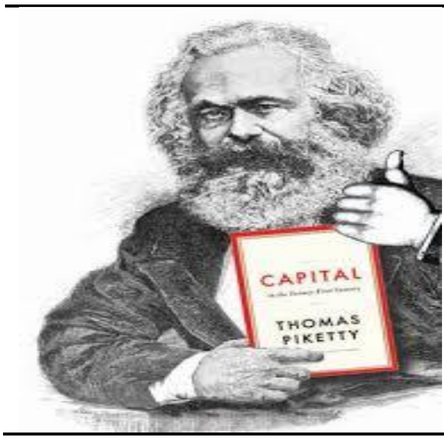
Capital in the 21st Century: A Must to Read Book and Some Interesting Points, including on Ethiopia



This year, 147 years after Marx wrote his path breaking book "Capital", a French economist called Thomas Piketty wrote a sensational book with the same title. This book has sent a shock wave on what is called neoclassical economics (or using the government of Ethiopian terminology "neoliberal" economics or in a plain English– the economics that worships a free market economy [*Amahirc "Ye netsa gebya economy*"]). This branch of economics is the dominant economic discourse and offers justification for the neoliberal ideology which says markets are nearly perfect and hence government need not intervene in the economy. This is the kind of economics thought in topnotch universities in US and Europe, and through their influence, throughout the world (the likes of Harvard and Oxford). The World Bank, the IMF and WTO backed by these neoclassical/neoliberal economists and their government (the likes of the US and Western Europe) have pushed the policy prescription of such free market economics to Africa. This is done through what is called "Structural Adjustment Programs (SAPs)" and recently "the Poverty Reduction Programs/Papers [PRSPS]. I put the latter in the same category as the former because in terms macro policy the prescription between SAPs and PRSPs are the same [ie. Both subscribe to us: liberalization of finance, trade, labour market; privatization, devaluation, no government intervention; as well as conservative fiscal and monetary policy etc). The impact of these policies in Africa since the 1980s has been a disaster that led the famous Western liberal magazine "the economist" to declare one of those decades of Africa as "the lost decade" before telling us today the story of "Rising Africa…"

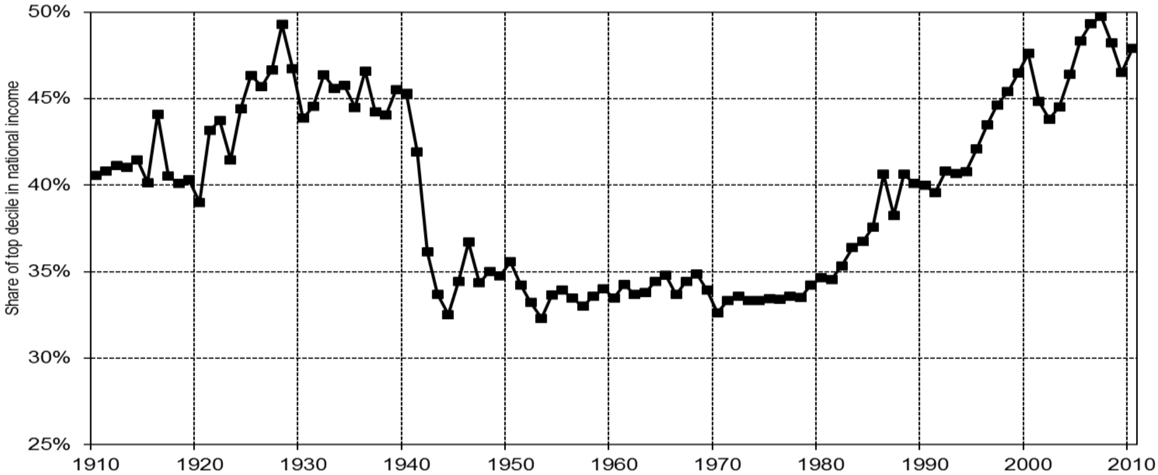
I felt I digressed a little from the topic. However, it is a justifiable digression because I am attempting to show the policy implications of economic policies that are the brain child of neoclassical economists and their institutions (such as the IMF, WB) and their dominant owners (the West – or the rich countries). What is striking about this neoliberal economics and ideology is that it doesn't talk about distribution of income/inequality at all -thus endorsing the existing distribution of income as justifiable. Thus, we teach the economy is efficient when the labourer gets wage, the entrepreneur profit and the asset owner rent which corresponds to their contribution to production. Thomas Piketty's book, contrary to the received wisdom, has squarely focused on the nature of inequality or distribution of income between capital (capitalists or capital owner) and wages& salaries (the working class) in the last 300 years. I need to say in passing here that progressive economists had always been concerned about distribution of income. However, since, research, publication and research funding are dominated by Western economies and their institutions (the likes of World Bank and Harvard), their call fell on deaf ears. This seems in line with the famous phrase of the Italian political writer Anotonio Gramsci [extending the idea of Marx & Engels] long time ago that stated: "the ruling class idea is the ruling idea". Ironically, when the West was hit by the global financial/economic crisis in 2008/09 it is the policy prescription from the economics of these progressive economists (not the neoclassical/neoliberal economist) that is used to offer remedy (and offer explanation about the crisis).

