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Monkey Cage

Adam Smith is not the antidote to Thomas Piketty

By Deborah Boucoyannis April 22, 2014

Joshua Tucker: The following is a guest post from University of Virginia political scientist Deborah Boucoyannis.

“Marx Rises Again,” “The new Marxism,” “Thomas Piketty and Millennial Marxists”: with a title like “Capital in the Twenty-First Century,” it is not surprising that the specter of “Marxism” is looming over Thomas Piketty’s “monumental” blockbuster. Especially given its author’s prescription, with Emmanuel Saez, of 80 percent taxation on the top 1 percent of income earners.

Yet the author sees himself as “Taking on Adam Smith (and Karl Marx):” both Marxism *and* laissez-faire economics, he says, “count on pure economic forces for harmony or justice to prevail.” Piketty sees his predictions about *r*, the return to capital, retaining its higher rates compared to growth *g*, as indicting the “optimism” of classical and neo-classical economics. If Marx were right about the declining rate of profit, things would not be as dire in Piketty-land.

But the problem for the reception of his argument in the U.S. is not (only) that it is confused with Marxism. Rather, his policy prescriptions attack a foundational American belief about the “free” market, that its outcomes are fair, and attempting to reverse them creates distortions and undermines productivity. Only 17 percent of the population believe addressing inequality should be a government priority. Among the groups that “count” (the better off), the majority believe government is already doing “too much” in the economy.

As political scientists Ken Scheve and David Stasavage have shown, over the last two centuries only war has altered these beliefs. This poses a powerful challenge to anyone concerned with current conditions: How can such change occur today “without war?”

One way, perhaps long overdue, is to return to the fundamentals of public discourse. Why has the public come to see steep inequalities as inevitable in the market economy in the first place? Why is it that inequalities are a given and the task is to justify redistribution by government — rather than, as Jacob Hacker has argued, prevent market returns accumulating in the hands of a few? Are steep concentrations of wealth a market reward of success? Or, as studies are increasingly showing, the result of political pressure by the rich — which Keynes long ago already ascribed to the effects of “the minimum rate of interest

acceptable to the generality of wealth-owners?” Despite cumulating evidence, the default assumption in public opinion is that redistribution is a government intervention that pits equality and justice against efficiency and “freedom.”

The basis for this public assumption lies not in economics, as models and data can support both the case for greater equality, as well as against it. The public instead draws on foundational narratives and, as even economists are now admitting, on moral arguments about how the world, and the market economy, should work. And the key foundational text, which not only set the blueprint for the market, but was untainted by the stain of “socialism,” as it preceded both industrialization and state capacity to shape the economy, was Adam Smith’s “Wealth of Nations.”

The text, unfortunately, continues to be read for the wrong lessons, despite the fact that some of the most distinguished philosophers, political theorists and historians of economic thought have revolutionized our understanding of Smith and recovered his progressive viewpoint, so apparent to his contemporaries. This revision has not extended beyond the group of specialists, with a few bright exceptions, not only because of a fixation on the moral dimension of his thought — which marginalizes the discussion as external to economics — but also because even his most progressive interpreters still accept the most conservative point about him: that his system necessarily predicts steep inequalities. At best they hold that he concedes a Rawlsian bargain, “if the worst off people are better off than they would be under a more equal distribution of goods.”

References that seemingly confirm this are typical: He says, after all, that there is “great inequality” where there is “great property” and that the idle rich consume “a hundred times” more than the working poor. These striking images have ingrained a perception of steep inequalities as fixed features of capitalism.

But, as I note in my article in Perspectives of Politics, none of these passages describe the economy that Smith envisaged — only the ones he observed, either in his time or in the past. This is what he was trying to fix. To understand what Smith’s system entailed as far as inequality is concerned, we have instead to work inferentially.

For instance, he described Holland as the most advanced and prosperous economy in his time. His explanation was simple but critical: Every “man of business” was forced to work because rates of profit were low (about 3 percent). With such low returns and little capital accumulation, it was “impossible” for anyone “to live upon the interest of their money.” This was the key to economic success for Smith: fundamentals forcing everyone to work. But you can’t get concentration of wealth in such a system.

For Smith, Rastignac’s dilemma — why work when one can inherit or marry? — was typical of a country going fast “to ruin.” Smith castigated the “unproductives” who lived from revenue (land rents or capital returns) as undermining the industry of those employing capital.

The economic fundamental underlying these views was crystal-clear: For Smith, high profits were bad. They were “always highest in the countries which are going fastest to ruin,” because profit was “naturally low in rich, and high in poor countries.” High profits were not condemned for normative reasons, but efficiency ones: de facto, in countries that thrive, profits are low (except in new economies). Are surging corporate profits during this depression not a pathology, after all?

But if profits cannot accumulate in a thriving economy, why should we expect inequality to surge? In fact, we can't: inequality is not an equilibrium outcome for Smith. In the article, I draw attention to many incidental, but telling, statements that confirm this. Smith may have been factually wrong about inequality in Holland, but he had more radical expectations from the market than Piketty — *without, critically, assuming a harmony of economic forces*, as I conclude below.

This becomes even more apparent when the building blocks of his system are put together. In Smith's system, profits are not only low; labor wages must be high, for efficiency reasons. He posits a floor that would correspond to double the minimum wage today.

What about the concentration of wealth that in Piketty "devours the future?" Smith's attacks on the laws that allow the concentration of wealth, primogeniture and entail, are not simply policy prescriptions; they are the lynchpin of his explanation for the delayed growth of Europe before 1700.

And not only is the taxation of inheritance advisable (except for minors), but taxation is a tool to micromanage incentives, especially for the spendthrift rich. His priorities are clear: The "inequality of the worst kind" is when taxes "fall much heavier upon the poor than upon the rich." Which is why the rich should be taxed "something more than in proportion." Smith in fact praises the British tax system, which taxed twice as much per capita as France, because "no particular order is oppressed:" The rich were taxed, unlike in France. Smith had only one criterion: Taxes should encourage the productive use of capital.

So did Smith believe that "spontaneous forces" would produce a magically just economy, eradicating these inefficiencies? Was this just a narrative premonition of the Kuznets curve? No. The invisible hand has long and deftly been shown not to imply any automatic functioning of the economy. Further, like many progressive analysts today, Smith believed profit-seekers succeeded because members of Parliament "knew nothing about" political economy. They convinced politicians that low labor wages were necessary for business growth, for instance, while Smith showed how high profits depended on keeping wages down (like the chief economist of Goldman Sachs today).

Where Smith emerges as more "radical," ironically, is in his insistence that if we see high profits (a high *r*) it is sophistry, deception, and power that are to blame, not technology and trade increasing demand for capital. He may have said, faced with Piketty's turn to taxation to fight inequality, that this treats the symptom, not the disease; that we should not be just treating inequality as pathological and inefficient, but high profits, too. As I argued also here, unless we start seeing high profits as a symptom of something wrong, any effort to limit them, either before or after taxes, will founder faced with the "insolent outrage of furious and disappointed monopolists." And that is Smith talking, not Marx.