Capital in the Twenty-first Century: A Critical Engagement with Piketty

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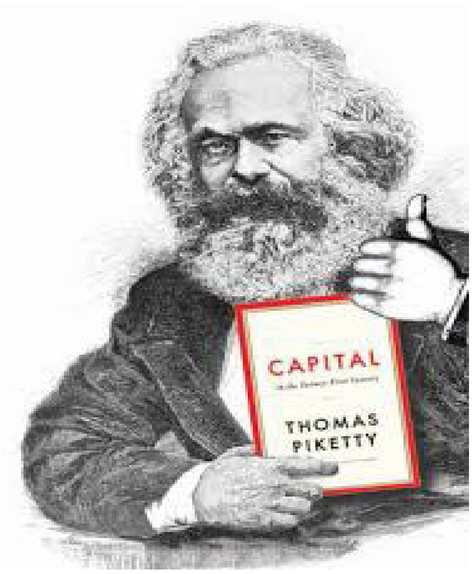
In 2015, 147 years after Marx wrote his path breaking book "Capital", a French economist called Thomas Piketty wrote a sensational book with the same title. This book has created a shock wave on what is called neoclassical or neoliberal/ mainstream/ economics or in plain English – the economics that worships a free market economy. This branch of economics is the dominant economic discourse and offers justification for the neoliberal ideology which says markets are nearly perfect and hence governments need not intervene in the economy. This is the kind of economics thought in topnotch universities in the US and Europe, and through their influence, throughout the world. The World Bank, the IMF and WTO as well as the governments' of the Western economies such as the US and Western Europe have pushed the



policy prescription of such free market economics to Africa. This is done through what is called "Structural Adjustment Pro-grammes (SAPs)" and recently "the Poverty Reduction Programmes/ Papers [PRSPS]. I put the latter in the same category as the former because in terms of macro policy the prescription between SAPs and PRSPs are the same. That is, both subscribe to: liberalization of finance, trade, labour market; privatization, devaluation, no govern-ment intervention; as well as conservative fiscal and monetary policy – what is called the "Washington Consensus". The impact of these policies in Africa since the 1980s has been devastating and led the famous Western magazine The Economist to declare one of those decades of Africa as "the lost decade".

I think I have digressed a little from the topic. However, it is a justifiable digression because I am attempting to show the policy implications of economic policies that are the brain child of neoclassical economists and their institutions (such as the IMF, WB) and their dominant owners (the West – or the rich countries). What is striking about this mainstream/neoliberal economics and ideology is that it doesn't talk about distribution of income or inequality at all – thus endorsing the existing distribution of income as justifiable, making income distribution a none-issue – this is a betrayal by neoclassical economists to their claimed intellectual ancestors, the classical economists. For the latter, distribution of income is not an afterthought but rather "the issue" as can be read from the works of Adam Smith and David Ricardo. Thus, we economists in Africa teach that the economy is efficient when the labourer gets wage, the entrepreneur gets profit and the asset owner rent which corresponds to their contribution to production. Thomas Piketty's book, contrary to the received wisdom, has squarely focused on the nature of inequality or distribution of income between capital (the income of capital owners) and wages & salaries (the income of the working class) in the last 300 years. I need to say in passing here that progressive economists had always been concerned about distribution of income – J.M. Keynes, M. Kalecki in the past and Lance Taylor today are cases in point. However, since, research, publication and research funding are dominated by mainstream economists and their institutions and governments, their call fell on deaf ears. This seems in line with the famous phrase of the Italian political writer Anotonio Gramsci who noted [extending the idea of Marx & Engels], long time ago, "the ruling class idea is the ruling idea". Ironically, when the rich countries were hit by the global financial-cum-economic crisis in 2008/09 it was the policy prescription from the economics of these progressive economists such as the Post-Keynesians (not the neoclassical economists) that offered explanation about and a remedy for the crisis – notice the "stimulus package of the USA". It is comforting to hear that famous mainstream/ neoclassical economists such as Paul Romer whose work and his colleagues book (such as David Romer) everyone is using in economics department across the world and who currently holds the chief economist and vice presidency position of the World Bank is openly and sarcastically ridiculing mainstream economics and their dominant economic models. These models, called Dynamic Stochastic General Equilibrium Models, DSGE, are the tools of central banks of the rich countries and currently being pushed by IMF into African central banks to espouse the free market ideology.

