N. GREGORY MANKIW TRIES TO DISCREDIT PIKETTY

In this paper, titled *Yes, r > g. So What?*. N. Gregory Mankiw tries to show that Thomas Piketty is wrong that if r > g wealth will accumulate in the hands of a tiny number of rich people. It's short and easy on the math, perhaps because it was part of a symposium rather than a stand-alone paper. For comparison, take a look at this by Piketty and Gabriel Zucman, which requires more than a passing familiarity with math. It seems unlikely that Mankiw had read this paper before he cranked out his, because Piketty addresses the issues Mankiw raises.

Mankiw makes three arguments. First, he says we need to have r > g. Second, he claims that the generational changes and taxation will prevent dynastic wealth. Third, he disagrees with Piketty's solution which is a wealth tax. Let's take them in turn.

1. The idea that r, the rate of return to capital, is greater than g, the rate of growth of the economy, is common in mainstream economic theory.

> If the rate of return is less than the growth rate, the economy has accumulated an excessive amount of capital. In this dynamically inefficient situation, all generations can be made better off by reducing the economy's saving rate. From this perspective, we should be reassured that we live in a world in which r > g because it means we have not left any dynamic Pareto improvements unexploited.

Mankiw's standard is whether the economy can produce Pareto Improvements, meaning an improvement in the wealth of one or more people that doesn't reduce the wealth anyone else. Mankiw simply ignores the fact that fabulous wealth carries with it the ability to influence the political process to extract more wealth, which is what Piketty says. Surely Mankiw isn't arguing that won't happen, because it does. Take, for example, the pharmaceutical industry where the business model is to increase prices with no additional benefit to anyone.

Then look at his cure. How exactly will the bottom 60% benefit by saving less? They won't, because they are barely saving. They cannot come up with $400 to fix a car. Most of the rest wouldn't be able to save less; they need to save for retirement, and to pay what their kids can't make in this rotten economy. What Mankiw means is that the very top, the .1%, would have to spend a lot more, But what are they going to buy? Expensive trips on private jets? Van Gogh paintings? That isn't going to help the economy or make anyone's life better. The fact is that this argument points directly to the need to hike taxes on the idle money of the rich.

2. Mankiw's second argument is an effort to show that taxes and generational changes will decrease dynastic wealth. Mankiw doesn't confront the detailed argument Piketty makes on those very points. I introduce it here, and link to the detailed argument for those interested. Instead, Mankiw offers a simple model that proves his point, and could be understood by anyone who read his introduction to economics textbook; for typographical reasons, subscripts are not used for cw and ck

> To oversimplify a bit, let's just focus on this economy's steady state. Using mostly conventional notation, it is described by the following equations.
>
> (1) cw = w + τ k
>
> (2) ck = (r − τ − g)nk
>
> (3) r = f ′(k)
>
> (4) w = f(k) − rk
>
> (5) g = σ(r − τ − ρ),

> where cw is consumption of each worker, ck is the consumption of each capitalist, w is the wage, r is the (before-tax) rate of return on capital, k is the capital stock per worker, n is the number of workers per capitalist (so nk is the capital stock per capitalist), f(k) is the production function for output (net of depreciation), g is the rate of labor-augmenting technological change and thus the steady-state growth rate, σ is the capitalists' intertemporal elasticity of substitution, and ρ is the capitalists' rate of time preference. Equation (1) says that workers consume their wages plus what is transferred by the government. Equation (2) says that capitalists consume the return on their capital after paying taxes and saving enough to maintain the steady-state ratio of capital to effective workers. Equation (3) says that capital earns its marginal product. Equation (4) says that workers are paid what is left after capital is compensated. Equation (5) is derived from the capitalists' Euler equation; it relates the growth rate of capitalist's consumption (which is g in steady state) to the after-tax rate of return.

Note that we didn't get a definition of the symbol τ, which in conventional notation means taxes. As we learn a couple of paragraphs down, Mankiw means not general taxes, but taxes on returns to capital. As he tells us, all the money from taxes is consumed by the workers (equation (1)), that is, the total amount of taxes on capital is transferred directly, in the form of grants or indirectly in the form of services, to wage-earners and none of it is consumed by the capitalists. in the real world, capitalists consume a great deal of the expenditure on taxes, whether the taxes are on capital or income or otherwise. Obviously we need to put a non-trivial number into equation (2) to show that capitalists consume a portion of the taxes, and make an appropriate modification to equation (1) if we want this model to make minimal contact with the real world.

Mankiw says that in this model, there is no steady increase in inequality.

> In this economy, even though r > g, there is no “endless inegalitarian spiral.” Instead, there is a steady-state level of inequality. (Optimizing capitalists consume enough to prevent their wealth from growing faster than labor income.)

This outcome was baked into the model with equation (2). If instead, we assume the same equations, but add a non-trivial number to equation (2), then the capitalist accumulates that non-trivial amount each year, and wealth inequality increases naturally even in his steady-state economy.

Also baked into this model is the remarkable idea that “capital earns its marginal product” and the rest of the money is paid out in wages. That’s just so far from reality that it makes the whole exercise pointless. But it enables Mankiw to justify rejecting Piketty’s recommendation of high wealth taxes. Mankiw explains that if the government wants to protect capital, it pushes the tax on capital into negative numbers, and the capitalists will push wages to subsistence level. But,

> Taxing capital and transferring the proceeds to workers reduces the steady-state consumption of both workers and capitalists, but it impoverishes the capitalists at a faster rate.

Taxing returns to capital hurts everyone in this model. Of course, if capitalists are taxed at the rate of their actual consumption of tax receipts, the non-trivial amount that should be added to equation (2), then you would get Mankiw's desired outcome of a non-increasing inequality. Or you could go a bit higher, and start reducing inequality without resort to his suggestion of a consumption tax.

Mankiw's sterile model doesn't explain the facts documented by Piketty and his colleagues, but it does demonstrate nicely the state of mainstream economics. Obviously the American Economic Association wanted a paper from Mankiw challenging Piketty, no matter its quality. Mankiw is an established figure, and thus the beneficiary of the social structure of the field described by Marion Fourcade and her colleagues in the section of this paper headed Inequality Within, p. 96,

> Second, we document the pronounced hierarchy that exists within the discipline, especially in comparison with other social sciences. The authority exerted by the field's most powerful players, which fosters both intellectual cohesiveness and the active management of the discipline's internal affairs, has few equivalents elsewhere.

THE THEORY OF BUSINESS ENTERPRISES PART 6: GOVERNMENT AS AN ARM OF BUSINESS

The international policies of the US government are organized around the needs of businessmen, according to Thorstein Veblen, in the same way the legal system was organized to protect their interests and not those of the common people.

