective and examine how a strategy of ‘attracting’ foreign capital has created problems for the Irish economy.

These methods allow Piketty to challenge some of the intellectual frameworks that many economists are imbued with. The foremost of these has been a tendency to neglect to study the distribution of wealth. Originally, this issue was at the very heart of the discipline of economics. Marx, for example, disagreed with the classical economist, David Ricardo, but he acknowledged that Ricardo was trying to analyse some of the underlying dynamics of capitalism rather than being a simple apologist for it. One of Ricardo’s concerns was that landlords would be able to extract a greater share of national wealth through rising rents. In other words, the ‘distribution question’ lay at the heart of his economics. This focus on distribution of wealth disappeared from modern economics because of the peculiar assumptions that lay behind its mathematical

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<sup>5</sup>Ibid. p.268.

modelling. As Piketty explains many of these models are based on a ‘representative agent’ whose behaviour is determined by the laws of supply and demand. However,

[i]n these representative models, which have become ubiquitous in economic teaching and research since the 1960s, one assumes from the outset that each agent receives the same wage, is endowed with the same wealth and enjoys the same sources of income, so that growth proportionately benefits all social groups by definition.<sup>6</sup>

In other words, these representative models assume that class does not exist. Alongside these extraordinary assumptions, most economics are taught about particular ‘laws’ which govern the ‘free market’. One of the most popular of these is the ‘Kuznets curve’ that Piketty rightly describes as a ‘fairy tale’. Kuznets was one of the few economists to study income distributions over a thirty-year period. His primary data came from US federal income tax returns and he suggested that inequality increased in the early phase of industrialisation. In the later stage of advanced industrialisation, however, inequality decreased and a larger proportion of the population shared in the wealth. The two primary factors that produced this curve were the growth of productivity, due of greater use of technology, and the spread of mass education. Kuznets’ data was based on the period 1913 to 1948 and was formulated as a law when he became President of the American Economic Association in 1954. The notion that inequality would automatically decrease in late capitalism

is clearly an ideological proposition and Piketty, rightly, decries it as ‘product of the Cold War’.<sup>7</sup> Nevertheless, it has assumed the status of a dogma for most conventional economists to this day.

## Inequality

Piketty’s book destroys this absurd claim and conclusively demonstrates that inequality is rising - not decreasing in late capitalism. This will hardly come as a surprise to Marxists but, nevertheless, they could learn considerably from Piketty’s exposition. There is, firstly, a detailed uses of sources to build his case and demonstrate conclusively the real trends that are occurring. The primary source for Piketty’s data is the World Top Incomes Database, which has been developed by thirty researchers around the world. This is mainly based on tax receipts and in a country like Ireland, which has perfected tax dodging to a fine art, and will tend to underestimate the degree of inequality. However, Piketty does not fall into the trap that even the best commentators on inequality often fall into - confining discussion to income by looking at the distribution of income tax returns and calculating the share of each decile or percentile. The problem with this approach is that income does not adequately take account of the returns from the assets of the wealthy. One can establish the average income of different groups of PAYE workers fairly easily but the income that comes from things like dividends, rents and sales of property is much harder to assess. Leaving aside the issue of tax declarations, the Central Statistics Office deliberately disguise these source by a technique known as ‘agglomeration’. They simply package the sources of income from different assets and do not

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<sup>6</sup>Ibid. p.581.

<sup>7</sup>Ibid. p.14.

decompose them. They have also failed consistently to conduct any real analysis on the wealth held in fixed assets. Piketty shows a heightened awareness of this type of problem and therefore supplements his reading of income data with a study of estate tax returns which give some - although, once again, inadequate - insights into holdings of wealth.

He is also able to present his data in a more concrete and tangible form. He notes that Balzac's and Austen's novels contained very precise references to the wealth needed to maintain a 'respectable' lifestyle. Both writers could state exactly how many francs or pounds were needed and their readers knew exactly what this meant. In the present era, where there is a surfeit of statistical information thrown at the population, it is sometimes difficult to get a concrete feel of the differences in wealth. One of Piketty's solutions is to outline the monthly incomes of different social groups. As a euro spent in France may be different to one spent in Ireland, he uses 'purchasing power parities' to even it up. This simply means that if a monthly wage of €2,000 a week gets you 10 percent more goods in France than Ireland then this difference is built into the calculations when comparing the two countries.

A small-stylised sample of Piketty's finding can illustrate the results: The average person on this planet gets €600 a month but this disguises vast variations. In Africa and India, they gain between €150 and €250 a month; in Western Europe and the USA, it is €2,500 and €3,000. But while these differences are shocking, the wealth disparities within regions are even more obscene. The normal contrast is between 'egalitarian' Sweden and 'inegalitarian' USA and, unfortunately, Piketty's social democratic instinct leads him to do the same. But if we use his own figures and

calculate inequality in income from labour alone - in other words, wages and salaries - we find that the top 10 percent in Western Europe/USA get about €6,500 a month while the bottom half of income earners get about €1,500 a month.

