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Considering Thomas Piketty's *Capitalism in the Twenty-First Century*

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Thomas Piketty offers a compelling analysis of the relationship of the returns to capital and labor in modern capitalist economies over time. The gist of the argument is that since the nineteenth century inequality has inexorably risen because, except during the roughly three decades following World War II, the returns to capital have been several times higher than the earnings of wage labor. The income shares enjoyed by top income earners declined significantly only during the two world wars and the Great Depression, when capitalists suffered major losses resulting from destruction of assets, bankruptcies, and inflation. A subsequent period of "catch-up" set in that reversed the trend for returns to capital, but only after three decades in which income and wealth inequality declined. From the 1970s forward the strategic advantages of capitalists over workers in the distribution of income were reestablished by what Piketty frames as the normal processes of capitalist accumulation in the modern era.

The study draws upon laboriously constructed and immensely valuable data series for incomes, taxes, and social spending mainly for Great Britain, France, Germany, and the United States (with side glances to the Scandinavian countries and Japan). The crucial variables in the distribution of income between capital and labor are the overall growth rate of each economy, the rate of return on invested capital, the share that capitalists enjoy of the total national income, the amount of time in years needed to reproduce the capital stock, the level of savings, and the level—high or low—of job creation and demand for labor. In a slow growth situation, a lot of saving in combination with a low or declining demand for labor leads to ever larger accumulations of capital and thus to an ever larger income share going to the investor/asset owning class. As the income from capital rises faster than the overall growth of the economy, demand for goods and services is unable to support a level of consumption that can sufficiently boost wages to offset the flow of income to capital.

Piketty nuances this analysis by exploring the changing composition of capital and of the capitalist class over time, moving through and beyond the historically slow-growing agrarian economies in which most land was held by a small class of hereditary owners who were able to collect high economic rents from those who worked the land. In both the U.S. and France, revolutions in the late eighteenth century briefly euthanized these landed rentiers, in France through expropriation and in the U.S. by making cheap or free land widely available. But as mechanized production extended to an ever larger share of the economy with more and more people engaged in wage labor, the tables turned and a new rentier class constituted itself. As Simon Kuznets noted in the 1950s, shifts of workers to higher productivity functions raised real wages. But massive accumulations of wealth by—in the U.S. case—the Vanderbilts, Carnegies, Rockefellers, DuPonts, Morgans, and their like in subsequent generations were converted to monopoly advantages that raised the capital/income ratio, setting inequality back upon what Piketty sees as its normal course. Until, that is, the shocks of the 1930s-1940s erased much of the market power possessed by the industrial titans along with massive amounts of their capital assets. These traumatic events also set in motion a subsequent "catch up" period of rapid investment and job growth that

Note: Page number references in this essay refer to the English edition of the book: Thomas Piketty, *Capital in the Twenty-First Century*, trans. Arthur Goldhammer (Cambridge, Mass.: The Belknap Press of Harvard University Press, 2014).

supported more equitable distribution of income—for a time. Since the 1970s, he finds, "decreased growth is responsible for capital's comeback" (p. 166).

Beyond this, Piketty locates a new type of rentier among the enormously highly compensated top managers—the "super-managers"—who are able outrageously in the U.S. and significantly elsewhere to pay themselves huge salaries, far beyond what is warranted by their actual productivity, though certainly related to their bargaining power with corporate boards that they in fact largely constitute. They do this with the consent of these corporate boards through a back-scratching arrangement that Piketty terms incestuous (pp. 330-335).

And beyond even this, Piketty finds, there is now in the countries he investigates closely on the basis of good data, and more generally in all countries and regions, a middle class segment that, by virtue of its inheritances, savings, and investments (including generous pension plans) can also skim off a higher share of national product than the share that goes to income from labor. This situation results, he posits, from the ever increasing opportunities for substitution of capital for labor, mainly in the form of new "labor-saving" technologies that "dumb down" the tasks required of human labor and thus—unless offsetting policy initiatives intervene—set wages on a downward slide across whole economies. Like the Taylorism of old, this process also creates the afore-mentioned managerial positions that in these times can claim super-salaries.

