

Finance Matters

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Lecture#5

The Capital: From Marx to Piketty

Warning: Marx vs. Piketty

- ♦ I don't claim here that Piketty is the Marx of the 21st century
- ♦ Karl Marx is a philosopher, journalist, economist... He built a complex theory around the "capital", the value, the political and social system.
- ♦ Piketty is an economist and conducted mainly statistical studies over a long period of time that aims at criticizing the accumulation of wealth and the rise of inequalities. He didn't offer any alternative model to capitalism, or formally criticized capitalism

Karl Marx

- ◆ Karl Marx (1818-1883)
- ◆ Marx, in conjunction with Friedrich Engels, published *The Communist Manifesto* in 1848
- ◆ Marx wrote *Das Kapital* (the first volume was published in Berlin in 1867; the second and third volumes were published posthumously in 1885 and 1894, respectively), which discussed the **labour theory of value**.

What Is Marxism?

- ♦ **Marxism** believes that there is a real contradiction between human nature and the way that we must work in a capitalist society
- ♦ **Marxism** has a dialectic approach to life in that everything has two sides
- ♦ **Marxism** believes that capitalism is not only an economic system but is also a political system

Main Ideas

- ◆ Marx argues that society is composed of two main classes: Capitalists and Proletariat
- ◆ Capitalists are the business owners who organize the process of production and who own the means of production such as factories, tools, and raw material, and who are also entitled to any and all profits

- ◆ Proletariat: it is a much larger class, composed of labour. Labourers do not own or have any claim to the means of production, the finished products they work on, or any of the profits generated from sales of those products.

Marx and the Criticism of Capitalism

- ♦ Marx was heavily critical of the current socio-economic form of society, capitalism, which he called the "**dictatorship of the bourgeoisie**"
- ♦ Marx accused capitalism to be run by the wealthy middle and upper classes purely for their own benefit, and predicted that, like previous socioeconomic systems, it would inevitably produce internal tensions which would lead to its self-destruction and replacement by a new system, **socialism**.

Historical Materialism

- ◆ This theory posits that society at any given point in time is ordered by the type of technology used in the process of production. Under industrial capitalism, society is ordered with capitalists organizing labour in factories or offices where they work for wages.

- ◆ Prior to capitalism, Marx suggested that feudalism existed as a specific set of social relations between lord and peasant classes related to the hand-powered or animal-powered means of production prevalent at the time

The Labour Theory of Value

- ◆ Like the other classical economists, Karl Marx believed in the labour theory of value to explain relative differences in market prices
- ◆ This theory stated that the value of a produced economic good can be measured objectively by the average number of labour-hours required to produce it. In other words, if a table takes twice as long to make as a chair, then the table should be considered twice as valuable.

Subjective Theory of Value

- ◆ For example, let's say you have one wool coat and the weather is extremely cold outside; you will want that coat to wear and keep you from freezing. In a case like this, the wool coat might be worth more to you than a diamond necklace. If, on the other hand, the temperature is warm, you will not want to use the coat, so your desire for – and amount you value – the coat wanes. In effect, the value of the coat is based on your desire and need for it, and so it is the value you placed on it, not any inherent value of the coat.

Before Marx, Adam Smith

- ♦ One of the fundamental differences between **Adam Smith** and **Karl Marx**, is that the former, although he was conscious of how workers are exploited by capitalists, supported the capitalists whereas the latter argued for the emancipation of workers
- ♦ **Adam Smith (1723-1790)** and **Karl Marx** both believed that competition among producers was beneficial for society as a whole. **Smith** believed that competition between producers was beneficial because it gave the consumer a choice about where they wanted to purchase goods from, thus keeping producers honest and fair towards consumers

Thomas Piketty (1971-)

- *Capital in the Twenty-First Century* (2013)

- ♦ Piketty starts his introduction “It is long past the time when we should have put the question of inequality back at the center of economic analysis.”
- ♦ President Barack Obama called it “the defining issue of our time.”
- ♦ He got inspired by literary characters in the novels of Jane Austen and Balzac.
- ♦ Wealth was best achieved in these stories through a clever marriage; everyone knew that inherited land and capital was the only way to live well, since labour alone would not produce sufficient income. He wondered how that assumption had changed from today

Main Findings

- ◆ His findings, aided by the power of modern computers, are based on centuries of statistics on wealth accumulation and economic growth in advanced industrial countries. He found that inequality increases when r (**rate of return on capital**) is greater than g (**economic growth rate**)
- ◆ There is a shrinking share going to income earned from wages, which rarely increase faster than overall economic activity. Inequality surges when population and the economy grow slowly.

- ♦ Piketty studies inequality specially in the American society
- ♦ He notes that education supposedly offers roughly equal access to all in order to promote social mobility. He calculates, however, that “the average income of the parents of Harvard students is currently about \$450,000,” which corresponds to the **top 2 percent of the income hierarchy**. In a typical understatement, he writes that “such a finding does not seem entirely compatible with the idea of selection based solely on merit.”

