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LOOKING AT PIKETTY FROM THE PERIPHERY

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Abstract:

This working paper discusses Piketty´s already famous book. It remarks some of the strong sides of the book, before critically discussing some aspects. It is argued that Piketty could have benefitted by using other theories of capital, different than the neoclassical one adopted. The note also places Piketty´s limited contribution, as seen in a more comprehensive context, in which international relations and reversal causality between growth and distribution are considered. The notes ends by pointing to the fact that Piketty presents modern development´s main stylized fact in a wrong way, because he is too narrowly focused on the developed regions.

Resumen

En este documento de trabajo se discute el ya famoso libro de Thomas Piketty, El Capital en el Siglo XXI. Se remarcan algunos de los lados fuertes del libro, para luego revisar críticamente algunos aspectos de la obra. Se argumenta que Piketty pudo haber sacado más provecho de su trabajo de haber usado otras teorías del capital, alternativas a la neoclásica, que es la que usa. También se destaca las limitaciones del trabajo por no considerar de manera sistemática las relaciones internacionales y la causalidad recíproca entre crecimiento y desigualdad. Se cierra señalando que el principal hecho estilizado de la era moderna identificado por Piketty se vería muy diferente visto desde una perspectiva más global y no limitada a las regiones desarrolladas.

Palabras claves: Desigualdad, periferia y capital

JEL COD: N01, N36, B25, F63, O54

Looking at Piketty from the Periphery

Luis Bértola

Thomas Piketty's *Capital in the Twenty-First Century* fully merits being the object of so much international attention.[1] While a critical approach is needed, and while many weak points of the book, or even errors, are discussed elsewhere, I cannot start this commentary without asserting my full agreement and concurrence with many points of departure adopted by Piketty.

the approach

The central topic of the book is very relevant today across the globe. Is capitalism always leading, as Marx suggested, towards a steadily increasing concentration of wealth, income and power? Or, on the contrary, are the forces that counteract these trends likely to prevail, making capitalism compatible with democracy and the ideal of an egalitarian society, as the badly interpreted Kuznets curve suggests?

When tackling this question, Piketty adopts some points of view that awaken my enthusiasm: he makes an effort to present an innovative theoretical frame-work; he bases his conclusions on impressive empirical work, accumulated by large numbers of scholars and with an important degree of methodological ingenuity; and he shows serious commitment, involving himself in controversial policy recommendations that are certainly not likely to be acceptable in the eyes of powerful actors in the economy, in politics and in academia. In short, he offers a precise definition and description of the problem, a theoretical framework to approach and explain it, and some courageous policy recommendations.

The way in which Piketty understands what economic science is about is entirely accurate. Far from departing from an abstract definition of a perfectly functioning economy and discussing the way in which we should approach this abstract model, the strategy is to see how things really work, what the real trends are, and to try to explain them with a set of tools that largely surpass what is often considered as pure

[1] I want to thank Jan Bohlin for instructive conversations and comments and corrections to the first draft of the manuscript. Thanks also to Jorge Álvarez and Javier Rodríguez Weber for reading and commenting on the first draft. And thanks to Pat Hudson and Keith Tribe for encouraging me to write this paper, and for their comments and editorial help. This paper will be part of a volume edited by Hudson and Tribe, published by Agenda Publishing, with the title *The Contradictions of Capital in the Twenty-First Century The Piketty Opportunity*.

economics. This necessarily involves knowledge generated by other social sciences. Using these different sets of tools is the way in which relevant, penetrating and realistic theories, deeply rooted in historical contexts, can be constructed. Among the long list of so-called fundamental sources of growth and development presented by Adam Szirmai,[22] there are none that could be termed purely, or even largely, "economic": geography, institutions, the state, power, social classes, culture and more are not part of the core of what is commonly defined, and taught, as economics these days. Thus, Piketty's political economy approach recovers the best of the tradition of economics, and it does not get dazzled by the lights of supposedly more scientific modelling. I find it interesting to note how the so-called convergence/divergence debate has hitherto considered divergence as some kind of market failure. It has been seen as an exception and, most of the time, defined in terms of conditional convergence occurring because various obstacles have interrupted the "normal" path of development. Once one controls for the many variables, that might explain deviation from the expected result, divergence is assumed to disappear. This is amazing because the clearly dominant stylised fact of modern development, particularly since the Industrial Revolution, has been divergence in growth rates and per capita income levels globally. In spite of several strong criticisms, the economics profession, in most universities around the world, has mainly focused on more and more sophisticated elaborations of models that often do not take into consideration critical qualitative aspects or other quantifiable variables, which are difficult to introduce in linear conceptualisations. Fortunately, other scholars, such as neo-institutionalists, evolutionaries, neo-Schumpeterians, neo-structuralists and others, depart from the fact that convergence is the prevailing stylised fact and have contributed to understanding the convergence and divergence dynamics. Unfortunately, these theories are still at the periphery of economics.

