Review Essay

Capital in the Twenty-First Century. *By Thomas Piketty*. Translated by Arthur Goldhammer. Cambridge, Mass.: The Belknap Press of Harvard University Press, 2014. viii + 685 pp. Tables, figures, notes, index. Cloth, $39.95. ISBN: 978-0-674-43000-6.

Reviewed by Per H. Hansen

Rarely does a relatively unknown professor of economics publish a book that sells more than 200,000 copies in a few months. When critics accuse the same economist of being normative, political, of manipulating data, of misunderstanding basic economic theory, and of wanting to impoverish everyone, surely it must be because he is on to something. Other commentators, perhaps a bit prematurely, are claiming that his book is the economics book that will define twenty-first-century debate.

Thomas Piketty has done all that with his book, *Capital in the Twenty-First Century*, which deals with economic inequality in the nineteenth and twentieth centuries. Despite the title and some extrapolation into the twenty-second century, the book is mostly an impressive piece of economic history rather than a forecasting book. However, despite the historical content, the book contains an immensely important and relevant message for today.

While Piketty deserves all the attention (or most of it anyway), the book is also the result of his long-term collaboration with, among others, fellow economist Emmanuel Saez at University of California, Berkeley. Before the book was published in French in 2013, Piketty and his colleagues published their results in highly ranked journals such as *American Economic Review* and, most recently, *Science*.[1]

Since the publication of the English version in March 2014, *Capital in the Twenty-First Century* has been intensely discussed worldwide. In Denmark, for instance, a Danish translation is being rushed through at the moment. Not surprisingly, the discussion converges along the usual demarcation line separating liberals and conservatives. The first group loves it, and the second hates it—thus demonstrating that,

[1] Thomas Piketty and Emmanuel Saez, "Inequality in the Long Run," *Science* 344, no. 6186 (2014): 838–43.

Business History Review 88 (Autumn 2014): 583–591. doi:10.1017/S0007680514000452
 ISSN 0007-6805; 2044-768X (Web).

despite the scientific, mathematical appearance of the discipline, economics is just another social science like, say, history and sociology.

That is a point Piketty is keen to make, especially in the conclusion where he pleads for "political and historical economics" to replace neoclassical economics (pp. 573–74). Piketty also distances himself from the idea of objectively mapping, explaining, and reducing inequality since, "whenever one speaks about the distribution of wealth, politics is never very far behind, and it is difficult for anyone to escape contemporary class prejudice and interests" (p. 4).

The heated discussion about the merits of the book seems to demonstrate this point. So does the fact that wealth and income inequality currently is a hot and much debated issue. The financial crisis of 2007–09 and the Great Recession have contributed to the resonance of the issue, and there have been a number of important publications on wealth and income inequity over the last decade. Among these are Paul Krugman's *The Conscience of a Liberal* (2007) and Joseph Stiglitz's *The Price of Inequality* (2012), in which he debates inequality from a progressive point of view and assigns explanatory power to political favoritism and market imperfections.

Other significant contributions are James K. Galbraith's *Inequality and Instability* (2012) and, to a certain extent, Mark Blyth's *Austerity: The History of a Dangerous Idea* (2013), and Raghuram Rajan's *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (2010).

In addition, the International Monetary Fund (IMF) has recently turned its attention to inequality, and IMF Staff Discussion Notes from 2011 and 2014 suggest that inequality may be harmful to economic growth and stability.[2] Finally, even the conservative magazine the *Economist* argued in a special report from 2012, "Growing inequality is one of the biggest social, economic and political challenges of our time."[3]

In other words, whether one likes it or not, the question of inequality has come to the forefront of contemporary discussion. Quite a few prominent economists, primarily of the neoclassical variety, are not really in favor of that discussion. For instance, in 2007, Nobel laureate Robert Lucas argued, "Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus

[2] Andrew Berg and Jonathan D. Ostry, *Inequality and Unsustainable Growth: Two Sides of the Same Coin?* IMF Staff Discussion Note, SDN/11/08 (Washington, D.C., 8 Apr. 2011); and Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides, *Redistribution, Inequality, and Growth*, IMF Staff Discussion Note, SDN14/02 (Washington, D.C., Feb. 2014).

