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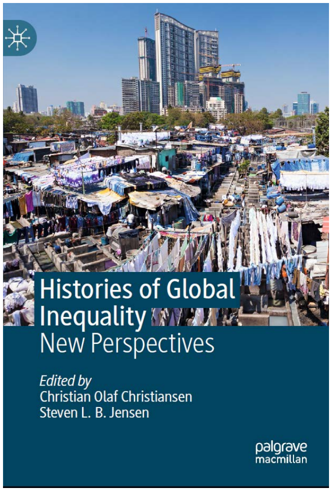

Historicizing Piketty: The Fall and Rise of Inequality Economics

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The floodgates of inequality economics have opened. The wave of studies ushered in by the unprecedented success of Thomas Piketty's *Capital in the Twenty-First Century* in 2014 have, in the past few years, come in many shapes and sizes: We now have global analyses such as Branko Milanovic's *Global Inequality*, centuries-long histories such as *Unequal Gains*, and a collected volume dedicated entirely to the future of the inequality agenda fittingly named *After Piketty*. The dramatic titles of other recent books reveal the current mood of inquiry, be it Thomas Shapiro's *Toxic Inequality: How America's Wealth Gap Destroys Mobility, Deepens the Racial Divide, & Threatens Our Future*, Dean Baker's *Rigged: How Globalization and the Rules of the Modern Economy Were Structured to Make the Rich Richer*, Steven Teles and Lindsey Brink's *The Captured Economy: How the Powerful Enrich Themselves, Slow Down Growth, and Increase Inequality* or Brian Alexander's *Glass House: The 1% Economy and the Shattering of the All-American Town*. It appears that the "1 per cent" have been, as Piketty's graphs famously revealed, gobbling up not only much of the wealth and

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income these past few decades but, in recent years, also the attention of economists, journalists and public intellectuals.[1]

The "Piketty Effect" has spread into political and policymaking circles as well. If there is, for example, one constant in the left rhetoric of Bernie Sanders, the most popular politician in the United States according to 2017 polls, it is his dogged emphasis on the massive wealth disparities between the super-rich and "the 99 per cent." The popularizing of the term "the 99 per cent," by David Graeber and the leaders of Occupy Wall Street, in fact, would not have been possible without the data that was collected and distributed by Piketty regarding the enormous income gains of the top centile in the past 40 years. A visit to inequality.org reveals a long list of think tanks, academic centres and public interest groups who now focus on inequality, be it the Economic Policy Institute, the Washington Center for Equitable Growth or the LSE International Inequality Institute. Inequality has even seeped into the staid world of central banking. U.S. Federal Reserve Chair Janet Yellen spoke at a Fed conference in Boston in the fall of 2014, just as Piketty's book was becoming a global sensation. "The extent of and continuing increase in inequality in the United States greatly concern me," Yellen said. "I think it is appropriate to ask whether this trend is compatible with values rooted in our nation's history, among them the high value Americans have traditionally placed on equality of opportunity." As the *New York Times* rightly noted at the time, "by the cautious standards of central bankers," Yellen's

[1] Thomas Piketty, *Capital in the 21st Century* (Cambridge, MA: Harvard University Press, 2014); Branko Milanovic, *Global Inequality*: A New Approach for the Age of Globalization (Cambridge, MA: Harvard University Press, 2016); Peter H. Lindert and Jeffrey G. Williamson, *Unequal Gains: American Growth and Inequality Since 1700* (Princeton: Princeton University Press, 2016); *After Piketty: The Agenda for Economics and Inequality*, eds. Heather Boushey, J. Bradford DeLong and Marshall Steinbaum (Cambridge, MA: Harvard University Press, 2017); Thomas Shapiro, *Toxic Inequality: How America's Wealth Gap Destroys Mobility, Deepens the Racial Divide, & Threatens Our Future* (New York: Basic Books, 2017); Dean Baker, *Rigged: How Globalization and the Rules of the Modern Economy Were Structured to Make the Rich Richer* (Washington, DC: Center for Economic Policy Research, 2016); Steven Teles and Lindsey Brink, *The Captured Economy: How the Powerful Enrich Themselves, Slow Down Growth, and Increase Inequality* (New York: Oxford University Press, 2017); Brian Alexander, *Glass House: The 1% Economy and the Shattering of the All-American Town* (New York: St. Martin's Press, 2017).

words were "downright radical." As we will see, this is not how Fed Chairs spoke about inequality before Thomas Piketty.[2]

The goal of this chapter, however, is not to focus on the revival of inequality economics. Rather, it is to try to answer a simple yet oft-overlooked question: What took so long? For all the attention it has garnered, it is easy to forget that Piketty's book became a smash hit not because of its explanatory power (few have actually agreed with his r>g model) but rather mostly thanks to his fairly straightforward empirical project which measured how income and wealth have been distributed in the United States and Western Europe across centuries. While Piketty and his colleagues' impressively Sisyphean archival work should be commended, the question still must be asked: If the second half of the twentieth century was hardly lacking in economists, how come Piketty's study had not already been carried out on numerous occasions? In the few cases in which similar, albeit far more modest, studies were undertaken, why were they mostly cast aside? Or, to put it another way: If, as we shall see, the question of economic inequality was central in the nineteenth century, why was it marginalized for much of the second half of the twentieth, only to return with a vengeance in the twenty-first?[3]

I am hardly the first person to recognize the fall of distributive economics in mid-twentieth-century Western thought. In *Capital in the 21st Century*, Piketty himself notes how "it is long since past the time when we should have put the question of inequality back at the centre of economic analysis and begun asking questions first raised in the nineteenth century. For too long, economists have neglected the distribution of wealth." Twenty years earlier, the same complaints were being heard by one of the

[2] Drew Schwartz, "Bernie Sanders is the Most Popular Politician in America, Poll Says," *Vice.com*, Aug 25th, 2017; www.inequality.org/resources/organizations; Neil Irwin, "What Janet Yellen Said, and Didn't Say, About Inequality," *New York Times*, Oct 17, 2014.