The US has led the way on this growth inequality and the famous Swedish 'egalitarian' model is in decline. Piketty points out that

If the trend in the United States were to continue, then by 2030 the top ten percent of earners will be making €9,000 a month (and the top 1 percent, €34,000)... and the bottom 50 percent just €800 a month. The top 10 percent could therefore use a small portion of their incomes to hire many of the bottom 50 percent as domestic servants.<sup>8</sup>

One of the reasons for this growing income inequality has been the rise of the 'super-managers' and 'super-salaries' for a section of the upper professional strata. Top managers now regularly expect an income of around €500,000 a year and feel aggrieved if they do not get it. Conventional economists - even when they look at this phenomenon - claim that the 'marginal productivity' of their labour justifies such huge figures. But there is no way of measuring their productivity and no way of separating their supposed efforts from those they manage. The spurious justification offered by economists is probably related to the fact, Piketty suggests, that they enjoy super-salaries themselves.

The rise of the 'supermanager' and 'super-salaries' among upper professionals has important implications for any class understanding of society. The term 'mid-

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<sup>8</sup>Ibid. p.257.

dle class' , for example, has become redundant as it conflates both these strata with a wider section of the population who subjectively regarded themselves as being of a higher status than manual workers. The 'supermanagers are, in reality, salaried members of the capitalist class who oversee the exploitation of workers on behalf of shareholders and mutual funds. Those on 'super-salaries enjoy huge autonomy in their working lives and escape the harsh discipline now being imposed on white collar employees. Almost invariably, this layer of society have become enthusiastic defenders of inequality and form the support base for austerity policies. In effect, this grouping - known as the new middle class - becomes the wider transmitter for capitalist ideas in the general population. They are the sounding board for conventional economists and re-echo their precise messages in more populist terms.

So far we have only discussed inequality in income but the polarisation in assets and wealth is far greater. Currently, in most European countries, the wealthiest ten percent own 60 percent of the national wealth. However, as Piketty points out, half of the population own virtually nothing or, to be more precise, they generally own 5 percent of a country's national wealth. The average net wealth - after debts - of a western European country is €200,000 per adult. This private wealth mainly comes in two forms - property (including family homes) and financial and business assets (bank deposits, pension funds, savings, portfolio of shares and bonds etc.). But averages disguise the social realities that compose them. When we decompose them, we find that each of the poorest people possess an average net wealth of just €20,000. Of course that figure itself varies between those who might have accumulated wealth of, say, €70,000

and a large number of people who own virtually zero. As Piketty points out:

For this half of the population, the very notion of wealth and capital are fairly abstract. For millions of people, wealth amounts to little more than a few weeks wages in a... low interest savings account, a car and a few pieces of furniture.... wealth is so concentrated that a large segment of society is virtually unaware of its existence, so that some people imagine it belongs to surreal or mysterious entities.<sup>9</sup>

Those in possession of vast wealth, however, have every reason to hide its distribution, scale and social power. The top 1 percent of European society owns about 25 times the wealth of individuals in the bottom half. In other words, these individuals own about €5 million each compared to the €20,000 owned by the bottom half.

There is absolutely no justification for these disparities in wealth. The cult of the entrepreneur, avidly promoted by the media, suggests that individuals who come up with a brilliant commercial idea deserve the reward they get. They hardly ever claim that people have a right to be born wealthy and stay wealthy like the aristocracy of feudal societies. But the meritocratic argument for inequality in wealth makes no sense. As Piketty notes, even if we concede that a person had a good idea at forty he or she will not necessarily be having them at ninety, nor are their children sure to have any. After examining the Forbes rich list, he notes that wealth of Liliane Bettencourt, the heiress of the L' Oreal company, founded in 1907, increased at the same rate of the supposed

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<sup>9</sup>Ibid. p.259.

‘entrepreneur’ Bill Gates. But, incidentally, Gates own wealth continued to increase as rapidly after he stopped working. In other words, there is no co-relation between wealth and effort. In fact, a growing proportion of the world’s wealth arises from inheritance. Piketty shows that there has been a substantial rebound in inherited wealth which now amounts to between 10 percent and 15 percent of the national income of individual countries. And, once again, conventional economists have largely ignored the scale and implications.