I will not attempt to offer either a review or a summary of Thomas Piketty's book in this short article. One has just to Google him to see how much hit this guy has: Last time I checked he had 2.7 million hits on Google. The book is the number one best seller this year at Amazon.com, ranked top even above top US sensational TV series & movies (such as the "Game of Throne" etc). It is the most talked about book by people: from top entrepreneurs (such as Bill Gate who critically reviewed it recently) to top politician (Obviously the French president, Barak Obama…). What I will do is just point out some points that impressed me about the book and then sufficiently motivate you to get hold of and read it.

The *first* important point that impressed me is that Piketty knows his audience and how to skillfully navigate through the profession that is dominated by neoliberal economists. First, he and his colleagues (including their doctoral students) did a meticulous research about distribution of income (inequality) for the last 15 years. Then they presented the basic findings, that latter appeared in this book, in top rated professional journal using sophisticated mathematical and related techniques so that they will be accepted by the profession (a profession dominated by the likes of Harvard as I noted earlier). After this acceptance, Piketty wrote the same basic ideas in plain English that can be read by any one, making the book a sensation.

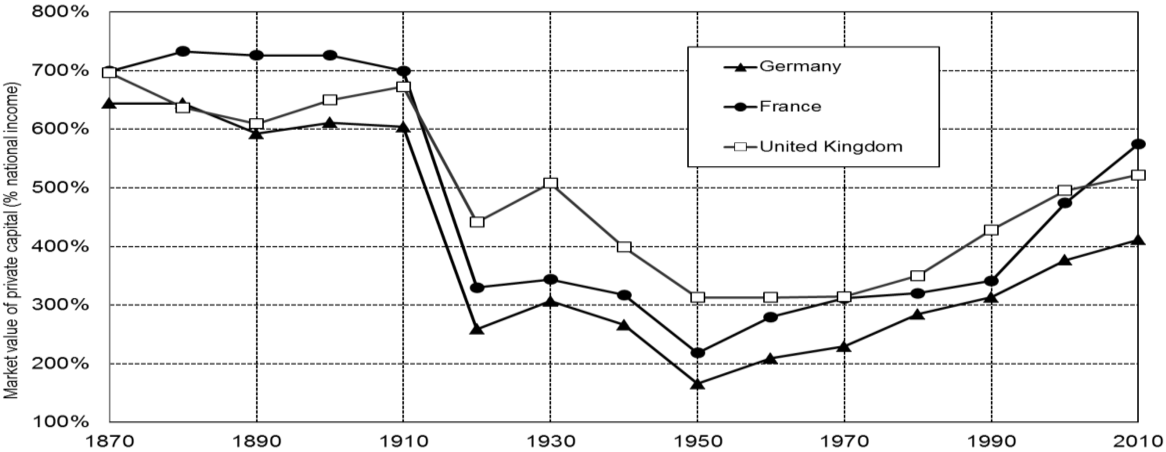
The second important point is the main message of the book, which is: the world is characterized by a shocking level of inequality and in the last 300 years; the rich is getting richer and the poor is getting poorer. He has captured this idea by a simple formula which says **r** is greater than **g**, **r>g** (**r** is the return to capital or the income of capital owners such as the profit from investing-; and **g** is the growth rate of the economy). In fact the formula is basically **r** is greater than **w**, **r>w** (**w** is wage/salary or the income of workers). In the rich countries at least the worker's income [**w**] grows by the growth rate of the economy[**g**] so **w** and **g** are equal. In Ethiopia, though, **w** (for instance my salary at AAU) is not growing by 11% annually for the last 10 years because the economy is officially growing by 11% for the last 10 years. In our case wage is almost constant – by the way this is in line with Marx's book which differentiate it from Piketty's. Over the 300 years investigated by Piketty **r** is always greater than **g [**or **w]** and the gap between profit and wage is widening (see below the graph). That is, the rich is getting richer and the poor is getting poorer. Thus, people have begun to compare Piketty's **r> g [**or **w]** to Einstein's famous equation of energy **E=MC^2**. As you may see in Figure I that is taken from Piketty's book, the top rich 10% of the US citizens are controlling about 50% of the US national income in 1930's and today, 2010 (national income is the total production/income of the whole population of a country in one year). That share has dropped to about 33% during 1940 to 1980 when it was the lowest. We can clearly see in Figure 1 inequality is rising sharply since 1980. In addition, Figure 2 shows that the rich countries aggregate private wealth was 6 to 7 years of the total national income of a country in each of the countriesfrom 1870 to 1910; 2 & 3 years of the national income in 1950; and 4 to 6 years of the national income in 2010. This takes me to third interesting point.