Be that as it may, I will not attempt to offer either a review or a summary of Thomas Piketty's book in this short article. Lansana Keita has done that by relating it to African condition in CODESRIA Bulletin No 3&4, 2016. Although he noted that the capital-wage gap (I think mistakenly Keita said Capital-Income gap in that article to mean Capital Income and Wage Income gap – assuming he takes capital related income as income) in Africa is not as big as in the West, as I will show at the end of this article, that may not be the case, either. Piketty's book was the number one bestseller in 2015. It is the most talked about book by people: from top entrepreneurs (such as Bill Gates who critically reviewed it recently) to top politicians (obviously the French president, and also Barack Obama, among others). What I will do here is just to point out some points that impressed me most about the book and then sufficiently motivate anyone to get hold of and read it. This is, thus, a rejoinder to Lansana Keita's piece in the last issue of CODESERIA Bulletin.

The first important point that impressed me most is that Piketty knows his audience and how to skilfully navigate through the profession that is dominated by neoliberal economists. First, he and his colleagues (including their doctoral students) did a meticulous quantitative and qualitative research about distribution of income (inequality) for the last 15 years. Then they presented the basic findings, that later appeared in his book, in top rated professional journals using sophisticated mathematical and related techniques so that they will be accepted by the profession (a profession dominated by the likes of top league US universities). After this acceptance, Piketty wrote the same basic ideas in plain English that can be read by any one, making the book accessible, and also a sensation.

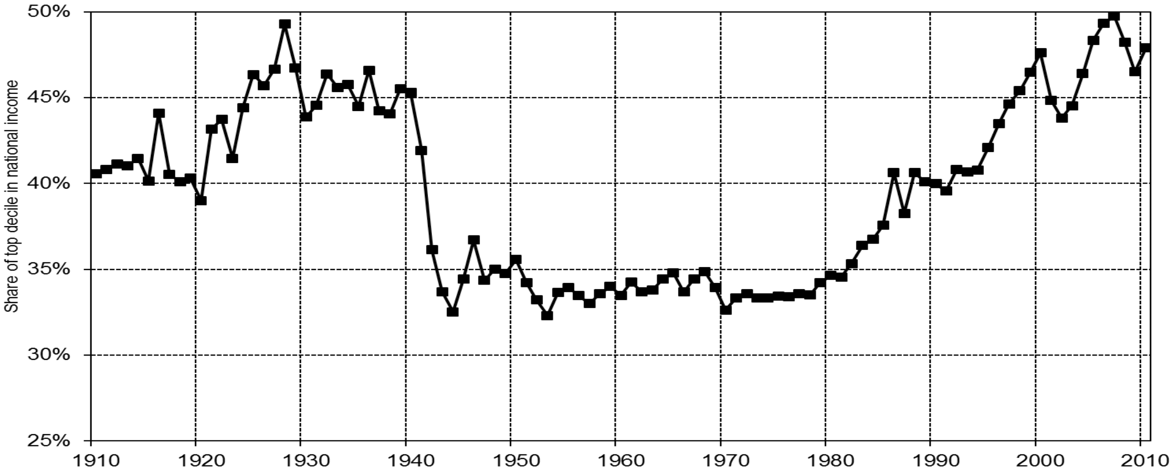
The second important point is the main message of the book: the world is characterized by a shocking level of inequality and in the last 300 years; the rich are getting richer and the poor are getting poorer. He has captured this idea by a simple formula which says r is greater than g, r>g (r is the return to capital or the income of capital owners such as the profit from investing; and g is the growth rate of the economy). In fact, the formula is basically r is greater than w, r>w (w is wage/salary or the income of workers). In the rich countries, the worker's income [w] is generally assumed to grow at least by the growth rate of the economy [g] so w and g are equal. In Africa, for instance in Ethiopia, wage, w (for instance my salary at AAU) is not growing by 11 per cent annually for the last 10 years because the economy is officially claimed to be growing by 11 per cent for the last 10 years. In our case, my salary is almost constant during this period – by the way this stagnant wage is in line with Marx's book which differentiate it from Piketty's. Over the 300 years investigated by Piketty r is always greater than g [or w] and the gap between profit and wage is widening (see the graph below). That is, the rich are getting richer and the poor are getting poorer. Thus, people have begun to compare Piketty's r>g [or w] to Einstein's famous equation of energy E=MC2. As you may see in Figure 1.I, taken from Piketty's book, the top rich 10 per cent of US citizens were controlling about 50 per cent of the US national income in the 1930's and also today. That share dropped to about 33 per cent during the period 1940-1980 when it was the lowest. We can clearly see in Figure 1.1 that inequality has been rising sharply since 1980. In addition, Figure 1.2 shows that in the rich countries aggregate private wealth was 6 to 7 years of the total national income in each of the countries from 1870 to 1910; 2 to 3 years of the national income in 1950; and 4 to 6 years of the national income in 2010. This takes me to the third interesting point.