An unspoken premise here is the acceptance to account for wage income of an economic theory put forth in the late nineteenth century simultaneously in four countries that rejected the theory that labor creates all value, which had been central to the classical economics of Adam Smith and Karl Marx. The alternative adopted in late-nineteenth century neoclassical theory held that the return to all factors of production (land, labor, capital) is determined by the amount that is added to the value of the total product by the last unit (the final increment) of each of them that can be profitably applied. The assumption involved here—that all the units of each of the factors up the line from the last to the first are interchangeable—has been rightly challenged (notably and immediately by U.S. economist Thorstein Veblen) on the basis that it defies logic: any sensible manager will put the best machines and the most skilled labor to work sooner. Like so many of the assumptions of neoclassical economics—among them the view that markets are natural systems operating according to natural laws and regulated efficiently by actual or potential competition—this one disregards both the embeddedness of markets in law and culture and the importance of institutions.[1]

Incorporation of embeddedness and of institutions is present in this work, but spottily. The most significant omission, in this reviewer's view, is the minimal treatment of labor unions and labor market regulation or deregulation as causal factors in the distribution of income and wealth. Piketty does devote an important chapter to the rise on the European continent, and in a more niggardly fashion in Anglo-America, of a "social state" that has provided not only mass education and some level of universal health care but also in some nations on the continent a large measure of income replacement, typically rated according to the length and remuneration of employment. Indeed, he sees the attacks on the social state (viz., Reaganism, Thatcherism, smaller cuts or attempted cuts in Germany and France) and the erosion of entitlements as among the most obvious consequences of the slashing of tax rates and the run-up of public debt that recent decades (1970s-2010s) often witnessed across Europe and North America. But when it comes to explaining why the balance shifted in favor of wage income during the three postwar decades from the historically entrenched advantages to the income share claimed by capitalists, relying so heavily on the "destruction and catchup" analysis leads Piketty to downplay the power of unions and the impact of their political influence on legislation affecting entitlements and

[1] For Veblen's intervention, see Thorstein Veblen, "Professor Clark's Economics," *Quarterly Journal of Economics* 22:2 (1908):147-195. Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1944), is the Ur text on the concept of embeddedness of markets in society and their escape from it during the nineteenth-century laissez faire era.

industrial relations, including the right and capacity of unions both to bargain collectively and to mount effective strike actions.

The U.S. case is perhaps the most obvious example. Piketty does clearly note that the "the compression of wage inequalities that occurred in both France and the United States during World Wars I and II was the result of negotiations over wage scales in both the public and private sectors." For the U.S. case, he states, rightly, that "the National War Labor Board (created during World War I expressly for the purpose) played a central role" (p. 308). Yet he fails even to mention the importance of the U.S. National Labor Relations Board, created by the National Labor Relations (Wagner) Act of 1935, which for the first time compelled employers to bargain collectively with labor unions of the workers' own choosing, rather than with the company sponsored unions that employers fostered as a way around the mandate to bargain included in title 7a of the National Recovery Act in force from 1933-34. The Wagner Act's mandate also made it possible for U.S. *national* unions to act as the bargaining agent, though typically they could bargain only firm by firm, rather than for a wage scale across an entire industry. Further, the U.S. did not develop the forms of peak-level codetermination structures for wages and working conditions that arose in some European countries. The early post-World War II strategic move by the powerful auto workers union to force General Motors to open company books and let the union share in production and pricing decisions failed as well, as the company fiercely defended what it saw as "management prerogatives." This failure, general across U.S. manufacturing industries, thwarted union efforts to extend production, and thus employment levels, beyond what management determined would yield the optimal price from the standpoint of profit and thus to shift income from investors and managers to labor.