## Piketty’s Weakness

Despite an impressive display of empirical material, there are major weaknesses in Piketty’s work. While he describes the inequalities of capitalism, his explanation of why they occur does not add up. Piketty claims that the ‘central contradiction of capitalism’ is that the return on capital,  $r$ , will be significantly higher than the rate of growth of income and output,  $g$ . The growth rate of advanced economies will not exceed an annual rate of between 1- 1.5 percent per year. The rate of return on ‘capital’, Piketty claims, is about 5 percent per year and so there is a both growing concentration of capital and an increased capital-income ratio. His suggests that where ‘capital’ is accumulated faster than the wider growth in the economy, there is a tendency for the capitalist to become a ‘rentier’. A ‘rentier’ implies an individual who lives off unproductive forms of capital. Piketty uses the term to refer to those who those who live off inherited wealth or, at least, wealth that is not invested in productive ways. From this tendency, he draws a conclusion that there is a need for greater regulation on capital.

However, there is much that is left unexplained in Piketty’s central contradiction. Let’s take, first, the question

of growth. Piketty uses long term data to suggest that the growth in capitalist economies is not as high as people sometimes think. World output per head increased by 1.6 percent on an annual basis in the overall period 1913-2012 but this small annual change led to major cumulative effects. However, the timeframe of Piketty’s figures overshadows important fluctuations in the rate of growth. So in the period between 1950 and 1970, for example, the annual growth rate of Western Europe was 4 percent. Which begs a question; why was the rate of growth in this ‘golden era’ higher than now? As Piketty’s central argument is that returns to capital will outstrip rates of growth, we surely need an explanation of the slowdown.

However, at no point does Piketty enter into a real discussion on what causes the fluctuations in the rate of growth. Instead he falls back on a neo-classical framework which sees demography and technology as the principal mechanisms which explain growth. Population growth, however, is not an independent variable that is uninfluenced by the cycles of growth in an economy. Nor will a vague reference to a ‘technological frontier’ do as an explanation for slowing rates of growth. Others have pointed to the increased use of information technology as the major cause for the miracle ‘Goldilocks’ economy in the US in the 1990s (The term Goldilocks referred to the fact that it was neither too hot or cold but grew steadily). Yet this positive illusion about the effects of technology was soon render asunder the decade after. Similarly, Piketty negative assessment of the impact of technology is equally vague and deterministic.

In reality, Piketty avoids an analysis of the central dynamics of capitalism. He simply ignores how capital is driven by the search for a rate of surplus value that it can extract from workers. It needs to en-

sure that this rate of exploitation can deliver sufficient profit to make the high cost of its investments worthwhile. The shareholders of a major corporation want to ensure that they get a higher rate of return than they would get by leaving their money in savings accounts or by buying up existing property. In other words, the expected levels of profit are the main engines for driving a capitalist economy forward. Yet this by no means a smooth process. As the pre-existing levels of capital investment rises, rates of profit show some signs of decreasing and capitalists have responded by trying to increase the rate of exploitation. This explains why there has been a decline in real wages in many countries and an intensification of work effort. Yet even these measures are not always sufficient to guarantee substantial investment. Gross fixed investment, for example, fell dramatically in advanced countries in the period 2000-2009, when compared to an equivalent period in the 1990s, from an average of 3.4 percent per year to 1.8 percent per year.<sup>10</sup> Piketty's failure to look at rates of investment means he cannot give an explanation for his 'central contradiction' about slow growth.

Nor does Piketty have any explanation of why the system has become more crises prone in the last twenty years. He points out, correctly, that the Great Recession that started in 2008 was not as deep as that in 1929 because government and central banks intervened to prop up the system. But he offers no explanation of why the crash occurred, except for a vague reference to a 'lack of transparency and the rise of inequality'.<sup>11</sup> There was certainly a lack of transparency in the fashionable financial instruments but the bigger question was

why did so much US capital migrate into finance? Why did 40 percent of US corporate profits come from Finance, Insurance and Real Estate compared to only 15 percent from these sectors in the 1960s? While growing inequality must be a part of the explanation for the crash of 2008, it cannot be the sole factor. Mass debt was used in the US and countries like Ireland and Spain to stimulate the domestic consumer market. This form of 'financialisation' exacerbated rather than alleviated the already made contradictions within the system.

Finally, while Piketty points out that the state bailed out of the system, he neglects the dialectical underside of that intervention. Namely, that there is a huge stock of debt and accumulated capital hanging over the wider system. We are witnessing a 'recovery' which has brought a huge surge in pre-tax profits and stock market and property speculation alongside continuing low levels of investment. Figures for the US, for example, indicate that net investment - investment after replacing worn out old capital - is running at a mere 4 percent.<sup>12</sup> Piketty neglects all these features because, even though he documents the terrible inequalities of capitalism, he has not appreciated its full horror. The 'central contradiction' that he ascribes to capitalism is nothing but a descriptive law which seeks to summarise his statistical results. It offers no explanation of the inherent dynamic of the system. He has no sense of how capital is a social force that is created by human labour but that lies outside of our control. Nor does he appreciate that it is driven relentlessly to expand itself until its own contradictions require the destruction of large parts of its accumulated

<sup>10</sup>IMF, *Statistical Annex: World Economic Outlook*, October 2008, Table A3.