[3] "For Richer, for Poorer," Special Report: The World Economy, *The Economist* 13 Oct. 2012, http://www.economist.com/node/21564414, accessed 6 July 2014.

https://doi.org/10.1017/S0007680514000452 Published online by Cambridge University Press

on questions of distribution."[4] Likewise, Willem Buiter, former London School of Economics professor and current chief economist at Citigroup, is reported to have argued, "Poverty bothers me. Inequality does not. I just don't care."[5] Harvard professor N. Gregory Mankiw has even taken upon himself the task of "defending the one percent" in numerous *New York Times* articles and in an academic article.[6]

Needless to say, then, there is no agreement about whether wealth and income inequality is worth considering or not. It seems that Piketty's point about the inherently political nature of the subject is warranted. But, apart from ideology, what is the disagreement really about? Well, first, inequality is a relative concept, and economists and others who just do not care about inequality emphasize that, even if inequality is increasing, the absolute level of economic well-being has increased dramatically over the last two hundred years.

Even if the richest decile or percentile of the population received a larger share of the pie, the pie has grown so much in size that everyone is better off, even if the "poorest" fifty percent only receives about five percent of the total income. The point is, of course, that absolute poverty is a problem, inequality is not, and there is not much absolute poverty in the Western world. Economists such as Mankiw, Buiter, and Lucas believe that any kind of intervention against inequality will change the incentive structure in a negative way, and thereby harm economic growth. More redistribution from the rich to the less fortunate will, their argument goes, reduce risk taking and entrepreneurship, and people will work less or move to another country. Thus, in the Mankiw, Buiter, and Lucas narrative, people are rich because they deserve it. Economic incentives, exclusively, drive them, and therefore they have exploited their own potential and created not only a personal fortune but economic growth as well. For this, they have received their fair reward, which according to neoclassical economics corresponds to their marginal productivity, if they are top managers, or to a supernormal profit if they are entrepreneurs. This narrative focuses on the individual managerial or entrepreneurial hero who created wealth without any assistance. The story legitimizes wealth and income inequality as a result of a meritocratic society. Taken to its extreme, this is the story of Ayn Rand's *Atlas Shrugged* (1957).

[4] Robert E. Lucas, "The Industrial Revolution: Past and Future," *2003 Annual Report Essay*, Federal Reserve Bank of Minneapolis, http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3333, accessed 5 July 2014.

[5] Quoted from Robert Wade, "From Global Imbalances to Global Reorganizations," *Cambridge Journal of Economics* 33, no. 4 (2009): 539–62, specifically 552.

[6] Gregory N. Mankiw, "Defending the One Percent," *Journal of Economic Perspectives* 27, no. 3 (2013): 21–34.

On the other hand, economists such as Thomas Piketty argue that inequality is a real problem in society. According to these economists, increased inequality contributes to economic and financial instability, reduces economic growth and social mobility, and leads to social and health problems. In addition, inequality is a democratic problem that puts the social state (as Piketty calls it) under pressure. His narrative is not about meritocracy but rather about privilege in terms of inheritance and social groups and networks privileging each other. While Mankiw, Buiter, and Lucas's "inequality-is-good" narrative focuses on the individual and competition, Piketty's "inequality-is-bad" narrative puts more emphasis on the collective and the social. Piketty's history of economic inequality can be categorized as an unusually empirical contribution to the latter narrative. Piketty begins his story by recapitulating Thomas Malthus, David Ricardo, and Karl Marx's views on developing inequality, and then he goes on to discuss Simon Kuznets's "fairy tale," as he calls it (p. 11). Kuznets argued that inequality increased during the first parts of the industrial revolution, but would then decrease with further economic growth.[7] He presented this so-called Kuznets curve in the 1950s, clearly as a result of a modernist ideology from a time when it still made sense to believe in history as a process of more or less uninterrupted progress. Another example of this is Walt Rostow's *The Stages of Economic Growth* (1960). It is not accidental that Kuznets presented his theory in the 1950s and 1960s, since the period from World War I to 1970 is the only period in world history, according to Piketty, when both total wealth relative to income, as well as wealth and income inequality, actually declined.