> … [W]ith the sanction of the great body of the people, even including those who have no pecuniary interests to serve in the matter, constitutional government has, in the main, become a department of the business organization and is guided by the advice of the business men. Chapter 8.

He explains that in the US and elsewhere, protecting business interests meant the use of force to enable businessmen to make profits safely in foreign lands. It meant using the military to obtain favorable terms of trade, at least as favorable as those awarded to other nations. Diplomacy, says Veblen, must be backed up by displays of force, especially among the "outlying regions of the earth", where the uncivilized people live. They like their own ways aren't used to doing business like the civilized nations. They must be forced to follow the rules. And the outcome is unusually high profits. We now think of this as the bad old age of imperialism.

The problem is that if US businessmen can make extraordinary profits, then so can those of other "civilizing powers", and therefore armaments are also useful in fending off other nations that want to civilize the barbarians. That leads to massive increases in armaments, what we would call an arms race.

He concludes that as military power increases, it shifts from its role in protecting the interests of businessmen and becomes a driver of national purpose. The initial impetus of militarization was business interests, but Veblen predicts that it will turn into something else:

> The objective end of protracted warlike endeavor necessarily shifts from business advantage to dynastic ascendancy and courtly honor.

Military armaments become instruments of national purpose, and businessmen see that as an opportunity for profit. They are equally happy to serve any of the potential warring nations, as long as it's profitable, "… whereby an equable and comprehensive exhaustion of the several communities … is greatly facilitated." That sounds a lot like World War I.

Reflections on Chapter 8

The idea that voters routinely elect businessmen to lead government and expect business representatives to play a major role in formulating policy is as true today as it was when Veblen wrote. A number of businessmen hold governorships, including Rick Scott of Florida, Rick Snyder of Michigan, and Bruce Rauner of Illinois. Each of them preaches that government should be run like a business, and that means poisoning the water of Flint to save money, ignoring climate change as Miami sinks, and refusing to negotiate with the legislature at the risk of wrecking the entire state. State legislatures are full of car dealers, funeral home directors and other small businessmen, and they are notoriously responsive to the arguments and cash of the business class including such representative groups as ALEC and the US Chamber of Commerce. There are plenty of these wreckers in Congress as well. Respect for businessmen has reached the Presidency with the the nomination of Trump, who isn't really a businessman but plays one on TV.

The idea that the role of government is the protection of business interests at home and abroad is still applicable today. There is an unbroken chain of politicians and judges devoted to protecting the interests of businesses at preposterous levels, as in the *Lochner* case, and efforts to return to that level of harshness towards workers. The Republican party generally stands for cutting taxes on the rich, destroying the regulatory structure and cutting social spending while increasing privatization of government services.

Here’s how the Green Party leader Jill Stein described US foreign policy in an interview by Brad Friedman of Bradblog, posted at Salon.

> Or foreign policy. The guys running the show in the Democratic Party are basically the funders, and that’s predatory banks and fossil fuel bandits and war profiteers and the insurance companies, and that’s what we get.

That’s even more true of the Republicans. It sure seems like a good explanation of US overt and covert intrusions in the South and Latin America and many other places around the globe. Veblen shows that this policy has been followed since the late 1800s.

And finally, there are plenty of examples of US companies doing business with our putative enemies, such as Halliburton with Iran and the Koch family with the Nazis.

The neoliberal program is the political project of both parties. There is the economics side and the national security side. The point of the economics stuff is to confuse people about the nature of the economy, and to use that confusion to make maximum profits. The goal of the national security side is to support businesses and to keep US citizens under control. There is bipartisan support for our interventions all over the globe, and for use of military power to control other nations. There is bipartisan support for use of market solutions to social problems instead of direct intervention with strict legislation and enforement. There is bipartisan support for government spying on people, and for use of a wide range of punishments including incarceration, drug tests for aid recipients, and for economic insecurity, hunger and fear of job loss to control the populace and keep the workers disciplined. Veblen describes the way this program looked in his day, and whatever progress has been made on these issues is under assault.

THE THEORY OF BUSINESS ENTERPRISES PART 5: A LEGAL SYSTEM THAT SUPPORTS BUSINESSMEN

In Chapter 8 of The Theory of Business Enterprises, Thorstein Veblen takes up the political and legal systems of the US. Both are designed to support business at the expense of everyone and everything else. By 1904, people were used to thinking about almost everything in terms of money, and that means that "… the management of the affairs of the community at large falls by common consent into the hands of business men and is guided by business considerations." And that's true of both national and international matters.

He claims that this habit of mind is reinforced by the doctrines of Natural Liberty, a reference to the theory of John Locke, which I discuss here. Locke's theory was formed at a time when production was dominated by the artisan and the small farmer. He argued that the worker, these individual small producers, were entitled by the principles of Natural Liberty to own the things they produced, whether it was the blacksmith, the cobbler, or the weaver/dyer. Locke was concerned to protect their production from the monarch, whose absolute power was backed up with troops. Apparently teh landlord was entitled to rent, and to a share of the produce of tenants, but never mind why, exactly. That notion carried over to industrial production, so that the owner of the factory was entitled to the goods produced by the workers. Veblen refers to this as a metaphysical theory, but it obviously doesn't explain much.

The unquestioned idea that property rights are part of Natural Liberty survived the days of artisans and small farmers, where they made some kind of sense. The common people could be said to be free in the sense that they controlled their hours of work and the methods of production. The idea carried over into the era of industrial production, where businessmen controlled much more of the work and private life of the worker. It meant that the arrangements of industrial production could not be interpreted as unlawful coercion. Workers were free to take whatever work was available at whatever price. They not entitled to any of the goods produced, directly or indirectly, but only to a wage, if the capitalist actually paid one. Or, they could starve. We've seen this before. https://www.emptywheel.net/2015/11/17/the-great-transformation-part-6-labor-as-a-fictitious-commodity/

Veblen offers this explanation for the willingness of the workers to put up with this arrangement. It's like the manorial system, where the workers thought, he says, that the production remained with the feudal lord, and thus increased the wealth of the group, and that was good for the peasantry. Also, the feudal lord provided protection to the peasants, for which they were grateful. This in turn looks like patriotism. These two ideas of property and patriotism in led the common people to feel as though they had "some sort of metaphysical share in the gains which accrue to the business men who are citizens of the same 'commonwealth'; so that whatever policy furthers [their] commercial gains … is felt to be beneficial to all the rest of the population." Or, as he puts it later when discussing the governmental support for all things business,

> And in its solicitude for the business men's interests it is borne out by current public sentiment, for there is a naive, unquestioning persuasion abroad

> among the body of the people to the effect that, in some occult way, the material interests of the populace coincide with the pecuniary interests of those business men who live within the scope of the same set of governmental contrivances.

