An Austrian Critique of Inequality as an Inherent Moral and Economic Problem

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I <u>Introduction</u>

Piketty and his supporters have attempted to show that capitalism creates inequality[1], and it is often assumed to be not only a grave economic problem, but a pressing moral concern. Even many mainstream economists have claimed that inequality is *per se* undesirable, thus sneaking in a value judgment and disguising it as a scientific proposition. There are several views on this topic in philosophy – but even claims based on moral intuitionism would need to be seriously discussed and we would still need to prove why any given idea is bad

1 Taken in a wide sense, as in the United Nations' own working definition: "Inequality—the state of not being equal, especially in status, rights, and opportunities —is a concept very much at the heart of social justice theories. However, it is prone to confusion in public debate as it tends to mean different things to different people. Some distinctions are common though. Many authors distinguish "economic inequality", mostly meaning "income inequality", "monetary inequality" or, more broadly, inequality in "living conditions". Others further distinguish a rights-based, legalistic approach to inequality—inequality of rights and associated obligations (e.g. when people are not equal before the law, or when people have unequal political power)." (Alkire et al., 2015)

("monopoly prices", free-riding, advertisement, inefficiency, inequality, etc., which are often presented as inherently problematic and explained in moralistic overtones).

"Equality" in the sense that each and every individual is equal at every margin necessarily means a world that, to quote Rothbard, "would necessarily be a world of horror fiction—a world of faceless and identical creatures, devoid of all individuality, variety, or special creativity." In *Man, Economy, and State*, Rothbard shows that one can use praxeological principles to show that certain ethical positions are wrong (like claiming that the free market causes business cycles). Even though praxeology is value-free, Rothbard holds that it can make direct contributions to ethics, and can show that some ethical goals are self-contradictory or incapable of being realized – and equality is precisely such a concept.

Equality is an impossible standard – to start with, geographical position will forever be different since we exist in three-dimensional space. Opportunities can never be equal either, since we all start at different places, families, careers, eras, levels of income, etc., and that no redistributive scheme can logically affect the past, and no such scheme can be large or all-encompassing enough to change every single variable, thus the "problem" of inequality can never fixed.

Furthermore, a point often ignored by those espousing egalitarian sentiments but instructed by Austrian monetary inflation theory, is the fact that changes in the money supply are disproportionately distributed throughout an economy, and as a result wealth inequality is exacerbated in societies where central banking financial elites are closely allied to power elites.

II <u>Some of Piketty's Mistakes</u>

In the academic book publishing industry, it is quite rare that a thick work can gain widespread public dissemination – such was the fate of Piketty's 2013 (2014 in English translation) *Capital in the Twenty-First Century*. As Rallo (2018) summarizes, according to

Piketty's central thesis, within capitalism the net rate of return on capital (*r*) tends to be higher than the rate of economic growth of aggregate income (*g*), so that the wealth accumulated in the past increases at a higher rate than aggregate production and, in turn, than wages. The heavy use of data, tables, charts, and mathematical notations leads Piketty to conclude that "to the extent that the distribution of net capital income is usually more unequal than that of labor income, the larger share of net capital income would lead to an increase in income inequality" (Rallo, 2018, p. 600). Piketty himself speaks rather clearly on this point:

> The overall conclusion of this study is that a market economy based on private property, if left to itself, contains powerful forces of convergence, associated in particular with the diffusion of knowledge and skills; but it also contains powerful forces of divergence, which are potentially threatening to democratic societies and to the values of social justice on which they are based. The principal destabilizing force 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*. The inequality $r > g$ implies that wealth accumulated in the past grows more rapidly than output and wages. This inequality expresses a fundamental logical contradiction.[2]

