# The Working Class Hero: Piketty's *Capital in the Twenty-First Century*

***Capital in the Twenty-First Century***
Thomas Piketty
Translated by Arthur Goldhammer
(Belknap Press, 696 pp., $39.95)

*By Nicholas Mastron*

Thomas Piketty's *magnum opus* launches a broad reconsideration of the wealth inequality question by identifying opposing economic forces. Simply put, economic inequality or class struggle can be shown by a simple equation: the total rate of return on capital (*r*) exceeds the total growth rate of the economy (*g*) or ($r > g$). Historical evidence, though, suggests that knowledge serves as the primary tool for closing this inequality gap. Piketty employs a three-hundred-year historical analysis spanning more than twenty societies to support this core argument and derive his unique methodology. Divided into four sections, the book first defines income and capital, subsequently introduces specific case studies, then constructs a new theoretical and methodological framework for addressing the inequalities present between capital and income, and finally posits far-reaching policy responses to the issues stemming from these gaps. Piketty thus reconceives the epistemology of economic research on distributional equity.

Tracking four of his economic predecessors, Piketty develops the framing for his analysis. Malthus, he argues, addresses the apparent association between population growth rates and income inequality, while Ricardo constructs the role resource scarcity plays in the theoretical development of the same inequality. For Piketty, capital—rather than resource—scarcity creates the ultimate problem of inequality, which leads to his Marxist discussion. Marx proposed that the rise in capital and the stagnation of incomes question the equity of economic growth. While Piketty holds this to be true and aptly names this seminal work after Marx's *Das Kapital*, the methodologies and the apocalyptic epistemology Marx used are now outdated (Piketty 9). Furthermore, Piketty suggests that how we track a persons' income, chiefly through household surveys, is also outdated. Here, he brings in the fourth and final thinker, Kuznets, who contends that tax records reflect a much more realistic picture of the income problem.

To grasp the core proposition, convergence and divergence must be understood in relation to the income-capital, or wealth, conundrum. Diverging income and capital ratios result in greater class distinctions, whereas converging income and capital ratios result in a more equal state. However, societal institutional knowledge and economic education directly correlate with a country's financial mobility and infrastructure in supporting large-scale investments. In short, a government's efficiency and legitimacy determine this knowledge spreading, thereby determining the effect to which wealth inequality pervades a system.

Chapters 1, 2, 3, and 4 build upon this discussion of the inequality $r > g$ and posit the foundation and nature of Piketty's First Fundamental Law of Capitalism: the share of capital incomes—that is, income derived from capital possessions, such as financial, real estate, or firm machinery—within total national income (real GDP plus net income from abroad or α) equals the real rate of return on capital ($r$) multiplied by the ratio between capital and annual income (β), or simply $\alpha = r\beta$. Piketty also defines this capital-to-income ratio (β) as wealth. As this share of capital incomes increases, two things occur. First, capital owners become richer, and Piketty uses the United Kingdom as his primary case study to support this argument. Second, unless these capital owners consume their entire return from capital, they will have more to reinvest in other ventures than otherwise, accelerating capital accumulation over time, increasing inequality.

First, Piketty focuses on the macroeconomic question of economic inequality among states. Chapter 2, entitled "Growth: Illusions and Realities," serves to break down the notion that economies become more equal over time, demonstarted by the Kuznets curve, which is derived from data collected during the historical rarity of the post-World War II boom in both productivity and population. However, the inequality between capital and annual income from 1900 until 2014 (instead of just post-WWII) is in fact a U-shaped curve, the opposite of the Kutznets curve. Wealth inequality measured relatively low for forty to fifty years (roughly 1930-1980) due to the massive capital destruction resulting from the World Wars, but higher capital-to-income ratios existed within the rentier state before this period and have returned since the market liberalization policies of many countries (i.e., the "Big Bang" reforms and "Reaganomics"). Thus, the chapter outlines a historical revision of productivity growth and population growth over the last three hundred years, with each type of growth equally responsible for total economic growth (see Table 2.1 on p. 73). Under low cumulative growth rates, societal progress stagnates and becomes a significant barrier to changing generational outcomes. In short, these historical advantages and decisions contribute to a country's ability to economically grow, because even when growth rates decline, past economic and societal gains reinforce the now-diminished benefits reaped.

