

# Piketty's *Capital in the Twenty-First Century*

*Slides on*

1. What is capital?
2. How it accumulates (the three laws)
3. How this differs from mainstream story

Michal Rozworski, June 25, 2014

# What is capital?

“ I define “national capital” or “national wealth” as the total market value of everything owned by the residents of a country at a given point in time, provided that it can be traded on some market...the sum of non-financial assets (land, dwellings, inventory, machinery...) and financial assets (bank accounts, mutual funds, stocks, bonds...). [48] ”

- Other possibilities:
  - Only productive capacity (mainstream) → quantitative difference
  - Social relation between people, not things → qualitative difference

# What is capital (good for)?

“ *Capital fulfills two economics functions: first, it provides housing...and second, it serves as a factor of production in producing other goods and services. Historically, the earliest forms of capital accumulation involved both tools and improvements to land and rudimentary dwellings.* ”

- Economic function
  - Factor of production (e.g. of housing services)
  - Store of value
- Anthropological roots

# How capital accumulates

- Stylized facts overlaid with theory
  - Three Fundamental “Laws” (not quite)
- Long-run values and ranges based on empirical data gathering project
  - Savings rate,  $s$ :  $\sim 10\%$  (+/-)
  - Return on capital,  $r$ :  $4-5\% \rightarrow 3-4\%$
  - Growth rate,  $g$ :  $1-2\%$
- Capital-income ratio (relative amount of capital),  $\theta$ , varies widely
  - Under capitalism so far: 200% to 700%

Law 1:  $\alpha \equiv r \times \beta$

*Capital income share  $\equiv$  rate of return  $\times$  capital income ratio*

- What is it? Accounting identity, true by definition
- Why does it matter? Undermines mainstream (neoclassical) stylized fact of stable capital share
  - Capital can take a greater or smaller cut

Law 2:  $\beta = s/g$

*Capital income ratio (Capital) = savings rate/rate of growth*

- What is it? “Asymptotic law”, or long-run tendency (with adjustment)
- Why does it matter? Describes how capital can accumulate if growth falls back after post-war reconstruction and global South catch-up