[3] For the typical enthusiastic response to Piketty yet disagreement with r>g, see Paul Krugman, "Why We're in a New Gilded Age", *New York Review of Books*, May 8, 2014; James K. Galbraith, *Kapital* for the Twenty-First Century?" *Dissent* (Spring, 2014); to be sure, there are a number of important exceptions in which economists did study inequality in the twentieth century, although most remained outside the neoclassical mainstream. See the life's work of Anthony Atkinson, including such works as *The Economics of Inequality* (New York: Oxford University Press, 1983); Claudia Goldin and Robert Margo, "The Great Compression: The Wage Structure in the United States at Mid-Century," NBER Working Paper 3817 (August, 1991); James D. Smith, eds., *Modeling the Distribution and Intergenerational Transmission of Wealth* (Chicago: Chicago University Press, 1980); Amartya Sen, *On Economic Inequality* (Oxford: Oxford University Press, 1973).

few economists who did focus on inequality. In April 1996, Sir Anthony Atkinson—who Piketty has labelled the "godfather" of inequality economics—gave the presidential address to the Royal Economic Society of England. Atkinson opened his talk by noting that "the subject of income distribution has in the past been marginalized. For much of this century, it has been very much out in the cold." Continuing, Atkinson noted how, for the past 50 years, only about 4 per cent of *The Economic Journal* articles, one of the leading economics journals for much of the twentieth century, had dealt with income distribution. In comparison, Atkinson demonstrated how international economics produced on average four times as many articles during that time span. In the 1970s, for instance, a quarter of the articles in the *Journal* were on globalization but only about *one* article per year was on distribution or inequality.[4]

Economists' own comments during the 1970s provide further evidence for Atkinson's claims. In 1974, for example, Alan Blinder published his PhD dissertation on income distribution which he had submitted a few years prior. In the preface to the book, Blinder noted how in the late 1960s and early 1970s "it appeared, at least to a graduate student single-mindedly immersed in the study of income distribution, that the profession was on the verge of a burgeoning interest in inequality, that the economic 'pie' had at last grown large enough so that more attention could be paid to its division and less to its size." Yet, as Blinder goes on to explain, the early 1970s "belied these lofty expectations, especially in so far as theoretical work is concerned…the university that offers a course on income distribution is still the exception rather than the rule." Likely recognizing that inequality economics would not be the way to move up in the profession, the ambitious Blinder—he would go on to head President Bill Clinton's Council of Economic Advisers in the 1990s—abandoned inequality for more mainstream topics such as monetary policy and human capital theory. He was not the only economist to make this shift. Blinder's

[4] Anthony Atkinson, "Bringing Income Distribution in From the Cold," *The Economic Journal* 107 (Mar, 1997): 297–231. For other works that have suggested that inequality was marginalized by economists in the twentieth century, see Daniel Hirschman, "Inventing The Economy: How We Learned To Stop Worrying and Love the GDP," (PhD Dissertation, 2016), 158–206; Michele Alavich and Anna Soci, *Inequality: A Short History* (Brookings Institution Press, 2017), 29–53; Maurice Dobb, *Theories of Value and Distribution Since Adam Smith: Ideology and Economic Theory* (New York: Cambridge University Press, 1975).

PhD advisor Robert Solow had also written his 1951 Harvard thesis on income inequality before turning to the issue of growth instead.[5]

So why was inequality economics marginalized in the latter half of the twentieth century? Piketty and others have placed much of the blame at the feet of Simon Kuznets and his famous 1954 American Economic Association presidential speech which gave birth to the "Kuznets Curve." In that talk, Kuznets posited that as capitalist societies develop, levels of inequality naturally tend to decline. Writing in the 1950s, one can understand why Kuznets would think this was so: he was basing his hypothesis on empirical data which showed (as does Piketty's current figures) a marked decline in inequality in the first half of the twentieth century, especially during and following World War II.[6]

Piketty is right that Kuznets allowed future economists, when confronted with the issue of inequality, to mumble a few words about the Kuznets Curve and move on to what they felt were more pressing inquiries. Nevertheless, this explanation will not suffice. When actual income inequality began to rise in the mid-1970s, the study of income inequality did not follow suit. What is more, the neglect of inequality economics in the mid-to-late twentieth century is so striking that it cannot be explained away by a single speech or "curve." Economists did not start ignoring inflation or unemployment when they happened to be low. Even Piketty seems to agree that there is more at work here. As he writes in his book, the neglect of distributional issues was also "partly because of the profession's undue enthusiasm for simplistic mathematical models." Yet except for some vague name-calling—Piketty later refers to neoclassical economics as "childish"—he never explains why or how exactly mainstream, mathematical economics downplayed inequality.[7]

The goal of this chapter is to explain precisely that. It will argue that it was, in fact, the slow yet steady rise of neoclassical economics in the first four decades of the twentieth century that effectively ended up marginalizing the issue of economic distribution in favour of the maximization of economic production and national growth in the latter half of the twentieth century. More specifically, I contend that three central theoretical

[5] Alan Blinder, *Toward an Economic Theory of Income Distribution* (Cambridge, MA: MIT Press, 1974).

[6] Piketty, *Capital*, 11–15; Simon Kuznets, "Economic Growth and Income Inequality," *American Economic Review* 45 (March, 1955): 1–28.

