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Capital, Ideology, and the Liberal Order

https://doi.org/10.1515/auk-2021-0017

Abstract: Thomas Piketty's *Capital and Ideology* (2020) offers a powerful critique of ideological justifications for inequality in capitalist societies. Does this mean we should reject capitalist institutions altogether? This paper defends some aspects of capitalism by explaining the epistemic function of market economies and their ability to harness capital to meet the needs of the relatively disadvantaged. We support this classical liberal position with reference to empirical research on historical trends in inequality that challenges some of Piketty's interpretations of the data. Then we discuss the implications of this position in terms of limits on the efficacy of participatory governance within firms and the capacity of the state to levy systematic taxes on wealth.

Keywords: Piketty, wealth inequality, consumption inequality, measuring inequality, classical liberalism, Austrian economics, knowledge problem, participatory socialism, private-property markets

1 Four Points in Defence of Capitalism

Thomas Piketty's *Capital and Ideology* (2020) is an impressive work that expands on his seminal *Capital in The Twenty-First Century* (2014). The main difference between both works is that the former is far less data-intensive than the latter. *Capital and Ideology* extends the Western orientation of the previous work to include global and colonial narratives. Piketty adds a fresh focus on the ideological justifications of what he terms the 'inequality regimes' of the past and present. Attractive elements to Piketty's agenda include his openness to interpretation of the new evidence and the prudence with which he states his conclusions. What Piketty provides is newly collected data on the growth of wealth and its shifting distribution, a framework for understanding the historical development and political justifications for inequality, as well as a new program for progressive

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reform. But he also acknowledges that others may look at the same historical facts and data and make different evaluations. While offering a novel account, we see the interdisciplinary method underlying *Capital and Ideology* as a recovery of a rich scholarly enterprise that combines political economy and sociology in the tradition of thinkers like Montesquieu, Smith, Marx and Polanyi. Piketty departs from a standard approach in economics where institutions and ideas are left to the background in favor of technological factors (See notably Goldin and Katz 2009; Juhn, Murphy, and Pierce 1993). In fact, in his article included in the recent special issue of *Analyse & Kritik*, Piketty summarizes his view efficiently as follows: "inequality is primarily political and ideological, rather than economic and technological" (2021, 147).

While there is much to admire in Piketty's approach, we have four interrelated points in defence of capitalist institutions that we feel are underweighted in his analysis. First, we argue it is not only public institutions that play a key role in determining the value of wealth. Rather private markets and their processes of putting capital to use are essential for conceptualising and pricing assets as well as discovering their most valuable uses. Second, we believe the historical record and contemporary outcomes of what Piketty terms ownership societies, that we would prefer to label commercial societies, are more positive than credited in *Capital and Ideology*. Piketty fails to account for how multiple corrective empirical works aimed at his previous work caused important interpretative differences (Armour, Burkhauser, and Larrimore 2014; Arnott, Bernstein, and Wu 2015; Auten and Splinter 2018, 2019, 2021; Geloso et al. 2020; Geloso and Magness 2020; Larrimore et al. 2021; Magness and Murphy 2015; Mechling, Miller, and Konecny 2017; Sutch 2017). Third, appropriately recognising this epistemic role of private markets indicates limitations to replacing firms under proprietary management with worker-controlled alternatives. Fourth, attempts to radically redistribute wealth through tax-funded universal endowments face a similar epistemic problem of valuing capital assets rather than the income they realize. Our overall message is that classical liberals seek not to defend the interest of capital, but rather to harness it through institutions that facilitate competition to ensure that it brings benefits to all.

2 The Classical Liberal Perspective in a Nutshell

Classical liberalism is the self-described ideology that puts property rights and voluntary contracting at the core of social order and human flourishing (Barnett 2014; Epstein 2003; Pennington 2011). It appears in *Capital and Ideology* under the labels proprietarian and neo-proprietarian as a set of arguments used mainly to justify the absolute protection of property, whether on grounds of

class distinction or merit, lest chaos and regime collapse ensue (Piketty 2020, 120). Classical liberals have certainly made arguments in that direction (cf. Alves and Meadowcroft 2014), but this only forms one element of a broader social theory. So, it is worth setting out the 'ideology' of classical liberalism on its own terms; that is the simplified model of reality that classical liberals use to justify some social arrangements, including their resulting equalities and inequalities.

Classical liberalism begins with the premise that all people are equal in dignity and moral worth; that everyone has rights and liberties to order their own lives as they see fit (Buchanan 1976). Social inequalities of income, wealth, and power, therefore, must be justifiable to those who are relatively disadvantaged along any of those dimensions. In this, classical liberals are in line with the literature at the intersection of social psychology and economics regarding tolerance for inequality. Studies tend to find that people are willing to tolerate highly unequal distributions of income and wealth *conditional* on these distributions resulting from merit, some sense of greater social welfare or that there are genuine chances of upward income mobility (Shariff, Wiwad, and Aknin 2016; Starmans, Sheskin, and Bloom 2017; Welch 1999). Classical liberals depart from other liberals when they emphasize that *institutions* are the conditions that determine tolerance to inequality. In their viewpoint, one must discuss and advocate for a configuration of institutions that best promotes everyone's interests, including the relatively disadvantaged (Novak 2018).