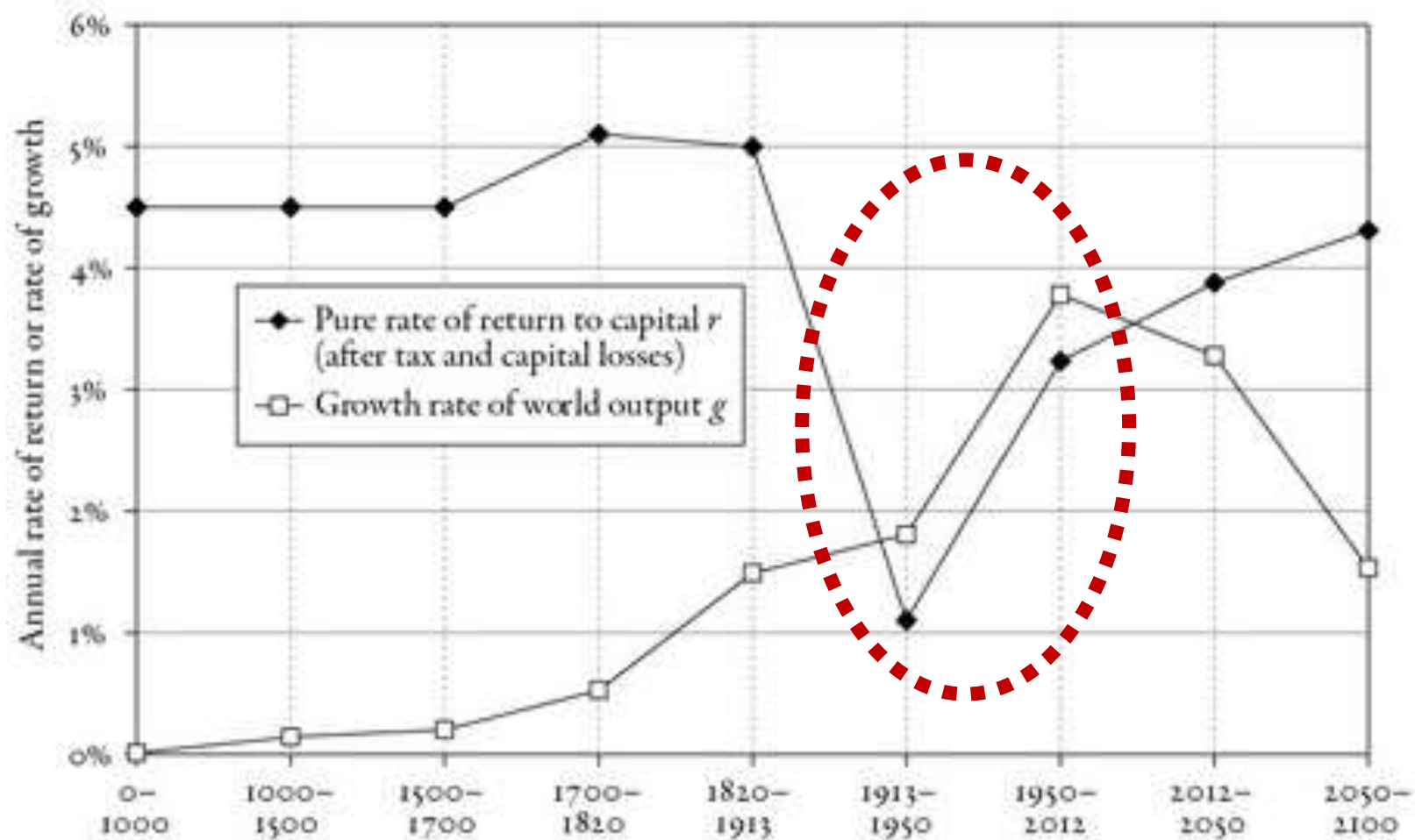
## Law 3: $r > g$

*rate of return exceeds the growth rate*

- What is it? Observed inequality throughout human history
- Why does it matter? Another tendency towards wealth concentration

“ *The inequality  $r > g$  in one sense implies that **the past tends to devour the future**: wealth originating in the past automatically grows more rapidly, even without labor, than wealth stemming from work...[378]* ”