[7] Piketty, *Capital*, 16–17. Piketty, in fact, seems puzzled, noting that "oddly, no one has ever systematically pursued Kuznets work."

pillars of neoclassical economics were most responsible for the downplaying of inequality and distribution for the remainder of the twentieth century: marginal productivity, utility theory and Pareto optimality. While some economists frame the history of economic thought as being driven mostly by the internal improvement of the discipline in its long march towards scientific truth, these neoclassical pillars did not emerge in a historical vacuum strictly because they were empirically more accurate than past models. Historians in recent years have shown that neoclassical economics was shaped by an assortment of political, social and cultural forces, be it the rise of consumer culture, corporate finance, modern psychology, social democracy or thermodynamic physics. In this brief chapter, I cannot touch on all the forces that led to the rise of neoclassical economics. I will, however, stress one crucial dimension that is most relevant to our discussion: the desire to downplay, marginalize and mitigate distributional questions and conflicts because they were deemed either too dangerous, moralizing or unimportant. In other words, the meteoric rise of neoclassical economics did not only lead to a sharp decline in distributive economics, but was partially constituted by this very goal.[8]

One final point. While this chapter will focus mostly on Anglo-American economic thought, the impact of these intellectual developments would soon reverberate around the world. As neoclassical economists came to hold a dominant grip on the Nobel Prize in economics, the top universities in the world, the World Bank, leading academic journals and countless other national and global institutions, the neglect of inequality slowly spread across the globe. As such, the marginalization of inequality in the second half of the twentieth century eventually became not only a Western intellectual phenomenon but a global one.

[8] For the history of neoclassical economics, see Yuval Yonay, *The Struggle for the Soul of Economics: Institutional and Neoclassical Economists in America Between the Wars* (Princeton: Princeton University Press, 1998); Philip Mirowski, *More Heat Than Light: Economics as Social Physics, Physics as Nature's Economics* (New York: Cambridge University Press, 1989); Eli Cook, "The Neoclassical Club: Irving Fisher and the Progressive Origins of Neo-liberalism," *Journal of the Gilded Age and Progressive Era*; Jamie Morgan, ed. *What is Neoclassical Economics? Debating the Origins, Meaning and Significance* (New York: Routledge, 2016).

The Centrality of Distribution in Classical Economics

Henry George's *Progress and Poverty* in 1879 was the last great work of what historians have referred to as "classical" economics. As I have noted elsewhere, there are great similarities between George and Piketty's works. Both came out exactly six years after a major economic crisis (the "panic of 1873" was considered, at its time, the greatest economic downturn in history) and both became global sensations. Both believed that inequality was caused by the ever-increasing concentration of unearned wealth in the hands of an elite class of unproductive rentiers. Both also argued for a simple solution—a tax on wealth that would prevent elites from profiting off the mere possession of property. Most importantly, however, at the heart of both books lay a disturbing correlation between capitalist growth and economic inequality. "Where…wealth is greatest, and the machinery of production and exchange most highly developed," George pointed out in his opening statement, "we find the deepest poverty, the sharpest struggle for existence, and the most enforced idleness." Continuing, he stunned many readers by declaring that "material progress does not merely fail to relieve poverty—it actually produces it." Much like Piketty, George saw rising inequality not as a distortion of capitalist development but its direct outcome.[9]

It was this notion that capitalist development brought with it great wealth to some but terrible suffering to others that gave George's book its radical and critical bite. Yet despite this—and the fact that his call for a "single tax" on the unearned rent of land monopolizers directly challenged the basic liberal tenets of private property—his work was still very much in line with the English classical tradition of Adam Smith, David Ricardo and John Stuart Mill. While not reaching the same subversive conclusions as George, these men had also been most interested, if not at times obsessed, in understanding how the fruits of market production were *divided* between the three classes of society—landholding aristocrats, profit-seeking capitalists and wage-labouring workers. They did so in part because they believed distribution to be an important social and moral issue that should not be ignored. But they also did so because they believed that it was the social relationships *between* these three social classes (rather

[9] Henry George, *Progress and Poverty: An Inquiry into the Cause of Industrial Depression and of Increase of Want with Increase of Wealth* (New York: 1879), 5.

than mere market supply and demand) that determined not only the rate of compensation of each class in the form of rent, profit and wages but the price of all market commodities. In classical economics, in fact, the market does not really set the price of goods at all. Rather, the "natural price" of any commodity is set by the rates of wages, rent and profit which, in turn, are set by the social relations between workers, capitalists and landholders. In this theoretical world, which focuses mostly on economic *production*, exchange serves only as the tool through which market prices become aligned with natural prices. In short, to study any aspect of "the economy" in classical economics, you had to study the distribution of wealth and income because it was these forces which determined the prices of all goods.[10]

George's focus on inequality, therefore, was no great departure from the classical economists who came before him, especially Ricardo and Mill. They too had placed the distribution of income at the centre of their discipline. Ricardo, for instance, famously began his magnum opus of 1817 by stating:

> The produce of the earth—all that is derived from its surface by the united application of labour machinery and capital, is divided among the three classes of the community: namely the proprietor of the land, the owner of the stock of capital for its cultivation, and the labourers by whose industry it is cultivated. But in different stages of society, the proportions of the whole produce of the earth which will be allotted to each of these classes, under the names of rent, profit and wages, will be essentially different…to determine the laws which regulate this distribution, is the principal problem in political economy.

Mill would continue Ricardo's emphasis on distribution, noting how "it is only in the backwards countries of the world that increased production is still an important object; in those most advanced, what is economically needed is a better distribution."[11]

[10] Samuel Hollander, *Classical Economics* (Oxford: Blackwell, 1987); Mark Blaug, *Economic Theory in Retrospect* (Cambridge: Cambridge University Press, 1997) ch. 2–7. Dobb, *Theories of Value*.

[11] David Ricardo, "Preface to Principles", Piero Sraffa ed., *The Works and Correspondence of David Ricardo* (1951) 1: xlviii; John Stuart Mill, *Principles of Political Economy*, (London, 1871), 755.

