On „Fatal Conceit" or the pretence of knowledge in Thomas Piketty's *Capital in the 21st Century*

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Abstract: *The authors provide a critical review of the main argument presented in the book "Capital in the 21st Century" by Thomas Piketty stating that modern economies need to build a legitimate and efficient public power in order to fight inequality and poverty. In this article, we attempt to prove that this book ignores a set of significant developments brought to the economic theory such as the contributions of the Austrian School (Mises and Hayek) and the School of Public Choice (Kenneth Arrow, James Buchanan, Gordon Tullock). Therefore, there is a huge difference between treating people equally and struggling to make them equal. State constructivism based on single models that are imposed as a general rule is another form of state servitude and at the same time the state's fatal conceit (Hayek, 2016b). It claims, in the name of false science, that it can say what is the general interest and how we may efficiently act to attain it. Also, the state is not a cold calculating machine but is made of people facing the same temptations and mistakes as common people, more exactly, it is neither almighty nor benevolent. Then why would we need more involvement from the state?*

Keywords: *Piketty, state, inequality, imperfect knowledge.*

1. Introduction

Appealing, at first sight, full of interesting information and data spread over time and space, Piketty's study at first seems to be a good source of information and a literature review for economists, historians and sociologists. Additionally, it is written in a clear and pleasant language that does not fall into the conventional mainstream of hermetic and mathematical style but is more philosophical, making the book accessible to the general public. The book is popular among readers who are sensitive to arguments based on figures. However, they might easily become victims of persuasion due to the lack of knowledge in fundamental theory.

In an essay *Measured*, *Unmeasured, Mismeasured, and Unjustified Pessimism* written in 2014 on Thomas Piketty's book *Capital in the 21st century*, Deirdre McCloskey stated at the end: *"It is a brave book. But it is wrong."* Intrigued by Piketty's work and also by the already mentioned essay, we started this review from a contradiction that will be presented in the pages that follow.

2. Contradiction

Starting from the first page, Piketty prepares his readers for a journey into the history of economic thought making references to Marx and Keynes, in which the state plays the main role *„There are nevertheless ways democracy can regain control over capitalism and ensure that the general interest takes precedence over private interests*" [p.14]. In a direct way, this can be achieved by "*building a legitimate and efficient public power*" [p. 128]. Especially since "*statism did no harm*" [p. 171] and "*the conventional doctrine of non-interference and non-involvement and non-intervention of public authority into economic life … has been completely discredited*" [p. 228]. In other words, statism is good. The state, seen by the author as the universal panacea for reducing inequality and fighting poverty, has to be empowered with effective regulation of the banking system and international financial flows. A tax on capital would "*promote the general interest over private interests while preserving economic openness and the forces of competition*" [p.780].

One could understand that the current capitalist system based on liberal principles of minimal regulation and a less burdensome tax system might need a significant revaluation following the lines mentioned by regulation and taxation. Piketty views progressive taxation as the solution for this ideal social state until it reaches the optimal level of the higher rate, which in "*developed countries should exceed 80%*" [p. 864]. But, it is not so, since, in his view, „*in terms of its fiscal and budgetary share ..., public power never played such an important role as in the last decades. No declining trend has been noticed contrary to what is often stated*" [p. 789]. The huge leap of the state between 1930 and 1980 has already occurred and is actually translated into „*compulsory taxation that accounts today for more than half of the national income in almost all European states*" [pp.789-790]. So, why would we need more state if there is no „*return of the state*" [p. 783] as the huge leap has already occurred?

3. A few arguments against Piketty's fundamental argument

Firstly, the author does not mention what consequences would this level of taxation have on the size of the public sector and in terms of the inevitable increase in regulation and bureaucracy. The author shows even less interest towards the efficiency of this oversized state. The literature of the last 60 years has never stopped providing arguments to support the idea of state's inefficiency in managing resources and reaching goals mainly due to its incapacity of making decisions in accordance with a more complex society.

