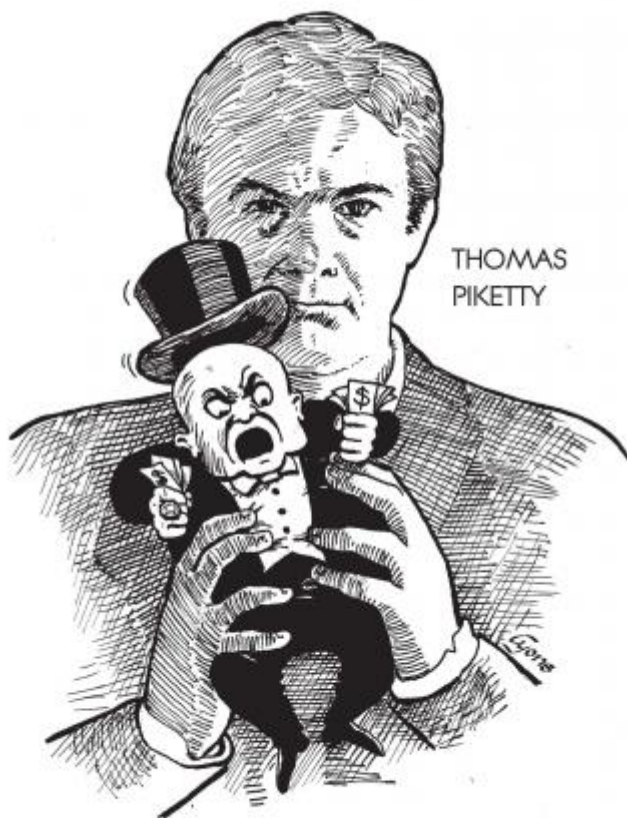


# Mapping the New Oligarchy

June 27, 2014

Inequality is the theme of our time. It should perhaps be said that it has always been so. But after the surge of globalization since the 1990s, the decreasing fortunes of the middle class, and the more recent shock of the 2008 financial crisis, it has come more sharply into focus. It is within this context that Thomas Piketty has published *Capital in the Twenty-First Century*, a book that is exhaustively researched and brimming with empirical data and interpretation. Piketty, a French professor of economics, seeks to place himself in opposition to most of the standard wisdom of the economic profession which argues for the existence of strong forces of convergence among incomes and wealth. The disparity of economic inequalities cannot become excessive, this standard wisdom goes, first because of the diffusion of knowledge and skill throughout a population. Productivity increases as well as increased opportunities and wages result as education and skill-sets make mobility easier. A second force of convergence is that as people live longer, they will accumulate more savings. Improved living conditions and longer lifespans therefore reduce class friction and move societies in the direction of greater equality. The capitalist economy is not just self-correcting, it is also self-equalizing.



But Piketty's findings lead him to directly oppose these optimistic assumptions about the modern capitalist economy and to assert a central thesis that he sees as the core explanatory finding of his work. According to him, the forces for the divergence of wealth and income, indeed for the structure of inequality itself, are propelled by the difference between the rate of return on capital on the one hand and the rate of growth of the economy on the other, summarized in the elegant inequality,  $r >$

$g$  (where  $r$  is the rate of return on capital and  $g$  the growth rate of the economy as a whole). Whenever this inequality is in play, there will be a powerful force for divergence between income and wealth groups. The more the rate of return on capital exceeds the rate of growth of the economy as a whole, the more that wealth will tend to concentrate and to be handed down generationally. The force for divergence expressed by  $r > g$  means that there exists a force internal to capitalism that, according to Piketty, is responsible for generating inequality. His approach is historical, allowing him to test his hypothesis over a long time series of data reaching back to 1700 and, in some instances, going back to antiquity.