In particular, the period from 1945 to the 1970s was the economic golden age of catch up and the development of the social state, where state intervention in the market economies, regulation of the financial industry, and capital controls were widespread. Piketty stresses that it was the total experience of two world wars and a devastating Great Depression that made possible this shift in policy. In general, though, there is only very little detailed discussion of the process that brought about these changes, and of how it affected the different deciles or percentiles of the population. In fact, Piketty focuses strictly on the top ten, top one, and top 0.1 percent.

Reviewers have frequently mentioned Piketty's literary references to Honoré de Balzac, Jane Austen, and Henry James and that they are an interesting way of substantiating or illustrating some of his arguments. However, one could have wished for a wider use of historical works on

[7] See, in particular, Simon Kuznets, "Economic Growth and Income Inequality," *American Economic Review* 45, no. 1 (1955): 1–28.

inequality in the United States, United Kingdom, and continental Europe. That history is not, however, the purpose of Piketty's book, which is a strictly macroeconomic history based on an impressive amount of data mining and number crunching.

The periodization of Piketty's book is not at all surprising. He follows the already widely used shifts in political, social, and economic history: the period of economic liberalism before 1914 where income and wealth inequality peaked, the period of state intervention (for various reasons) from 1914 to the 1970s where inequality declined, and the neoliberal breakthrough after that where inequality rose again, this time driven primarily by labor income rather than income from wealth. And this is one of the points in Piketty's narrative: that the periodization correlates closely with the main shifts in inequality. Piketty contradicts Kuznets's fairy tale; contrary to Kuznets's assumption that capitalism had a built-in trend towards increased equality, Piketty demonstrates that there is a built-in tendency towards increased inequality. The decline in wealth and income inequality during the postwar period was the exception, not the rule.

The rule, then, according to Piketty, is that inequality will continue to increase forever and, in 2100 or 2200, will reach the same level as around 1900 or even more. The only way to avoid this development is for the state to intervene in the economy. The market economy cannot by itself ensure an egalitarian development. What is needed is the introduction of high marginal tax rates on income and wealth, and, if this does not happen, the current race to the bottom will continue with nations competing for capital by lowering taxes. Under these circumstances, the social state with relatively free access to education, health care, and insurance against unemployment cannot survive. Piketty also argues—together with the IMF and other authors—that increased marginal taxes will not reduce economic growth. In the meantime, every time one percentage point of wealth or income is moved to the top decile, the middle class gets more squeezed. This has been happening since the 1970s, while the lowest fifty percent has received around five percent of total income in the whole period.

As already indicated, Piketty, with his colleagues, has established time series for wealth distribution back to 1810 and income distribution back to 1910—for France, the United Kingdom, Sweden, and the United States. He includes many other countries in the statistics but on a somewhat more erratic basis. He derived national income figures from Angus Maddison's huge work (the online Maddison Project: http://www.ggdc.net/maddison/maddison-project/home.htm). Piketty himself acknowledges more than once that there is some uncertainty about the reliability of Maddison's figures. He has, however, set an example by putting all

https://doi.org/10.1017/S0007680514000452 Published online by Cambridge University Press

data on his own website where everyone is free to scrutinize them: http://piketty.pse.ens.fr/en/capital21c2.

Indeed, *Financial Times*'s economic editor Chris Giles has examined Piketty's sources and concluded that he does not trust some of the data and that, therefore, Piketty's "conclusions . . . do not appear to be backed by the book's own sources." Piketty has replied to these accusations in a lengthy response, which, while encouraging further research, also emphasizes that his conclusions still stand. The *Economist* and others have supported Piketty in this conclusion.[8]

While Giles's critique seems exaggerated, it is not at all surprising that attempts at undermining Piketty's conclusions abound. Piketty is definitely right in his statement that politics follows research in inequality closely. But he has also exposed himself to risk by emphasizing that the validity of his conclusions rests on the new data and the already famous inequality $r > g$. Here he might have remembered Donald McCloskey's classic 1983 article, "The Rhetoric of Economics," that states it is as much the narrative strength of a text that determines its validity.[9]