Humanity faces systematic barriers to social order and prosperity. Humans face scarcity in both the natural world and the social world. They face material scarcity in the form of food, shelter, and comfort. They face scarcity more fundamentally in terms of the time they have for enjoying life as well as access to social status within a community. When trying to resolve these scarcities together, humanity faces two key challenges: the knowledge problem and the incentive problem (Cowen 2017, 2021a; Pennington 2011). The knowledge problem is figuring out how to best make use of natural and social resources and coordinate production to satisfy people's needs and preferences. The incentive problem is ensuring that people, at least those who are capable, contribute fairly to social production and are assured that other people are doing the same. Critically, these problems are pervasive in all spheres of social activity, including the economic and political (Delmotte 2020), which are inevitably entangled with one another (Wagner 2016). The essential institutional recipe for solving these problems is relatively simple: free association of individuals, as well as several property and voluntary contracting under the rule of law. The *political* economy of living well together, by contrast, is a wicked problem that no one has yet managed to solve, although institutions of limited government and

liberal democracy have come closest and continue to be the most promising avenue for progress. We now consider the economics and politics of liberalism in turn.

2.1 The Economics of 'Natural Liberty'

The economic case for commercial society is arguably first systematically stated in Smith's (1981/1776) *The Wealth of Nations*. Smith's famous proposition is that specialisation through trade improves the quality and quantity of goods and services that can be produced. Specialisation is limited by the extent of the market. Thus, a larger market of available buyers, whether consumers or purchasers of intermediate goods, means that it is both reasonably safe and more efficient for individuals to specialise and become more productive in a particular line of work. The essence of familiar economic arguments for the benefits of domestic trade liberalisation, international trade, and the agglomeration of productive enterprises in cities can be found in Smith. Smith perceived a close connection between the productivity of workers and their resulting purchasing power. Competition between enterprises with free entry into the market benefits workers by forcing employers to bid up workers' wages or else lose them to more productive alternatives. Smith observed that the highest wages were found in societies with the densest cooperative networks and most connections with global trade, as found in the Netherlands when he was writing. The moral basis for commercial society is the expansion of welfare and opportunities for people who rely on their labor for their living.

Smith argued that the best way to bring about what we now call 'Smithian growth' was the system of natural liberty, a now-familiar set of rights to move, associate and contract with others, as well to possess, exchange and modify property (Barnett 2014). This framework can encourage even selfish individuals to cooperate spontaneously to meet each other's needs. The beneficial role of government is to protect people's rights within this framework, as well as to provide public goods, especially infrastructure, that makes people living and trading in proximity comfortable, healthy, and safe. Although easily characterised as a relatively conservative ideology today, Smith's vision, and that of the Scottish Enlightenment more generally, had strong radical credentials in its day, including frank and principled opposition to slavery, imperialism, and discrimination (Levy 2001).

Smith wrote during a time of tentative industrialisation but before scholars conceived of the industrial revolution. Subsequently, the 19th and 20th centuries saw explosive growth in economic productivity and income. Although the division of labor and the expansion of world markets played an important role

in this growth, it cannot explain very much of it alone. Classical liberals, especially those working within the Austrian school of economics, offer an epistemic explanation for economic improvement: the incremental discovery and utilisation of knowledge in society (Boettke 2002; von Hayek 1945). A great deal of growth has involved not so much making existing production practices more efficient at scale but rather the invention of entirely new kinds of goods and services, as well as novel production techniques and practices (Rogge 1979; Schumpeter 1943). Natural liberty facilitates this process by allowing people to commit their resources (and those of willing investors) to novel enterprises. When successful, they profit and expand while encouraging other enterprises to imitate their innovative practices. In the end, the poorest gain the greatest in terms of utility and well-being even though innovators grow richer as well (McCloskey 2016; Nordhaus 2004).

In what sense does this framework justify inequality? At points, Piketty (2020, 27) implies that social inequality must be deliberately instituted to be sustained and thus any inequality regime needs a positive justification for its persistence. For example, free-market ideologues could argue that some degree of inequality might be needed to incentivise hard work – an argument that some classical liberals have indeed made (Scully 2003). From an Austrian perspective, however, inequality does not require justification as such because it results from the undirected, independent activity of people participating in markets and civil society (Nozick 2013; von Hayek 1976). The liberties people have to associate and exchange while engaged in mutually beneficial economic activity lead to the emergence of some inequalities because people have different opportunities to cooperate and make different choices when doing so. It is not the fact of inequality that drives competition and rivalry in the marketplace. Rather, market competition is simply the ongoing attempt to find productive and cooperative niches within a social order (Cowen 2020a, 2020b). Although everyone who contributes through market participation can expect to benefit substantially, certainly compared to non-cooperation and social isolation, some individuals will be fortunate to benefit a great deal more than others. Because the market process is a site of experimentation, it is impossible to say *ex ante* who specifically the process will provide outsized rewards. This account agrees with Piketty (2020, 562) that there is nothing intrinsically merit-worthy about the people who benefit more than others from this social process. Nevertheless, having participated on fair terms with other people within a framework of rules, people have a reasonable *pro tanto* claim to their rewards.