Piketty's procedure for tracking and analyzing inequality is to examine the share of income from capital in national income which is essentially the product of the rate of return on capital on the one hand and the capital/income ratio on the other (or  $\alpha = r \times \beta$ , where  $r$  is rate of return on capital and  $\beta$  the capital/income ratio). This he calls the "first fundamental law of capitalism" and it tells us the extent to which those who own capital are able to accumulate more than those who have less or none at all. Since Piketty's theory about the dynamics of inequality is driven by the ability of those who own capital to gain from investment returns as opposed to from labor, measuring inequality is centered on the relation of capital to incomes. Take the capital/income ratio. As the value of this ratio increases, the force for divergence will also increase since income from capital will be more dominant than income from labor. Further, if the rate of return on capital rises, then the power of capital to agglomerate more of itself increases again. Hence, the share of income from capital, or  $\alpha$ , is an essential way to track the inequality dynamic. As fewer individuals command more capital, the gap between them and the remainder of society widens and the ability of the rest of society—literally the 99 percent as Piketty shows—to catch up to the 1 percent becomes impossible.

What this all basically means is that capital accumulation outstrips income from labor and over time is a major explanation for economic inequality. As a result, a very different kind of society begins to take shape than the one defended by liberals and conservatives alike: inherited wealth becomes dominant, social mobility from labor is neutralized, and economic elites are able to command high salaries from managing the firms sustained by capital and which continue to create more capital in the form of high super-salaries. If public policy is not able to change matters, Piketty's data suggests we will be living in a world where the wealthy will no longer need to labor as the remaining mass of society stagnates—effectively a re-feudalization of modern society.

Empirically, what Piketty has to report is sobering. The contours of wealth and income inequality that he reveals are staggering, even for those who are familiar with inequality statistics. He finds that inequality has basically been constant historically, with the upper ends of the wealth scale earning about five times the amount of national income throughout the eighteenth and nineteenth centuries and again in recent decades. One basic finding that the data make abundantly clear is that the concentration of wealth increases exponentially as you move up the wealth scale. The top decile (or 10 percent) of the wealth distribution in the United States, for instance, "structures the economic and political landscape." (p. 277) In terms of labor income, they receive 35 percent of national income in the United States compared to the bottom 50 percent of the population who receive only 25 percent of national income. In terms of capital ownership, the top decile owns 72 percent of the capital nationally compared to the bottom 50 percent who own a mere 2 percent.

But these facts are to be seen historically. Piketty shows that the patterns of inequality before World War I were extreme and our present conditions are headed in the same direction. The Great Depression, World War II, the rise of the welfare state and a patrimonial middle class capable of owning property and therefore gaining a small share in national wealth (largely through home ownership and pension funds) explain the compression of incomes between 1945 and 1980. But

Piketty emphasizes that this was merely a blip on the screen, an exception to the fundamental laws of capitalism that tend toward divergence and toward capital concentration.

What has changed is the structure of inequality, or how that money is being produced and accumulated. In contrast to the pre-World War I era that was dominated by rentiers—people who lived off their rents from land, government bonds, and other investments and did not work—today's structure of inequality is dominated by hyper-salaried managers (Piketty calls them "supermanagers") who have "managed to obtain extremely high, historically unprecedented compensation packages for their labor." (p. 302) This has no economic basis, according to Piketty, and is instead the result of the creation of new social norms and values that serve to justify inequalities of income and wealth—a "hypermeritocratic society" where economic "superstars" are created and seen to be justly rewarded for their remarkable talents and ingenuity allowing for the toleration of extreme salaries by CEOs and other elites.

But it is only the top thousandth of the top 10 percent that has extreme control over capital ownership and control. These oligarchic elites earn returns to capital even as the rest of the top 10 percent increase their share of national income, but they will become a new class of super-elites whose offspring will live off of inheritance and, because of fiscal competition, lower tax rates in the long run. The forces of divergence outweigh all of the classic mechanisms for redistribution and convergence that the liberal state has at its disposal. Economic growth can offset the inequalities gained from the rate of return on capital, but even this is no guarantee. What is needed, argues Piketty, is a modernized welfare state that can equalize incomes through public goods such as pensions, health care, education, and so on. But the essence of the story is clear: capital is centralizing, incomes at the highest end of the distribution are exploding, and the new patterns of inequality that we are witnessing show no sign of abating or dispersing. Piketty sees economic inequality returning to the rates of the *Belle Époque* and the Victorian era unless "new forms of property and democratic control over capital" (p. 569) can be invented.