In any case, it is also not surprising that the other main critique aimed at *Capital in the Twenty-First Century* is about $r > g$, and already working papers are being published about the model.[10] The inequality $r > g$ states that over time the return on capital (r) will be larger than economic growth per capita (g). The model rests on Piketty's assumption that future growth will be around 1–1.5 percent, while return on capital will be around 4–5 percent. The result will be that wealth will increase and inherited wealth will come to dominate, just as it did before 1914, and that inequality will rise indefinitely. This trend threatens the meritocratic principle upon which capitalism is assumed to be built—even more so, since, according to Piketty, there are economies of scale to wealth. Thus, the return to capital increases with the fortune one

[8] For Chris Giles's original critique, see *Financial Times*: http://blogs.ft.com/money-supply/2014/05/23/data-problems-with-capital-in-the-21st-century/; and for Piketty's response, see http://blogs.ft.com/money-supply/2014/05/30/capital-in-the-21st-century-a-response/. Finally, see the *Economist*'s discussion here: http://www.economist.com/news/finance-and-economics/21603022-latest-controversy-around-thomas-pikettys-blockbuster-book-concerns-its (all accessed 7 July 2014).

[9] Donald McCloskey, "The Rhetoric of Economics," *Journal of Economic Literature* 21, no. 2 (1983): 481–517.

[10] See, for instance, Stefan Homburg, "Critical Remarks on Piketty's *Capital in the Twenty-First Century*," Discussion Paper no. 530, Institute of Public Economics, Leibniz University of Hannover, April 2014; Guillaume Allègre and Xavier Timbeau, "The Critique of *Capital in the Twenty-First Century:* In Search of the Macroeconomic Foundations of Inequality," Working Paper 2014-10, OFCE, Sciences-Po, Paris, May 2014, http://www.ofce.sciences-po.fr/pdf/dtravail/WP2014-10.pdf. Also, see Lawrence H. Summers, "The Inequality Puzzle," *Democracy* 33 (Summer 2014): http://www.democracyjournal.org/33/the-inequality-puzzle.php.

has amassed, and this return will, needless to say, be to the advantage of the top decile. The result will be a never-ending redistribution of wealth to the top decile, and in particular the top 1 and top 0.1 percent, while the middle class will be ever more squeezed.

Piketty has to admit, however, that wealth, and especially inherited wealth, does not play as important a role in the total income of the top decile as in Europe before 1914. Income from labor has taken over, except for the richest of the richest—the top 0.1 percent. While this view might seem reassuring, it really is not, according to Piketty, because of the rise of the labor income of the super-manager. Since the 1970s, super-managers have replaced the "super-rentiers," or as Piketty says, "We have gone from a society of rentiers to a society of managers, that is from a society in which the top centile is dominated by rentiers . . . to a society in which the top of the income hierarchy, including the upper centile, consists mainly of highly paid individuals who live on income from labor" (p. 278).

The income from top managers has increased dramatically and now is at a level several hundred times higher than average wages in a company. Surely, this must be reassuring; because top managers' salaries are supposed to be determined by their marginal productivity, don't they deserve every cent of it? Not really, says Piketty. While he recognizes the long-term role of education and skills and thus marginal productivity for most of the labor force, super-managers' salaries are more a result of social norms legitimized by cultural and sociological processes (pp. 333–35).

This part of Piketty's analysis is, in my opinion, one that needs a closer microlevel analysis in order to get to a better historical understanding of these norms and of the cultural, historical, and sociological processes that shape them. This issue, along with some others that Piketty does not dig into deeply enough, is an obvious task for business historians. Pamela Laird's important work on social networks and the self-made man has already helped us to understand how the meritocratic narrative may be deeply problematic.[11]

In my own work, I have tried to show how the construction of competing narratives about finance and markets have had tremendous influence on those financial markets and society at large. My research relates to Piketty's mention of the importance of financial globalization for increasing inequality, a topic which also needs further historical analysis. I have also discussed how narratives play an important role in constructing business managers and entrepreneurs as heroes. This process clearly

