A “Sort of Intellectual Sleight of Hand”: How Nobel Laureates Paul Krugman, Robert Solow, and Joseph Stiglitz Praised Thomas Piketty’s Capital in the Twenty-First Century, and What That Tells Us About the State of 21st Century Economics

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Commenting on French economist Thomas Piketty’s global bestseller, *Capital in the Twenty-First Century,* a whimsical article in the *Wall Street Journal* gave it the dubious distinction of being the “most-unread book” ever.

“The contest isn't even close,” reported the Journal. “Mr. Piketty's book is almost 700 pages long, and the last of the top five popular highlights appears on page 26. Stephen Hawking is off the hook; from now on, this measure should be known as the Piketty Index” (Ellenberg, 2014).

The Journal reporter was referring to the fact that, in Amazon’s Kindle edition of the book, readers are able to highlight passages. According to Amazon data, few passages were highlighted past page 26, which indicated that very few read past that page. So Piketty’s bestseller may be even more unread than the previous champ, physicist Stephen Hawking’s *A Brief History of Time.*

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Capital in the Twenty-First Century therefore belongs on the shelf with two other best-sellers that have had enormous influence but are also virtually unread: John Maynard Keynes's *The General Theory* and the multi-volume tome whose title no doubt inspired Piketty's: *Capital,* by Karl Marx. When a book is much discussed but hardly read, great harm is often done, and not just to intellectual discourse.

I attest that I have read all the pages in *Capital in the Twenty-First Century*, some more than once. In the English translation by Arthur Goldhammer, the book is fairly easy going. In what follows, I'll contrast the somewhat surprising contents of Piketty's tome with the interpretations put forward by three Nobel laureate economists: Paul Krugman, Joseph Stiglitz, and Robert Solow.

As we'll see, based on his comments, it's doubtful that Joseph Stiglitz got past page one of this book, much less to page 26. Robert Solow appears to have read much of it, although he missed key parts. Paul Krugman probably read it all, although he has not been above misrepresenting its contents when the occasion has suited him.

As I'll also explain—and as Krugman himself can be found to acknowledge--Piketty's book is an especially strange case for a simple reason: Despite its title, it's not really about capital in the twenty-first century. It's about the salaries of corporate executives.

INCOME AND WEALTH INEQUALITY CAUSED BY WHAT?

"I took a course in speed reading," comic Woody Allen once joked, "learning to read straight down the middle of the page, and I was able to go through *War and Peace* in 20 minutes. It's about Russia."

Twenty minutes with *Capital in the Twenty-First Century* is probably enough to learn that the book is about widening inequality of income and wealth. It takes a little longer to find out what the book purports to say about that subject.

The book supposedly says that under a capitalist system, ownership of capital leads to rising inequality that is (in Piketty's words) "potentially terrifying"; and that the only way to curb this terrifying tendency is for the government to impose heavy taxes on wealth and income.

According to Piketty, the "principal destabilizing force" that causes this widening inequality "has to do with the fact that the private rate of return on capital, r, can be significantly higher for long periods of time than the rate of growth of income and output, g."

Taking Piketty at his word, Robert Solow observes approvingly, "This is Piketty's main point, and his new and powerful contribution to an old topic: as long as the rate of return [on capital] exceeds the rate of growth, the income and wealth of the rich will grow faster than the typical income from work" (Solow, 2014).

The math of Piketty's "r" and "g," can be expressed as follows: $r > g$. So, for example, if r (wealth from ownership of capital) increases by 5% per year and g (income from work) by 2%, there will be a 3% gap. If that 3% gap persists over time, then according to the law of compound interest, it will exceed 100% in 25 years. Hence the inequality gap becomes "potentially terrifying."

There have been many cogent criticisms of this formulation, which have been more than enough to render it so implausible as to be unworthy of serious consideration. I won't rehearse those criticisms here (Reisman, 2014; Delsol, Lecaussin, Martin, 2015). I will focus instead on a strange fact about Piketty's book: The best refutation of its "terrifying" thesis can be found in the book itself.

Imagine that in Marx's *Capital,* the author had made the shocking declaration that its core ideas did not apply to capitalism in Britain. British capitalism was then the dominant form of capitalism, and Marx's principal bête noire; he even did his research in the British Museum. Had Marx made such a fantastic statement, the admission would surely punch a hole in the intellectual edifice of Marxism. After all, if this formidable thinker

could not apply his own ideas to British capitalism, why should the rest of us bother taking them seriously?

In Piketty's case, this fantasy has become reality. He makes the shocking admission that the "r > g" model at the core of *Capital in the Twenty-First Century* does not apply to his own principal bête noire—today's dominant form of capitalism—capitalism in the United States.