George, moreover, was not only continuing the tradition of English classical economics but also that of American republicanism and producerism. The United States came into being as a society of freehold farmers and planters who placed an enormous emphasis on the basic freedom (if you were white) to receive a "full return of one's labour." Steeped in the labour theory of value not of Karl Marx but Benjamin Franklin, nineteenth-century white men in the United States were raised to believe that an unequal distribution of wealth or income was unnatural and therefore *must* stem from exploitative social relations in which labourers do not receive all that they have produced. As the prototypical American economic thinker Edward Kellogg noted in his 1849 book *Labor and Other Capital*, "to obtain labor without rendering a fair equivalent is also a violation of the rights of property." In his eyes, like that of most Americans of his day, this meant that "the great disparity in the conditions of the rich and poor is the natural result of unjust laws."[12]

Such Americans also found a basis for their claims in English classical economics. Following in the footsteps of Ricardo and Mill, most nineteenth-century economic thinkers in the United States believed that a capitalists' profit stemmed from his selling of goods for more than his workers had been paid to make them. This approach positioned labourers and capitalists in a zero-sum struggle for the economic surplus. "If… wages should rise," Ricardo repeatedly stated, "profits would necessarily fall." Or, as Mill noted in 1869, if a capitalist "has to pay more for labour, the additional payment comes of of his own income."[13]

There were, of course, plenty of conservative economists who pushed back on this idea throughout the nineteenth century. Classical economists like France's Frederic Bastiat and England's Nassau Senor argued that the profits of capital did not come from their power struggle with labour or their appropriation of the surplus but rather from risk, abstinence, skill, entrepreneurship and other positive qualities. "Capital has its roots in three attributes of man," Bastiat typically declared in 1850, "foresight, intelligence, and thrift." Yet, try as these conservatives might to separate

[12] Edward Kellogg, *Labor and Other Capital: The Rights of Each Secured and the Wrongs of Both Eradicated* (New York, 1849), 80; see also James Huston, *Securing the Fruits of Labor: The American Concept of Wealth Distribution, 1765–1900* (Baton Rouge: Louisiana State University Press, 1998); Michael Thompson, *The Politics of Inequality: A Political History of the Idea of Economic Inequality in America* (New York: Columbia University Press, 2007).

[13] Ricardo, *On the Principles of Political Economy* (London: Empiricus Books, 2006), 65; John Stuart Mill, *Thornton on Labor Claims* (London, 1869), 645.

profits from wages, the labour theory of value which stood at the centre of classical economics made this very hard to do since it was assumed that wealth was created mostly by workers. To make matters worse for such economists, by the late nineteenth century a far more radical thinker than Ricardo, Mill or even George had turned to the classical labour theory of value in order to argue that the exploitative basis of capitalist accumulation meant the entire system must be overthrown: Karl Marx. All across Europe, waves of socialists turned to Marx's economic writings in order to prove that capital profits were nothing more than the appropriated "surplus value" of exploited labour. It was in the midst of these political pressures that our first neoclassical pillar was born.[14]

Pillar I: The Theory of Marginal Productivity

The year was 1899 and Columbia Economics Professor John Bates Clark—the undisputed American father of neoclassical economics—was gravely concerned. He felt that all this socialist talk in Europe and the United States about inequality and exploitation was threatening to destabilize the very foundations of a modern, capitalist society. As he saw it,

> the welfare of the laboring classes depends on whether they get much or little; but their attitude toward other classes—and, therefore, the stability of the social state—depends chiefly on the question, whether the amount that they get, be it large or small, is what they produce. If they create a small amount of wealth and get the whole of it, they may not seek to revolutionize society; but if it were to appear that they produce an ample amount and get only a part of it, many of them would become revolutionists, and all would have the right to do so. The indictment that hangs over society is that of "exploiting labor." "Workmen" it is said, "are regularly robbed of what they produce. This is done within the forms of law, and by the natural working of competition." If this charge were proved, every right-minded man should become a socialist; and his zeal in transforming the industrial system would then measure and express his sense of justice.[15]

[14] Frederic Bastiat, Economic Harmonies, George B. de Huszar, trans. and W. Hayden Boyers, ed. 1996. Library of Economics and Liberty. 11 February 2018. http://www.econlib.org/library/Bastiat/basHar7.html; on Europe, see Albert Lindemann, *A History of European Socialism* (New Haven: Yale University Press, 1984); on Marx's theory of exploitation, see Karl Marx, *Wage Labor and Capital*, trans. Friedrich Engels (London, 1891).

[15] John Bates Clark, *The Distribution of Wealth* (New York, 1899) v; on Clark, see John F. Henry, *John Bates Clark: The Making of a Neoclassical Economist* (New York: Springer,

Luckily for "the stability of the social state," in the same book in which Clark voiced these concerns, he also presented a novel economic theory which claimed to prove that the distribution of wealth in a competitive market society was, in fact, inherently just and that there simply was no such thing as labour exploitation. On the contrary, according to Clark, every class in society got what it deserved for it earned what it had produced. The book was titled *The Distribution of Wealth* and its main goal was made perfectly clear in its opening pages:

> It is the purpose of this work to show that the distribution of the income of society is controlled by a natural law, and that this law, if it worked without friction, would give to every agent of production the amount of wealth which that agent creates.[16]

Unlike in classical economics, where labourers and capitalists fought over the same pool of surplus production, Clark sought to insulate the economic mechanism through which wages were determined from the economic mechanism through which profits and rents were determined. Here too, Clark was refreshingly open about the political reasons for wanting to do this, noting that "it was the claim advanced by Henry George…that first led me to seek a method by which the product of labor everywhere may be disentangled from the product of cooperating agents and separately identified." As neoclassical economist Frank Fetter later recognized, "one can hardly fail to see on almost every page" of Clark's writings the single-tax spectre of Henry George.[17]

Clark's great innovation was to treat the labour of workers, the capital of capitalists and the land of landholders as three utterly separate "factors of production" whose respective incomes in the form of wages, profits and rents were determined in three utterly separate markets by their owner's own marginal productivity. According to Clark, a worker earned $10 an hour not because his boss may be exploiting him but rather because that was the contribution of his final (or marginal) hour of labour to the production process. On the other hand, a capitalist may earn $10,000 in profit not because he had the social power that accompanied the ownership

2016); Joseph Persky, The "Neoclassical Advent: American Economics at the Dawn of the 20th Century," *Journal of Economic Perspectives* 14 (Winter, 2000): 95–108.