2.2 The Politics of 'Natural Liberty'

If the benefits of 'natural liberty' are so outstanding, then why are so many existing social rules repressive and likely to deviate from classical liberal ideals? The key problem with natural liberty is that it seldom sustains and protects itself spontaneously, as Piketty notes. People do not consistently converge on norms and social relations that reflect general and abstract rules that are equally applied to all (North, Wallis, and Weingast 2009). Rather, the persons and possessions of the weak and socially isolated are prone to predation, exploitation, and plunder from the powerful. Moreover, the capacity to use violence is often subject to similar gains from the division of labor as other enterprises. In other words, relatively small groups of people with the capacity to use organised violence tend to dominate governance arrangements and make up any political elite (Olson 2003/1965). This explains the high prevalence of slavery and tyrannical, authoritarian rule within states, as well as colonialism and imperial expansion beyond state borders throughout history (Geloso and Salter 2020; Ma and Rubin 2019).

The challenge, therefore, is somehow persuading a political elite to build and sustain protective and productive institutions while keeping predation to a minimum (Buchanan 2000). Essentially, classical liberals admit that an ideal world will forever be elusive. The question is how to marginally move towards less imperfect ones. The solution, unfortunately only available in some historical circumstances, is to configure political rights granted to elites in such a way that they have to compete with each other for citizens and wealth (Piano and Salter 2020; Salter 2015a, 2015b). Each ruler's ability to attract people and capital checks the ability of other rulers to succumb to their desire to become predators. In other words, rulers are forced into a chain gang whereby no one can try to run away without the others making him fall. Thus, the capacity for ordinary people to 'exit' from bad governments is the first key constraint that forces rulers to act better. Second, democracy is an important step in the civilising of politics by creating a voicing mechanism. It offers an additional mechanism through which ordinary citizens can influence policy priorities (Acemoglu et al. 2019; De Mesquita et al. 2005). Accidentally, democracy lowers the stakes of competition between elites, allowing leaders (and their parties) to give up power without violence after their departure from office (Cox, North, and Weingast 2019; Weingast 1997).

With this perspective in mind, classical liberals generally locate the more problematic sources and consequences of inequality in the political sphere (Cowen forthcoming). They are relatively relaxed about the billions that entrepreneurs can occasionally make because as rich as someone like Jeff Bezos or Oprah Winfrey may become, their power to harm individuals is limited. They are

far more concerned about the power of a police officer to kill a civilian with broad immunity from prosecution or even accountability, or a president to unlawfully order a drone strike in a remote country (Coyne and Hall-Blanco 2016; Schweikert 2020). They argue that granting the state power to cut rich individuals down to size, a prerogative that the Chinese Communist Party has recently exercised with respect to Jack Ma and Jimmy Lai, to be aligned with the same tyrannical powers that authorise the ethnic cleansing of religious minorities and the organ harvesting of everyone from convicted criminals to ideological opponents. For classical liberals, to fear extremely rich but relatively honest businesspeople more than the unlimited state is the result of peering at the world through a distorted lens. Of course, the state in alliance with wealthy individuals can be an object of legitimate fear too.

2.3 Emergent Epistemic Institutions of the Market

On Piketty's account, the definition and distribution of property rights, and ultimately wealth and capital, is centrally a political question, inevitably settled through conflicts (both violent and discursive) between states and interest groups within society. On a classical liberal account, the political sphere is only one influence on property-rights institutions. Property rights are an institutional technology that facilitates various forms of cooperative economic and social activities. Thus, the details and practicalities of many property-rights arrangements have their origins in social conventions developed and adopted by mutual co-operators rather than impositions from a central authority (Boudreaux and Aligică 2007; Goetzmann 2021; Harris et al. 2020). Central authorities, such as states, often observe the persistence of an institution and decide to recognise it because it finds the resulting regularity and transparency useful for its own governance objective. An important example of this is the lex mercatoria (the law merchant), an independent body of law developed to manage disputes between international merchants that continues to operate as a forum for commercial litigation (Leeson 2006). Some of its principles have occasionally been incorporated into common and statutory law. In other cases, the state has granted merchants the liberty to manage disputes according to their customs while the state reaps the benefits in terms of greater wealth creation within its territory.