“Some occult way”, a lovely description of much economic theory.

The main function of the law is to insure that the interests of business men are protected. In large part, that means enforcing “freedom of contract”. That means the freedom of the workers to enter into whatever contract they choose. The reality is that workers don’t have much in the way of freedom, and the businessmen were free to offer whatever terms they chose. The pressure on the workers was pecuniary, and therefore wasn’t assault and battery nor breach of any contract. Consequently the law had no interest in the matter. If the jury of workers objected to this interpretation of the law, and ruled in favor of a worker injured on the job, that was because their vulgar minds couldn’t grasp the grandeur of the rules of Natural Liberty, and they would be quickly corrected by the superior minds of the Judiciary.

Veblen’s view was to receive confirmation the very next year in the now famous case of *Lochner v. New York*, 198 S.Ct. 45 (1905), where SCOTUS upheld the freedom of bakers to work more than 60 hours a week despite a New York statute designed to protect their health and safety. The case is famous for the dissent filed by Justice Oliver Wendell Holmes, who claimed that the majority decided the case on the basis of “…an economic theory which a large part of the country does not entertain.” Also, it was decided under the Fourteenth Amendment, just the first of a long string of horrible misuses of that Amendment.

Here’s Veblen’s view of the results:

> De facto freedom of choice is a matter about which the law and the courts are not competent to inquire. By force of the concatenation of industrial processes and the dependence of men's comfort or subsistence upon the orderly working of these processes, the exercise of the rights of ownership in the interests of business may traverse the de facto necessities of a group or class; it may even traverse the needs of the community at large, as, e.g., in the conceivable case of an advisedly instituted coal famine; but since these necessities, of comfort or of livelihood, cannot be formulated in terms of the natural freedom of contract, they can, in the nature of the case, give rise to no cognizable grievance and find no legal remedy.

Veblen doesn't mention one ground of support for property rights that seems important to me: That's Mine!. This may be the most deep-seated view that any of us has, and the idea that we have to share anything, including the very air we breathe, seems unfair to many of us. I can do what I want with my property, so If I want to paint my house with polka dots, hand a garish sign on my shop, or poison the air and water, and lie about it, that's my right and you can't stop me. The natural extension of that idea is that businessmen can do whatever they want with their property, just like I can with mine, and screw the community.

With that background, and with a grasp of how firmly it's held, we can begin to understand how the neoliberals found a strong basis for their reworking of neoclassical economics into the force it has here today. Natural Liberty reinforces That's Mine to create loathing for any intrusion on the freedom to do what one wants with one's property. Everyone agrees that the proper role of government is to enforce those property rights. And that is the real ground of property rights: raw power. Locke makes a metaphysical argument, but the Monarch had armed troops. If Locke’s conception prevailed, it was because the power to command those troops to seize property and give it to the monarch had been eliminated.

In the US, private property is protected by the Constitution, and all levels of government enforce that protection zealously. Laws that restrain the use of property to damage the community are not enforced zealously, as we know from the aftermath of the Great Crash and the rate of rise of prices of pharmaceutical drugs. This is a deeply stupid and dangerous arrangement of priorities.

TESTING THE LIMITS ON WEALTH INEQUALITY

In this post, I pointed out that we are going to see an empirical test of Piketty’s theory of rising wealth inequality. The theory itself is not well understood, and Piketty has revisited it since the publication of *Capital in the Twenty-First Century*, and published an economist’s dream of a paper in full mathematical glory here. The American Economics Association devoted space in its journal to arguments about the theory, giving Piketty an opportunity to discuss his theory in what I think is a very readable paper, and one worth the time.

He starts by saying that the relation between r, the rate of return to capital, and g, the rate of growth in the overall economy, are not predictive. They cannot be used to forecast the future, and are not even the most important factor in rising wealth inequality. The crucial factors are institutional changes and political shocks. Neither can the relation tell us anything about the decrease in the labor share of national income. He points to supply and demand for skills and education in this paper, as he does in his book, but this is a at best an incomplete explanation, owing more to the neoliberal view that the problems of workers are their fault than to a clear understanding of social processes in the US. A better explanation lies in tax law changes, changes in labor law and enforcement of labor law, rancid decisions from the Supreme Court, failure to update minimum wage and related laws, and government support for outsourcing and globalization.

What the theory does say is the subject of Part II.

> I now clarify the role played by r > g in my analysis of the long-run level of wealth inequality. Specifically, a higher r − g gap will tend to greatly amplify the steady-state inequality of a wealth distribution that arises out of a given mixture of shocks (including labor income shocks).

In other words, as the raw number r – g increases, wealth inequality reaches a limit at a higher level, and income and wealth mobility become lower.

> The important point is that in this class of models, relatively small changes in r − g can generate large changes in steady-state wealth inequality. For example, simple simulations of the model with binomial taste shocks show that going from r − g = 2% to r − g = 3% is sufficient to move the inverted Pareto coefficient from b = 2.28 to b = 3.25. Taken literally, this corresponds to a shift from an economy with moderate wealth inequality – say, with a top 1 percent wealth share around 20–30 percent, such as present-day Europe or the United States – to an economy with very high wealth inequality

> with a top 1 percent wealth share around 50–60 percent, such as pre-World War I Europe.

The inverted Pareto coefficient β is a measure of inequality used by Piketty and his colleagues. Here’s how he explains it in this paper:

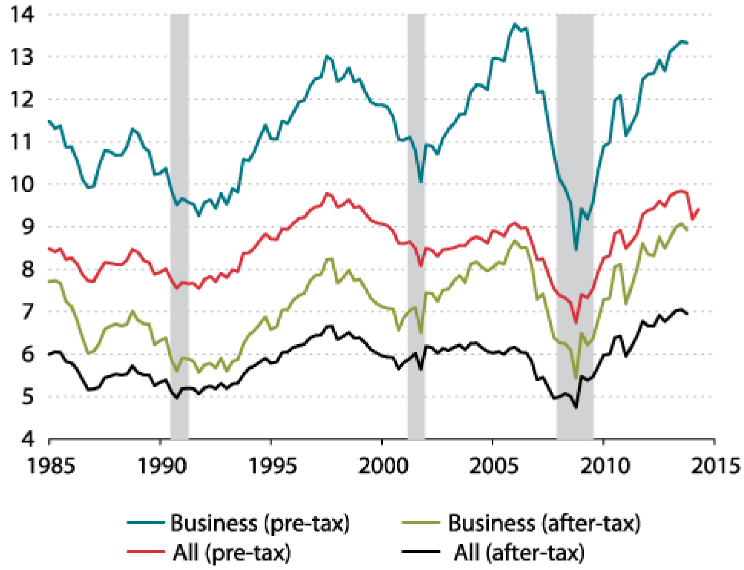
> That is, if β = 2, the average income of individuals with income above $100,000 is $200,000 and the average income of individuals with income above $1 million is $2 million. Intuitively, a higher β means a fatter upper tail of the distribution. From now on, we refer to β as the inverted Pareto coefficient.