16 Clark, *Distribution of Wealth*, vi.

17 Ibid., viii; Frank Fetter, *Capital, Interest and Rent: Essays in the Theory of Distribution* (Menlo Park: The Institute for Humane Studies, 1977), 127.

of the means of production but rather because this was the productive contribution of the machinery he owned. The moral of the model was clear: the distribution of wealth in free market societies was inherently fair. So long as the government or unions did not interfere in the workings of a competitive market, both worker and capitalist would receive their just deserts.[18]

As the title of his book makes plain, Clark clearly did not ignore or downplay the issue of economic distribution. Quite the opposite in fact. Yet as his marginal productivity theory grew to become one of the central pillars of neoclassical economics in the second half of the twentieth century, its effect was largely to sideline questions of distribution. For if each person in society received what they had produced, then what mattered most was not the question of inequality but rather *productivity*. So long as neoclassical economists studied ways in which to increase productivity, they had little need to examine how it was actually distributed. As a result, the neoclassical economists who followed in Clark's footsteps put far less of an emphasis on distribution. For example, in 1946 Yale Economics Professor and neoclassical *savant* Irving Fisher derided socialists who thought "the problem of economic mass welfare is primarily one of *distribution*," arguing, rather, that "it is primary one of production." Clark's claim also took the ethical sting out of inequality. Since each person gets what he deserves, whatever inequality that does exist in society is legitimate.[19]

To see the long-term impact of Clark, look no further than Paul Samuelson's *Economics: An Introductory Analysis*, which became the best-selling economics textbook of all time in the latter half of the twentieth century. In the seventh edition from 1967, there are over 800 pages. How many directly examine the issue of wealth or income inequality? About two dozen. Why so few? We will get to the other main reasons in a moment but it is interesting to note that in his discussion on economic distribution

[18] Nancy Cohen, *The Reconstruction of American Liberalism* (Chapel Hill: University of North Carolina Press, 2002), 279–285; Jon Levy, "Capital as Process and the History of Capitalism," *Business History Review* (2017): 1–28.

[19] Irving Fisher, "An Address on the Irving Fisher Foundation, Sept. 11, 1946" in *The Works of Irving Fisher*, William J. Barber ed. (London: Pickering and Chatto, 1997) 1: 29. Earlier in his career, Fisher had placed a somewhat larger focus on inequality. See Fisher, "Economists in Public Service: Annual Address of the President," *The American Economic Review* 9, no. 1 (Mar. 1919); Alfred Marshall, *Principles of Economics* (London: Macmillan, 1890), 335.

Samuelson instructs his readers "to appreciate J.B. Clark's advance over such classical economics as David Ricardo." Moreover, he argues not only that "the Clark neoclassical theory of distribution, although simplified, is logically complete and a true picture of idealized competition," but also that empirical evidence "seems to provide rough corroboration for [his] theories of production and marginal-products."[20]

The Chicago School's notion of "human capital," which took off in the 1960s and 1970s, also reveals how marginal productivity theory led many economists to focus more on productivity than distribution. In the late twentieth century, human capital theory quickly became the most dominant approach by labour economists for not only valuing people but explaining inequality. In treating people as capitalized factors of production much like machines, human capital theory posited—just like Clark—that labour wages were largely determined by labour productivity which, in turn, was largely determined by how much a worker "invested" in themselves to improve the "rate of return" on their human capital. In following Clark's theory of marginal productivity, these labour economists did not usually examine how the economic pie or national income was divided between labour and capital. Rather, since they assumed that each worker earned what he or she in fact produced, they focused only on the question of labour productivity and how it could be increased via self-investments in training and education. Just as Clark had intended over 100 years before, gone were the classical economic questions regarding the ways in which social or power relations influenced the distribution of wealth or income between labour and capital.[21]

Pillar II: The Consumerist Turn of Utility Theory

Another key reason neoclassical economics came to downplay distribution was its shift from a labour theory of value which focused on production to a utility theory of value which emphasized consumption. Unlike classical

[20] Paul Samuelson, *Economics: An Introductory Analysis, 7th edition* (New York: McGraw-Hill, 1967), 521.

[21] On human capital, see Jacob Mincer, "Investment in Human Capital and Personal Income Distribution," *Journal of Political Economy* 66, no. 4 (August 1958): 281–302; Gary Becker, *Human Capital: A Theoretical and Empirical Analysis* (Chicago: Chicago University Press, 1964); Sherwin Rosen, "Human Capital," in *The New Palgrave Dictionary of Economics*, 2nd ed., ed. Steven N. Durlauf and Lawrence E. Blume (Basingstoke: Palgrave Macmillan, 2008).

economics, in neoclassical economics the distribution of wealth between social classes plays no role in the determination of commodity prices. This is not only because there basically *are* no social classes in neoclassical economics, only individual utility-maximizing exchangers (incredibly, labour can buy capital in neoclassical models just as capital buys labour) but also because neoclassicists believe it is the prices of goods that help determine the rate of wages, profit and rent and not vice versa. The price of any commodity, meanwhile, is determined by the final (or marginal) amount of subjective utility it offers individual consumers and has little to do with the distribution of wealth (or power) in a society.[22]

The move from a producerist labour theory of value to a consumerist utility value theory marginalized distribution by offering an alternative meaning of freedom and well-being. While American farmers and European socialists had used a labour theory of value to argue that to be free and prosperous entailed a full return of the fruits of their labour, the invention of marginal utility reflected a consumerist turn which envisioned freedom as the consumption of the fruits of industrial progress. Labourers should not care what the profits of their employers were in comparison to their own wages, the argument went, so long as their "standard of living" and consumer comfort was increasing.[23]

A perfect example of this consumerist marginalizing of inequality took place in the late nineteenth century in the United States, just as neoclassical economics was coming into being. As a PhD student at Columbia in the 1880s, Charles Barzilai Spahr wrote a dissertation published later as a book titled *An Essay on the Present Distribution of Wealth in the United States*, Spahr meticulously mined the taxation data at his disposal to make one basic point: as time passed, the distribution of wealth in the United States was becoming more unequal. "Seven-eighths of the families [in America] hold but one-eighth of the national wealth," Spahr concluded, "while one per cent of the families hold more than the remaining

[22] Richard Howey, *The Rise of the Marginal Utility School, 1870–1889* (New York: Columbia University Press, 1989); Margaret Schabas, *A World Ruled by Number: William Stanley Jevons and the Rise of Mathematical Economics* (Princeton, NJ: Princeton University Press, 1990); Dorothy Ross, *The Origins of American Social Science* (New York: Cambridge University Press, 1991), 172–219.