Piketty's key points are sixfold: (1) his exposition of historical data to predict ever-higher future inequality, and his corresponding prescription of punitive taxes on both wealth and income at the nation-level to prevent the scenario that he predicts (and conveniently the restructuring of higher education finance); (2) his claim that the historical data reveal a universal tendency towards wealth concentration (yet those who have poured over the data have reached different conclusions[3]); (3) his prediction of rising wealth inequality relying on two major assumptions, both of which are implausible – the first one being that capital accumulation is unimportant for wage growth and the second one that that all wealth (not just reproducible capital) is a factor of production; (4) his strong suggestion that if governments enacted high income and wealth taxes, national economies would not shrink significantly; (5) the need for a global annual tax of at least one percent on wealth over 1 million euros and a two-percent tax on wealth above 5 million euros[4] (built into this solution is the espousement of a supranational State structure – the details of which are left murky); and (6), that high wealth

2 Thomas Piketty (2014) Capital in the Twenty-First Century (Cambridge, MA: Harvard University Press), p. 571.
3 See Murphy (2014).
4 Piketty (2014), pp. 515–539.

inequality breaks down democracy (there are various Austrian responses to such a claim – suffice to say that democratic governments expanded during the late 19th century in Europe and North America and collapsed in some countries during the high capital consumption periods between the two world wars).

There are also valid terminological issues that many of Piketty's detractors have pointed out – that Piketty is not careful about the meaning of his data[5] – that the terms "wealth" and "capital" are conflated[6]; and that his analysis is "strangely ahistorical in its failure to interpret data in the process of economic evolution and change. Identification problems involving substantive claims are ignored."[7]

Many economists, even within orthodox schools of thought, have shown that Piketty's statistical evidence for inequality (and the further gripe that much of his data regarding income inequality are based on pre-tax incomes) is questionable at best, that most if not all of the proposed solutions by those opposed to inequality would actually worsen inequality. A unique Austrian contribution to these criticisms would be to remind us that redistributive schemes have empirically been failures even by their own merit, and that human biodiversity (thus logically, as will be shown, one of the original sources of inequality) is actually a strength, not a weakness, and is best served by free-market capitalism.

Regarding the earnings of capitalists, Piketty falls prey to the fallacies that Böhm-Bawerk demolished more than a century ago[8]. Let us take but one example, a passage in which

5 "As rich as *Capital* is in data description, it is impoverished in ascribing meaning to these measurements. The interpretations that are presented suffer from problems in terms of ambiguity as to what is being measured and in the way in which long-run data are interpreted as observations of a dynamic economy." In Lawrence E. Blume, and Durlauf N. Steven (2015) "Capital in the twenty-first century: a review essay." Journal of Political Economy, vol. 123, iss. 4: pp. 752.

6 *Ibid*., p. 751.

7 *Ibid*.

8 See mainly Eugen von Böhm-Bawerk (1898) *Karl Marx and the Close of his System*. London: T.Fisher Unwin, reprinted by the Ludwig von Mises Institute, 2007, and Eugen von Böhm-Bawerk (translated by William Smart) (1890). Capital and Interest, A Critical History of Economical Theory. (London, New York: Macmillan and Co.). Rothbard on this point: "Capital as a fund of savings or lending may earn interest; but capital goods - which are the real physical factors of production rather than money funds - do not earn interest. Like all other factors, capital goods earn a price, a price per unit of time for their services. If you will, capital goods, land, and labourers all earn such prices, in the sense of 'rents', defining a rental price as a price of any good per unit of time. This price is determined by the productivity of each factor." Murray Rothbard (1995) An Austrian

Piketty alleges that the return to capitalists is due to the increment in output due to additional machinery, land, and other forms of physical "capital"[9]:

> Technology naturally plays a key role. If capital is of no use as a factor of production, then by definition its marginal productivity is zero. In the abstract, one can easily imagine a society in which capital is of no use in the production process: no investment can increase the productivity of farmland, no tool or machine can increase output, and having a roof over one's head adds nothing to wellbeing compared with sleeping outdoors. Yet capital might still play an important role in such a society as a pure store of value: for example, people might choose to accumulate piles of food (assuming that conditions allow for such storage) in anticipation of a possible future famine or perhaps for purely aesthetic reasons (adding piles of jewels and other ornaments to the food piles, perhaps). In the abstract, nothing prevents us from imagining a society in which the capital/income ratio β is quite high but the return on capital r is strictly zero. In that case, the share of capital in national income, $\alpha = r \text{X} \beta$ would also be zero. In such a society, all of national income and output would go to labor.[10]