The bottom-up origins of many property rights and contracting arrangements apply critically to the technologies of measurement and assessment of wealth. Assessments of credit and debt liabilities were made more transparent through the development of accounting, especially double-entry bookkeeping, invented by Italian merchants and then subsequently adopted as a best practice by states (Gleeson-White 2012). Rozumalski (2017) examines the origins of

the Modern English state. He finds that many of the institutional technologies that are characteristic of modern state capacity have their origins in attempts by property owners to solve their challenges of managing large-scale enterprises in coordination with an increasingly mobile working population, including the use of written financial accounts, bureaucratic hierarchies, as well as cartography as part of estate management and litigation over borders. In these cases, it was private actors that developed the technologies that states ultimately imitated to cope with the increasing complexity of the societies they attempted to govern.

What are the implications of this perspective for the assessment of wealth and ultimately the capacity of the state to define and distribute it? Robust property institutions under the rule of law do not merely facilitate cooperation in civil society. They are also critical for furnishing states with the knowledge and technological capacity to rule effectively which is why history has often witnessed states and markets growing in complexity and strength in conjunction (Johnson and Koyama 2017). The market is ultimately what gives the state its economic senses. For this reason, the main barrier to effectively implementing state-directed socialism is not ideological opposition but epistemic impracticality (Boettke 2001, 2005; Boettke and Candela 2017; Trantidis and Cowen 2020). Leviathan cannot abolish or significantly attenuate private-property markets without encumbering its own epistemic capacity to observe the economy supposedly under its control.

3 Capitalism's Record

Assessing any model of human sociability based on historical experience is fraught with difficulties. The reason for this is that no regime, no social reality, could ever exemplify all the desirable features and policies of an ideology. Nevertheless, there is some agreement among both proponents and opponents alike that key features of capitalism have been more pervasive at the end of the 19th and early 20th centuries as well as the end of the 20th century. Defenders of capitalism have typically focused on the capacity to raise people out of poverty, that is the absolute reduction in material disadvantage. Piketty, like other critics, focuses instead on the consequences of capitalism for inequality, or relative disadvantage. Moreover, these critics point out the plausibly destabilising features of ever-increasing wealth inequality.

This focus stems from the rich empirical work of Piketty that started in the 1990s and continued in the early 2000s with his creation of data series that measured inequality in countries like France and the United States. His methods, which expanded on earlier efforts by Kuznets and Jenks (1953), have essentially

formed what amounts to the 'gold standard' in terms of measuring income inequality. From these methods, Piketty (2021, 420) (and those in his wake) has built his critique of capitalism because of the purported pattern of a 'U-curve' of inequality over the 20th century. This U-curve where inequality starts high in the 20th century, levels off and then rises again fits his claims about ideology: inequality was high in the pre-welfare state era, it fell during that era and rose when it was gradually rolled back during the 1970s and 1980s.

There are several empirical problems with this interpretation. First, the era of the 'minimal state' (i.e. *circa* 1860 to 1910) is more probably marked by *falling* inequality than rising inequality. Many series show rising levels of income inequality, but these do not account for relative price changes. Geloso and Lindert (2020), following Hoffman et al. (2002), studied the effect of inequality in the cost of living on income inequality from the 17th to the early 20th centuries. Their premise is that economic growth had uneven effects on price structures with prices that matter more heavily to the poor falling more than those that matter to the rich. This means that inequality trends in *real* income would have differed from trends in *nominal* income. For countries like Canada, Britain, Australia and the United States, they find strong egalitarian price trends post-1850. These price trends, in turn, reduce the level of income inequality to the point that some series show *declines* in income inequality to 1914. For that period, there are also other signs of greater equality. For example, the stunning reductions in infant mortality and increases in life expectancy were disproportionately concentrated in lower-income classes (Ho and Slavov 2012; Peltzman 2009). Another piece of evidence is the case of human stature – which is heavily correlated with nutritional status. Highly unequal societies will have their inequality reflected in the distribution of adult people's heights through the effect of poor nutrition for the poorest during childhood. Falling inequality in heights thus indicates that income gains are benefitting the poor more heavily than the rich through better nutrition. Western European countries and their offshoots exhibit *falling* heights Gini coefficients during the 1860–1920 period (Baten and Blum 2013). For a period marked by what some classical liberals dub the 'era of the minimal state', this is a stunning finding. Simply put, when combined with the improvements in absolute living standards, this is a sizable win for the classical liberal argument.