The theoretical basis for this result can be found here, where Piketty and his colleague Gabriel Zucman provide a typical economists mathematical explanation. I’ve read some of this paper, but it is tough going.

The returns to capital, especially business capital, are quite a lot higher than the levels given in Piketty’s example. Here’s the chart:

Figure 2

Real Returns on Capital (percent)



SOURCE: Authors’ calculations; for details, see Gomme, Ravikumar, and Rupert (2011).

The returns to all capital after tax are about 7%. Paul Krugman put up a blog post saying that a realistic growth rate is about 2.2% at best for the next few years. This gives a difference r – g = 4.8%. Then using the equations on page 1356, we get an estimate that the inverted Pareto coefficient would be in the range of 11, which is a lot higher than the levels Piketty uses in the quoted material. By way of comparison, with that number, the average wealth of people with more than $10 million net worth would be $110 million. In the example Piketty gives for the top .1% with β =3.25, the figure would be $32.5 million.

Piketty notes that these coefficients are a rapidly rising function of r – g, which is apparently the case. In a recent paper, Emmanuel Saez and Gabriel Zucman estimate that the top .1% has a wealth share of 22% as of 2012, and there is every reason to think that has risen.

With Piketty's general rule standing alone, there is no obvious limit to the level of wealth inequality, but in practice there are many practical reasons that it will level off. Some people will have more children, so the fortunes are divided into smaller shares. Some are lucky in investments and others aren't. There are external shocks, wars and depressions. There are divorces, which split fortunes. Some people are able to earn high levels of labor income on top of capital income, increasing their wealth. Some die early, so their offspring are forced to spend more of their capital income to preserve their existing level of consumption. Others have expensive tastes and spend too much. These external forces eventually bring about a more or less static level of wealth inequality. Overall, this static level is higher when the fraction g/r is lower.

The time periods in the theoretical models used by Piketty and his colleagues are generational, they run 30 years. The big changes in wealth inequality began in the 70s, I'd guess, but became prominent enough that they were noticed in the late 80s and early 90s as the Reagan/Bush era tax cuts took hold, and regulatory structures were dismantled. By 2000, the final touches of formal deregulation were complete, and the Bush administration stopped enforcing most remaining laws leaving capital accumulation without restraint from legal pressure. It's been about 15 years with little change, about half a cycle. The results follow the line Piketty and his colleagues predicted, and every year the new data supports their theories.

From this we can see that the coming empirical test is the maximum level of wealth inequality, or to put it another way, it's a test of the downward pressures on the limits of wealth accumulation.

As a nation we have only taken the smallest possible steps to stem that tide, such as slow increases in the minimum wage, and tiny increases in taxes on the wealthiest to the extent they choose not to evade taxation in all sorts of allegedly legal ways. Neither of the presumptive candidates has any intention of making the kinds of changes necessary to change the outcome.

That brings us to the second empirical test: the level of wealth inequality that a civilized nation will accept before demanding change.

Or maybe the test is whether we are so cowed we won't ever make any demands on our new lords and masters.

Update: for more on the uselessness of tweaks to the current system, see this interview by the excellent Lynn Parramore with Lance Taylor.

THE THEORY OF

BUSINESS ENTERPRISES PART 3: CAPITAL AND CREDIT

In Chapter 5 Veblen takes up the use of credit. He defines credit as any money obtained from third parties to run a business, including the owner's capital, but excluding profits. He disregards the form in which the capital is contributed: equity, preferred stock, debt whether collateralized or not, all are credit. That's because the business has to pay for the use of the money one way or another. Of course, structure matters in bankruptcy, because debt gets a preference over equity, and the order of payment is set by the documents of the capital structure. Veblen says that in economic downturns, bankruptcy takes hold, and the creditors determine the ownership of the material means of production and redistribute them in their best interests.

Veblen distinguishes the newer credit economy from the money economy described by the earlier economic thinkers, including Adam Smith.

> It has been the habit of economists and others to speak of "capital" as a stock of the material means by which industry is carried on, — industrial equipment, raw materials, and means of subsistence. This view is carried over from the situation in which business and industry stood at the time of Adam Smith and of the generation before Adam Smith, from whose scheme of life and of thought he drew the commonplace materials and conceptions with which his speculations were occupied. It further carries over the point of view occupied by Adam Smith and the generation to whom he addressed his speculations. That is to say, the received theoretical formulations regarding business capital and its relations to industry proceed on the

> circumstances that prevailed in the days of the “money economy,” before credit and the modern corporation methods became of first-class consequence in economic affairs. They canvass these matters from the point of view of the material welfare of the community at large, as seen from the standpoint of the utilitarian philosophy. In this system of social philosophy the welfare of the community at large is accepted as the central and tone-giving interest, about which a comprehensive, harmonious order of nature circles and gravitates. These early speculations on business traffic turn about the bearing of this traffic upon the wealth of nations, particularly as the wealth of nations would stand in a “natural” scheme of things, in which all things should work together for the welfare of mankind. Chapter 6.

In Adam Smith’s time, and the generation after him, production occurred in a “money economy”. The earlier economists examined this from the standpoint of natural law and later utilitarianism. I understand the first part, about natural law. That appears in a number of French thinkers and British as well, and perhaps is part of the thinking of Smith, as Veblen asserts. The idea is roughly that factory owners would benefit from an engaged working class, and all would want to improve things in their communities because that would benefit them and because it was the natural order of things. Veblen adds the notion of the utilitarian philosophy which I assume is a reference to Jeremy Bentham, although that name does not appear in the book. The connection isn’t obvious to me.

By the early 1900s the money economy was replaced by a “credit economy”. Veblen seems to be saying that the ideas of the money economy were imported into the credit economy, including the ideas of natural law and utilitarianism. He does not elaborate on this idea at this point, turning to a discussion of the general forms of business organization.