Despite this failure, general across the U.S, a combination of two additional factors contributed to U.S. union strength in ways that shifted the flow of income, creating between the 1940s and the 1970s what had been called a Great Convergence that reduced inequality by lifting the floor and lowering the ceiling on class-based incomes. The first was the desire of employers in major manufacturing industries to prevent interruptions of production during the period following World War II, when the U.S. dominated world markets and enjoyed nearly full utilization of industrial capacity. The second was the greater bargaining power of industrial unions in a period of very high union density—at least 35% nationally in the U.S., which translated to a much higher level in the heavily industrialized regions and those with strong traditions of worker activism. As late as 1964, when Lyndon Johnson was elected, union density remained over 35% in Michigan, Washington, Indiana, Alaska, New Jersey, Oregon, Pennsylvania, Ohio, Montana, and Minnesota, meaning that the Democratic Party had been able to count on a strongly supportive voting base in the wage-working class through five presidential elections following the Second World War. The decline in union density removed a major source of support from the party most dependent upon labor votes. Equally important, it laid a basis for the Democratic Party's (necessary and proper but also highly consequential) adoption in the subsequent War on Poverty of policy goals that favored other constituencies over, and in some measure alienated, elements of the white working class.[2]

Even in the era of greater union density, there were limits to union bargaining power and political influence—most clearly in their aforementioned failure to achieve the inclusion of key qualitative issues. But the introduction into major union contracts of COLAs (cost of living allowances) and employer-provided health insurance and pensions (now derided as "legacy costs" that companies have tried to off-load) undoubtedly made important contributions to somewhat more equitable income distribution. Achieving and retaining such employer-provided supplements to income became more difficult as the NLRB lost influence after the 1970s, even before Ronald Reagan's attack on the Air Traffic Controllers

[2] Gerald Mayer, "Union membership trends in the United States," (Washington, D.C.: Congressional Research Service, 2004).

Union in 1980. The latest affront along this line came recently when the United States Supreme Court unanimously declared President Barack Obama's recess appointments to the NLRB invalid![3]

Another omission that causes one to wish for a more institutionally grounded account is attention to the end of the vogue of central planning that became prominent during certain components of the U.S. New Deal. A central feature of the public works programs that continued into the early 1940s, the development of long-term planning for the utilization of natural resources and manpower was a major subject of informed deliberation in the National Resources Planning Board, where studies by economist Gardiner Means revealed the prevalence of administered prices across developed industries, which yielded monopoly gains for capitalists and slowed investment in new industries that would expand employment. An NLRB document titled "Security, Work, and Relief" laid out plans for collective provision of income security for three categories of people: those at work, those beyond working age, and those incapable of being securely attached to the work force.[4]

This vision became the blueprint for the Full Employment Bill of 1946, strongly backed by President Harry Truman, which would have mandated the continuation of sufficient public works employment to make up for an anticipated shortfall in the number of jobs projected to be produced by the private economy. This bill was decisively rejected by a congressional coalition of Southern Democrats and business-friendly Republican conservatives. The Employment Act that replaced it, which passed over Truman's veto, merely endorsed efforts to sustain employment that were compatible with controlling inflation. As if to underline the rejection of the New Deal planners' labor formula encapsulated here, in the following year the Taft-Hartley Act permitted individual states to pass so-called right-to-work laws that exempted new hires from having to join a unionized firm's union. Immediately adopted by 17 mostly southern states, this provision helped to offset the American Federation of Labor's drive to unionize the South in response to the relocation there from northern states of much manufacturing enterprise.[5]

Equally oddly, in this reviewer's estimation, for one who sees history as an indispensable resource for the study of inequality in the long term, Piketty also says almost nothing about the significance of changing forms of business organization and changes in their legal status. Yet these elements were factors in the bargaining relations between possessors of capital and their employees, in the capacity of very large firms to dominate their markets, and even in the out-sized remuneration of "supermanagers" that he sees as somewhat diluting the share in top incomes scooped up by the owners of capital. A Supreme Court decision in 1886, *Santa Clara County v. Southern Pacific Railroad*, gave U.S. corporations the very same protections against denial by any state of the privileges and immunities that the Fifth and Fourteenth Amendments to the U.S. constitution guaranteed to flesh and blood individuals. Nor could a state deny any person of life, liberty, or property without due process of law. *Santa Clara* declared a corporation to be a person within the meaning of the 14th amendment, thus shielding corporate persons from forms of taxation or regulation that states did not also demand of natural persons.[6]

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[3] Adam Liptak, "Supreme Court Rebukes Obama on Right of Appointment," *New York Times*, June 26, 2014. On the rise and decline of U.S. unions, see also Nelson Lichtenstein, *State of the Union: A Century of American Labor* (Princeton, N.J.: Princeton University Press, 2003).