[11] Pamela Laird, *Pull: Networking and Success since Benjamin Franklin* (Cambridge, Mass., 2006).

https://doi.org/10.1017/S0007680514000452 Published online by Cambridge University Press

correlates with the demise of managerial capitalism and the rise of the idea that corporations exist to maximize shareholder value—a transition that business historians still need to explore more fully.[12]

So, Piketty does not find much evidence to support the meritocracy narrative. There is no doubt that *Capital in the Twenty-First Century* explores a moral dimension and conveys an idea about fairness. But Piketty is also worried about the social and economic stability of extremely unequal societies, and he considers high inequality to be a democratic problem as well. What to do about it? Piketty is pretty clear, if a little unrealistic, on this issue. Since increasing inequality in his narrative is not a result of market imperfections but, quite the opposite, of "perfect" markets, it will not stop unless some "external" forces intervene. That is what happened during the interwar and the postwar period, when two wars and a depression destroyed capital, and state intervention redistributed income from both wealth and labor.

Interestingly enough, Piketty shows how the United States and the United Kingdom, in particular, introduced very high marginal taxes on wealth and labor income in this period, while Europe lagged (p. 499). In contrast, since the late 1980s, the United States and the United Kingdom have had lower marginal tax rates than Germany and France. If the current trend towards ever-increasing inequality is to be stopped, Piketty argues, the state must intervene with high marginal taxes on income and wealth. And since Piketty finds no correlation between declining marginal taxes and increasing productivity, this taxation will not harm economic growth (pp. 509–10).

Piketty recognizes that such measures do not correspond well to the direction the world is taking at the moment, as a further race to the bottom among competing states seems more likely. International coordination and cooperation is going to be necessary, and Piketty suggests that the European Union take the first steps in this direction. Even if it is not possible to introduce all measures, Piketty writes, at least now he has established a benchmark on which to evaluate future interventions aimed at reducing inequality.

So, is Piketty's argument true? Is Piketty right? The question will always devolve to a political and ideological discussion, and therefore it is not really fruitful to ask if Piketty *is* right. The question is whether he *will be* right. Piketty has already been likened to great historical

[12] Per H. Hansen, "From Finance Capitalism to Financialization: A Cultural and Narrative Perspective on 150 Years of Financial History," forthcoming in *Enterprise & Society* 15, no. 4 (2014); Per H. Hansen, "Making Sense of Financial Crisis and Scandal: A Danish Bank Failure in the Era of Finance Capitalism," *Enterprise & Society* 13, no. 4 (2012): 672–706; and Per H. Hansen, "Business History: A Cultural and Narrative Approach," *Business History Review* 86 (Winter 2012): 693–717.

economists such as Adam Smith, John Maynard Keynes, and Milton Friedman. Not because they wrote about the same message or reached the same conclusions as he has, but because they addressed the big contemporary economic and political challenges of their own times, as he does.

In their time, critics of the period all contested Smith's, Keynes's, and Friedman's works—as do modern critics today—but their theories, nevertheless, won significance at specific points in time, precisely because they had timely answers to contemporary challenges. It was because of this relevance that these three names came to play a big role in economic thinking and in the shaping of their societies. When they published their theories, there was already a "need" for them, but the theories also proved to be performative and legitimized, and thereby furthered a development already under way.

The big issue, then, is whether the problem of economic inequality constitutes such a pressing challenge to contemporary society that *Capital in the Twenty-First Century* may become, or at least may contribute to, the scientific legitimization and understanding of the state intervention Piketty is calling for. We cannot know yet. Smith's, Keynes's, and Friedman's ideas were not accepted overnight, and neither are Piketty's ideas. Only time will tell whether Piketty *will be* right. In the meantime, this reviewer believes that Thomas Piketty has written an enormously important, well-argued, learned—and even well-written—book about economic inequality in historical perspective.

Per H. Hansen is professor of business history at the Centre for Business History at Copenhagen Business School.

https://doi.org/10.1017/S0007680514000452 Published online by Cambridge University Press