[23] On the producer to consumer shift, see Lawrence Glickman, *A Living Wage: American Workers and the Making of Consumer Society* (Ithaca: Cornell University Press, 1999); Jeff Sklansky, The Soul's Economy: Market Society and Selfhood in American Thought, 1820–1920 (Chapel Hill: University of North Carolina Press, 2002).

ninety-nine." More than a century before Thomas Piketty, Spahr had discovered the infamous "one percent."[24]

Spahr, however, has been completely forgotten in large part because of the scathing review he received in the premier academic journal of the era by Columbia University Economics Professor (and close colleague of John Bates Clark) Richmond Mayo-Smith. "Having shown that property and incomes are unequally distributed and that (in his opinion) the inequality is increasing," Mayo-Smith wrote, "Dr. Spahr seems to think that his task is ended. But that is only the beginning. The real question is whether such a concentration of wealth is not a good thing for the whole community." Continuing, Mayo-Smith reflected the turn to subjective utility value by arguing that "the happiness of individuals is measured not according to their ownership of property…but according to their command of the enjoyments of life."

Mayo-Smith's argument that labour should focus on its subjective consumer enjoyments rather than the unequal gains of capital was repeated numerous times in the second half of the twentieth century. During that era, most economists agreed that the goal of economic policy was not to limit inequality but prevent poverty. No one made this point clearer than Harvard Professor and National Bureau of Economic Research President Martin Feldstein just as economic inequality was finally beginning to return to mainstream American economic discourse in 1999. He did so by arguing that such a focus on inequality stemmed from an ideology of "spiteful egalitarianism" and that economists need not make such trouble-making comparisons:

> According to official statistics, the distribution of income has become increasingly unequal during the past two decades. A common reaction in the popular press, in political debate, and in academic discussions is to regard the increase in inequality as a problem that demands new redistributive policies. I disagree. I believe that inequality as such is not a problem and that it would be wrong to design policies to reduce it. What policy should address is not inequality but poverty.[25]

[24] Charles Spahr, *An Essay on the Present Distribution of Wealth in the United States* (Boston, 1896), 69.

[25] Richmond Mayo-Smith, "Review," *Political Science Quarterly 12* (1897): 346–348; Martin Feldstein, "Reducing Poverty, Not Inequality," *The Public Interest* 137 (Fall, 1999).

Yet the relationship between the rise of a utility theory of value and the demise of inequality economics in the twentieth century was not nearly so cut and dry. In the first generation following its inception—and crucially before the "Paretian Revival" of the 1930s that would place "Pareto optimality" at the very centre of neoclassical economics—marginal utility actually led many economic thinkers to focus *more* on the relationship between economic inequality and efficiency—not less. In fact, in the late nineteenth century the socialist Fabian society and its leaders Sidney Webb and George Bernard Shaw became enthusiastic proponents of the utility theory of value and its potential for reigniting the case for economic equality. This is because they, and many other pre-Pareto utility theorists in the early twentieth century, were very "Benthamite" in their approach to social welfare.[26]

Like the eighteenth-century utilitarian philosopher Jeremy Bentham, these economic thinkers believed that in order to measure the total welfare of a society all one had to do was *sum* up the utility consumed by every individual. They argued that it was theoretically possible to add together individuals' subjective feelings of satisfaction or happiness because individual utilities were *comparable* between people and thus also capable of aggregation. This interpersonal comparison approach to utility theory led to radically egalitarian conclusions: Since all neoclassical economists believed in the principle of diminishing marginal utility, Benthamites logically concluded that the marginal utility of a rich man was lower than that of a poor man. This meant that even if one disregarded the moral elements of inequality, the most *efficient* way to maximize social welfare was to redistribute money from the rich to the poor. As Cambridge economist Arthur Pigou (hardly a radical socialist) explained in his renowned 1920 book *Economics of Welfare*, egalitarianism was the most efficient way to maximize welfare because "more intense wants to be satisfied at the expense of less intense wants must increase the aggregate sum of satisfaction." Pigou, therefore, concluded that any redistributive policy "which increased the proportion of the national dividend by poor persons,

[26] See Mark Bevir, "Sidney Webb: Utilitarianism, Positivism, and Social Democracy," *Journal of Modern History* 74, no. 2 (June, 2002): 217–252; Yonay, *Struggle for the Soul*, chapter 9.

provided that it does not lead to a contraction of the dividend…will, in general increase economic welfare."[27]

Pillar III: Pareto Optimality

The egalitarian era of marginal utility theory, however, was short-lived. By the mid-twentieth century, it had been pushed to the heterodox margins of the economics discipline. Since the marginal revolution, there had always been leading neoclassical economists, such as Stanley Jevons, Francis Edgeworth and Vilfredo Pareto, who rejected such arguments for equality. Pareto led the charge in this regard. A classical liberal, men like Pareto were disturbed by the notion that marginal utility theory could be used as a tool to legitimize the redistribution of wealth from the rich to the poor. To counter these arguments, he made key modifications to utility theory in his 1906 book *Manual of Political Economy* that disarmed such egalitarian arguments while also marginalizing the issue of inequality all together. First off, Pareto argued, one could *not* make interpersonal comparisons of utility. Since utility was subjective desire, Pareto contended, it was simply impossible to compare one person's marginal utility—no matter how rich they happened to be—with that of another. This modification to utility theory led Pareto and other neoclassicists to claim that "Benthamite" economists could not compare the utility of two people nor could they measure social welfare by adding up the utility of all individuals in a given society.[28]

Basing his analysis on these key assumptions, Pareto came up with his own definition of social optimality. Since the utilities of individuals could not be compared or aggregated, Pareto argued, it was not necessarily economically optimal to take from the rich and give to the poor because it would not be clear if this was a net utility gain for society or not. In a world where interpersonal utility comparisons could *not* be made, Pareto continued, a definite efficiency improvement could *only* take place if one person was made better off without injuring anyone else—even in the

[27] AC Pigou, *Economics of Welfare* (London: Macmillan, 1920); see also A. Bergson, *Essays in Normative Economics* (Cambridge, MA: Harvard University Press, 1966).