Second, there have been several challenges to the empirical constructs of Piketty which tend to apply to the post-1917 era and largely to the United States (which feature so heavily in Piketty's narrative).[1] These divide themselves into

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1 However, Magness (2019) also finds that the problems mentioned below also apply to Britain. Moreover, Sutch (2017) also found further complications with Piketty's inequality estimates.

two subperiods: pre-1960 and post-1960. For the pre-1960 period, the main revisions of Piketty's estimates have been provided by Geloso et al. (2020) and Geloso and Magness (2020). Without disputing the methodology by which inequality was measured, Geloso et al. (2020) identified multiple issues with the way the data from tax records was employed and converted into a usable form. Geloso and Magness (2020) compounded this by pointing out that pre-1940s tax data in the United States suffered from a weak tax bureaucracy and rampant income underreporting in lower-income classes (thus skewing the distribution). Using state-level income tax data from states who had their own income taxes and who enforced their tax codes aggressively, Geloso and Magness (2020) find that Piketty overestimated inequality pre-1940 by a factor of 1.18. Similarly, Geloso et al. (2020) showed that incorrect treatment of missing filers, tax deductions and total income significantly reduced inequality levels (roughly by one-fifth of the depicted level). Piketty (alongside Emmanuel Saez) showed that there was a rapid increase in inequality to 1929 and then a relatively stable level until the Second World War at which point there is a marked collapse in inequality. Thereafter, inequality is much lower. Geloso et al. (2020) show a different pattern: a milder increase to 1929, a pronounced reduction during the Great Depression that continued during the War and a slight rebound after the war. The differences in trend suggest a wholly different narrative: inequality was mostly reduced by the long and pronounced contraction that was the depression. This alters the relative importance of the role of social policies post-1945 in securing the low plateau of the post-war period. For the post-1960 period, Auten and Splinter (2018, 2019, 2021) and Mechling, Miller, and Konecny (2017) have shown that there are sizable problems due to changes in the tax code that force largely artificial changes in *measured* inequality (as opposed to actual inequality). Their proposed adjustments suggest that the plateau was not as low as depicted by Piketty and that the subsequent increase during the 1980s was much more modest than they depict.[2] These revisions to the data weaken the relationship between the observed world and the predictions of Piketty's argument. They also weaken the case against classical liberals.

Most importantly, a share of the rise of inequality post-1975 has nothing to do with ideology as it is merely a by-product of rising levels of immigration relative to the total population of western countries (Card 2009; Moore and Pacey 2003). Generally, immigrants suffer some form of wage penalty in their host country (all else being equal) due to unfamiliarity with norms, practices, and other informal institutions. This means that their distribution of income differs from that of the

2 Further calculations for how to incorporate capital gains also tend to reduce the level of measured inequality (Armour, Burkhauser, and Larrimore 2014; Larrimore et al. 2021).

native population. Technically speaking, this opens the door to a composition bias. Even though members of both groups could enjoy the same percentage in income over a period of time, increases in the number of immigrants cause an illusion of greater inequality.[3] This illusion is quite problematic because international migration actually causes a *reduction* in *global* inequality. When immigrants go from poor country X to rich country Y, their incomes tend to increase by a sizable proportion (Clemens, Montenegro, and Pritchett 2008; Clemens and Pritchett 2008). While there is greater inequality in the host country, the gain from migration is great enough to reduce *global* inequality. This is an underappreciated egalitarian trend associated with a key tenet of classical liberalism (i.e. free movement of people and factors of production). It also comes with a flipside *against* Piketty's analysis. The backlash against immigration of the 1910s and 1920s across the western world brought an end to rising levels of migration. This had the effect of eliminating the composition bias mentioned above which meant greater equality but only within western societies. Globally, the barriers against migration that were erected in the first decades of the 20th century increased inequality *worldwide*. This point further reinforces the claim of classical liberals that institutions that secure economic freedom (e.g. property rights, freedom to trade and relocate) will tend to be more egalitarian than illiberal institutions that fail to do so.

In other words, the case *against* capitalism's record is not as strong as Piketty proposes. The classical liberal case remains quite strong. This does not, however, mean that classical liberals have been handed a win. As Williamson (2011) suggests, globally liberal changes can lead to institutional changes that increase inequality. For example, Williamson shows how globalization in the 19th century occurred thanks to a mixture of more liberal trade policies and new technologies (e.g. refrigeration, steamships, trains) that eliminated 'natural' trade barriers. For some countries, including those at the periphery, these changes caused a cascade of changes in terms of relative factor prices. Greater openness accidentally allowed landowners in the poor periphery (which could more easily specialize in land-intensive goods and products) to be wealthier. This greater wealth allowed them to command more political power and they altered institutions in their home countries in *illiberal* directions. Thus, classical liberals still have to contend with the strong possibility that liberal reforms can yield eventual effects that they would deem illiberal.

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3 This is why studies that concentrate *only* on natives find much smaller increases in inequality (Moore and Pacey 2003).

4 The Limits of Participatory Socialism

Piketty distinguishes between two popular strategies of democratic empowerment adopted by social democratic parties in the twentieth century: nationalisation and codetermination. Nationalisation was the main strategy adopted in France and Great Britain. It involves taking private firms into state-ownership based on their size, relevance to strategic industrial policy, or both. Nationalisation has two weaknesses from Piketty's perspective. The first is that it presumes that politicians and civil servants acting from the centre can pick qualified management. The second is that, in practice, nationalisation is quite easily reversed into privatisation whenever a more neoliberal-inclined government takes power (Piketty 2020, 503).