The relevance of the topics addressed by Piketty can hardly be overstated. Capitalism has shown itself to be well capable of improving the standard of living of the population. This is noticeable almost everywhere. Nevertheless, it is also clear that it produces and reproduces unacceptable inequalities, with an incredible concentration of wealth and political power, and the persistence, in many parts of the globe, of extreme poverty, exclusion, marginalisation, coercive labour conditions and even slavery. One of the most revealing images of this situation is probably the massive contemporary immigration to Europe and the US, and the severe measures being taken to reduce and control such labour movements, at a time when free capital and commodity movements are prized as the path to development and higher growth. The power to impose free trade in manufactured goods and free capital movements

[2] Adam Szirmai, *Socio-Economic Development*, 2nd edn (Cambridge: Cambridge University Press, 2015). Szirmai is a professor at UNU-MERIT and Maastricht University.

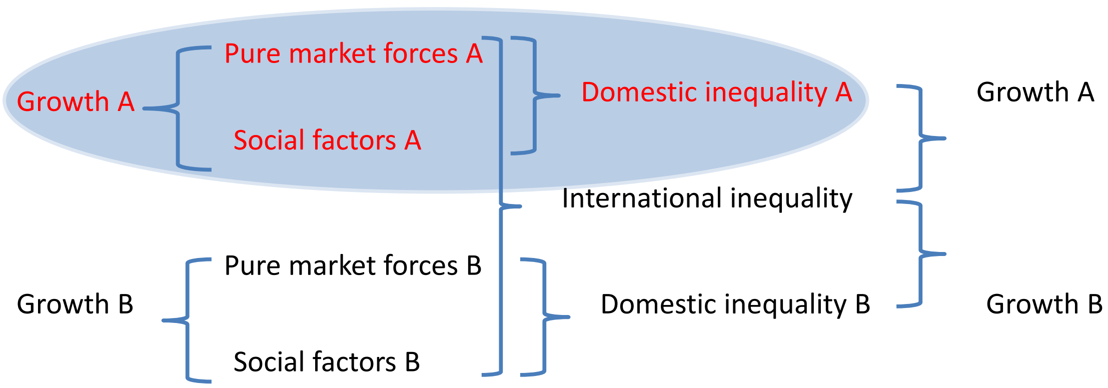
contrasts with the exertion of that same power to reduce labour movements and protect agricultural production in the developed world.

the theory: a context

Piketty's theory and conclusions about the prospects for the world economy and for future inequality trends are simple and clear. I will present them very briefly. His first law of capitalism says that the share of capital profits in economic output depends on the interest rate and the wealth/income ratio. If the rate of return is given (say, 5 per cent, as he has measured it), then the income share of capital will depend on the wealth/income ratio. The second law says that, if a fixed savings rate is assumed, movements in inequality depend on the growth rate of the economy: the lower the growth rate, the higher the wealth/income ratio and share of capital profits in total income, and vice versa. On the basis of his assumptions and stylised facts, and based on different estimates of future growth rates worldwide in the decades to come, Piketty concludes that inequality will continue to rise unless counter-acting political action is taken.

In order to discuss Piketty's contribution, it is important to place it within a more general framework: that of the relationship between growth and distribution in the world economy. Figure 10.1 presents a sketch of the main relation-ships that one needs to consider. Let us say that we have two kinds of country: more developed and less developed (A and B). Let us assume that there are two kinds of forces in action that determine the way in which growth impacts on distribution: pure economic forces on the one hand and social forces on the other, including power relations, institutions, culture and more. Let us also assume that these forces have an impact both on domestic distribution and on distribution between the two kinds of country. Let us further assume that distribution has an impact on growth at the domestic level as well as on relative growth between this pair of countries.

Figure 1. Distribution and growth in the world economy



Piketty's approach mainly concentrates on the relations included in the oval. I do not mean that he completely forgets the other relations but, as we will see, his statements are mainly focused on this part of the story. And that is why I think his approach is severely limited. My purpose is not to completely disregard his theory, but I would like to make some criticisms of the way he approaches some of these relations as well as to present some ideas on how the inequality map can be completed.

what piketty says

Piketty can easily be placed in the Kuznetsian tradition that discusses the impact of growth on inequality. In the end, what he is saying is that, left to economic forces alone, the rate of growth determines the inequality outcome. He does not give us many ideas about how inequality impacts on growth. His concerns about inequality are mainly to do with social and political outcomes, and with ethical values. There is a large amount of literature discussing how inequality impacts on growth: through human capital, through the distribution of financial assets, through political instability, through aggregated demand, through the impact of heterogeneous consumption markets on innovation and economies of scale, through the creation of extractive institutions and more. These lines of research are very weak in his approach.