[4] Mary O. Furner, "From 'State Interference' to the 'Return to the Market': The Rhetoric of Economic Regulation From the Old Gilded Age to the New," *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen and David Moss (Cambridge University Press, 2009), 92-142.

[5] On the congressional reaction to the New Deal, the best single source is Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Time* (New York: Liveright, 2013).

[6] Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy* (New York: Oxford University Press, 1992).

More than this, the corporate form of business organization became the dominant form in U.S. manufacturing by the 1890s, and during the Great Merger Movement of 1895-1904 over 1800 manufacturing firms disappeared into mergers, of which over 40 held at least a 70% market share in their industries. The dominance of the corporate form in the United States came well before the decline of family capitalism in England and coincided with the legal formation of regulated cartels in Germany, even as peak-level organizations of large U.S. corporations such as the National Civic Federation (1900) and the U.S. Chamber of Commerce (1912), and—with similar intent later—the Business Roundtable (1972), were founded to facilitate close collaboration with business-friendly corporate liberal political leaders. These business lobbies aided in the elaboration of the voluntary corporatism that flowered in the 1920s and restored business influence in public policy circles during the 1970s and beyond. Exemplifying the fruits of these efforts, the Roundtable was instrumental in preventing the North American Free Trade Agreement from including binding environmental and labor standards, in diluting consumer protection initiatives, and in promoting Reagan-era tax cuts.[7]

Other national differences also counted. Yet how much the presence of codetermination on the continent—robust peak level determination of wage levels, income replacement rules, and access to job training—may have mattered in the distribution of income in the subject countries, again we do not see in the book under review. Nor is there consideration of the methods for moving, in the European countries closely studied here, toward what is somewhat euphemistically titled "labor market reform," a rhetorical covering term for the process of eroding wages and labor standards in the interest of boosting "competitiveness." Further studies of national differences in this regard might, for example, have included attention to the effort of German national and regional governments in the Gerhard Schröder and Helmut Kohl years to dial back the levels of income replacement by their social states and limit the extent of codetermination, particularly of regulations such as working hours that profoundly affect the quality of workers' lives. Thus even if the inversions—the shift of the bell curve from the Great Convergence of income shares following World War II back toward the Great Divergence after the 1970s—track similarly in the subject countries, again we need to know whether and how much the differences actually mattered, along with the shifts in growth rates in relation to the rate of return on capital. We can also question whether differential rates among advanced nations of the "turn" to globalization and financialization have been related to their distinctive patterns for the macro-organization of capital.

Piketty's analysis does give us much to consider on the subject of tax policies, and here may well be his greatest single contribution. His description of the adoption of the progressive income tax by his quarto of capitalist countries, of their very low incidence in the early years followed by their rise to near confiscatory heights on affected incomes during and after World War II, and of their subsequent leveling down in relation to a historic rise in national indebtedness has significant implications. It paves the way for his pointed reflection upon ways that various forms of taxation—on income, wealth, consumption—have become insufficient to support desirable social insurance states and to reduce inequality even minimally. The shift in U.S. marginal income tax rates across the twentieth century was particularly startling. From a mere 7 percent in 1913, it rose to 73 percent during the First World War,

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[7] The standard source on the merger movement is Naomi Lamoreaux, *The Great Merger Movement in American Business, 1895-1904* (New York: Cambridge University Press, 1985). See also, on the emerging dominance of the corporate form in the U.S., Martin Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916: The Market, Law, and Politics* (New York: Cambridge University Press, 1988). Useful sources on the organization of business for political influence are Sar A. Levitan and Martha R. Cooper, *Business Lobbies: The Public Good and the Bottom Line* (Baltimore: Johns Hopkins University Press, 1984); and Kim McQuaid, *Uneasy Partners: Big Business in American Politics, 1945-1990* (Baltimore: Johns Hopkins University Press. 1994).

dropped to 25 percent in the 1920s, reached 94 percent in the final year of World War II, and remained above 70 percent until 1982, but has not risen above 39.6 percent since 1987.[8]