For those reasons, Piketty (2020, 495) sees the prospects of codetermination as established in Germany, Sweden, and Denmark (and France for particularly large firms) as more promising. Rather than increasing state control, codetermination assigns more governance power to workers through board representatives. By generating a more solid interest among specific stakeholders, codetermination seems to be a more enduring policy strategy. It is not associated with the same degree of incompetence and corruption seen in attempts at nationalisation. So, Piketty's (2020, 973) praxis is to take what has already worked and endured and radicalize it: apply codetermination rules to smaller firms and shift towards worker representatives playing a decisive, rather than advisory, role in firm governance.

Considering this proposal, we have an important point of agreement with Piketty: classical liberals should not be in the business of defending private firms, and especially the shareholder corporation, as a natural default of economic organisation. The shareholder corporation is not necessarily a permanent feature of capitalism (Anderson and Tollison 1982). Experiments in firm governance, including an enhanced role for workers should be encouraged, and the legal system should offer flexibility as to how firms can be structured.[4]

Nevertheless, there are reasons to resist the political imposition of worker control on private firms. A central observation of Austrian economics is that the most important function of economic institutions is to overcome the knowledge problem (Kiesling 2015). This is the problem that at any given moment the necessary knowledge for effective coordination, especially the availabilities and scarcities of resources that constitute intermediate goods, is dispersed across

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4 A good example of experimentation in firm governance is that of flour milling cooperatives in Britain during the Napoleonic wars (Tann 1980).

society in a form that cannot be assessed by a single mind or from a single point in place and time (Lavoie 1986). The competitive pricing of commodities ameliorates this problem, by giving decision-makers a summary estimate of the relative value of available resources (von Hayek 1937, 1945). These competitive prices are produced through a process of discovery (von Hayek 2014). Actors taking an entrepreneurial role can observe the public prices that other actors are prepared to offer for a good and come to believe that using their personal knowledge they can provide the same good at a lower price (Kirzner 1996, 2009). If that belief turns out to be correct, and they act on it, the entrepreneur reaps a profit, and their successful application of local knowledge is incorporated into the public prices of commodities. If the entrepreneur is mistaken, however, they will produce a loss. This process of trial and error incrementally refines competitive prices and allows them to respond dynamically to changes in the availability of resources.

Businesses operate in conditions of both risk and uncertainty (Knight 1921; O'Driscoll and Rizzo 2015). Private enterprise involves committing resources to a particular production plan in the expectation of offering a good or service that consumers will find valuable; more valuable than all the inputs that went into production combined. The more advanced and complex enterprises often involve committing a diverse range of resources over a long period of time in the expectation of producing an eventual profit. Commercial ventures necessarily involve committing resources based on limited knowledge about market conditions today and a high degree of conjecture about what market circumstances will be like in the future. Inevitably, nearly all enterprises go through periods of making losses and many ultimately fail. Yet, the realisation of loss is as important as profit as it disciplines enterprises that are engaging in socially costly activities, producing less valuable products than their inputs (Cowen 2020a, 2020b).

A critical element of the knowledge economic actors use is local and tacit. This means it cannot be articulated and communicated consistently to others. As a result, people are apt to disagree about whether a particular practice or venture is likely to work, produce value and generate profit. Entrepreneurship involves acting against prevailing wisdom and common knowledge, examining given conditions, and imagining that there is some way of doing better on some specific margin that no one has yet considered worth trying. Even if the entrepreneur is right, there is no expectation that they can persuade people generally that this venture is a good idea *ex ante*. Indeed, the likelihood of any single entrepreneurial venture succeeding as expected according to the individual pursuing it can be low.

The advantage of private-property markets is that it allows for rival ventures to be tried out through applying the resources of willing investors and creditors who are liable to absorb the losses of failed ventures while sharing the profits of the successful ones. This is where the specific characteristic of private firms

allowing for a division of roles and liabilities, between proprietors, investors, managers, and workers, turns out to be so useful (Cowen 2021b). It facilitates relatively close cooperation between individuals who potentially disagree a great deal about the viability and value of their mutual venture. An employee does not have to be concerned about the long-term profitability of her firm. In fact, an employee can avoid taking on any of the peculiar risks and liabilities associated with their current employer. A proprietor can welcome new employees to a firm while remaining able to steer it according to their vision of what they think is profitable and valuable. Managers can hire employees based on their competence for the tasks they will be undertaking rather than agreement about the way the firm overall should operate. It makes matching between employees, managers, and investors much more straightforward. Under alternative institutions where the inclusion of employees in firm governance is compulsory, then existing employees and firm owners will have to be much more careful about who they can hire. Not only will they need to hire competent people, but also people who share the same commitment and interest in the venture. Otherwise, governance of the firm will break down through disagreement as people wrestle to use the firm's resources to achieve different ends. Because successful entrepreneurship often involves executing a very particular idea that few will share, a great many ventures will simply not happen at all under a system of worker-control or worker-ownership.