But what about the theory behind the data? As much as Piketty claims to go against the grain of his profession, as one labors through the almost 700 pages of this thick tome, it becomes increasingly obvious that his empirical findings are more compelling than his explanation of them. In fact, Piketty tries too hard to distance himself from Marx, whose theories seem to fit better with the data and their social implications than Piketty is willing to admit. An actual theory that penetrates the mechanisms creating inequality—i.e., a true theory of capitalism in the twenty-first century—is precisely what Piketty's book lacks.

If we begin with the two "fundamental laws of capitalism" that Piketty outlines in the first chapter, we see immediately some frustrating elements to the argument. Recall that the first fundamental law of capitalism was the share of income from capital, or  $\alpha = r \times \beta$ . Piketty sees this as fundamental because it is able to explain the historical dynamics of economic disparities. Similarly, he advances a second fundamental law of capitalism, which is that the capital/labor ratio is determined by dividing the savings rate by the rate of growth of the economy. Taken together these two "fundamental laws" are supposed to explain capitalism. But does it really explain anything other than his data? For one thing, it tells us nothing about the social mechanisms of capitalism let alone the mechanisms that produce inequality. It is an accounting equation, little more. If we simply see capital as the stock of "nonhuman assets that can be owned and exchanged on some market," (p. 46) we fail to see that capital, as Marx correctly hypothesized, can only grow by being employed for some purpose through human labor.

Capital is also the amount of money advanced in wages for the purpose of production. Indeed, the

return on capital for Piketty is simply a rate of return, it possesses no social foundation. But this is an inadequate discussion of the matter. All capital grows through an exploitive relation between owners on the one hand and workers/consumers on the other. If person *A* invests  $x$  dollars in person *B*'s firm, the rate of return on  $x$  will be a function of the amount of profit,  $p$ , that *B* is able to accumulate from his enterprise. But  $p$  itself does not simply emerge from capital and appear as the rate of return; it is accomplished by a whole series of means of exploiting labor (i.e., suppressing wages, weakening unions, re-engineering regulatory laws, moving production to low-wage areas, making people purchase useless or superfluous commodities and services, and so on, none of which Piketty mentions) as well as other factors of production that expand the value of  $p$  and, logically, expand the rate of return on capital, and therefore flow back to *A* as income from capital. This is what bolsters the wealth of hedge fund managers and venture capital firms: not simply the manipulation of fictitious capital, but the employment of capital for the expansion of exploitation and profit. And the same holds when someone invests money in a savings account or mutual fund, which then goes through the same circuit. Money does not make money—money requires that it exploit the labor of others for surplus to be created. The mistake that Piketty makes is that an accounting procedure *is not a theory of capitalism* since the latter requires that we have an insight into the mechanisms that generate profits and, by extension, more capital.

What is compelling about Marx's critique of capitalism is not his use of precise empirical data, which was largely unavailable in his day. Rather, it rests on the idea that he is able to unmask the forms of social power that underlie economic reality. The idea that profit was simply a by-product of the production process, or that inequality was the result of differentials in meritorious labor, were seen as absurd by Marx. Instead, he saw that the fundamental reality of capitalism as a social system was that it enabled those who own capital to extract benefit in the form of profits ("surplus value" in Marxian parlance) from workers. For Marx, this was expressed in the simple equation  $e = S/V$ , which Marx variously called the rate of surplus value or the rate of exploitation where  $S$  is surplus value produced and  $V$  variable capital, or the amount of capital paid to labor. This means we can discover the extent to which profits are made through the suppression of wages paid to labor. Marx's hypothesis, like Piketty's, was that the concentration of capital into fewer and fewer hands would result from the fact that capitalists would be able to extract increasingly more production from labor even while remuneration for that labor decreases, stays constant, or increases at a rate lower than profits over time. The super-salaries of CEOs are little more than this: the result of massive profits derived from increased extraction from workers whose average real income has not increased since the early 1970s. Economic growth, although slowing, is still going more to the owners than to workers.