Piketty distinguishes public wealth and debt from private in chapters 3 and 4. He uses historical records to show that most capital wealth was held in land prior to 1800. Then, the nineteenth century saw the capital wealth shift into real estate and industrial capital. During the nineteenth century, large government debts (deriving in part from civil and continental warfare) were financed through private wealth, leading to the rise of the rentier state—an economy based in large part on specific private patrons' support—with wealthy citizens collecting steady, significant incomes from government debt holdings. This primitive patronage system within war-torn Europe constituted an early private-public partnership model that resulted in the working class outcry embodied by Marx and other socialists. This ultimately led to the suspicions of public debt that Marxists saw as profiting only the rich. While national capital remained relatively unchanged, private capital expanded at a much greater pace than public capital did, as capital owners owned an increasing proportion of the state through their debt holdings.

Conversely, the period from 1920 to 1970 shows another vast increase in public debt due to geopolitical conflict, but this debt erodes much more quickly than the previous century's war debts due to high inflation and strict financial controls. The rentier state could not continue and subsequently diminished, while public debt during this time soared to assist those people under severe economic pressures. Again, the ratio of national capital to national income holds constant during this period, but the distribution of national capital favors a wider audience. Without the assistance of wealthy individuals, governments turned to businesses for the necessary finances. Furthermore, many states sought higher inflation to help alleviate the long-term burden on firms. However, inflation is a rough tool for debt management, causing many to call for its elimination by the 1980s. Piketty concludes by stating, "debt is the vehicle of important internal redistributions when it is repaid as well as when it is not" (135).

This debt warning hints at why chapters 5 and 6 focus on Piketty's final theoretical law, or the Second Fundamental Law of Capitalism: the ratio of capital to income (β) equals the savings rate ($s$) divided by the economic growth rate ($g$), or $\beta = s/g$. It should be noted that this equation is true in the long run, but it does not hold in the short run. Over the past 30 to 40 years within developed economies, retrenchment in both technological innovation and population growth has caused an increase in wealth, or β, as compared to income. These high-saving, low-growth economies additionally yield more foreign investors that posess significant foreign capital, increasing the share of capital incomes within that country. Would-be entrepreneurs become rentiers, creating a market for public debt patronage and driving $r$ even higher.

Descending to the microeconomic level, Piketty argues perhaps the most interesting point in his work: capital and labor's elasticity of substitution, or essentially the ability of a firm to replace humans with machinery, currently appears to be greater than one, differing from pre-1800 levels (233), implying that capital pays more than labor. He elaborates upon this through a literary example known as Rastignac's dilemma: if one can simply earn money without working, then why toil all day? People with wealth are able to make more money on their investments than people who labor for a living.

Since the 1970s, capital's stock and its share of total national income have increased, reinforcing the above scenario. Coupled with a slowing growth rate and an increasing savings rate, capital's power has increased within society, and Rastignac's dilemma has reemerged, prompting many to reconsider the capital inequality question.

However, Piketty's model hinges on the $r > g$ inequality, which prompts consideration of the stickiness of the rate of return to capital. The high elasticity between capital and labor substitution along with the increasing returns to wealth holders (those aforementioned rentier investors) keeps the weighted capital returns high. Restated, if the capital-to-income ratio increases so drastically, wouldn't the marginal return to capital actually decrease, potentially flipping the inequality equation? Because Piketty's model is more in line with the Malthusian tradition of demographic considerations of ever-increasing population growth, this technical pitfall in his argument is worth noting even though history suggests that this is not the case.

The third section of the book addresses the structure of wealth and income inequality over six chapters. Chapters 7, 8, and 9 all center on the nature of income, while the latter three chapters consider income's relationship to capital. This relationship is actually between labor and capital, given that labor is the source of income in the Piketty model. Focusing on the concentration of income argument, most people could not work their way into a better living until just before the World Wars. The United States, outside of its southern aristocracies, was originally a distinct exception to this principle, but after Reconstruction, the American society significantly departed from a fairly balanced capital-income ratio. Essentially, the argument deduces to the natural inequality of the distribution of capital as opposed to labor. Data from the World Top Incomes Database show that labor inequality among economic subgroups, organized into centiles, remains fairly moderate, which should be expected. Yet the distribution of capital is increasingly unequal, and this trend holds for almost all of the countries included in this study.