The way that worker cooperatives behave in practice illustrates this theoretical concern remarkably effectively. Cooperatives are a common form of organisation in real-world commercial societies. They are often the preferred form of firm for professional partners (such as lawyers and accountants) and retailers (Lehmann 2014; Porter and Scully 1987). They can be a good choice when the key employees are expected to have relatively homogenous needs, competencies, interests, and career paths. As a result, professional partnerships tend to take great care when deciding to admit a new member, much more than a private firm hiring a new employee. They are not so useful for enterprises that require long-run risky investment commitments and where there are significant returns to scale. The reason for this is that worker-owners do not benefit substantially from scaling up an organisation when it involves diluting their ownership and control when bringing in new employees. Within a commercial society, this is not a problem for cooperatives: they can specialise in sectors where they are most effective. However, applying the principles of worker-ownership to all sectors would be deleterious to innovative and scalable enterprises. Effectively, many successful ventures will not take place at all under such institutional arrangements. Classical

liberals take this to be a heavy cost because it means a substantial range of ways of meeting people's needs will never be implemented.[5]

From this perspective, it is precisely the limited extent to which codetermination has been implemented so far that explains why it has been successful in parts of Western Europe (Jäger, Noy, and Schoefer 2021). It has been applied to large firms rather than small firms. Large firms already often struggle to make rapid and effective use of tacit and contextual knowledge, so they are not significantly further encumbered by a compulsory consultation process. In addition, decisions are still ultimately driven by a board that represents shareholders. This means that the essential division between individuals willing to take on the particular risk associated with the enterprise, and the employees contributing to implementing the enterprise, has been hitherto maintained. Departure from that division, however, will attenuate the market process significantly such that it becomes harder for many people to find cooperative niches that allow them to contribute to social production.

5 The Limits of Capital Taxation and Universal Endowments

Piketty makes the above governance reform proposals alongside radical approaches to the redistribution of wealth. One of his key contentions is that the policies of social democracy, including progressive taxation, public education and healthcare, nationalization, and pensions, were enormously valuable for distributing income and providing public services to the relatively disadvantaged. But they have proved insufficient to prevent the growth of massive wealth inequality under what he calls the current era of hyper capitalism (Piketty 2020, 486). To complement the traditional social democratic platform, Piketty (2020, 1002–3) advises first the expansion of minimum income guarantees found in much of Western Europe into more universal and automatic basic income policies, and second, universal capital endowments that have the dual aims of reducing the accumulation of wealth in a few hands and making equality of opportunity a reality by giving everyone a personal substantial share in wealth. Similarly, since progressive income and inheritance taxes are insufficient, they must be complemented by direct taxation on wealth holdings (Piketty 2020, 976–9).

5 In addition, imposing workers' cooperatives (or buyers' cooperatives) through fiat can artificially inflate the rent-seeking abilities of a particular interest group – allowing them to extract rents that are as economically costly as rents extracted by private monopolies (Banerjee et al. 2001).

As with enhancing worker control, there is some overlap between what classical liberals believe is possible and what Piketty proposes. Most classical liberals have endorsed the institutions of a welfare state in some form (Tebble 2009; von Hayek 2011). Moreover, several classical liberals explore the benefits of universal basic income policies which have the advantage of incentivising productive contributions from welfare recipients who are capable, as well as resisting political manipulation and moral paternalism within a welfare regime (Lehto and Meadowcroft 2021; Munger 2015). Some, although admittedly fewer, classical liberal theorists have noted the risks associated with wealth inequality (Geloso 2019). Buchanan, for example, favored a confiscatory tax on inheritance with the aim of preventing a permanent elite based on familial wealth from emerging (Berggren 2013). Nevertheless, the attempt to tax wealth systematically faces a severe epistemic challenge: identifying capital within society and valuing it fairly.

The idea that a pure realisation approach to taxation is inequitable because it misses relevant resource inequalities has strong theoretical support. According to the Haig-Simons definition of income, in principle, everyone's taxable earnings should constitute both their income and the net change in the value of all their capital and property holdings (Haig 1921; Simons 1938). As a result, many economists and tax theorists have proposed supplementing taxes on income with taxes on capital gains and wealth holdings (Bankman and Shaviro 2015; Meade 2012; Shakow and Shuldiner 2000). Yet, excepting certain sorts of property taxes, most taxes in developed economies are levied based on income realisation or beneficial transfers. Taxes on wealth in the real world are often limited to capital gains based on realisation or inheritance. The reasons given for this are practical: many sorts of wealth are hard to value and held in illiquid form (Mirrlees et al. 2011, 347).