Starting with Adam Smith and up to Friedrich Hayek, economists argued that the *open market* is the most efficient system of socio-economic coordination; it is the only mechanism that can systematically receive and respond to feedback from millions of consumers and producers. If the government could coordinate the economic activity in a simple world, it would not have all the necessary information making prompt decisions in a complex world at its disposal. Taking into account the chimaera of utility and social need, the state might see some field as being more important, even more, strategic and it might neglect the other sectors. It might neglect technical progress and innovation in some fields to favour the fields that it sees as being more useful. The state might also support weaker businesses and thus create inequality on the market through discriminatory measures, stimulating one area to the detriment of another and ultimately creating monopolies instead of limiting the ones already created by the market. Regulation errors that were made not necessarily out of bad intentions might generate new regulations in a chain process. In a more and more complex system, this might result in the annihilation of the competition. The on-going regulation process that is self-sustaining will inevitably create inequality among individuals. Larger administrative structures would not be able to monitor the entire economic life and new mechanisms of control would be required until all governmental structures are turned into an instrument aimed to favour one category over another.

Secondly, the philosophy on which such an idea is based is that of social constructivism. Turning to this philosophical tradition, economists may borrow rigorous structures and formulate ideals for transforming the reality and reconstructing it based on precise theoretical models. Political decision-makers act out of the desire to allocate resources efficiently and to be able to correct the economic disequilibrium and transform the entire society using a perfect formula. Social consensus and harmony reached through a centralised decision-making mechanism and not on a voluntary basis could certainly be viewed as utopia since unanimity in an area of common interest is rare, if not impossible. For instance, some people believe that 1$ should be allocated to education, some other – to defence and the third category – to pensions depending on their interests, experience and personal values. The classical authors of the economic science proved that voluntary behaviour of individuals during peaceful times based on individual interest may lead society towards prosperity and wealth even if their interests are divergent. What interests are we talking about when it comes to public policy and actions? Do we mean the interests of a poor citizen who needs a subsidy for his rent or welfare benefit for his 8 children or the interests of a rich citizen who does not want to pay additional tax to meet the goals of the welfare state as these do not affect him directly or the interests of a politician who does not care which political coalition he joins as long as he stays in power? How is consensus achieved on issues representing the general interest?

Most of us believe without thinking too much about it that the state acts in the public interest. Yet, what is this public interest? How can we define and measure it? Subjectivity is the main characteristic of a human choice. Each of us values one thing over another depending on our immediate interest, beliefs and values, education, age and experience, the influence of the group we belong to. The difficulty of choosing one social program over the other lies in the fact that the terms *correct* or *ethical* are vague and individuals have different opinions on what is wrong or right. Single people or families made of two employed individuals might think that they get very little back from the state through the system of social benefits, while a family composed of one employed individual and a housewife might believe that it is fair to be given benefits from the state (Baciu et al., 2014, p. 60).

Assuming that political decision-makers are well-intentioned and correctly informed on people's preferences, would they still be able to make the best decisions considering these preferences? Is it fair to assume that you can make a general summary by reducing all preferences to a single goal and the means to reach it? In other words, do you own perfect knowledge? Is it not an *infatuation* to pretend you do it in the name of the common interest? Kenneth Arrow, a Noble Prize Winner in Economics (1972), demonstrated in his book *Social Choice and Individual Values* (1951) that any social outcome is *imposed* or *dictatorial* because it is impossible to satisfy all individual preferences since interpersonal comparisons among tastes of individuals are impossible to achieve. Starting from Arrow's impossibility theorem, the representatives of the *public choice* theory demonstrated that the institution of the majority vote, on which social constructivism is based, causes the justification of a state that is preferred just by a minority. For example, a third of the voters support a politician because they favour a specific trade policy he wants to implement (Baciu *et al.,* 2014, p. 83). Another third does not like his trade policy but appreciate his educational or health policy. So, this politician may win by capturing two-thirds of the votes even if the majority of voters oppose his trade policy. This is why not all political victories reflect the will of the majority (Weimer&Vining, 2004, pp. 200-201). In terms of legislation, this leads to the idea that not all public actions are justified by voters' consensus or unanimity or even by the majority vote. This phenomenon occurs especially in the case of extremely heterogeneous societies where there is a significant difference among their members. The general costs of the decision-making process are lower in homogenous collectivities in comparison to heterogeneous ones in which there is no basic consensus regarding fundamental values (Buchanan & Tullock, 2010, p. 156).