A "SORT OF INTELLECTUAL SLEIGHT OF HAND"

This strange plot thickens. Paul Krugman—unlike Solow and Stiglitz-- recognizes this embarrassing problem, while still managing to praise Piketty's book as a work of great achievement.

"And yet there is one thing," Krugman writes in his laudatory review, "that slightly detracts from the achievement—a sort of intellectual sleight of hand, albeit one that doesn't actually involve any deception or malfeasance on Piketty's part." Krugman continues: "Still, here it is: the main reason there has been a hankering for a book like this is the rise, not just of the one percent, but specifically of the American one percent. Yet that rise, it turns out, has happened for reasons that lie beyond the scope of Piketty's grand thesis" (Krugman, 2014).

It's of course slightly absurd that it only "slightly detracts" from "Piketty's grand thesis" that the thesis does not apply to growing inequality in the U.S. What if Piketty had posited a theory about the habits of his fellow Frenchmen while admitting that the theory did not apply to the citizens of France? The admission would fatally detract from his grand thesis, not slightly detract from it.

We cannot really claim, however, that Krugman is wrong to find no "deception of malfeasance" in this "sort of intellectual sleight of hand." That's because, in a section of the book headlined, "The Rise of Supersalaries," Piketty's intellectual sleight of hand occurs in plain sight.

"Let me return now to the causes of rising inequality in the United States," this section begins. "The increase was largely the result of an unprecedented increase in wage inequality and in particular the emergence of extremely high remunerations at the summit of the wage hierarchy, particularly among the top managers of large firms."

Thus, insofar as *Capital in the Twenty-First Century* concerns capitalism in twenty-first century U.S., it's not really about capital at all, but about wages—in particular, about those "supersalaries" paid corporate CEO's. Piketty's magnum opus turns out to be yet another diatribe against those over-paid executives.

Whatever else we may say about this well-worn complaint, it lacks even superficial resemblance to the "potentially terrifying" idea that r grows faster than g. In the latter case, we might imagine that a 3% annual gap in growth leads to the dominance of a small group of capitalist wealth holders whose obscene riches dwarf the holdings of everyone else. In fact, as critics have shown, the chances that this will actually happen are too unlikely to be taken seriously.

But when it comes to CEO salaries, the chances of a "potentially terrifying" outcome are virtually nil. CEO tenure has been variously estimated at six to 10 years; and unlike capitalist wealth, CEO jobs can rarely passed from parent to offspring. These people have no way to create a long-lasting dynasty, especially since their offspring will often lack their talents, given the tendency for the new generation to succumb to the law of regression toward the mean.

Nowhere does Piketty confront this key question: Why a researcher with his energy and brilliance was unable to apply his "r>g" model to the U.S. Instead, the role of capital income occurs only as an afterthought. As Piketty insists—no doubt plausibly: "[T]he fact that the unprecedented increase of wage inequality explains most of the increase in U.S. income inequality does not mean that income from capital played no role."

But for capital income to be demoted to a merely supporting role in a book called *Capital in the Twenty-First Century*—while wage income gets the starring role-is damning enough. According to the dictates of truth-in-labeling, the title should really have been, *Executive Salaries in the Twenty-First Century,* given that so far in the 21st century, the dominant form of capitalism is in the U.S., where concern over rising inequality is greatest.

Then the book would have been revealed for the nearly toothless tome it really is, even assuming that its analysis of CEO pay holds up—which it doesn't.

CORRUPT CORPORATE BOARDS

In Piketty's quite conventional view, the corporate executives get paid so much due to the unholy alliance between them and the paymasters, who are sometimes one and the same. "At the very highest levels," he writes, "salaries are set by the executives themselves or by corporate compensation committees whose members earn comparable salaries (such as senior executives at other large corporations)."

One question that arises: Why did CEO salaries only began to take off around 1980? Couldn't corporate compensation committees take after their cronies in 1970 or 1960? Wasn't there plenty of corporate corruption at the top during those pre-1980 periods?

According to Piketty, the explanation for the rise in CEO salaries post-1980 lies in the decline in marginal tax rates. "The very large decrease," he writes, "in the marginal income tax rate in the English-speaking countries after 1980 (despite the fact that Britain and the United States had pioneered nearly confiscatory taxes on incomes deemed to be indecent in earlier decades), seems to have totally transformed the way top executive pay is set, since top executives now had much stronger incentives than in the past to seek large raises."

But just for starters, in the U.S. at least, those “confiscatory taxes” may never have been very confiscatory, given the abundance of loopholes in the tax code. In 1979, the top marginal rate was 70%, but according to the Congressional Budget Office, the top 1% paid just 22.7% in federal income taxes. In 2000, the top 1% paid 24.5%, or slightly more, even though the top marginal rate had plunged to 39.6%.