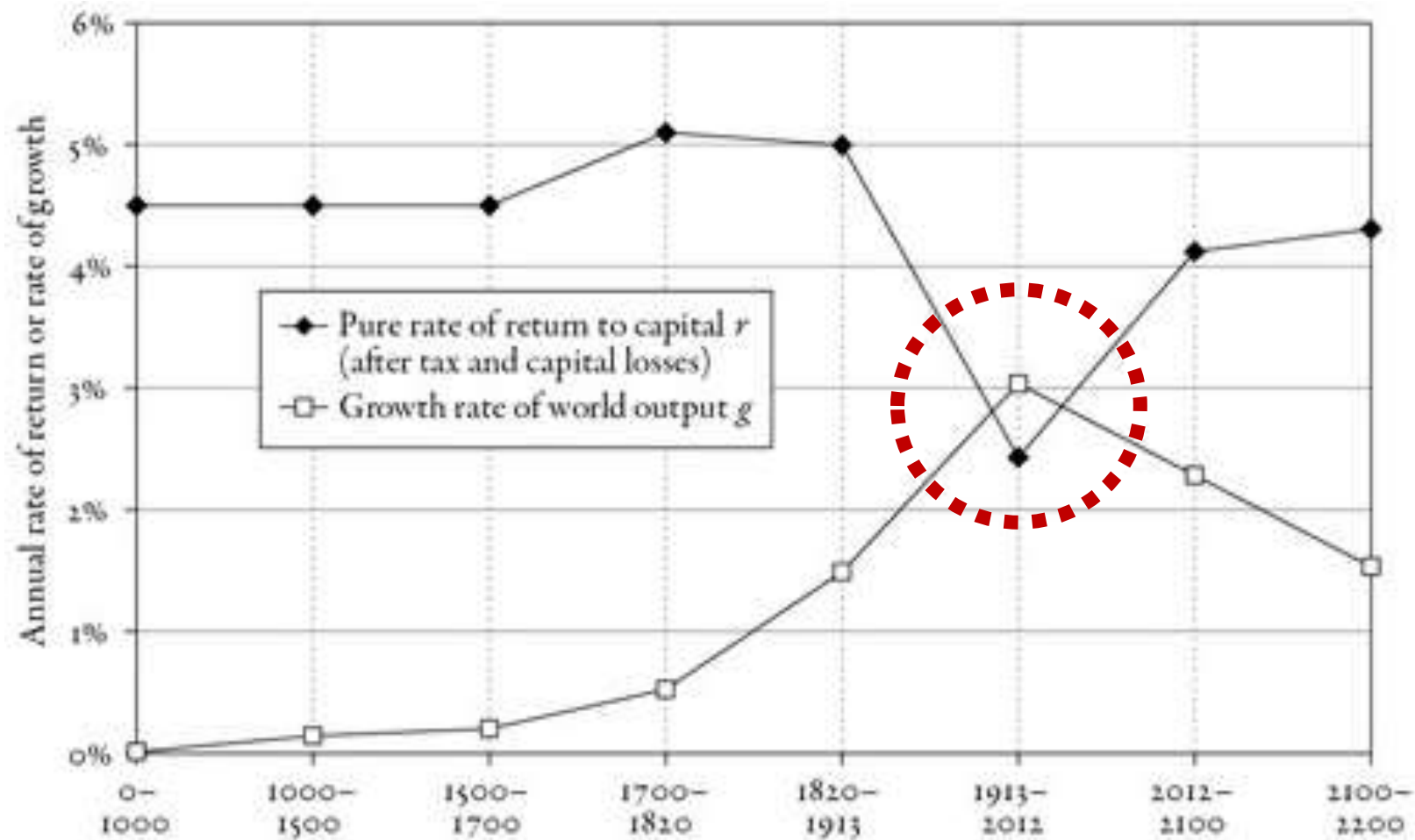
# Law 3: $r > g$



Source: Piketty, *Capital in the 21<sup>st</sup>-Century*, Fig. 10.10 [356]



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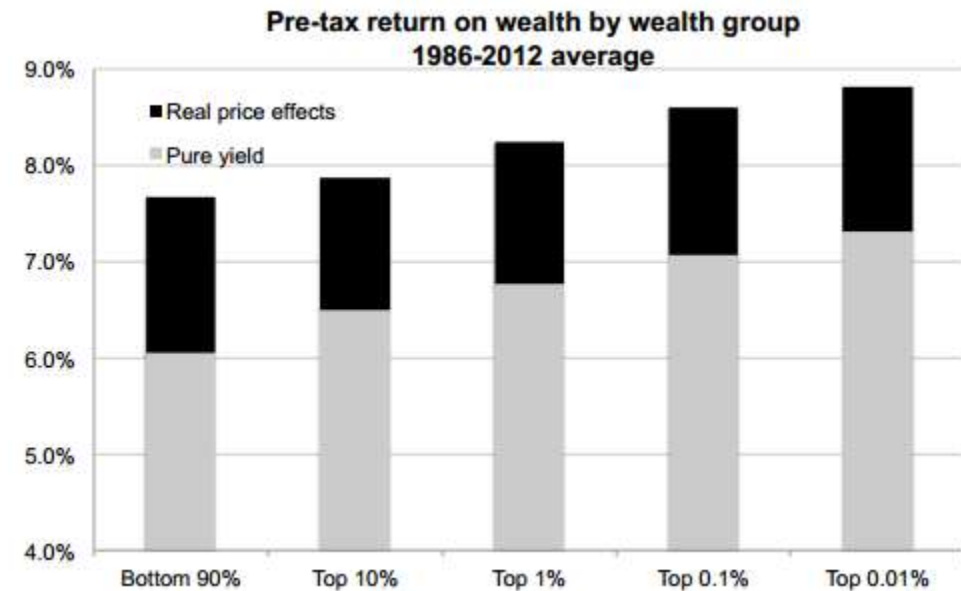
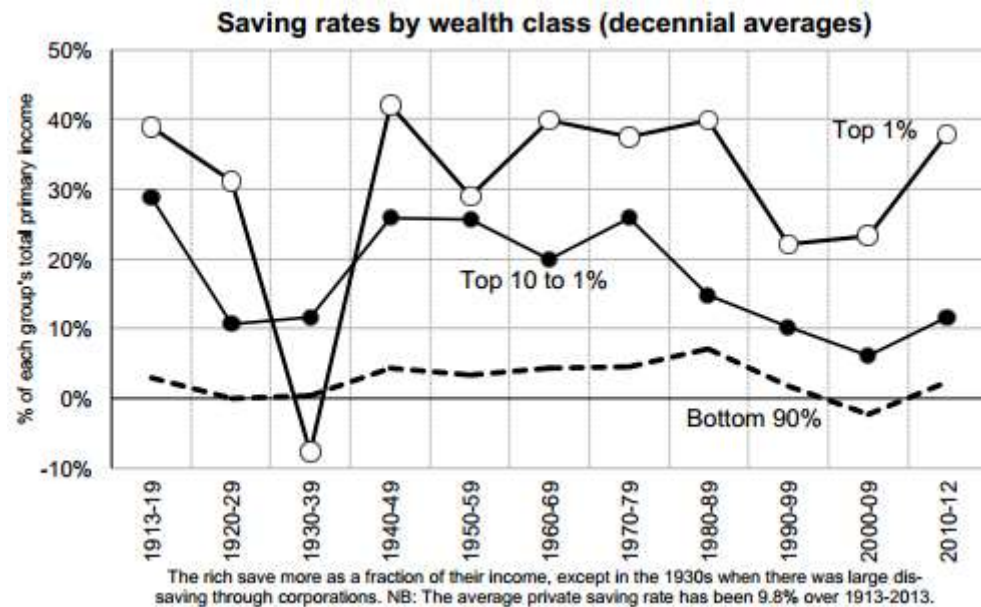