In discussing how growth impacts on inequality, he defends the interdisciplinary political economy approach. However, his work is not entirely consistent. Jan Bohlin, in his excellent review of *Capital in the Twenty-First Century* (unfortunately only published in Swedish),[3] very clearly shows how Piketty is weak when discussing the Cambridge debate and naively adopts the neoclassical approach to capital. As is well known, the European Cambridge view is that capital cannot be measured using its own technical unit; this is in contrast to labour, which can be measured in working hours. The only economically meaningful way to measure capital is by using its monetary value, as Piketty does. But that also means that the market value of capital is dependent on the income it generates. When profits rise among firms, their market value rises on the stock exchange. The same goes for the value of land if the income of landowners increases. This is probably the mechanism behind the remarkable long-run trend (around 5 per cent) in the rate of return on capital, documented by Piketty. Why the long-run rate of return on capital should fluctuate around 5 per cent is left unexplained by Picketty; however, it surely cannot be explained by the marginal productivity of "capital", since the market value of the latter, and thus its productivity, is causally dependent on the income stream it purportedly should explain.

What is really important is that there is an alternative way to approach the profit accruing to capital, not by quantifying it and estimating the average return to capital, but the other way round: by estimating the value of capital through the profits

[3] Jan Bohlin, "Kapitalism och ojämlikhet: *Capital in the twenty-first century* av Thomas Piketty", *Historisk tidskrift* 134(4) (2014), pp. 686–97.

capitalists expect to gain. This profitability is not a pure market relation, but a social relation. The profit expected by capitalists is a social relation that rests upon the relation of forces in terms of market power as well as social and political power. The profit accruing to capital is itself a social relation. This is the approach followed not only by Marxists but also by post-Keynesians associated with the surplus approach, such as Piero Sraffa. The theoretical option chosen by Piketty is strange because the surplus approach seems to be much more in line with his general approach. Moreover, by adopting the surplus approach the theory loses the deterministic outcome present in Piketty's predictions. His message suggests that if economic forces are left alone, the outcome will be a bad one. The problem is that there are no pure economic forces in the way in which the returns to capital are set. Continuing in this direction, the explanations of the different trends in income distribution may be better understood in terms of the social actors involved and the ways in which they organise and develop their bargaining forces. A highly industrialised society, with well-organised unions and a powerful social state, may give rise to a more equal society than one that is dominated by less organised service-sector workers within a globalised world, facing important outsourcing processes. Many other arguments along these lines may be mobilised to explain the trends found by Piketty.

what piketty does not say

So far I have mentioned that Piketty does not really pay too much attention to the way in which inequality impacts on growth. There are in fact several issues that he does not deal with. Let us go back to Figure 10.1 and look more closely and consider domestic inequality in the less developed world. How can we understand inequality trends in the less developed world? In spite of his goodwill, Piketty's approach has been very Eurocentric. The data available, on the basis of which the main stylised facts are created, are largely from the most developed European countries, and many times we get the idea that the entire story of inequality is about the developed world. Of course, this is not what Piketty thinks. Nevertheless, he devoted less than five pages to inequality trends in emerging economies, without reaching any clear conclusions.[4]

The case of China is challenging. China has been growing very fast, with increasing inequality. Is this because the amount of capital has grown much faster than the rate of economic growth, or is it mainly due to a changing institutional environment? Or perhaps it is because of a huge technological spill-over. The case of Latin America could validate the laws we are discussing, if we consider that South America is a continent that, in the long run, has been growing rather slowly and has maintained very high levels of inequality. In spite of many internal differences, Latin America has had structurally high inequality. No doubt these inequality levels must be related to

[4] Thomas Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: Harvard University Press, 2014), pp. 326–30.

particular economic, social and political circumstances, which have developed and transformed over the very long period of time since the European conquest. Nevertheless, if we look at the period since the 1870s, it is very difficult to find a law relating growth to inequality. We have witnessed several different patterns of growth along-side different patterns of inequality. We have long-run estimates for two Latin American countries: Chile[5] and Uruguay[6]. These two cases show, on the one hand, that the levels of inequality were steadily higher in Chile than in Uruguay. But, on the other hand, and in spite of that, both countries show a similar pattern. Instead of a Kuznets curve, we have a succesion of periods of increasing and falling inequality, with some periods lasting several decades. In neither of the two countries is it possible to find a correlation between inequality trends and growth trends: periods of fast growth are found both with increasing and falling inequality, and the other way round. Moreover, inequality changes differ from crisis to crisis. What the authors of the studies on Chile and Uruguay agree on is that what matters are the patterns of economic development, which can only be understood using a political economy approach.