Chapter 7, The Theory of Modern Welfare, is primarily a discussion of the business cycle. Financing costs, including interest on debt, preferred stock dividends, and a normal rate of profit, are more or less fixed. Prices decline because of competition as new entrants use more efficient machines and processes, while facing the same or lower financing costs. When prices decline, the more heavily burdened businesses fail, causing a downward spiral in prices for suppliers and their suppliers. It takes an external shock such as a war to restore the previous price levels. And, as noted, the creditors get to decide how to redistribute the capital equipment and factories of the bankrupt companies. From this he concludes that the natural condition of the capitalist economy is chronic depression.

He concludes his discussion of the business cycle by arguing that the economy will sink unless prices can be maintained by oligopolies and monopolies operated through trusts. That's not a complete solution, though, unless almost all competition can be eliminated.

> The great coalitions and the business manoeuvres connected with them have the effect of adding to the large fortunes of the greater business men; which adds to the large incomes that cannot be spent in consumptive expenditures; which accelerates the increase of investments; which brings competition if there is a chance for it; which tends to bring on depression, in the manner already indicated.

That doesn't include workers, though. They are hung out to dry in this setting. Or as Veblen puts it: "there remains the competitive friction between the combined business capital and the combined workmen."

Veblen begins Chapter 7 with this interesting observation. In a money economy, the welfare of the community, apart from issues of war and peace, "turned on the ease and certainty with which enough of the means of life could be supplied."

> Under the old regime the question was whether the community's work was adequate to supply the community's needs; under the new regime that question is not seriously entertained.

This fleshes out the section quoted above about natural law. With this measuring principle, under the natural law, "…all things should work together for the welfare of mankind". It makes a nice contrast with the credit economy which disregards the welfare of the community and concentrates all its efforts on the frantic search for profits.

It seems to me that the structures and theories Veblen identifies have grown into the structures of business today, but observing them in their earliest stages is helpful in thinking about alternatives. Veblen's point that the costs of financing are included in the price reminds us of something we rarely think about. The price we pay for goods in a credit economy includes the amount necessary to pay off banks, bondholders, preferred stockholders and so on, and to produce profits to pay off shareholders and managers. The profits have to be great enough to persuade the businessman to stay in the business. At each step in the process, the ultimate consumer pays for capital.

At the same time, Veblen points out that competition will force profits to zero over time through efficiency gains, mismanagement, or other mechanisms, usually with disastrous consequences. Theoretically the US has an antitrust policy which pushes back against monopoly, but that has mostly fallen into oblivion. As a result, we preach competition but operate in an oligopoly at best, and in many areas, in an effective monopoly. That means that capital is being paid more than necessary to produce sufficient goods and services for the community.

There is effectively no limit on the amounts that the monopolist can collect. We see this in operation in the pharmaceutical industry. Pfizer, for example, raises the prices regularly on drugs in which it has a monopoly or an oligopoly. See also this discussion of an interview Pfizer CEO Ian Read did with Forbes. The pricing strategy for new drugs is to maximize profits, not to provide for the needs of the community. The explanation is that a business valued by capitalization of future earnings, like Pfizer, must show increases in earnings every year, or the stock price will stabilize or perhaps fall, and perhaps even the interest rates charged by lenders will rise. That should make us ask why we think this is a good plan for something as important as medicine. But we don’t ask that question. Instead, our politicians protect businesses with favorable trade treaties and other accommodations, and raise prices to consumers for drugs.

Suppose the goal of manufacturing drugs is to produce sufficient quantities to meet the needs of the community, and to pay the owner of a plant a reasonable living wage, as Veblen says was the case in Adam Smith’s time. This business model was used by actual non-profit hospitals like the one my Dad worked at, a Catholic hospital built and operated with cash raised from the community. In that setting, there is no need to raise prices beyond inflation and depreciation (shorthand for new and replacement equipment and plant, training and so on). Any new entrant would face the same situation, so there is no advantage to be obtained in the near term from introduction of new capital. The business of creating new drugs can be pushed off to venture capital, as is mostly the case already, so there is no need to provide for R&D. There would be no need in this setting to pay dividends, and the need for interest payments would also be reduced. There would be other savings as well.

I leave as an exercise for the reader working out methods for forcing this outcome. I assume there must be some problem with this analysis, and leave that open as well.

EMPIRICAL TEST OF PIKETTY'S R > G THEORY COMING

Bernie Sanders forced the issue of wealth inequality into the presidential campaign, which presented a real problem for neoliberals of the Democratic persuasion. They want us to believe that the market rewards people in accordance with their merit and hard work. It doesn't. They want us to believe everyone can get ahead if they get a good education and work hard. Not so. So the neoliberal dems fall back on their version of trickle-down: economic growth is the cure. So what is the future of economic growth?

Earlier this year Gerald Friedman did a study of the potential impact of Bernie Sanders' economic ideas, saying they would create enormous economic growth. That drew fire from many liberal economists, including Paul Krugman who wrote several blog posts saying Friedman's numbers were ridiculous, and using that as a opportunity to bash Sanders supporters for naiveté and for encouraging impossible expectation. On February 23, he put up a post with his own predictions of growth: a fraction over 2%. And that, he says, is good enough.

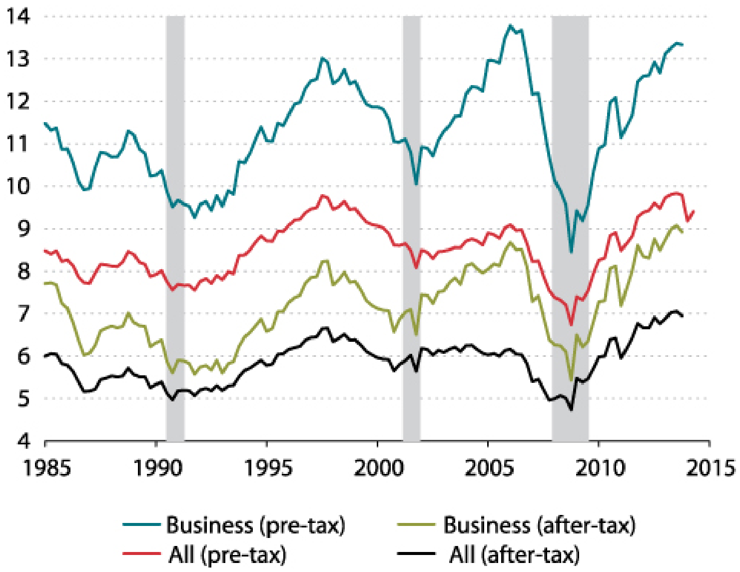
> And let me say that the great thing about a progressive agenda is that it

> doesn’t require big growth promises to make it work, because the elements of that agenda are good things in their own right. Conservatives need to promise miracles to justify policies whose direct effect is to comfort the comfortable (cutting taxes on the rich) and afflict the afflicted (slashing social insurance); progressives only need to defend themselves against the charge that doing good will somehow kill economic growth. It won’t, and that should be enough.