[28] Vilfredo Pareto, Manual of Political Economy, trans. Ann Schwier (New York: AM Kelley, 1971); Joseph Schumpeter, "Vilfredo Pareto, 1848–1923," *Quarterly Journal of Economics* 63 (May, 1949): 147–173; Maurice Dobb, *Welfare Economics and the Economics of Socialism: Towards a Commonsense Critique* (Cambridge: Cambridge University Press, 1975) 77.

slightest. According to Pareto's logic, even though a starving man could use a dollar far more than a millionaire, if that millionaire felt even an inkling of pain in giving up that dollar, then by definition redistributing the money was not optimal. The principle of "Pareto optimality" which still dominates neoclassical economics was born. With its rise, economists' interest in inequality would significantly wane.[29]

In time, Pareto optimality would form the core of neoclassical economics' case for free markets as Pigouvian approaches were pushed to the margins. As Pareto (and his Lausanne University predecessor Leon Walras) had argued, the wonder of the unregulated free market lay in its ability to *always* lead society to a Pareto optimal point in which no more transactions could be made that improved one person's lot without harming anyone else's. Translated into highly mathematical terms, the free market's almost magical ability to result in Pareto optimality allocations came to be known as "the first fundamental welfare theorem of welfare economics." For the generations of neoclassical economic students who followed, this theorem would be key not only because proving it required a high level of mathematical expertise but also because it gave a scientific veneer to the idea of "the invisible hand." As Paul Samuelson would explain to generations of economics students in his 1960s textbook, the idea of Pareto optimality had shown that

> Adam Smith, in his talk about an Invisible Hand, which led the selfish actions of individuals toward so harmonious a final result, did have some point…Under perfectly perfect competition…where the genuine desires and well-being of individuals are represented by their marginal utilities… then the resulting equilibrium has the efficiency property that 'you can't make any one man better off without hurting some other man.' What does this mean exactly? It means that a planner could not come along with a slide rule and find a solution, different from the laissez-faire one, which could improve the welfare of everyone.[30]

[29] Pareto, *Manual*, 266–269, 451–452.

[30] Samuelson, *Economics*, 609; Samuelson goes on to state that this does not mean that Pareto optimality necessarily promotes the "public interest." On first welfare theorem, see Allan Feldman, "Welfare Economics," *The New Palgrave Dictionary of Economics, Second Edition*, eds. Steven Durlauf and Lawrence Blume (New York: Palgrave Macmillan, 2008); Joseph Stiglitz, "The Invisible Hand and Modern Welfare Economics, NBER working paper 3641 (March, 1991).

The idea of Pareto optimality not only helped legitimize free markets but it also reflected the bourgeois ideology of classical, Lockean liberalism: The ownership of private property was a natural right above any artificial state intervention. As such, no infringement on private property, no matter how large the wealth disparities in a society may be, could possibly be socially desirable. Implicit in this argument was the claim that economists need not focus on inequality since any attempts at redistribution would distort the workings of the free market and thus lead to suboptimal allocation points.[31]

Pareto's approach to utility theory did not catch on right away. In fact, it was "Pigouvian" and not "Paretian" welfare economics that seemed to be more popular in the early twentieth century. As a result, one can still find in the early twentieth century many studies on wealth and income inequality, including a ground-breaking report by the American National Bureau of Economic Research in 1920 which rejected many of Pareto's theories. All this changed, however, in the 1930s and 1940s. Within the span of less than two decades, neoclassical economics swung almost completely to the side of Pareto optimality. While the Paretian Revival would encompass the entire discipline—from socialists like Oskar Lange to liberals like Paul Samuelson to conservatives like Milton Friedman—the man perhaps most responsible for bringing this change about was Lord Lionel Robbins, a London School of Economics professor and member of the "neoliberal" Mont Pelerin Society who gave Austrian School economist Friedrich Hayek his first job in England.[32]

In the late 1930s, Robbins reiterated Pareto's arguments regarding the inability to make interpersonal utility and, therefore, comparisons between the rich and the poor. In so doing, however, Robbins went one step further than Pareto by reaching the conclusion that *any* analysis of inequality or distribution was inherently normative and, therefore, should play a limited role, if any, in the positivist science of economists. Robbins' 1938 article on interpersonal utility comparisons is widely regarded for turning

[31] On Lockean Liberalism, see C.B. Macpherson, *The Political Theory of Possessive Individualism: Hobbes to Locke* (Oxford: Clarendon Press, 1962).

[32] On Pigouvian Welfare Economics, see Ian Kumekawa, *The First Serious Optimist: AC Pigou and the Birth of Welfare Economics* (Princeton University Press, 2017); on the Paretian turn, see SAT Rizvi, "Postwar Neoclassical Economics," in *A Companion to the History of Economic Thought*, ed. Warren J. Samuels, Jeff Biddle, and John Davis (Malden, MA: Blackwell, 2003), 377–395.

the tide in the neoclassical economic approach to distribution. Here is the most quoted section:

> But as time went on, things occurred which began to shake my belief in the existence between so complete a continuity between politics and economic analysis…. I am not clear how these doubts first suggested themselves; but I well remember how they were brought to a head by my reading somewhere—I think in the work of Sir Henry Maine—the story of how an Indian official had attempted to explain to a high-caste Brahmin the sanctions of the Benthamite system. "But that," said the Brahmin, "cannot possibly be right—I am ten times as capable of happiness as that untouchable over there." I had no sympathy with the Brahmin. But I could not escape the conviction that, if I chose to regard men as equally capable of satisfaction and he to regard them as differing according to a hierarchical schedule, the difference between us was not one which could be resolved by the same methods of demonstration as were available in other fields of social judgment.