The interwar period (roughly 1915 until 1945) destroyed or "euthanizeed" the society of rentiers rather than their simply being bested by what Piketty refers to as the "society of managers" (276-278). Yet, contrary to popular Marxist-inspired beliefs, enhanced collective bargaining and rising worker productivity had minimal impact in undermining capital's societal power. Instead, this interwar euthanizing allowed for greater societal mobility due to the harsh economic impact that the wars had on the previously wealthy aristocrats who had been protected by their economic systems for their purchase of public debts, an argument Piketty employs vast amounts of real estate and financial information to supplement. Here, Piketty finally exposes the goal of his work: "to compare the structure of inequality in societies remote from one another in time and space, societies that are very different a priori, and in particular societies that use totally different words and concepts to refer to the social groups that compose them" (252). In doing so, Piketty returns to discussing class struggle, but he views the actual problem as a centile struggle;

this struggle emerges as the political control of capital really rests with the top 1 percent of an economy, as opposed to the top 10 or even 5 percent of an economy, who only saw modest or proportional gains to their wealth statuses. This is the purported causal link between capital and income upon which the book is premised: capital controls income at a systemic rather than just personal level. Hence, Piketty's title reads only *Capital*, not *Capital and Income*, because capital *is* income of the richest sort, and thereby the potential culprit of inequality.

Piketty uses chapters 10, 11, and 12 to demonstrate that the real rate of return on capital has historically been greater than the economic growth rate, showing that this is not a recent phenomenon. So if the distribution of capital is almost always more unequal than the income distribution, a concentration of wealth accumulates more quickly with access to and control of capital, implying that wealth control has always been held by society's richest.

The final section of the book, chapters 13 through 16, analyzes potential regulatory frameworks for capital in this century and the future outlook. Piketty begins in chapter 13 by analyzing the welfare systems in Sweden, France, the United Kingdom, and the United States. He claims that France, the United Kingdom, and the United States are inapt to manage the demands placed upon their welfare systems by their large populations. Based on these outlooks, though, smaller-populated developed economies, such as those in Scandinavia, particularly Sweden, have stronger prospects of retaining or regaining a balanced income-capital ratio, one in which the returns on labor and capital are equally valued. Absent these population advantages, Piketty calls for bureaucratic reform and for a unified retirement scheme based upon individual accounts. In the closing paragraphs of the chapter, the focus shifts to the future of the welfare state in poor and emerging economies, but this assessment indicates a greater need for research, where other scholars like Jeffrey G. Williamson have begun historical economic analyses.

Chapter 14 evaluates income taxes, and argues for progressive tax reform. Although high taxes on the richest populations would yield minimal revenues, higher marginal rates for top income earners would arguably dissuade those earners from asking for higher salaries. Piketty uses the US as an example, where during the 1960s and 1970s, the top US marginal tax rate was about 90 percent, which Piketty claims eliminated the main reasons for seeking higher salaries. Now, the top US marginal tax rate is only 25 percent, which does not effectively dissuade higher salary attainment. Taxation, therefore, is a potential tool to curb the political power of the richest members in a society by reducing their ability to accumulate wealth through grossly inflated salaries. Now, a radical theme emerges within these policy recommendations, separating Piketty from others: the implication in each of these suggestions that markets are indeed limited in their ability to effectively institute equality, requiring politics to intercede.