But what about inequality in this scenario? Thanks to Thomas Piketty and his book *Capital in The Twenty-First Century*, we can say with some certainty that it isn’t going to get better with this kind of thinking. Remember Piketty’s basic finding: if r > g, wealth inequality will increase to a very high level. In this formulation, r is the rate of return to capital, and g is the growth rate of the economy. Here’s a chart from the St. Louis Fed showing the rate of return to capital in the US:

Figure 2

Real Returns on Capital (percent)



SOURCE: Authors’ calculations; for details, see Gomme, Ravikumar, and Rupert (2011).

With the exception of the immediate post-Great Crash years, the All capital after tax line doesn’t sink below 5%, and the most recent figures show it near 7%. Here’s the definition, found in Note 5:

> “Business” capital includes nonresidential fixed capital (structures, equipment, and intellectual property) and inventories. “All” capital includes business capital and residential capital.”

Piketty’s definition of capital is broader than this definition of “all”, but there isn’t any reason to think that will have a material effect on the overall number. In other words, r is about 5% higher than g, so we can expect a steady increase in wealth inequality.

The Republicans couldn’t care less: they nominated a billionaire. What’s on offer from the Democratic Party? Here’s Hillary Clinton’s webpage on economic issues. It’s mostly neoliberal ideas, from cutting taxes to deregulation to trade (see the part on small businesses), and some liberal ideas: investment in infrastructure and research, equal pay, paid leave and affordable child care. Her new idea? Let’s give tax breaks to companies that share profits with workers. Also, raise the minimum wage to $12 some day, and some tiny steps to increasing taxes on the rich by closing loopholes and making sure rich people pay more taxes than Warren Buffett’s secretary.

We are going to get an empirical test of Piketty’s idea, but we already know how it will turn out. The rich have nothing to fear.

THE THEORY OF

BUSINESS ENTERPRISE PART 3: BUSINESS PRINCIPLES

By principles, Veblen means the overarching habits of mind that enable one to participate effectively in a society or a subset of society. Before the machine age, the age of the industrial process, people thought about themselves and the world around them in terms of "…the principles of (primitive) blood relationship, clan solidarity, paternal descent, Levitical cleanness, divine guidance, allegiance, nationality". Veblen thinks these principles are in decline as of 1904, replaced by habits of mind of thinking in terms of cause and effect, a scientific habit of mind, because that is what a machine culture needs. These habits relate to the pecuniary nature of the machine age. And the basis for the pecuniary culture is the ownership of property, which is the only one of the primitive standards to survive into the machine age. It not only survives, it becomes the dominant principle of the machine age. Every transaction, it seems, is settled with a payment of money.

Veblen says that the theory of property as used in the machine age comes from John Locke. Before Locke, the general theory was that the Deity gave dominion over the earth to humans, and specifically the King, who in the name of the Deity gave control over land and the things in it to those he desired, who in turn gave it to others. Locke offers a different view, which Veblen describes this way; the quotes are from Locke's Second Treatise on Government.:

> This modern European, common-sense theory says that ownership is a "Natural Right." What a man has made, whatsoever "he hath mixed his labor with," that he has thereby made his property. It is his to do with it as he will. He has extended to the object of his labor that

> discretionary control which in the nature of things he of right exercises over the motions of his own person. It is his in the nature of things by virtue of his having made it. “Thus labor, in the beginning, gave a right of property.” The personal force, the functional efficiency of the workman shaping material facts to human use, is in this doctrine accepted as the definitive, axiomatic ground of ownership; behind this the argument does not penetrate, except it be to trace the workman’s creative efficiency back to its ulterior source in the creative efficiency of the Deity, the “Great Artificer.”

I had never read any of Locke’s works, so I took a look at the Second Treatise. Here’s the original, and here’s a translated version that is somewhat easier to grasp. As I read Chapter 5, Veblen seems to be accurate. There is a lot of scholarly material attempting to understand and apply Locke’s ideas; here’s an example. For those interested in a polemical current view of Locke (and who isn’t?), here’s a fascinating essay by John Quiggan in Jacobin, *Locke Against Freedom*. Quiggan says that David Hume offered a rejoinder to this view:

> As Hume objected, “there is no property in durable objects, such as lands or houses, when carefully examined in passing from hand to hand, but must, in some period, have been founded on fraud and injustice.”

Veblen agrees with Hume:

> It became a principle of the natural order of things that free labor is the original source of wealth and the basis of ownership. In point of historical fact, no doubt, such was not the pedigree of modern industry or modern

> ownership; but the serene, undoubting assumption of Locke and his generation only stands out the more strongly and unequivocally for this its discrepancy with fact.

He thinks that Locke's general idea came from a time when most useful work was done by small artisans like cobblers and blacksmiths, and farmers. He traces it on to the needs of merchants, and into his time. Veblen saw that while that this idea might work in earlier times, it's application was not suited to the machine age. Still it was the dominant theory.

Veblen describes two other business principles. The first is the stability of money values, which at the time stood on the stability of the price of gold and to a much lesser extent, of silver. It was an assumption of businessmen, but not of economists, says Veblen. The second is a regular rate of profit. This enabled businessmen to capitalize their plant and equipment and their industrial processes, so that value turned on the capitalization rather than output, livelihood of the owner, or serviceability of products.

Veblen's discussion of Locke is strikingly contemporary. Locke's theory of ownership by reason of work done certainly doesn't seem like a useful principle to me. Suppose a person sets up a factory, buys raw materials and machines, and hires some people to work for him. Who exactly is mixing labor with goods so as to "own" the resulting product? Or, consider a scientist working in a lab on identifying anti-virals for the Zika virus. The project will require the current work of thousands of people, and past work of uncounted numbers. Who exactly do we identify as the owner of the finished protocols and the final results? Whatever it is, it has little to do with the work done by those uncounted people. Ownership is divorced completely from substantially all of the workers who created the new solutions.

On the other hand, those old ideas that Veblen dismissed so casually never died. I don’t think many ideas ever die, but the ties of kinship, nation, and the Church are especially hardy. Even the idea of Levitical cleanness remains, as we can see in the unending efforts to control the lives and health of women, not just here, but around the world. There are even theoretical frameworks in which such principles have an important place, such as Moral Foundations Theory, discussed here:

> We propose a simple hypothesis: Political liberals construct their moral systems primarily upon two psychological foundations—Harm/care and Fairness/reciprocity—whereas political conservatives construct moral systems more evenly upon five psychological foundations—the same ones as liberals, plus Ingroup/loyalty, Authority/respect, and Purity/sanctity.