<sup>11</sup>Piketty, p.473.

<sup>12</sup> M. Roberts, 'Nobody's Investing' <http://thenextrecession.wordpress.com/2013/09/17/nobodys-investing/>

reserves.

All of this arises because the focus of Piketty's analysis lies in the sphere of distribution and not production. He wants greater equality but on the basis of capitalist relations of production. Although he points to the inconsistencies of neo-classical economics, he cannot break from it. The early schools of political economy led by Adam Smith, David Ricardo and later by Marx inquired into how value was produced. This is in contrast to the Physiocrats in France, who argued that value was created by the fertility of the soil, they located it in human labour. Marx took this analysis forward to its logical conclusion and pointed to the role of exploitation in the generation of profit. Capital and labour were, therefore, intertwined in a dialectical relationship where both depended on the other - at least until the system had been overthrown. Marx did not see capital, as Piketty does, simply as a category that includes the physical buildings and machinery needed to produce. He understood capital as a social force that required labour as it pursued its goal of relentless self-expansion. There were different forms of capital - productive capital which exploited workers directly; commercial capital which took a cut from the wider pool of surplus value for distributing and selling the goods; finance capital and a host of forms of fictitious capital which did not create value but transferred it to themselves. But the crucial point was that they rested on the exploitation of human labour. Put more simply, money did not make money by magical means but by its relation, however indirect, to extracting surplus from work.

In the later nineteenth century, this type of analysis was jettisoned in favour of a marginalist revolution. Essentially, value

was re-defined as the subjective preferences of individuals and 'marginal utility' of any good or service and was the price that someone would pay for one more item of the object they preferred. This concept of value intersected with the laws of supply and demand and it was assumed that a harmony was established in the free market when individuals matched their 'marginal utility' to level of scarcity. Capital itself was simply another 'agent' that paired off with labour to add marginal productivity. The effect of this shift was to lead economists away from any focus on the role of capital in production and to assume that market economies gravitated continually towards equilibrium.

Piketty's blind spot is evident in the initial theoretical schema he constructs to analysis his data. Capital, he defines as 'the sum total of non human assets that can be owned and exchanged on the market'.<sup>13</sup> It includes houses, property, factories, machinery, and patents whether used by firms or government agencies. But this leads to an immense confusion. People need a house or an apartment to live in but their house is hardly involved in the production of extra value. Nor do patents add value; rather they function as a device to extract rent. In their current form, they were a legal invention of the pharmaceutical and computers industries to impose rent seeking on the rest of society. Piketty uses a category known as 'capital' but divorces it from the relationships that real capital must engage with if it is to create value and profit. Put differently, Piketty has no concept of how human energy is reified and transformed into a static category that dominates our lives. He simply regards capitalism as a permanent state of affairs and that the only alternative to it - which he wrongly associates with Marx -

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<sup>13</sup>Piketty, p.46.

<sup>14</sup>Ibid. p.11.

is some form of ‘apocalypse’.<sup>14</sup>

Piketty’s conclusion is that there needs to be an updating of social democracy. He proposes a global tax on capital, increasing with the amount of capital. One could imagine, he writes, a 0 percent rate on assets below €1 million, a 1 percent between €1 and 5million and a 2 percent tax above €5 million. One advantage of such a tax is that it would make wealth far more transparent and, he claims, it would help governments to regulate it. He noted in passing - and much to the consternation of his Irish liberal admirers - that this tax is different to a tax on people’s homes. Many homeowners have high mortgages and so a property tax as conceived by the Irish government leads to a situation where ‘a heavily indebted person is taxed in the same way as a person with

no debt’.<sup>15</sup> Piketty, it seems is a genuine social democrat unlike those who masquerade as ‘progressives’ in Ireland. However - and somewhat bizarrely - he notes that a ‘global tax on capital is a utopian idea’.<sup>16</sup> He assumes that nothing resembling it will be put into practice but it can serve as a worthwhile reference point. And in a sense he is right - but not in the way he thinks about it. If such a modest proposal for a tax on capital is regarded as utopian by an honest social democrat, then does that not say something about the tyrannical power which capital holds over our lives? And if so much effort is needed to overcome vast obstacles to achieve it, should we not be better serviced devoting our energies to removing this economic terrorism that dominates our lives?

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<sup>15</sup>Ibid. p.157.

<sup>16</sup>Ibid. p.515.