Citizens need to know, and Piketty graphically tells us, that clever methods exist for concealing income and for relocating wealth beyond the reach of the tax collector. Waged and salaried workers need to recognize that the sheer size of the capital owned by the top .01 percent, the top 1 percent, and the top 10 percent means these wealthy cohorts will need little of it for consumption, which most lower-waged employment in consumption-based, service economies depends upon. Further, most of this super-wealth is simply reinvested, and thus never turned into taxable income. The hardest tax to escape is the real estate tax, but real estate now constitutes a tiny fraction of the wealth not only of the super-rich, he shows, but also of the newly patrimonial middle class. Thus it remains a regressive tax falling heaviest on those whose homes are the major, perhaps the only, component of their household wealth.

For Piketty the fairest tax would be a worldwide, highly progressive tax on all forms of wealth—including both physical and financial assets. To achieve this form of taxation successfully, rules would have to change—a lot—regarding the accumulation, release for tax assessors' use, and cross-border exchange of information revealing who owns what and what the flows of income are from these holdings. Some progress has been and can be made in these regards, he shows; but the lack of international cooperation means that a certain utopian quality inheres in the proposal, notwithstanding the often sudden changes in taxation regimes that have occurred in past decades.

The point, though, for Piketty, is that without some such measure—some way of apportioning the support of communally beneficial projects, some way of meeting fundamental human needs, some viable way of protecting internationally-recognized human rights to adequate subsistence—it will be impossible to sustain faith in democracy. All through the book, Piketty rightly questions the validity of so-called meritocratic explanations for huge disparities in income, particularly those of the super-managers whose incomes are often 300 or more times those of waged workers. He warns of the consequences for political legitimacy of the fact that the youngest cohort in the subject nations will not achieve the income status of their parents and instead have loaded themselves with debt in pursuit of the putative wage and lifetime earnings premiums they are told will come to those in command of advanced education and highly-developed, technology-related skills.

Many have bought and will buy this marvelous book. But despite Piketty's admirably teacherly manner of presentation, one fears that far fewer will actually read all the way through it. This will be tragic, for though it is guised as a treatise in economics, the book—despite its signal omissions—is as well a major contribution to public philosophy, suitable to stand on the shelf alongside John Rawls' provocative *A Theory of Justice* (1971). Rawls asked those who could influence policy regarding "who gets what," including ordinary voters, to put themselves in what he called "the original position," i.e. one of not knowing whether a change in the distribution of government favors would advantage or disadvantage her individually. Thus he basically asked us to make decisions such as those about the extent of the social state on the basis of individual utilities—or, in effect—our enlightened selfishness.

This approach was morally a step down from the Pigovian standard, that of British economist A. C. Pigou, which asked states to tax or to prohibit market actions by capitalists that inflicted "negative externalities" on people, thereby making them suffer costs without receiving commensurate benefits. The attention to the problem of "social costs" by Pigou, and in the U.S. by economist John Maurice Clark, shined a light on the common practice by employers in the industrial era of deliberately failing to pay wages sufficient to cover the full cost of decent individual or family subsistence. This led to shifting of the costs of work-related accident or illness, early death, insufficient education, stunted growth of

[8] Tax Foundation, "U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)," accessed November 8, 2014 at http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets.

child workers, and the like onto extended families, communities, and always insufficiently funded private charities. We could add to these concerns about externalities and social costs these days the necessity for families to have at least two adult earners in order to "make rent" and keep food on the table, leaving aside the chance to pay for children's education and to save.

Piketty does not ignore the invidious and mostly false justifications for the contraction of "welfare" in recent decades that critics of government programs have based on the argument that income replacement encourages dependency. But he sees an even greater threat in the inevitable decline of genuine democracy that must—that already has—accompanied great and growing inequality. For those readers who share his concerns it will make sense to think historically about the correlations between political and ideological fractures and reconstructions, such as—in the U.S. case—the rise of New Deal liberalism in the 1930s and the resurgence of the political right in the 1970s. It will also behoove scholars energized by Piketty's important work to think systematically about the linkages between changing fashions in economic theory (such as the twilight until the recent Great Recession of Keynesianism and the renaissance of neoclassicism) as well as changing patterns in the distribution of income and wealth.

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