In the US the rise of the anti-Enlightenment right wing and its sponsors forces us to question whether the scientific mind continues to be a form of self-governance and of shared cultural values. And, of course, Natural Law lives on in the jurisprudence of Clarence Thomas, at least according to an astonishing article in the Regent University Law Review which I couldn’t make myself read because the sections I did read were appalling, google it if you have to know.

Locke’s ideas generally are associated with the Founding Fathers. No doubt his positions on slavery and expropriating the lands of Native Americans, and his idea that ownership of private property free of governmental interference is a crucial element of freedom, were congenial to their personal desires and philosophical positions. We may need to think about property more closely, as we have done with the other two.

RECENT DISCUSSIONS OF NEOLIBERALISM

People seem to have trouble defining neoliberalism adequately, and especially when it comes to labeling Hillary Clinton as a neoliberal. In a recent article at *Jacobin* Corey Robins gives a short history of the neoliberal version of the Democratic Party, specifically aimed at the Clinton/DLC/Third Way. Billmon discussed this article in this storify piece, in which he describes three current factions in the practice of neoliberalism, There is the Neo-Keynesian version, as with Krugman; the Monetarist version, that of Milton Friedman and his many followers;, and the Supply Side version, like Paul Ryan and his economic advisors. Each of the factions has attached itself to a political ideology. Both of these pieces should be read by anyone seeking to clarify their thinking about neoliberalism.

Underlying all of them is the broader program described by Michel Foucault, which turns in large part on the notion of governmentality, a point made by Mike Konzcal in this review of Philip Mirowski's *Never Let a Serious Crisis Go to Waste*. After I read that book, I wrote several pieces at FDL trying to comprehend the idea of governmentality and make it comprehensible. Here are links to several of those posts.

1. How We Govern Our Selves and Ourselves.

2. The Panoptic Effect.

3. Discipline for the Benefit of the Rich.

4. Control of Markets in Foucault's The Birth of Biopolitics.

5. Liberalism and the Neoliberal Reaction.

The idea of governability is present in the texts I've been looking at. In Polanyi, we saw the transformation of the farm-dwelling peasant into the city-dwelling factory worker. Arendt touches on it with her discussion of people who cannot find a place in the productive sector of society, the superfluous people. Veblen writes about the enormous productivity of machine culture, and the changes it demanded of the worker, about which more later. The great problem is that machine culture required a tremendous amount of self-discipline from the workers to make factories function. The principal institutions of society were remade to enforce that self-discipline, from the Army to the schools to the government. Other tools included prisons and mental institutions.

In one way or another, all of these writers on neoliberalism seem to agree that the goal of neoliberalism is to replace the notion of the self as reasonably free citizen, responsible for the self, the family, the community and the state, with the notion of the self as a buyer and seller engaged in zero-sum competition with all other buyer/sellers. We are consumers of any and all goods and services, and entrepreneurial sellers of the self seen as a bundle of skills on offer to the highest bidder. Each separate transaction, buying and selling, is an opportunity for judgment by the all-knowing market. If we are successful, it's because we are winners. If we are losers, we are superfluous. It's an even harsher transformation of the human being than the one from peasant to factory worker.

UPDATE: The excellent Paul Rosenberg discusses the rise of neoliberalism in the sense used by Robins in this Salon article.

THE THEORY OF BUSINESS ENTERPRISE PART 2: NEOCLASSICAL ECONOMISTS AND VEBLEN

> The material framework of modern civilization is the industrial system, and the directing force which animates this framework is business enterprise. To a greater extent than any other known phase of culture, modern Christendom takes its complexion from its economic organization. This modern economic organization is the "Capitalistic System" or "Modern Industrial System," so called. Its characteristic features, and at the same time the forces by virtue of which it dominates modern culture, are the machine process and investment for a profit.

That's the first paragraph of *The Theory of Business Enterprise* by Thorstein Veblen. The 1904 book is written in an unfamiliar style, combining words and formulations we don't use any more with a decided lack of the kinds of references we'd expect in a work of sociology or economics. It shows a kind of subversive humor as well. The reference to Christendom is funny coming from an agnostic whose rejection of religion made it difficult for him to find work. And it's blunt.

The first three chapters lay out several ideas about the way society was organized at the time he wrote. By then the industrialization of the country and the consolidation into trusts, holding companies and interlocking directorates was well underway. The dominant force in society, Veblen says, was the industrial process with its intricate workings that required coordination of workers across many plants and industries for maximum efficiency. It required standardization of processes and goods across the range of activity, from hours of operation to fine details about the items produced so that they could be used for many different purposes. That meant that a large segment of the population had to adapt the way they lived to accommodate the processes of industry. The people who controlled the great enterprises held direct or indirect control over a large part of the lives a vast number of working people.

At the beginning of the Industrial Revolution factories were owned an operated by individuals with a view to making a living. Over time the Captains of Industry (his words) built up capital and began to treat factories not as sources of livelihood but assets to be bought and sold, and operated as generators of profit from investment. As Veblen describes the activities of the businessmen, it feels like the creation of a market in plants and equipment and other rights of ownership like railroad rights-of-way and patents. The industrial processes themselves were not operated, or even necessarily understood, by the Captains. They were designed and operated by engineers, inventors and mechanics, ond operated by workers with varying degrees of skill. All of them were working to make production as simple and as useful as possible. They depended for their livelihoods on paychecks from the Captains of Industry.

As different parts of production moved from handicraft to machine process, ownership of parts of the industrial process often were not the most efficient, as with railroads and electricity. The boundaries were unstable because the Captains of Industry were constantly fighting with one another for control of different parts of the process.

Standard economics in Veblen’s time looked a lot like our neoliberal economics as taught by Mankiw. Veblen disagrees. He starts with the proposition that the sole point of investment for profit is profit, not efficiency or the good of the community.

1. Standard economics taught that businesses are efficient. The smooth working of industrial processes require constant attention and interstitial adjustments. Veblen points out that there are opportunities for profit when the smooth operation of industrial processes is disrupted. It doesn't matter how the disruption comes about, whether there is an improvement that reduces a cost, or a spike in demand perhaps because of a war, or a drop in demand because of a depression, or whether the Captain of Industry disrupts his own operations or whether a competitor does so. Disruptions are opportunities for profit. It doesn't matter that the workers are thrown out or the community suffers. There are profits to be made.