Inequalities

- ♦ The top-25 highest earners took home a combined \$13 billion in 2015, according to the industry's annual "rich list" compiled by Institutional Investor's Alpha magazine.
- ♦ The **median** household income in the **United States** is \$56,516, according to 2015 data from the **U.S. Census**
- ♦ (In 1633-1637, the price a tulip bulb sold at 400 guilders and that was more than the yearly salary of an unskilled labourer)

Piketty

- ♦ The remuneration of what he calls the “supermanagers” cannot be explained by the “rational productivity justification.” The “extremely generous awards meted out to top managers” are a “powerful force” intensifying economic inequality, especially in the United States.
- ♦ Ontario: “In total, Tarion paid out more than \$4 million in executive compensation last year. The corporation also paid \$520,000 to its 16 board members, half of which typically have experience in the homebuilding industry.” CBC, October 16, 2019

Wages Gap in Canada

- ◆ Lee Valley Tools has ensured that the highest-paid worker never makes more than 10 times the wage of the lowest-paid worker.
- ◆ By contrast, that ratio averaged 122-to-one last year at Canada's biggest companies, up from 84-to-one a decade earlier, according to data prepared for The Globe and Mail (2013)

Main Difference between Piketty and Marx

- ◆ Piketty wants to re-distribute the fruits of capitalism so as to even out the highs and lows; Marx wants to transform capitalism so as to end its dominion
- ◆ Much of Marx's work, early and late, sought to document the misery of workers. Hundreds of pages of *Capital* described the average working day (and night) and its discontents.
- ◆ Piketty is silent about this matter, although he mentioned labour strike in his book.
- ◆ What really concerns Piketty is the inequalities not the labour relations.

- ♦ While Marx presumed that the rate of return on capital, because of the system's contradictions, would fall close to zero, bringing collapse and revolution
- ♦ Mr. Piketty is saying the opposite. “The rate of return to capital can be bigger than the growth rate forever — this is actually what we've had for most of human history, and there are good reasons to believe we will have it in the future.”

- ◆ Labour in Piketty exists mainly as numbers about income. For instance, he observes that the fortune of Liliane Bettencourt, heiress of L'Oréal, the cosmetic giant, increased from \$4 billion to \$50 billion between 1990 and 2010.
- ◆ “In other words, Liliane Bettencourt, who never worked a day in her life, saw her fortune grow exactly as rapidly as that of Bill Gates.”

Piketty and Utopia

- ♦ Piketty proposes a progressive global tax on capital, which will “stop the indefinite increase of inequality in wealth.” He admits the idea is “utopian,” but maintains is useful and necessary. “Many people will reject the global tax on capital as a dangerous illusion, just as the income tax was rejected in its time, a little more than a century ago.”

Criticism of Piketty

- ◆ In a sense, Piketty offers a Swedish-style capitalism that has softened the economic extremes.
- ◆ It does not address a redundant labour force, alienating work, or a society driven by money and profit.
- ◆ Piketty accepts these “oppressive” forces.
- ◆ He describes something people know, capitalism with all of its pluses, but fewer of its minuses.

Marx and Utopia

- ◆ Marx's *Capital* offers no real solutions. In his final chapter, he alludes to “new forces and new passions” that spring up to transform capitalism, leading to an era of “cooperation and the possession in common of the land and the means of production.”
- ◆ The agency is the working class. Today, the Marxist experiences are considered as utopian or worse, depending on how one interprets the Soviet, Chinese, Cuban experiences.

Marx and his ideas

- ◆ Under socialism, he argued that society would be governed by the working class
- ◆ In what he called the "dictatorship of the proletariat", the "workers state" or "workers' democracy".
- ◆ He believed that socialism would, in its turn, eventually be replaced by a stateless, classless society called pure **communism**.

- ◆ Piketty skips over the political and social history that led to Fordism, then to neoliberalism.
- ◆ For him wealth generated through business enterprise is good — unless the rich merely sit on that wealth.

Sequel: Capital and Ideology

- ◆ The French edition of “Capital and Ideology,” weighing in at 1,232 pages, came in French last September 2019.

- ◆ In the new book, Piketty argues that no shareholder should control more than 10% of voting rights at a company -- even if they hold a much bigger stake.
- ◆ He backs a kind of capital handout for the public
Piketty's "inheritance for all" would grant all French citizens a lump sum of 120,000 euros (\$132,000) when they reach the age of 25.