The third point is the so called Kuznet curve, named after a famous American economist named Simon Kuznet who studied the pattern of inequality until the early 1940s. When you see Figure 1.1 this pattern, until 1940s, looked like an inverted U. The optimistic scenario and conclusion Kuznet drew from this pattern is that as a country develops, inequality initially will rise but eventually will decline – has a shape of inverted U (see the coloured picture that mimics the trend of the data line). This has become a Bible/Koran for neoliberal economists and their Western governments. Thus, they began to advise us that "don't worry if inequality is worsening while you are growing today because it will eventually decline". In fact, Kuznet even got a Nobel Prize for it and related studies on national income and economic growth (Note who gets the Nobel Prize!). He accepted the award and the prestige that comes with it although he was aware that his thing is a snap shot picture of a post-world war phenomenon. As we can see from figure 1.1 of Piketty's long-time series data, in fact the pattern of inequality over time has rather U shape (not inverted U shape). This in turn means inequality is getting worst over time. This is one of Piketty's key contributions. I should note here that unlike the West's growth history, Taiwan and South Korea grew with a sensible distribution of income, and hence it is not a universal truth that inequality should get worse as a country grows.

The fourth point relates to the role of "technological diffusion", and "expansion of quality education for all" to address the problem of inequality which is discussed at length in the book. For this to happen, however, the role of well-informed policy (i.e. policy informed by rigorous research) through conscious government intervention to abate inequality is important. This is the opposite of the policy recommendation of neoliberal economists and their backers who are against the role of state (apart from a night-watch man stature) in development. However, we need to be cautious here that if the government is not well-informed the government failure could be worse than the market failure.

Finally, before I conclude this brief article and advice anyone to get hold of the book and encourage researchers to do similar studies across Africa, see the two figures below that I have attempted to make in line with Piketty's ideas for Ethiopia. It is an interesting research to do, not only for any other particular country in Africa but also across Africa. As can be read from the first figure the share of capital in Ethiopia is on the average 10 times that of labour. If I had the latest data I am sure the trend would go up even further as the recent growth in Ethiopia is accompanied by an alarming level of inequality that threatens social cohesion. The second figure also shows the share of profit in national income in Ethiopia. This is about 80 to 90 per cent of the national income, leaving the share of labour to be just 10 to 20 per cent. Household level data also shows that inequality, especially in urban areas in Ethiopia is getting worse and hence the rich are getting richer and the poor are getting poorer. Recent studies shows that the poor in urban Ethiopia, who spend over 70 per cent of their income on food, are unable to properly feed themselves because of rent, food and energy price hike - thus coping with this through cutting of meals and through the generosity of friends and relatives. I wouldn't be surprised if the picture is similar in other African countries. Inequality is a major social problem in Kenya, for instance – a country that I know very closely. The problem of inequality in South Africa is a common knowledge. The implication is that growth by itself is not enough for poverty reduction. It could be anti-poor when it is especially accompanied by inflation as the story in Ethiopia using the 2004-2009 household level data shows. It doesn't matter for the Ethiopian poor if the economy grows by 10 per cent if food prices increase by more than 10 per cent at the same time (assuming very generously that the poor's income will growth by the growth rate of the economy – a heroic assumption in Africa). This needs to be addressed squarely because such inequality (especially if it is accompanied by horizontal inequality) invariably leads to poverty of the mass, escalation of crime level and political violence and instability with dire consequences for the economy and the country in question.