Thirdly, the author suggests that the goal of this ideal social state should be the reduction of inequality by means of applying a "*global and progressive tax on capital*" (p. 780). "*Progressive taxes always a relatively liberal method for inequality reduction …*" (p. 847) "*…the optimal level of the superior rate in developed countries should be higher than 80%*" (p. 864). According to Piketty, even though the amounts already allocated in America or Europe are not small, social benefits amount to 25% and 35% of GDP and „*…the development of the fiscal state in the last century mainly matches the setup of the social state*" (pp. 794-795). „*Modern redistribution is built around a logic of rights and a principle of equal access to a specific amount of goods viewed as fundamental*" (p.795). Piketty refers to the Declaration of Independence of the USA adopted in 1776 on the equality in rights of individuals and also to John Rawls and Armatya Sen, who talk about „*maximal and equal opportunities for all*" (p. 798).

The author once again ignores economic theory stating that progressive taxation is unfair for some businesses. If in the name of social usefulness, we may assume that an additional dollar brings more happiness to the poor than unhappiness to the rich after losing it, this type of reasoning is wrong because we cannot make interpersonal comparisons due to the subjectivity of the individual views. A policy based on such a reasoning is impossible to put into practice without a value judgment on the relative wellbeing of the individuals without violating the fundamental rights of one of the categories. History showed us how the equalisation of satisfaction, income and of other opportunities went hand in hand with state despotism, brainwash, tax evasion, capital drain, corruption and distortion of justice. So, even if Piketty states that public utility is less important than the „notion of *rule of law*" which seems more operational, economic theory provides sound analysis of differences in perception regarding what people view as *fair* and *unfair*, *correct* and *wrong.* Even if the representatives of the welfare theory accept the loss in efficiency in the favour of gains in equality, one cannot estimate the long-term loss in terms of innovation, technical progress, productivity, as well as its indirect effects.

Unless individuals are paid based on their effort, need or using a subjective reasoning related to social justice – higher the taxation, more reduced is the appetite for work and the efficiency of the working individuals. Moreover, it is known that if the unemployment allowance is high, the desire to seek employment decreases. "*Forcing in an illiberal way the French style of equality of outcome, cutting down the tall poppies, envying the silly baubles of the rich, imagining that sharing income is as efficacious for the good of the poor as are equal shares in a pizza, treating poor people as sad children to be nudged or compelled by the experts of the clerisy, we have found, has often had a high cost in damaging liberty and slowing betterment*" (McCloskey, p. 45). This occurs due to the fact that the rich are no longer motivated to develop products, employ additional workforce and the poor are not motivated to do anything in order to overcome their condition. The only way to increase the pie we want is to guarantee those who make it that they can enjoy it! So, equal opportunities before the law are acceptable in the name of individual rights and freedom and not in that of the outcome. *To have* and *to be* are interchangeable notions with respect to individuals, *what we have* being intrinsic *to who we are*. If the goods of individuals can affect the essence of their being, then the control over these goods is the control over their being. If people were so happy to give up their property and inheritance and were glad to share their goods with the others, the socialist dream would have become a reality without the need for any violence (Baciu *et al*, 2014, p. 65).