Piketty very briefly mentions the importance of the profits from natural resources for some less developed countries. It is difficult to overestimate the role played by this. As with other primary producers, Latin American countries have been subject to very high volatility in their growth rates, which can mainly be related to patterns of specialisation based on a few families of products centred on primary production.[7] In spite of the existence of significant techno-logical change and productivity growth, cyclical growth is mainly explained by the appearance and disappearence of huge profits from natural resources. The way in which these profits are distributed is at the core of political life in Latin America, but the crises produced by the downward phase of the cycles have in most cases induced radical political changes. It is no accident that the current crisis of the Latin American economies after a decade of fast growth has been accompanied by extensive political changes. While many populist and Leftist movements in power fueled the social agenda and were able to construct broad political alliances behind them, the fall of commodity prices made the distributive agreements unsustainable, including the distribution of bribes among politicians. These trends are not clearly related to the capital–output ratio, productivity growth or technological change. The prospects for income inequality in Latin America are very much tied up with how the profits from the natural resources are distributed, in a context in which, finally, democratic rule seems to have consolidated. These prospects also depend on whether Latin American countries will be able to change their pattern of

[5] Javier Rodríguez Weber, *Desarrollo y Desigualdad en Chile (1850-2009): Historia de su economía política* (Centro de Investigaciones Diego Barros Arana: Ediciones de la Dirección de Bibliotecas, Archivos y Museos, 2016).

[6] Luis Bértola, "A 50 años de la curva de Kuznets: crecimiento económico y distribu-ción del ingreso en Uruguay y otras economías de nuevo asentamiento desde 1870", *Investigaciones de Historia Económica* 3 (2005), pp. 135–76.

[7] Luis Bértola and José Antonio Ocampo, *The Economic Development of Latin America Since Independence* (Oxford: Oxford University Press, 2012).

development through changes in their productive structures and institutional environments and take advantage of the huge technological gap still in existence.

But this is not the whole story. What is also of great importance is how inequality has impacted on growth in Latin America. Some authors, such as Coatsworth[8], have stressed that increasing inequality was a precondition for growth during the nineteenth century, which involved the privatisation of land and the creation of a capitalist labour market. However, there is no doubt that the sequels of slavery and other forms of coercive labour have impacted upon Latin American social structures, leaving a legacy of limited access to political participation, significant backwardness in levels of education and very slow development of skill-based economic activities. Thus, the link between high inequality and distinctive patterns of development and specialisation ended in a long-run trend of slow growth and limited structural change.

mind the gap

It is somewhat confusing to see how the concepts of inequality and divergence are used almost as synonyms in Piketty's work. He is well aware of the work of Bourguignon and Morrison,[9] who adopted the global view by quantifying inequality "among world citizens", which is something that has also been done by Branko Milanovic in several books.[10] This approach explicitly considers and quantifies both domestic and international inequalities. Moreover, Milanovic likes to say that, in order to understand inequality nowadays, it is of more importance to know someone's nationality than their social class. However, this is not congruent with Piketty's work, because his whole discussion has been clearly dominated by inequality trends within the developed countries. Because of his approach, Piketty is missing the very important debate about convergence and divergence trends in the world economy that has been taking place in recent decades. This debate involves both empirical and theoretical questions of huge interest.

The bold lines of international relative growth are very clear: divergence has been the dominating stylised fact since the Industrial Revolution, even during the decades in which Piketty finds decreasing inequality in the developed countries due to high growth rates. The high growth rates of the Golden Age implied a huge increase in international inequality. This is very important, because the income of capital is a socioeconomic phenomenon that takes place within and between particular political

[8] John H. Coastworth, "Inequality, Institutions and Economic Growth in Latin America", *Journal of Latin American Studies* 40 (2008), pp. 545–69.

[9] François Bourguignon and Christian Morrisson, "Inequality among World Citizens: 1820–1992", *The American Economic Review* 92(4) (2002), pp. 727–44.