Figure I.1. Income inequality in the United States, 1910-2010



The top decile share in U.S. national income dropped from 45-50% in the 1910s-1920s to less than 35% in the 1950s (this is the fall documented by Kuznets); it then rose from less than 35% in the 1970s to 45-50% in the 2000s-2010s. Sources and series: see piketty.pse.ens.fr/capital21c.

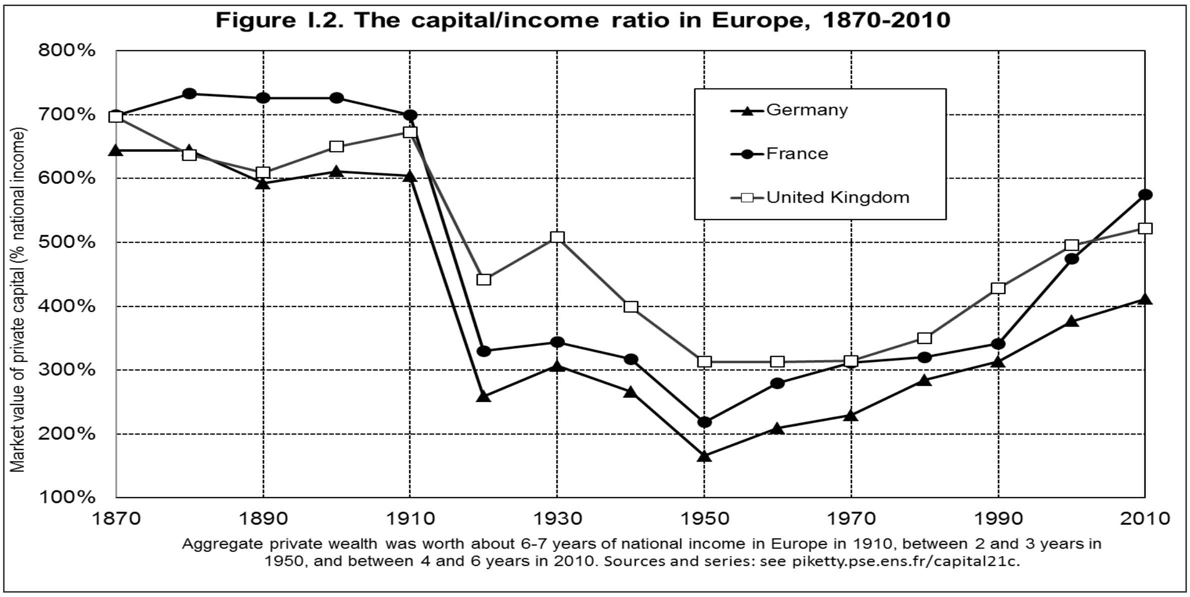
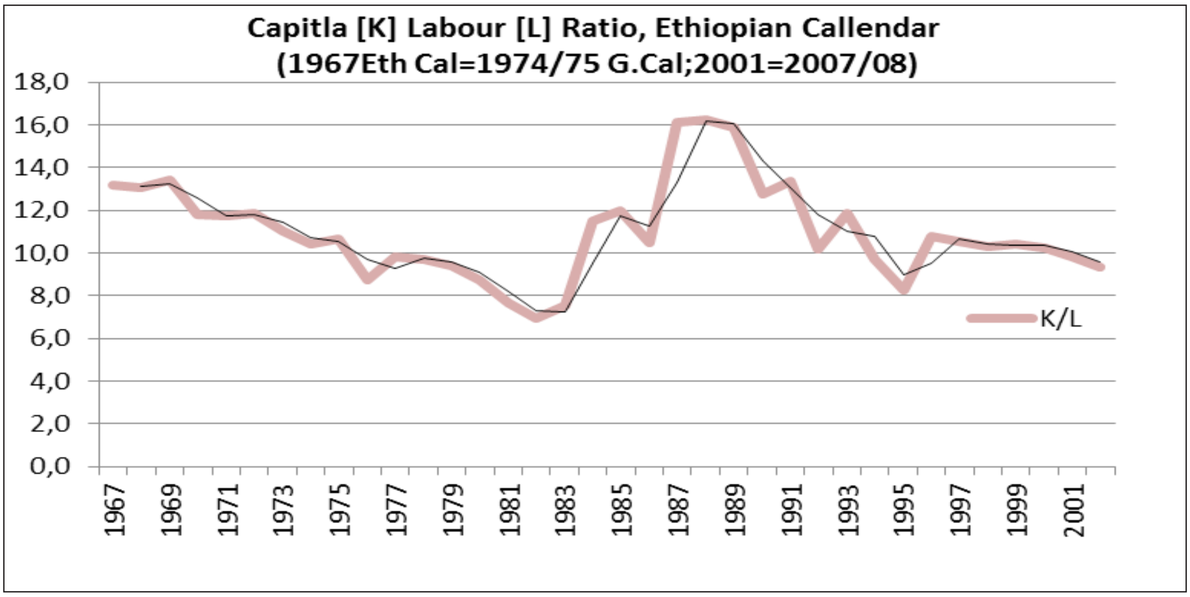
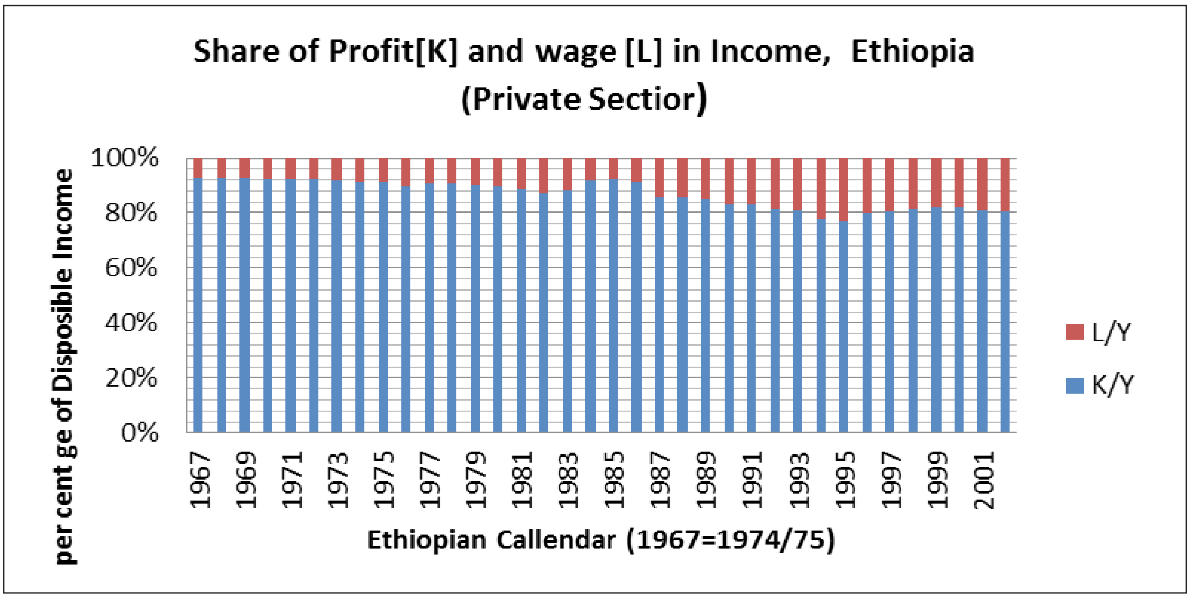


Figure I.2. The capital/income ratio in Europe, 1870-2010
Market value of private capital (% national income)
800%
700%
600%
500%
400%
300%
200%
100%
1870
1890
1910
1930
1950
1970
1990
2010
Germany
France
United Kingdom
Aggregate private wealth was worth about 6-7 years of national income in Europe in 1910, between 2 and 3 years in 1950, and between 4 and 6 years in 2010. Sources and series: see piketty.pse.ens.fr/capital21c.


Capitla [K] Labour [L] Ratio, Ethiopian Callendar
(1967Eth Cal=1974/75 G.Cal;2001=2007/08)
18,0
16,0
14,0
12,0
10,0
8,0
6,0
4,0
2,0
0,0
K/L
1967
1969
1971
1973
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001


Share of Profit[K] and wage [L] in Income, Ethiopia
(Private Sector)
per cent ge of Disposible Income
100%
80%
60%
40%
20%
0%
L/Y
K/Y
1967
1969
1971
1973
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
Ethiopian Callendar (1967=1974/75)