Fourthly, social generosity and politics are not free. The European social state is founded on suffocating taxes, oversized administration, abusive bureaucracy and regulation, corruption, political favouritism and governmental waste. If we view the state only as a dehumanised calculating machine, then perhaps in a specific context, starting from a set of data and information on the preferences of individuals, this machine would be able to take an optimal decision. But the state is by far not an impersonal machine. Moral hazard, lack of impartiality, corruption and bureaucracy are very real phenomena among real people. Piketty does not mention what the efficiency of the existing social state is but he nevertheless argues for increasing the taxation up to 70-80% by 2050-2060 (p.800). The author warns about the organisational difficulties of an oversized state and mentions such European states as France, Italy, Germany or Sweden with public spending exceeding 50% of the GDP, for which the debates over the social state in the next decades will be focused on „*organisation, modernization and consolidation*" (p.803). The representatives of *Public Choice Theory* (Kenneth Arrow, James Buchanan, Gordon Tullock), ignored by Piketty, teach us that people who represent the state are not guided by the public interest but by the private one. The great political exchange starts where its representatives, elected by means of electoral mechanisms, implement only those goals that ensure their re-election. The individual both in private and public sectors is driven by the rationale of higher expected benefit than the anticipated cost. In the case of the elected politicians, the *interest to be re-elected* prevails since this would increase their chances to participate in more cycles of "pie sharing". The *rent seeking* behaviour of politicians is very real and costly. It creates opportunities for transferring wealth from one group to another depending on the political coalition (Baciu *et al*, 2014, pp.84-85). Public intervention is not a free good, decisions on economic policy are made by officials and bureaucracy is costly. The implementation of policies is often inefficient as the government is not able to control the institutions in charge with their implementation. Bureaucrats are more interested in consolidating their position, which offers them material and non-material privileges, rather than in public welfare or well-done work. This personal gain, irrespective of its nature, places a burden on the public administration budget and any reforms inside it become slow or even impossible to implement. The implementation of policies pleasing voters is possible only after the bureaucrats have reached their goals and it requires high public spending. The fact that this one-thousand-page book that has the pretence of being almost an *encyclopaedia* forgot to mention James Buchanan – the Nobel Prize Winner for Economics in 1986, as well the outcomes of the Public Choice Theory is not just an omission (Henri Lepage, 2016, p. 97).

Finally, who and how could impose a "*global and progressive tax on capital*" (p. 780)? Who would control the controllers? The regulation and the created institutions for such a tax would just create conditions to move the legal property to the illegal zone. Corruption is the daughter of regulation (Salin, 2013, p.326). Large whale protection is an example of failed international regulation. Why could poaching not be stopped? Due to ocean's vastness, the oversight of the way in which regulations are implemented is almost impossible; the cost for overseers is higher than for poachers. Private benefits are higher; the more appealing is the recourse on the market. As long as there is demand, private actors will be interested in exploiting resources to enhance their benefits. Similarly, if wealth and capital could be taxed up to 80%, legal entrepreneurship will be transformed into illegal or political (fiscal, monetary) one. The sanctioning of entrepreneurial opportunities may become a serious obstacle for economic development. The capital does not exist in itself, it is formed through the accumulation of profit due to entrepreneurial skills to innovate and transform challenges into opportunities, to continuously improve the methods of production. Thomas Edison, Henry Ford and Steve Jobs are just a few examples of innovative entrepreneurs that we tremendously benefit from. Known under the name of product democratisation, this phenomenon means that even the poor of the 20th century afford bulbs, TV sets, telephones and even cars. A similar situation may be noticed in the reduction of inequalities in life expectancy, education, recreation and entertainment (Jean-Phillipe Delsol, 2016, p. 37). Globally, the inequality has been significantly reduced by reducing the number of poor people. A study published in 2014 by the experts of the World Bank showed that the number of Latin Americans living on less than four dollars a day dropped to 40% in 2000 and below 30% in 2010 (*Ibidem,* p. 39). Specialisation, innovation and creativity and other entrepreneurial skills are the sources of wealth. To punish them by abusive taxation would lead to an *increase* in social inequality and not to its decrease.

Final Remarks

Hayek – another great omission of Piketty, also the Noble Prize Winner for Economics in 1974, teaches us that: "*where there is no private property, there is no justice; what cannot be known, cannot be planned; the state that takes the stand of an expert of unique models of behaviour or treatment in search of equality imposes on us a new and invincible form of servitude in the name of poorly understood concept of social justice; that the only mechanism that produces and distributes wealth in the most and efficient moral way is the market. Only the market shows us what is our contribution to the global flow of goods and services and it also should influence the remuneration or the remuneration we are entitled to*." (Hayek, 2016b, p. 127). People condemn capitalism and its main attributes (free market, capital, even money, profit, competition, private property and contract) without even understanding that it represents the very thing to which we owe our comforts of life and even civilisation. Under competitive market economy, the poor receive more than in a centralised system just because the adverse effect of *social justice* prevents individuals from making full use of their work and the efficient use of resources becomes possible (Hayek, 2016a, p. 69).

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