Figure I.1. Income inequality in the United States, 1910-2010



The top decile share in U.S. national income dropped from 45-50% in the 1910s-1920s to less than 35% in the 1950s (this is the fall documented by Kuznets); it then rose from less than 35% in the 1970s to 45-50% in the 2000s-2010s. Sources and series: see piketty.pse.ens.fr/capital21c.

Figure I.2. The capital/income ratio in Europe, 1870-2010

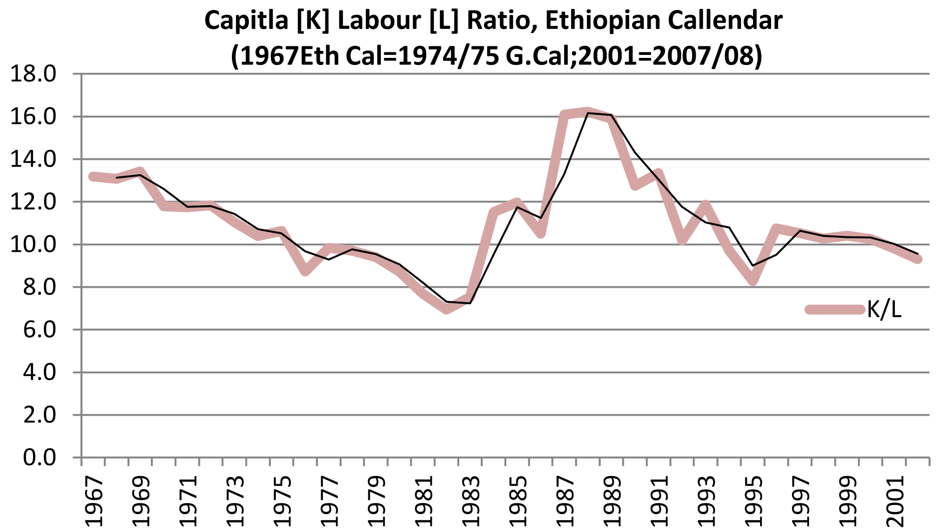


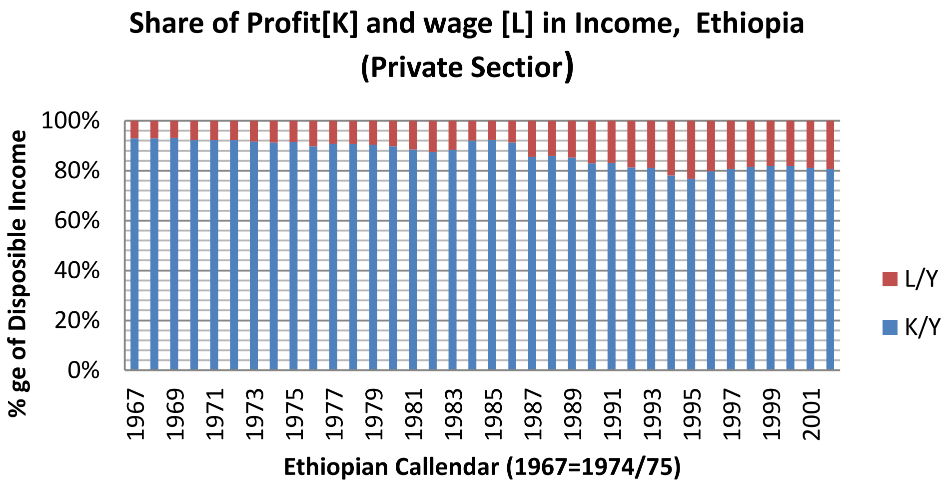
Aggregate private wealth was worth about 6-7 years of national income in Europe in 1910, between 2 and 3 years in 1950, and between 4 and 6 years in 2010. Sources and series: see piketty.pse.ens.fr/capital21c.

The third point is the so called the Kuznet curve, named after a famous American economist named Simon Kuznet who studied the pattern of inequality until the early 1940s. When you see Figure 1 this pattern until 1940s looks like an inverted **U**. The optimistic scenario and conclusion Kuznet drew from this pattern is that when a country develops/grows, inequality initially will rise but eventually will decline. This has become a bible/Koran for neoliberal economists and their Western governments. Thus they began to advise us that "don't worry if inequality is worsening while you are growing today because it will eventually decline". In fact, Kuznet even got a Nobel Prize for it (Note who gets the Nobel Prize!). He accepted the prestige although he is aware that his thing is a snap shot picture of a post-world war phenomenon. As we can see from figure 1 of Piketty's long series of data, in fact the pattern of inequality over time has rather **U** shape (not **inverted U** shape). This in turn means inequality is getting worst over time. This is one of Piketty's key contributions. I should note here that unlike the West's grwoth history, Taiwan and South Korea grew with a sensible distribution of income, and hence it is not a universal truth that inequality should get worse when a country grows.

The fourth point relates to the role of "technological diffusion", "expansion of quality education for all" to address the problem of inequality which is discussed at length in the book. For this to happen, however, the role of well-informed policy (ie. policy Informed by rigorous research) through conscious government intervention to abate inequality is important. This