Also recall that Piketty claims that the inequality  $r > g$  is fundamental to understanding the dynamic that drives wealth and income dispersion. Here again, Piketty faces off against Marx on the issue of the law of the falling rate of profit. In fact, Piketty's  $r > g$  equation obfuscates more than it clarifies. If the global rate of economic growth is declining and continues to decline, as Piketty suggests (from about 3.2 percent per annum in 2012 to about 1.5 percent in 2050) then the rate of return on capital will also fall, and perhaps fall to such an extent that increased investment will also fall, which was the essence of Marx's hypothesis about the crisis tendencies of capitalism.

How, then, can elites maintain  $r$ ? One way would be through unproductive forms of economic activity such as derivative trading and the like. It could also be that they will continue to exploit global reserves of labor. Or we will revert to a largely rentier economy, with the wealthy living off of rents of varying kinds. But it is also possible that the rate of return on capital could also decrease as growth decreases. Once there are no more global reserves of cheap labor and natural resources become more scarce, the source for  $r$  will also erode. The fact that capitalists can earn a return on capital during a period of increased globalization is not surprising since they are able to exploit new

reservoirs of low wage labor; the idea that this could continue indefinitely within a capitalist framework of growth imperatives is, however, not convincing.

What all of this means is that Piketty's empirical analyses seem to support hypotheses that he rejects. For Piketty, capital concentrates into fewer and fewer hands, but there is no sense that an increased exploitation of global labor is the source of increased profit; the stagnation of growth rates in the advanced capitalist economies since the 1960s is responsible for widening inequality, but the tendency for the rate of profit (and hence growth) to fall is invalid. The question really is, what is capitalism for Piketty anyway? Indeed, there is no sense that the theories he advances are anything more than a means to explain his data trends, not a means to explain capitalism as a social system. He really does not offer us a theory of capitalism *per se*, but a theory of what drives the data. These are not the same thing. The political and moral confrontation with economic inequality loses its edge once we leave the social sources of it behind and instead look only at the econometric data.

To be sure, Piketty lets his own moral disapproval of inequality show in passages throughout the book. He does not seem to approve of the high salaries of CEOs and of the widening gap between them and everyone else. Nevertheless, this book is not a critique of capitalism, as those on the right have been charging. It is a plea for its domestication. A global tax on wealth, a modernized social state, and a more progressive income tax sound nice, but they do not question the legitimacy of a social system that can only grow the more labor it exploits, the more resources it wastes, and the more that it relies on the minority of society to decide when and in what to invest their capital. They also have not worked in the past for very long. Oligarchic wealth grants elites stronger social and political capacities for wealth defense: to manipulate laws, cultural norms and values, and so on, for their own interest. Only through new ways of making private capital public in some sense can we begin to see a way out of the endless trap of inequality.

Inequality is a deeper problem than Piketty lets on. A society that allows private ownership of unequal capital reserves will always be able to orient the labor and consumption of society according to ends that generate profit, not valid social need. An unequal society will waste human capital and natural resources, and will orient the purposes of education, culture, politics, and society as a whole toward elite interests. And for this, Piketty should be taken to task. Economic inequality is primarily an issue of importance not because some have more than others, but because some are able to command the labor and efforts of the society as a whole according to their own interests and concerns, and not for those of the public interest and good.

For all of the personal discussion in his preface about his distaste for contemporary economic thinking, he is unable to break out of its stranglehold. Economics is still for him a statistical matter of numbers, not the social context within which it is embedded, and certainly not a system of power relations between people. For this reason, it is important to take Piketty's powerful analysis of the data and synthesize it with a critical political economy, one that grasps the ways that wealth, profit, and bloated incomes thrive off of extractive power, the exploitation of the many by the few. And this is not the theme merely of our time, but all of history as well.