An Austrian perspective recasts these practical problems as much more fundamental. If the market process is fundamentally about discovering better ways of coordinating and using resources then taxing capital assets is an attempt to tax benefits before they have been effectively realised (Delmotte and Cowen 2019). Although capital as a concept is prolific and heterogenous, prone to being applied in novel ways to different fields, it is primordially a label for intermediate goods in a production process (Kirzner 2012; von Hayek 1941). In other words, capital goods are the resource inputs that when combined with productive plans are supposed to generate valuable goods and services. Piketty, following common neo-classical assumptions, generally conceptualises capital as having a given value and a predictable return in a persistent equilibrium (Kirzner 1996, 211–212). From an Austrian perspective, however, capital does not have an established value until it has been effectively put to use (Cowen 2018). Any values imputed to capital assets are conjectural and subjective until the role of those assets in a production process has been proven. Even attempting to tax people based on

the volatile values of the assets they presently hold is likely to be impractical but also unfair. Someone might be taxed based on firm value assessed on anticipated profitability. But that profitability might never materialise.

The challenge of figuring out what to value as capital and how to value it can be illustrated with an example familiar to academics: intellectual copyright and book royalties. From the standpoint of realisation, payments based on these sorts of assets are relatively straightforward. The publisher and the author are taxed based on the annual profits and income received in book sales. A capital levy, by contrast, is much more complicated. Theoretically, the item of copyright represents a stream of future income until the copyright expires. But how much is that stream likely to be? Most works will not sell very much at all and will sell unpredictably, so the value of most copyright assets are so low that the rights are hardly worth claiming and policing. A small portion of individual works will become popular. But which ones will be popular and for how long will they remain popular? This is subject to enormous uncertainty. Moreover, the specific characteristics of a work are only one part of what will eventually determine its value. For example, the readership of the genre of the work might shrink or expand for reasons independent of that work. The way the work is marketed could change. The availability and popularity of technological mediums for conveying the work, and how well the work can be adapted to it, may change (consider the unanticipated invention of eBooks and handheld electronic reading devices). All this can happen many times throughout the history of a copyrighted work. If the publisher is a public company listed on a stock exchange, then the estimated value of their catalogue of copyright works might be implicit in their stock price (although that will not indicate what each individual asset is worth). However, many copyright assets are held by individuals and private firms that do not have anything like a public price valuing their assets. The idea that anyone, whether an author, editor, publisher, or tax official, could effectively estimate the capital value of a work is implausible.

From Piketty's standpoint, this challenge might appear to be putting the cart before the horse. The key reason we do not have assessments of capital assets like that is that regimes have not (yet) opted to tax those assets systematically. From an Austrian school perspective, however, authorities lack the capacity to make or demand sensible assessments of specific items of capital. Instead, a great deal of knowledge about what represents value is held exclusively by those with local and specific knowledge, sometimes the owner and even they cannot conceptualise that knowledge in the form of a price. A fair assessment of any particular asset could only be generated through a market process where the owner of the asset decides it might be worth selling and potential buyers consider offers. The real value of the asset is not so much concealed but unknown and

unknowable until and unless the asset is sold (disposal) or effectively applied to a productive endeavour (income realisation). This clarifies the advantage of taxes based on income and beneficial transfers as it generally allows for tax assessments to be based on something approaching real agreed market prices.

If this account is correct, then states are epistemically constrained from levying a wealth tax systematically on all kinds of wealth. Any attempt to do so would be partial, missing illiquid, intangible, unknown and otherwise hard to value aspects of people's property holdings with the result that the higher the tax on known holdings, the more people would be likely to shift their wealth into less liquid assets. Of course, the comparatively rich can more easily handle risks associated with holding illiquid assets compared to the less rich. The result might be a decrease in wealth inequality (at least according to official data) but it would come at a severe cost in terms of facilitating open and productive economic activity. Competitive markets benefit from transparent pricing of intermediate goods as it facilitates their progressive application to more productive and beneficial ventures. Yet a formal tax on capital is ultimately a tax on the more transparent forms of capital, which means it is effectively a tax on common knowledge of productive activity itself.

6 Conclusions

Piketty draws on both historical political economy and the history of ideas to make the case for an egalitarian alternative to existing institutions. In response, we have made a counter-case for the classical liberal perspective that seeks equality and progress through better economic institutions and has a more positive assessment of what capitalism has achieved for humanity so far. Our response has highlighted the theoretical epistemic and incentive contributions of private-property markets. We have justified this theoretical position with even-handed consideration of the evidence of general prosperity and its relative distribution. Then we have examined what this means for two key areas of reform that Piketty proposes: participatory socialism and universal capital endowments. In each case, we have acknowledged the scope for productive reform in this direction but highlighted the epistemic constraints on achieving them in the way that Piketty proposes. Our conclusion is that liberal capitalism remains a core part of how societies can progressively grow more enriched and more equitable.

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