Chapter 15 outlines Piketty's primary policy recommendation: a progressive and global tax on capital. As stated previously, the profit from capital investments *is* income to those who currently own the capital, rather than just relying on labor income (which most people rely on). Therefore, a tax on capital could institute an income redistribution that could benefit a state. Admittedly, this proposal suggests a highly unlikely policy outcome, but it deserves attention if only as a future reference point and ideological foundation for policymakers. One could argue that here Piketty exits the academic realm and enters the domain of concerned citizens, and this is even present in the work's structure. Both the diction used within these four policy chapters and the relatively small space devoted to each suggestion indicates this stylistic shift. Furthermore, Piketty speculates upon the proposed tax's nature and its cost compared to other systems, such as those in communist or authoritarian states. The capital tax would force individuals to declare their real wealth, as is already the case for income, suggesting that the problem is also an accounting one. This chapter additionally probes into three topic areas: the Chinese system of capital control, redistribution of fossil fuel rents, and the possibility of redistribution through immigration.

Unfortunately, Piketty offers only superfluous commentary rather than substantive critiques on these topics by not actually discussing country-specific policies at any great length. Thus, Piketty's weakest points remain his policy recommendations, as he does not identify in any of the systems surveyed the legal and financial barriers to enacting his suggestions. Politics is virtually ignored in his model, and this shortcoming merits greater attention, especially given his otherwise scientific examination of the volume's critical questions. Piketty closes the book by calling for a return to political economy within his policy recommendations, which he, himself, does not employ substantively in his analysis. Perhaps he is establishing the baseline here for a second exposé, *Politics in the Twenty-First Century*.

Piketty's work introduces several revolutionary aspects to policy analysis and economic theory that must be critically assessed. First, the alternative methodology, inspired by Kuznets, highlights the inadequacies of relying on household survey data. These traditional datasets, such as the American Community Survey for the United States, are by nature dependent upon voluntary— rather than required—information. By using tax records, Piketty shifts the burden of informational accuracy in analyzing economic history to governments' accounting bureaus. Shifting to governmental accounting of wealth might additionally prompt further efficiency considerations and policies for understanding taxpayer wealth rather than just income. Piketty's extensive compilation of the records within the World Top Incomes Database broadcasts the latent potential of newer and more complete economic resources.

However, this tax return methodology also poses some legitimate issues. First, tax returns are not always filed, potentially failing to capture the full scale of income disparities. Second, fiscal units, not necessarily individuals, serve as the basis for returns. This obfuscates the exact magnitude of the income as well as capital ratios among economic subgroups. Another potential pitfall in reliance upon tax records is the changing definition of income, as various types have not always been accounted for in the data (e.g., Social Security income in the

United States). A related problem is Piketty's definition of wealth, which accounts for nearly any transferrable asset that could potentially generate a financial return. This broad definition represents a major point of contention among scholars and policymakers. Very few consistent tax and income accounting policies have lasted over the entire scope of this long-term analysis. Problems in defining wealth and income could skew results toward greater disparities in the very long run.

Piketty's economic forecasting, holding the growth rate of the economy constant at 1.5 percent, facilitates a discussion about the effects of capital and income both on the macroeconomic and micro-cultural levels (such as Piketty's reliance on French literature) throughout history. Inequality has mattered, presently matters, and will continue to matter, given the direction and intent of Piketty's illustrations and evidence. Piketty's linkage between present-day income inequalities to labor inequalities provides critical evidence to tie Marxist concerns over workers' economic access to the partial publicly subsidized protection of capital controllers.

Finally, the slaying of conventional economic wisdoms, rhetoric, and rules of thumb through the use of long-term historical and economic evidence constitutes the greatest shift Piketty and his school of thought have made on a very broad level. Some of these slain axioms include the basic tenets deriving "trickle-down economics" and the basic economic growth theory that claims that income equality derives from a stronger national economy. Piketty is the twenty-first century working class hero in this devotion to income and wealth inequality. That said, Piketty differentiates himself by not attacking the business industry, per se; instead, he is challenging the business philosophies at work in many of these economies. I concur with many scholars that Piketty's school of thought establishes a socioeconomic theory that is both mature and detailed enough to lay the foundation for policymaking in the twenty-first century.

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The reviewer dedicates this work to Darcy Sharp, his best friend and loving fiancé, for the long nights spent theorizing and sifting through these complex societal problems of income and capital while also binging *House of Cards* and *The West Wing*. He also acknowledges the supreme editing abilities and demonstrated empathy of Mathew Vicknair and Christine Mellen, without whom this review would remain infantile.