Based on these numbers, executives may have had about the same incentive to seek large raises both pre- and post-1980. But even assuming that the 70% marginal tax rate really did bite, it defies belief that executives had no incentive to capture the other 30%. If, as Piketty informs us, the “salaries are set by the executives themselves or by corporate compensation committees,” not much effort was required to realize another $30,000 for every extra $100,000 in gross pay. Indeed, if Piketty is right that a 70% marginal rate can deter such minimal effort, it’s probably powerful enough deter anyone from the effort of taking a CEO’s job in the first place.

For a more realistic explanation of the rise in salaries at the top, try “The Real Story Behind Executive Pay,” by Steven N. Kaplan (Kaplan, 2013). Why, Kaplan asks, do they get paid so much more than they used to? “The most compelling answer,” he writes, “involves market forces, not corrupt corporate boards. Specifically, improvements in technology and the growth in the size of firms and the scale of finance have allowed more talented people to increase their productivity relative to others. The larger the company, the greater the returns to hiring a productive CEO. And as firms have become more valuable, boards have responded by spending more to attract talent that can affect that value.”

While Piketty singles out corporate executives, Kaplan points out that they are “far from unique.” The expanded scale of operations in law firms and hedge funds has also propelled a huge financial premium on talent in those fields. Kaplan’s most telling comparison is between private- and public-company CEO’s.

"Executives of private companies should possess similar skills and come from similar pools as executives of public companies," he observes, "yet they are different in one important way: because private companies are controlled by shareholders, the boards that pay their CEO's have a greater stake in the companies' success." For this reason, "they should be less subject to any skewed incentives that supposedly inflate CEO pay when it is determined by public-company boards." Despite this, however, "the incomes of private company executives have actually risen faster than those of public-company executives."

"CORPORATE WELFARE"

So far, we have seen that Nobel laureate economist Robert Solow thought that Piketty's book really was about the race between capital income and wage income, while Krugman managed to praise the book, while acknowledging that reaons for inequality in the U.S. "lie beyond the scope of Piketty's grand thesis."

What about Joseph Stiglitz? This Nobel laureate economist has written (Stiglitz, 2014): "One stream of the extraordinary discussion set in motion by Thomas Piketty's time, important book, *Capital in the Twenty-First Century* has settled on the idea that violent extremes of wealth and income are inherent to capitalism…."

Now, that is what Solow, among others, thinks the book is about--but not Stiglitz. "This is actually a superficial reading of Mr. Piketty's work," he goes on to inform us, "which provides an institutional context for understanding the deepening of inequality over time."

The "institutional context" provided by Piketty has to do with the fact, says Stiglitz, that "Our current brand of capitalism is an ersatz capitalism. For proof of this go back to your response to the Great Recession, where we socialized losses, even as we privatized

gains…. It is not the inexorable laws of economics that have led to America's great divide, what is it? The straightforward answer: our politics and our politics. So corporate welfare increases as we curtail welfare for the poor."

By speaking of "corporate welfare," and the degree to which losses have been "socialized" and gains "privatized," Stiglitz is certainly on to something. Crony capitalism has indeed fueled income inequality.

But this also demonstrates that Stiglitz barely cracked Piketty's book. The "institutional context" in which crony capitalism operates is not even mentioned by Piketty, much less explored. Just to be absolutely sure, I put "corporate welfare" into the search function of my Kindle edition, along with other key words like "crony capitalism," and came up with zero hits.

Also capitalizing on the fact that, since no one has ready Piketty's book, anyone can say anything about it, Krugman has made other observations in a separate article called "The Piketty Panic" (Krugman, 2014). "What's really new about *Capital,*" he writes, "is the way it demolishes that most cherished of conservative myths, the insistence that we're living in a meritocracy in which great wealth is earned and deserved…. But how do you make that defense if the rich derive much of their income not from the work they do but from the assets they own? And what if great wealth comes increasingly not from enterprise but from inheritance?"

Quite apart from whether great wealth has indeed come increasingly from inheritance rather than enterprise, Krugman knows quite well that Piketty's main target in the U.S. is not wealth; the main target is CEO salaries that have brought widening inequality. So this could hardly be what is "really new" about the book, assuming we keep in mind what the book is really about.

But Krugman is certainly right that we do not live in a meritocracy in which great wealth—or at least, great income—is earned and deserved. Just for starters, Piketty must have made a

great deal of money from a global bestseller that is devoid of merit.

In my view, the money was neither earned or deserved; but that makes no difference. Free market capitalism consists of capitalist acts between consenting adults. So long as no force or fraud is involved, we have no right to object. And buyers of *Capital in the Twenty-First Century* were definitely not promised a money-back guarantee if they could not get past page 26.

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