[10] Branko Milanovic, *Global Inequality: A New Approach for the Age of Globalization* (Cambridge, MA: Harvard University Press, 2016); Branko Milanovic, *The Haves and the Have-Nots: A Brief and Idiosyncratic History of Global Inequality* (New York: Basic Books, 2010); Branko Milanovic, *Worlds Apart: Measuring International and Global Inequality* (Princeton, NJ: Princeton University Press, 2005).

units, with particular institutional features. As has been stressed many times, the fruits of productivity growth are not distributed as if markets worked perfectly; most of the time, distribution takes collusive forms. These collusive forms apply to the international arena in particular. However, in spite of growing inequality in both the developed world and China, the high growth rates of China and other emerging economies have produced, in recent decades, a slight reversal of the long-run inequality trend. Thus, when taking inequality worldwide into account, the stylised facts look quite different to those sketched by Piketty, and we need more analytical tools.

In order to simplify this discussion, let us consider that international divergence or covergence trends depend on factor accumulation and factor movements as well as on technological change. If factors move following the neoclassical diminishing marginal returns assumption, then we can expect a process of convergence. However, we have seen that the profits of capital involve social relations that may take different forms. Besides, the very concept of marginal diminishing returns to capital has been critised from very different schools of thought, even the neoclassical, because of the existence of economies of scale and agglomeration. Even if these arguments may be used in favour of Piketty's assumptions of increased inequality (between countries), the logic is quite different and, if the social conditions are given, as the case of China is showing us, capital may move to the less developed regions and foster high growth rates there.

What about technological change as a source of growth? For the sake of simplicity, let us follow the model developed by Verspagen.[11] Technological change depends on R&D investment, some kind of supply of knowledge and a demand-side technological change induced through the pattern of specialisation, i.e. through the dynamic response of exports to the expansion of world demand. It can be assumed that in both cases developed countries have an advantage over less developed countries. The per capita GDP level is higher, and the shares of R&D investment in GDP are higher in developed countries than in developing ones. The pattern of specialisation is much more favourable, as rich countries control the markets of fast-expanding sectors, inducing faster technological change. Thus, the expected outcome is one of international diver-gence and, thus, increasing world inequality. However, as endogenous growth theories have stressed, there exist counteracting mechanisms, such as technological spillovers. The wider the technological gap, the higher the potential growth rate of technological change of a less developed country. Technological spill-overs may overcome the increasing gap produced by the two other components, thus generating a process of convergence. However, a very wide gap may

[11] Bart Verspagen, *Uneven Growth Between Interdependent Economies: An Evolutionary View on Technology Gaps, Trade and Growth* (Aldershot: Avebury, 1993).

imply that the less developed country has no social capabilities to make use of the gap; therefore, the divergent trend results in a steady process of polarisation. There is plenty of space here for policy: increasing R&D investment, changing the patterns of specialisation, developing social capabilities to take advantage of the gap, etc. A country may diverge if the gap is wide and social capabilities weak; a country may conditionally converge, using the gap, towards a point of equilibrium given by the relative position in terms of specialisation and R&D investment; and a country may absolutely converge, or even forge ahead, if it takes leading positions in R&D investment and specialisation.

In short, we can get quite different outcomes as a result of the interaction between different supply and demand forces. Different growth rates at the inter-national level result in changing international inequalities, but these changing inequalities have a huge impact on growth prospects in different parts of the world. It is difficult to believe that increasing international inequality can be the best environment for increasing global growth rates. International coordination and cooperation is not only a way to reduce inequality within countries, but also a way to reduce inequality between countries and to stabilise and increase global growth.

Finally, a short note on technological change and economic growth. Technological change is not at the core of Piketty’s theory, but technological change has been the driving force of capitalist development. Much of future development will depend on how our societies succeed in directing techno-logical change in environmentally friendly ways as well as on the path that the new technological paradigm – based on information and communications technology, nanoscience and biotechnologies – follows across the world. We will face new challenges in measuring growth and well-being, and it will probably be difficult to compare growth rates between different periods, as the content of growth and development may differ. If we were just talking about how the less developed countries of today could make use of the still huge technological gap, we could be optimistic about a reduction in international inequalities. However, technology is specific to particular sectors and activities, and taking advantage of the gap will depend on many domestic transformations in the developing countries. The great problem we are facing is that the whole world economy needs a substantial change in the technological and social paradigm to take place in order to continue growing, so the developing countries have to converge towards an unknown. In a context in which technological change is at the core, the distributive outcomes of growth, within and between countries, is not predictable. Neither is the way in which distributional outcomes will impact on the pattern of technological change and the pace of economic growth.

In any case, my agreement with Piketty on this point is total: policy matters, politics and social relations are at the core of this, and the extent to which the world will be a better place to live in in the future depends upon both.