In conclusion, Robbins declared that "I still cannot believe that it is helpful to speak as if interpersonal comparisons of utility rest on scientific foundations—that is upon observation and introspection…I still think, when I make interpersonal comparisons, that my judgments are more like judgments of value than judgments of verifiable fact."[33]

Not everyone agreed with this argument. In the same year as Robbins' article was published, Sir Roy Harrod warned that "if the incomparability of utility to different individuals is strictly pressed, not only are prescriptions of the welfare school ruled out, but all prescription whatever. The economist as an adviser is completely stultified." By the late 1940s, however, Robbins' argument that economists should not deal with issues of inequality or distribution because they were normative and thus unscientific had catapulted itself to the heart of the economics profession. In so doing, economists began to present themselves as objective number crunchers whose only goal was to maximize productive efficiency in such a manner that reaches a Pareto optimal point (as if this was not a political construct), regardless of what the distributive ramifications may be. The

[33] Lord Robbins, "Interpersonal Comparisons of Utility," *Economic Journal* (Dec 1938): 640–641; see also IMD Little, *A Critique of Welfare Economics* (Oxford: Clarendon Press, 1950) 55–56; on Robbins impact on neoclassical economics, see Thiago Dumont Oliveira and Carlos Eduardo Suprinyak, "The Nature and Significance of Lionel Robbins' Methodological Individualism," *Economia* (October, 2017).

question of distribution, they claimed, should be left to the political realm. In fact, students were taught—through what came to be called the "second fundamental theorem of welfare economics"—that governments could, via lump-sum transfers, set the initial endowments before markets worked their Pareto magic and, in so doing, determine what level of Pareto optimal distribution they desired in their society. Crucially, however, such distributive discussions would be held by politicians, *not economists*, since it was a political and ethical issue rather than a scientific one. As a result, the second welfare theorem gave generations of neoclassical economists the perfect excuse to neglect the question of inequality.[34]

Once again, Samuelson's textbook—which, it is important to remember, was clearly situated on the liberal side of neoclassical economics—offers a perfect articulation of how this worldview controlled the mainstream by the second half of the twentieth century:

> It is an ethical rather than a scientific question as to just how large, relatively, each person's final income ought to be. As a science, economics can concern itself only with the best means of attaining given ends; it cannot prescribe the ends themselves. Indeed, if someone decided that he preferred a feudal-fascistic kind of society, in which all people with little black moustaches were to be given especially high incomes, the economist could set up the pricing rules for him to follow to achieve his strange design best.[35]

The separation of economic inequality and economic efficiency was, perhaps, the most powerful force behind the marginalization of inequality economics in the twentieth century. It seeped into every nook and cranny of the discipline, while reaching the highest stages of economic decision-making. I opened this chapter by quoting how, after Piketty's book came out, Federal Reserve chief Janet Yellen warned of the dangers of inequality. In 2007, however, the then Federal Reserve chief and Princeton University economist Ben Bernanke made a very different argument, one that mainstream neoclassical economists had been making for much of the second half of the twentieth century. In explaining

[34] Roy Harrod, "Scope and Method of Economics," *The Economic Journal* (Sept, 1938): 397; on the second welfare theorem, see Allan Feldman, "Welfare Economics," *The New Palgrave Dictionary of Economics, Second Edition*, eds. Steven Durlauf and Lawrence Blume (New York: Palgrave Macmillan, 2008); Joseph Stiglitz, "The Invisible Hand and Modern Welfare Economics," NBER working paper 3641 (March, 1991).

[35] Samuelson, *Economics*, 613.

why the Federal Reserve did not examine the issue of inequality, Bernanke explained that he would "not draw any firm conclusions about the extent to which policy should attempt to offset inequality in economic outcomes; that determination inherently depends on values and social trade-offs and is thus properly left to the political process." Of course, Bernanke's decision to bail out the big banks rather than the small homeowners had massive distributive repercussions. But in his view, this was not "political" since he had done so only for the sake of "the economy" writ large.[36]

Conclusions

This chapter has briefly unpacked the main neoclassical pillars which helped bring about the fall of inequality economics in the second half of the twentieth century. While it has focused mostly on Anglo-American thinkers, neoclassical economics spread across the globe in the latter half of the twentieth century—even finding a vast and overlooked audience behind the Iron Curtain. Paul Samuelson's textbook, for example, has been translated into 41 languages and sold over four million copies. In Israel, the formerly socialist-leaning country where I live, neoclassical economists have dominated academic departments since the 1960s. This is not unique. In India, D.M. Nachane has recently pointed to the "virtually unshakeable position that neoclassical economics occupies in mainstream economic thinking." The *Routledge Handbook on the History of Global Economic Thought* is in agreement that "neoclassical economics eventually became the most popular of all economics in independent India." Similar developments can be found in other areas of the world, be it the case of Chile, Greece, Japan or Germany where the *Handbook* notes how Anglo-American neoclassical economics "dominated post-war German academic economics."[37]

[36] Irwin, "What Yellen Said," *New York Times*; see also James Coleman, "Equality," *The New Palgrave Dictionary*.

[37] On the reach and impact of Samuelson's textbook, see Mark Skousen, "The Perseverance of Paul Samuelson's Economics," *Journal of Economic Perspectives* 11, no. 2 (Spring, 1997): 137–152. On the global spread of neoclassical economics, see Vincent Barnett, ed., *Routledge Handbook of the History of Global Economic Thought* (London: Routledge, 2014), 331, 91, 71–73. On the Eastern Bloc, see Johanna Bockman, *Markets in the Name of Socialism: The Left-Wing Origins of Neoliberalism* (Paolo Alto: Stanford University Press, 2014).

Today, inequality economics is witnessing a rebirth—but the depth and breadth of this intellectual impact on *actual* wealth and income inequality across the world remains to be seen. If this chapter on the past can tell us anything about the future, it is that for the study of inequality to really take off, and global wealth inequities to really decline, the basic pillars of neoclassical economics may first have to be toppled. Can mainstream economics reinvent itself in the age of the 1 per cent?