is the opposite of the policy recommendation of neoclassical/neoliberal economists and their backers who are against the role of state in development (Western countries, WB, IMF, and prestigious Western Universities etc). However, we need to be cautious here that if the government is not **well-informed** the government failure could be worse than market failure.

Finally, before concluding this brief article and advice you to read this book, see the two figures below that I have attempted to make in line with Piketty's ideas for Ethiopia. It is an interesting research to do, not only for Ethiopia but also across Africa. As can be read from the first figure the share of capital in Ethiopia is on the average 10 times that of labour. If I had the latest figure I am sure the trend would go up even further. The second figure also shows that the share of profit in national income in Ethiopia is about 80-90%, leaving the share of labour to be just 10 to 20%. Household level data also shows that inequality, especially in urban areas in Ethiopia is getting worst and hence the rich is getting richer and the poor is getting poorer. Recent studies shows that the poor in urban Ethiopia , which spends over 70% of its income on food, is unable to properly feed him/herself because of rent, food and energy price hike - thus coping this through cutting meals and through the generosity of friends and relatives. The implication is that growth by itself is not enough for poverty reduction. It could be anti-poor when it is especially accompanied by inflation as the story in Ethiopia using the 2004-2009 household level data shows. This need to be addressed squarely because such inequality (especially if it is accompanied by horizontal inequality) invariably leads to poverty of the mass, escalating of crime level and political violence and instability with dire consequences for the economy and the country at large.


Capitla [K] Labour [L] Ratio, Ethiopian Callendar
(1967Eth Cal=1974/75 G.Cal;2001=2007/08)
18.0
16.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
K/L
1967
1969
1971
1973
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001


Share of Profit[K] and wage [L] in Income, Ethiopia
(Private Sector)
% ge of Disposible Income
100%
80%
60%
40%
20%
0%
L/Y
K/Y
1967
1969
1971
1973
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
Ethiopian Callendar (1967=1974/75)