> The outcome of this management of industrial affairs through pecuniary transactions, therefore, has been to dissociate the interests of those men who exercise the discretion from the interests of the community. This is true in a peculiar degree and increasingly since the fuller development of the machine industry has brought about a close-knit and wide-reaching articulation of industrial processes, and has at the same time given rise to a class of pecuniary experts whose business is the strategic management of the interstitial relations of the system. Broadly, this class of business men, in so far as they have no ulterior strategic ends to serve, have an interest in making the disturbances of the system large and frequent, since it is in the conjunctures of change that their gain emerges. Qualifications of this proposition may be needed, and it will be necessary to return to this point presently.

What this means that that there are people in businesses who job is to disrupt things to make a profit. Veblen doesn’t believe in the magic invisible hand of the market; he sees the fists of the Captains of Industry.

2. Standard economics taught that one of the main values provided by the businessman is the rationalization of industrial processes. Veblen says that consolidation is done not in the interest of smoother industrial processes, but in the interest of profits. It only happens when the Captains of Industry can profit, which is always long after the need becomes obvious, and only in the way in which the Captains of Industry can profit, which may or may not be most efficient. He admits that a businessman may be motivated by ideals of workmanship and serviceability (his word) to the community, but this is “not measurable in its aggregate results”. To the extent it is measurable, it comes from the elimination of the costs of the business transactions that are eliminated by mergers and “industrially futile manoeuvring” to gain leverage for deals, so that

> … probably the largest, assuredly the securest and most unquestionable, service rendered by the great modern captains of industry is this curtailment of the business to be done, this sweeping retirement of business men as a class from the service and the definitive cancelment of opportunities for private enterprise.

3. Standard economics taught that businesses are subject to the indirect control of consumers, who decide by their purchases which businesses survive and which fail. Veblen says that businesses of his day, business owners are removed from actual contact with customers. There is plenty of money to be made cheating customers, he says, in part because industrial processes were so efficient that there was plenty of room for waste and war.

4. Standard economics taught that competition is the lifeblood of capitalism. Veblen says businessmen charge as much as they can. Competition is only a factor when the Captain doesn't have a monopoly, and then it is only one of several factors.

> But it is very doubtful if there are any successful business ventures within the range of the modern industries from which the monopoly element is wholly absent. They are, at any rate, few and not of great magnitude. And the endeavor of all such enterprises that look to a permanent continuance of their business is to establish as much of a monopoly as may be. Fn. omitted.

5. Standard economics taught that the market pays according to the value of the work done, which is taken to be proportional to the value to the community. Veblen says there is no relationship between the profits and wages of a business and value to the community, and that money is a poor proxy for value to a community. He also says that wages bear no relation to the productive value of the work done, but rather workers are paid only enough to get them to work hard enough to make the products of their labor saleable.

Standard economics from Veblen's day is taught in Econ 101 today. Veblen is an astringent antidote.

THE THEORY OF BUSINESS ENTERPRISE PART 1: INTRODUCTION

Thorstein Veblen wrote *The Theory of Business Enterprise* in 1904. He is best know for *The*

Theory of the Leisure Class, with its famous phrase, conspicuous consumption. Here's his Wikipedia entry. There are two things that recommend him to me. First, he studied with Charles Sanders Peirce, one of the central figures of American Pragmatism, and eventually worked with John Dewey, another central figure in the only genuinely American philosophy. Second, he studied with John Bates Clark, one of the earliest neoclassical economists, and rejected his views. In general, he saw the economy as embedded in social institutions, not as an entity on its own. Mark Thoma presents the views of Veblen and Clark on the state of the worker in a capitalist system; the two short pieces will help set the context for this series.

Much of what I have written here is directed at showing that neoliberal economic theory is almost useless as a guide to policy that works for the 99%. The series on Thomas Kuhn's *The Structure of Scientific Revolutions* showed that in the hard sciences, successful ideas are been verified and formalized and organized into textbooks to speed up learning. In economics, the academics took the same route. That's how we got economics textbooks like Samuelson and Nordhaus and Mankiw, both of which are I have addressed in a number of posts. The difference is that practicing economists don't believe that Econ 101 textbooks are the best understanding of the way the economy works. Those ideas can be quite dangerous. For example, academic economists used models that don't predict crashes to advise policymakers that deregulating the financial sector would be just fine. That led to the Great Crash. There is no penalty for being wrong. The same old failures just maunder on until death knocks them out of the expert hierarchy. As far as I can tell, they have never managed to excise a single one piece of the arrant nonsense they spout to an ignorant reporter or a politician looking for validation of a crackpot idea. They can't even kill off the gold standard which is out there today thanks to the supposedly-educated Ted Cruz.

Why is that so? Marion Fourcade and her colleagues have some answers. What I want to do is to examine older books by the dissenters, people who didn’t buy into the silly ideas like this one from *The Theory of Political Economy*, 1871, by William Stanley Jevons:

> I wish to say a few words, in this place, upon the relation of Economics to Moral Science. The theory which follows is entirely based on a calculus of pleasure and pain; and the object of Economics is to maximise happiness by purchasing pleasure, as it were, at the lowest cost of pain.

By “moral science” Jevons means the utilitarian philosophy of Jeremy Bentham. It was Jevons’ intent to translate those ideas into calculus. The discussion was not meant to be humorous. Keynes said that if people knew the principles underlying economics, they’d consider them preposterous, but sadly he was wrong. Nowadays, those ideas are taught to everyone as gospel. Keynes in his time, and I in mine, doubt that academic economists ever read Jevons or Pareto or any of their other intellectual ancestors, let alone the dissenters, including Veblen.

It’s my hope that by reading older books at the boundary of economics and sociology and other disciplines, we can unearth a different tradition and different solutions. And here’s a story.

I went to a sort of book club moderated by a very old man who had long since retired from the University of Chicago where he taught English literature. One of the books he selected was *De Rerum Natura*, by the Roman writer Lucretius, a fascinating work from about 50 BCE. It’s usually described as an early version of atomic theory. He started by telling us a story. He said that when he was in college he read a lot by the ancient Greeks, plays, philosophy, and even a bit of Euclid. It made him wonder why such smart people would take Greek Mythology seriously, when it was obviously just a bunch of fanciful stories. There were the Sophists who rejected the philosophy of Plato and Aristotle [cf. *Zen and the Art of Motorcycle Maintenance* by Robert Pirsig], but as we know from Plato, Socrates was condemned to die in part because he did not believe in the gods of Athens. It wasn't until this session of his book club and his reading of Lucretius that he realized that there were Greeks who flatly rejected the mythology and attempted to conjure up from their limited knowledge a completely material description of the world.

In just the same way, there have always been dissenting economists who offered completely different views of the way a capitalist economy works. The dominant version has concealed the dissenters, not least from themselves, but we are more likely to get a good ideas from the dissenters than from people trying to tweak the dominant structure.