

Capital – in the Twenty-First Century

Introduction and Precis

This evening we are going to have a discussion of sorts, a debate perhaps, about a book of nearly 700 pages, on one economic theory. It was published in 2013 in French and subsequently in 2014 in English, and it titled: “Capital in the Twenty- First Century” by Thomas Piketty. Despite what you might think about such a mind numbing topic as a book on one economic theory, it has become something of a best seller. But it is actually part of an old story....it began about 11, 000 years ago, not far from here, in Boone County, Kentucky, where there was an enormous salt lick; today called Big Bone Lick State Park.

It was dusk, and finally the mastodon stumbled to his knees; then it toppled slowly over on its side. The hunters closed in, slowly, carefully, on the prey they had been stalking and stabbing at for nearly all the day. Finally, one of the taller hunters lunged forward and thrust his Clovis pointed spear into the creatures heart releasing an enormous gush of blood; and the great body seemed to shrink towards the ground with a great sigh.

And then it began, as the tribesman began to butcher the beast: Who gets which cuts? Who, among those who had hunted, and who, among those who remained behind the hunt guarding the elders, the women, and the children, gets what? And beyond the meat, who gets the hide that would provide shelter in the colder times, and perhaps the tusks for what use to whom?

Who gets what is an old story. And we are still arguing about it and producing studies and proposing solutions. For example, in the Bible, there are numerous writings about sharing in one’s income or wealth with those less fortunate --- less hunterly, if you will. And we may recall that Adam Smith, who wrote “The Wealth of Nations” in 1776 explaining the economics of capitalism had preceded that book with one titled “The Theory of Moral Sentiments.” A book that spelled out what one might recognize as the responsibilities that governed relations within the mercantile system of the time as well as the moral and ethical basis that he believed undergirded his most famous work on free enterprise; the former book on moral sentiments and conduct setting the stage for what a free enterprise society ought to look like in “The Wealth of Nations.

It is also revealing to note that both books by Smith were written just before both our Revolution, and the French Revolution. And, it is true that both these are often described as having to do with the rights of citizens within their countries. But I might argue, as I’m sure Piketty does, that this may be confusing the solution with the problem; that these revolutions were caused more by “pocket book” issues stemming from the enormous inequality in wealth

and income in the late 18th century. In any case, once again, we encounter the argument about who was entitled to what.

And then, of course, there were Marx and Engels who published the Communist Manifesto in 1848 and, in doing so, popularized the famous dictum “From each according to his ability to each according to his needs.”

And, while we may indeed share these sentiments, they have, for most of history, remained suppositions because of a lack of means to provide a robust scientific foundation upon which to discuss the facts underlying the suppositions regarding who gets what. While it was not difficult, within France, to see that the “landed” classes were becoming far better off than the tradesmen and agrarian workers, there were no “national income” data with which to examine the situation, or the trends in the situation, in any detail.

In any case, it remained a truism that the issue of who gets what in any economic system was still a live topic and was thought to be the basis for what have euphemistically been called “disruptions” in society.

However, after the Second World War, something changed. The United States and other developed economies began to compile substantial data on national income and wealth and this data, coupled with the beginnings of computer science, enabled an economist, Simon Kuznets, to publish a major study examining the trends in income and wealth distribution in the first half of the 20th century. His work showed that inequality in the distribution of income had fallen sharply over the period. From this data he posited that “democratic capitalism” was working and would do so across the globe if permitted to develop. And so the distribution question seemed to have been settled and a muffler placed on many of the social and political value debates that had previously dominated the discussion....see Marx, for example.

However, the author on point this evening, Thomas Piketty, began to observe what he postulated was the emergence of another wave of inequality in the distribution of income and wealth beginning in the 1970's. Working with a number of colleagues, the group mined massive amounts of national income and wealth data for virtually all the developed world and using these massive data sets, with modern computers, compiled the underpinnings of his book. While there are some academic debates about his methods, it is his conclusions and prescriptions that have provoked substantial and heated debate – of the social and political kind that seemed to wane after Kuznets publication in 1953.

Piketty finds that there is something that he calls the “Central Contradiction of Capitalism.” In essence he argues that the system may contain the seeds of its own destruction and bases this conclusion on his exhaustive studies and analyses of his gigantic data base.

The main footings for his study and conclusions are data that compare the private rate of return on invested capital with the growth rate of income and output in a given economy, and then follows this data across many significant economies. To simplify - what you get to be an owner compared to what you get for working. He argues that the data show conclusively that a market economy based on private property ownership contains, and I quote, “powerful forces of convergence (income and wealth distribution becoming more equal) and of divergence (greater inequality.)” In particular, first he argues that the principal force for convergence in these two rates has to do with the diffusion of knowledge and skills. Interestingly, Piketty, having called this a “powerful force” ultimately downplays this force and focuses on what he sees as the very powerful trend for divergence; that is, that the rate of return on invested capital is able to remain higher than the growth rate in income and output for significant periods of time – and that this is the “significantly destabilizing force” going forward today.

Now let us not be hasty here. Isn't that why I “invest” in the first place? To earn a return over and above whatever I can earn in the mastodon hunt?

But, to simplify, the stickiness problem works this way. I own that field you are using to grow grain to sell and feed your family. And when the market price of grain falls do I reduce my rent commensurately? This sort of force, that keeps the rate of return on capital higher than - growth, is what he believes is leading us towards extremes of inequality in wealth and incomes that will make the extremes of the 18th and 19th century seem almost modest.

And we all know about the “disruptions” that occurred then. For example, in the twenty years ending the 19th century into the early 20th, no less than six heads of state were assassinated by those protesting the gross inequalities in the distribution of income and wealth, among them our own President McKinley. And then, of course, we had the Russian revolution and those “disruptive” World Wars.

What does Piketty propose? A steeply progressive annual tax on wealth. He avoids the idea that capital income should be taxed because he does recognize that capital investment is necessary to maintaining the underlying generators of income and output; but he believes that taxing the egregious accumulation of wealth in the hands of a few would reduce the inequality and avoid the fearful “disruptions.”

Now Bill Sena will discuss his views of Piketty's book and his nostrums. And he will be followed by Rich Lauf. Then we will have time for rebuttals and questions from the floor.