An interesting side note is that if standard Austrian business cycle theory is correct, then the income and wealth data would have, according to Murphy (2014), the very same pattern that alarms Piketty and his followers. Yet Austrians see things very different and come up with entirely different policy prescriptions:

> Soaring stock and real estate prices would naturally swell in the hands of the richest Americans, while income concentration would also become more skewed because of the capital gains accruing from the price appreciation. Yet what Piketty would diagnose as "$r > g$" and the rich plowing savings back into their fortunes, would instead be an artificial jump in prices caused by loose money. If the Austrians are right about the boom-bust cycle, then the solution is of course *sound money*, not confiscatory taxes.[11] [Italics in original.]

Many more anti-Picketty works[12] will doubtless come about in the near future, as the aftereffects of different levels of freeish-market economies produce more of Piketty's educated and privileged ilk.

Perspective on the History of Economic Thought, vol. 2 Classical Economics (Auburn: Mises Institute), p.. 22-23.

9 Mises on this point at p. 847 of *Human Action*: "Even those who look upon the inequality of wealth and incomes as a deplorable thing, cannot deny that it makes for progressing capital accumulation. And it is additional capital accumulation alone that brings about technological improvement, rising wage rates, and a higher standard of living."

10 Piketty (2014), pp. 212-213.

11 Murphy (2014), pp. 19-20.

12 For a more Austrian flavor, see Philipp Bagus and Andreas Marquart (2016) and George Reisman (2014), for a mainstream response, see Jean-Philippe Delsol, Nicholas Lecaussin, and Emmanuel Martin (eds.) (2017).

III Failure to Make a Case Against Inequality *per se*

We will stick mostly to the arguments (a small number of them due to space limitations) against inequality made by Piketty and his followers, though we could just as easily pick out any number of intellectuals espousing egalitarian ideals from a wide range of fields.

Piketty's take on capital and income does not come with any explanation as to savings and ignores variations across individuals in their attributes, geography, genetics, luck, earlier choices, historical movements, etc., yet it is always not just assumed – it is also outright stated several times that inequality is a grave problem to be dealt with using the swiftest and most coercive means, such as "[t]axation is not a technical matter. It is preeminently a political and philosophical issue, perhaps the most important of all political issues. Without taxes, society has no common destiny, and collective action is impossible."[13] He continues to conceal his contempt for the rich and successful by couching his language in collectivist euphemisms: "[f]rom the standpoint of the general interest, it is normally preferable to tax the wealthy rather than borrow from them."[14]

Oddly, Piketty does not even appear that enthusiastic at the prospect of increased government revenue, and admits that his proposed taxation schemes would likely not yield much increased revenue: "when a government taxes a certain level of income or inheritance at a rate of 70 or 80 percent, the primary goal is obviously not to raise additional revenue (because these very high brackets never yield much). It is rather to put an end to such incomes and large estates, which lawmakers have for one reason or another come to regard as socially unacceptable and economically unproductive"[15] Thus, we are left to conclude that his arguments for equality must be rooted (at least superficially) in some moral concern.

13 Piketty (2014), p. 493.
14 *Ibid*., p. 540.
15 *Ibid*. p. 505.

Piketty also conflates several notions of distributive justice. In his own words, "[s]ocial inequalities are acceptable only if they are in the interest of all and in particular of the most disadvantaged social groups. Hence basic rights and material advantages must be extended insofar as possible to everyone, as long as it is in the interest of those who have the fewest rights and opportunities to do so. The 'difference principle' introduced by [...] Rawls [...] is similar in intent. And the 'capabilities' approach favored by [...] Amartya Sen is not very different in its basic logic."[16] Though this area of moral and political philosophy can be quite muddled, Sen (1999) and Nussbaum (2006) shift the focus of justice away from income to capabilities (thereby not making a *reductio ad mathematicum*) and so "represent a curious basis for arguing against income and wealth inequality *per se*."[17]

However, the part which few journalists and academics seem to have caught is Piketty's base assumption that such inequality is *per se* a moral bad[18]. Nothing much has changed since 1974, when Rothbard wrote: "It is rare indeed in the United States to find anyone, especially any intellectual, challenging the beauty and goodness of the egalitarian ideal."[19] We are again left to ascribe uncharitable aims or subjective states of mind such as envy or dislike of the more successful.