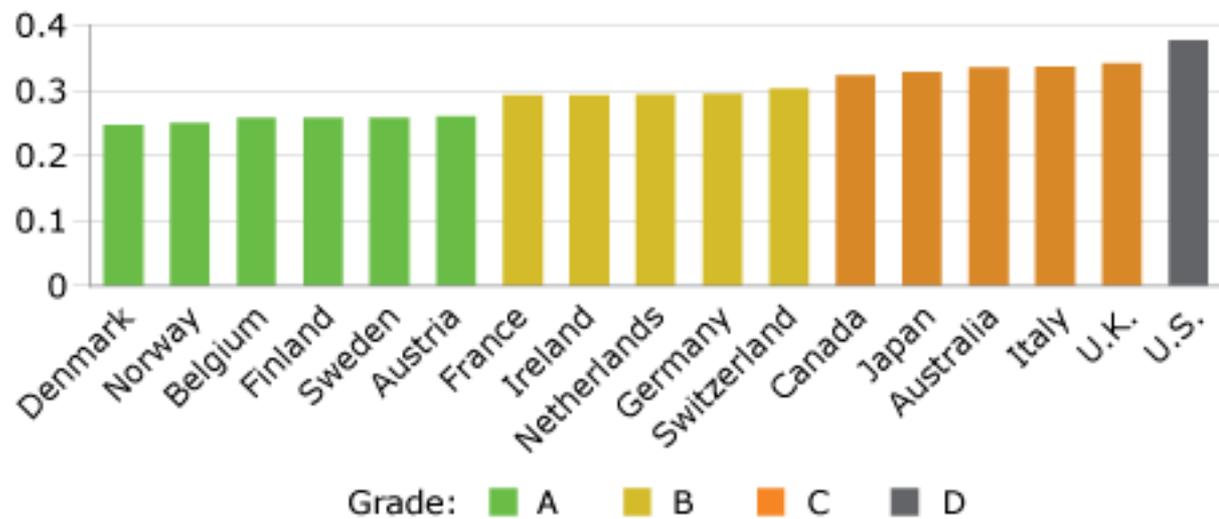
Money and Power

- ♦ Piketty advocates for a **wealth tax** to enshrine the idea that ownership of property above a certain value can only be “temporary”. In France, for example, the scale would range from a 0.1% charge on wealth below the national average of 200,000 euros, to as much as 90%.
- ♦ “The system I propose makes it possible to own several million euros, or even tens of millions, at least for a while,” Piketty told L’Obs. “But those with several hundred million euros, or several billion, will have to share power.”

Inequalities in Canada

- ◆ Canada gets a “C” grade and ranks 12th out of 17 peer countries.
- ◆ Income inequality in Canada has increased over the past 20 years.
- ◆ Since 1990, the richest group of Canadians has increased its share of total national income, while the poorest and middle-income groups has lost share.

Income Inequality, Late 2000s
(Gini coefficient)



Why Inequality Hurts?

- ◆ Despite being a moral question
- ◆ It is becoming an economic question
- ◆ Joseph Stiglitz argues that this is an economic question
- ◆ <https://economics.com/joseph-stiglitz-inequality-unearned-income/>

The International Monetary Fund

- ◆ A 2011 study by the IMF found the following:
- ◆ When growth is looked at over the long term, the trade-off between efficiency and equality may not exist. In fact equality appears to be an important ingredient in promoting and sustaining growth. The difference between countries that can sustain rapid growth for many years or even decades and the many others that see growth spurts fade quickly may be the level of inequality. Countries may find that improving equality may also improve efficiency, understood as more sustainable long-run growth.

Inequality Explained

- ◆ Two main factors:
 - ◆ - The increase of debt to levels that can lead to financial crises
 - ◆ The social instability which may lead to less foreign investment
 - ◆ The skills and capabilities of all the citizens are not fully used that leads to less economic growth

- ◆ The richest 1 per cent of Canadians took almost a third of all income gains from 1997 to 2007—the decade with the fastest-growing incomes in this generation, according to a 2010 study by Canadian Economist Armine Yalnizyan

Why Inequality is Rising

- ◆ Market forces:
- ◆ Some economist argue that “in our technologically advanced society, skill has higher value than it does in a less technologically advanced society”
- ◆ Institutional forces:
- ◆ Paul Krugman argues that factors like declines in unionization rates, stagnating minimum wage rates, deregulation, and national policies that favour the wealthy. In Canada, Armine Yalnizyan notes that falling top marginal tax rates are part of the explanation for the rise of the richest 1 per cent of the population.

Lars Osberg

- ◆ *In The Age of Increasing Inequality: The Astonishing Rise Of Canada's 1% by Lars Osberg, Economic Professor at University of Dalhousie*
- ◆ Since 1980, the bottom half of Canada's earners have actually seen their earnings in the workforce shrink, when adjusted for inflation.

- ◆ Among the top one per cent, incomes have more than doubled — and income growth has been even stronger for the top 0.1 per cent. The higher you are on the income ladder, the better you've done in the past 40 years.
- ◆ As the 99 per cent watch the one per cent do better and better, they develop a sense they are falling behind, even if for many of them, incomes are still improving.

Sources

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- ◆ <https://www.theguardian.com/books/2017/mar/13/utopia-realists-how-we-can-get-there-rutger-bregman-review>

Your Thoughts