Source: Piketty, *Capital in the 21<sup>st</sup>-Century*, Fig. 10.11 [357]

# Mechanisms for rising inequality

- Social, psychological factors
- But  $s$  and  $r$  both higher for already-wealthy
  - *Increasing effect the larger your initial wealth*

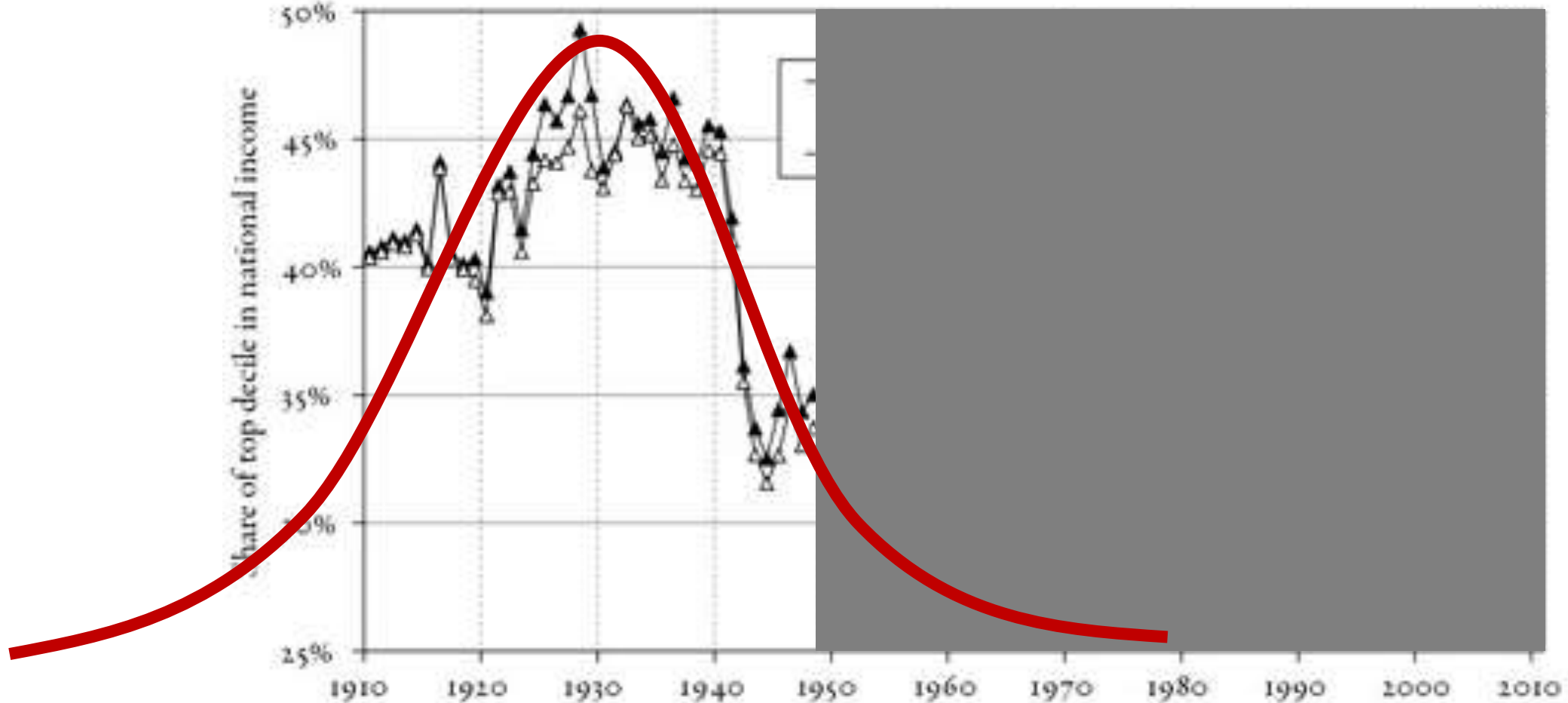
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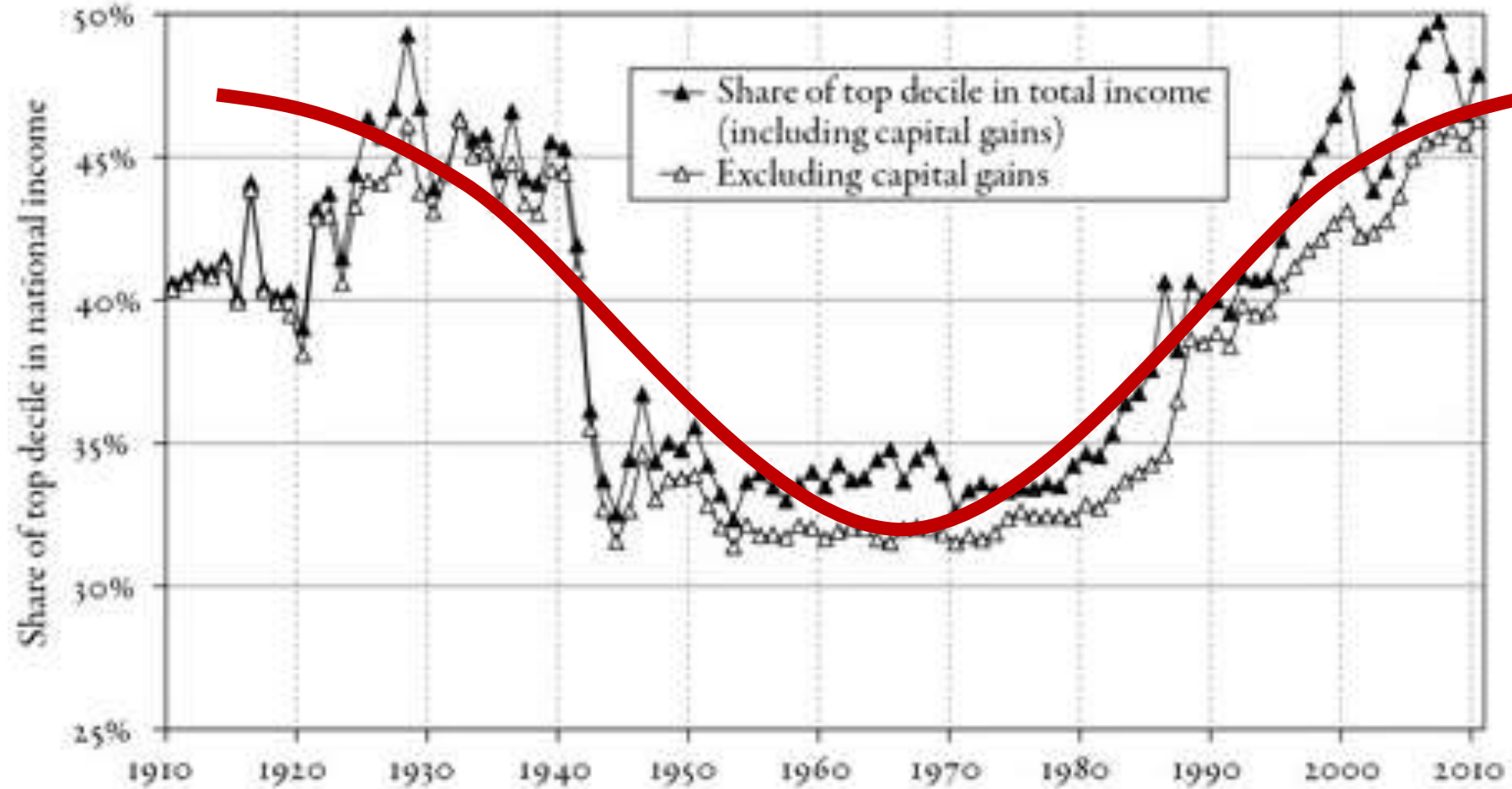
- Social, psychological factors
- But  $s$  and  $r$  both higher for already-wealthy
  - *Increasing effect the larger your initial wealth*
- Globalized and flexible financial markets
  - Financial as important as technical engineering for capital's bargaining power
- Inheritance as a good in itself