Another curious point is that those like Piketty rarely, if ever, advocate that the cut-off point for their redistributive schemes disturb their income too much. As Mises pointed out in the 1940s, "what those people who ask for equality have in mind is always an increase in their own power to consume. In endorsing the principle of equality as a political postulate nobody wants to share his own income with those who have less."[20] Thus, when Piketty, or any modern

16 Piketty (2014), p. 480.

17 Blume and Durlauf (2015), p. 766.

18 Mises calls inequalities in non-human resources across the world and individual variation as one of the essential elements of the market economy. In *Human Action*, he writes: "The fact that freedom is incompatible with equality of wealth and income has been stressed by many authors. There is no need to enter into an examination of the emotional arguments advanced in these writings. Neither is it necessary to raise the question of whether the renunciation of liberty could in itself guarantee the establishment of equality of wealth and income and whether or not a society could subsist on the basis of such an equality. Our task is merely to describe the role inequality lays in the framework of the market society" (p. 285).

19 Murray Rothbard (2000) *Egalitarianism as a Revolt Against Nature and Other Essays* (Auburn: Mises Institute), p. 2.

20 Mises (1949), p. 836.

upper-middle class intellectual, clamors for punitive taxation on “the rich”, they do not typically suggest a curtailment of their own income for the benefit of those 98 or so percent of the Earth’s population whose income is lower than theirs.

Even if we grant every single argument to Piketty, and say that the case has been made that capitalism undeniably is responsible for the increasing inequality in income and wealth – it *still* does not follow that the average person in the world is worse off under such a system, it *still* does not follow that this is a worse situation than all of humanity being near subsistence level (as was the case throughout the vast majority of history and prehistory), and it surely does not demonstrate why this kind of inequality is such a pressing moral and economic problem.

IV <u>**Inequality as Moral Horror and Conceptual Impossibility**</u>

We will now go where Piketty and the bulk of his followers would never venture – and that is pushing equality to its limits. Rothbard starts criticizing the ideals of equality early in his career, and bases his arguments in both praxeology and history (paying special attention to the fact that one can never change the past): “...each person *could not* begin from the same point, for the world has not just come into being; it is diverse and infinitely varied in its parts. The mere fact that one individual is necessarily *born in a different place* from someone else immediately insures that his inherited opportunity *cannot* be the same as his neighbor’s”[21] [italics in original].

It is always practically easier to reduce the standard of living of the top rather than raise the standard of living of the bottom (or everyone’s simultaneously, though ironically for the egalitarians, that is what the market economy is for), hence the overwhelming bulk of the anti-inequality literature recommends confiscatory measures such as income tax, property tax, sales tax, currency controls, etc.. Furthermore, it is far easier in terms of energy expenditure and time to destroy than to build; thus, by logical extension, if we were truly

21 Murray Rothbard (1962) Man, Economy, and State (Scholar’s Ed.) (Auburn: Mises Institute), p. 1310-1311.

serious about implementing a full-scale forced egalitarian scheme, that world would necessarily be a world of horror fiction and an eternal struggle against biology and geography (and one can fairly argue, even physics), in the words of Rothbard:

> "The egalitarian revolt against biological reality, as significant as it is, is only a subset of a deeper revolt: against the ontological structure of reality itself, against the "very organization of nature"; against the universe as such. At the heart of the egalitarian left is the pathological belief that there is no structure of reality; that all the world is a *tabula rasa* that can be changed at any moment in any desired direction by the mere exercise of human will—in short, that reality can be instantly transformed by the mere wish or whim of human beings. Surely this sort of infantile thinking is at the heart of Herbert Marcuse's passionate call for the comprehensive negation of the existing structure of reality and for its transformation into what he divines to be its true potential. "[22]

It is thus in fiction that we see the most horrific ramifications of such a worldview – L. P. Hartley's *Facial Justice*, Kurt Vonnegut's *Harris Bergeron*, and Ray Bradbury's *Fahrenheit 451*, to just name a few, in which the unsightly details of a system striving for full egalitarianism are spelled out for us. One of the main differences between such fiction and everyday governmental intrusion upon the economy is that the former is grounded in visceral body horror, whereas the latter is achieved by complicated tax codes, preferential regulations, social welfare schemes, byzantine laws, and couched in vague social justice terms or political slogans.

Rothbard goes even further – he attacks the egalitarian mindset by carefully laying out the conceptual impossibility of their own goals, and then recommends that "the proper critique here is to challenge the "ideal" goal itself [of equality]; to point out that the goal itself is impossible in view of the physical nature of man and the universe; and, therefore, to free mankind from its enslavement to an inherently impossible and, hence, evil goal."[23] This impossibility would extend even if we were to grant a global superstate total control over human genetics, as subjective experiences such as view (say, if one lived on the 77th floor, and another person lived on the 12th – we would thus have achieved some level of inequality anew), or atmospheric conditions (a settlement in a valley will trap different kinds of air particulates compared to a windy plains area), or climate, would still differ.

22 Murray Rothbard (2000), p. 17.
23 *Ibid*., p. 6.

As Rothbard points out, forcing upon humanity a total equality of condition "would reduce humanity to an anthill existence,"[24]and though such a goal is most assuredly unattainable, "an enormous amount of damage—the crippling of individuality, as well as economic and social destruction—could be generated in the attempt."[25]

We often think of our capacity to experience the suffering of others as the ultimate source of goodness – and there is some truth to that statement. Adam Smith and Mises have written interesting passages on the origins of empathy and their significance in economic theory, and modern neuroscience and psychology would likely support many of their thoughts on the subject. However, far from helping us to improve the lives of others, empathy without the prerequisite knowledge in economics, history, and philosophy, "is a capricious and irrational emotion that appeals to our narrow prejudices. It muddles our judgment and, ironically, often leads to cruelty. We are at our best when we are smart enough not to rely on it, but to draw instead upon a more distanced compassion."[26]

V <u>**Conclusion**</u>

Inequality, especially in terms of monetary wealth, and that such inequality would persist even in an ideal free-market, should be the expected outcome. In the words of Murray Rothbard:

> "That there is inequality of ability or monetary income on the free market should surprise no one. As we have seen above, men are not "equal" in their tastes, interests, abilities, or locations. Resources are not distributed "equally" over the earth. This inequality or diversity in abilities and distribution of resources insures inequality of income on the free market. And, since a man's monetary assets are derived from his and his ancestors' abilities in serving consumers on the market, it is not surprising that there is inequality of monetary *wealth* as well.[27]" [Italics in original]

24 *Ibid*., p. 279.
25 *Ibid*.
26 Paul Bloom (2017). *Against Empathy: The Case for Rational Compassion*. Random House.
27 Murray Rothbard (1962) Man, Economy, and State (Scholar's Ed.) (Auburn: Mises Institute), pp. 656-657.

Even if a system were created with a seemingly perfect, flat, “fair” head tax on all activities with zero loopholes in the name of solving inequality, along with draconian controls over all human beings born unto that system, Mises would warn that that “economists must never disregard in their reasoning the fact that the innate and acquired inequality of men differentiates their adjustment to the conditions of their environment,”[28] and thus, such a system would quickly find a way to inadvertently produce inequality, besides the glaring fact that some people will require all sorts of legal privileges to impose that kind of system in the first place.

28 Mises (1949), p. 325.

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