From optimism...



Source: Piketty, *Capital in the 21<sup>st</sup>-Century*, Fig. 8.5 [291]

# From optimism...to pessimism



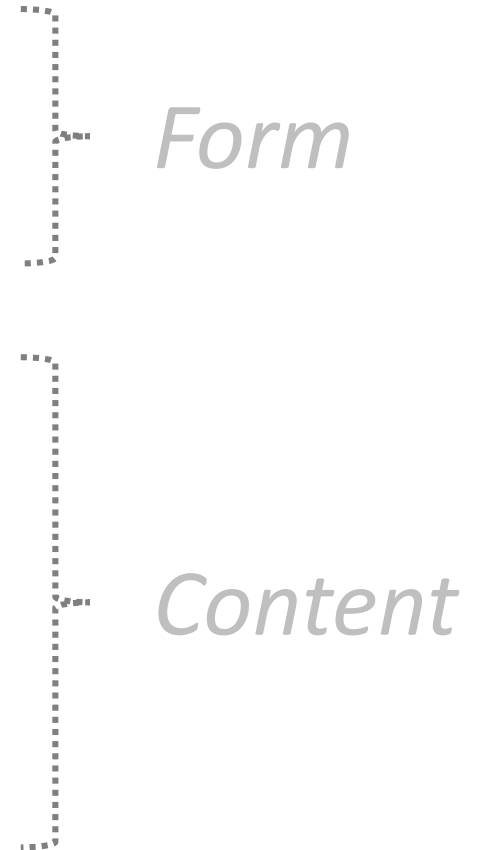
Source: Piketty, *Capital in the 21<sup>st</sup>-Century*, Fig. 8.5 [291]

# From neoclassical economics...

- Balanced growth path and long-term tendency towards equilibrium
  - Stability, even of bad outcomes
- Growth → population and technology
- Not much of a role for finance and crisis
  - Real-economy story that ignores financial instabilities and credit

# ...to classical political economy

- “Simple” math and critique of abstract models
- Literary style
- Historical data to form conclusions
- Social conflict over distribution
  - Divorced from individual (+) and from production (-)
  - Wealth transmission rather than consumption smoothing
- Divergence rather than convergence





# Example: why is $r$ stable?

- Controversy over elasticity of capital
  - Elasticity  $> 1$ : capital can easily replace labour
  - Combine with increase in capital's bargaining power  $\rightarrow$  growing inequality

“ *...no self-corrective mechanism exists to prevent a steady increase of the capital/income ratio...[and] capital's share of income.* ”

- Institutions matter
  - But how do they arise, evolve and fall
  - Going beyond catastrophic events like war for social explanation

# Avenues going forward

Two sociological observations to be explained:

1. The “supermanagers”: labouring capitalists
2. The “patrimonial middle class”: a split in the working class
  - Drawn into the orbit of wealth accumulation largely through housing

One large, barely initiated methodological rupture:

- A return to political economy
  1. Power
  2. Politics
  3. Production



*Piketty's focus*

# Open wide...

