Inequality from a theoretical-historical perspective

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Book Review – Branko Milanovic: Visions of Inequality, From the French Revolution to the End of the Cold War[2]

To a wider professional audience, Branko Milanovic is best known for his elephant curve. In that figure, he showed how the income position of the world's population has changed between 1988 and 2008. The curve shows the rise of China and the stagnation or possible decline of income growth for the middle class in the United States and in the rest of the developed world, too. Like all curves, this one also tells a story – a narrative of global economic realignment from an income distribution perspective. Milanovic's article was part of a broader shift in the literature to focus on income distribution. This new topic reflected the new economic policy direction after 2008, which was not devoid of populism. After the recession, in contrast to the neo-conservative-neoliberal trend that started in the mid-seventies, the focus shifted to the groups catching up and the groups lagging. The trickle-down theory was less and less accepted, and so was the idea of separation of state and market, the economic policy doctrine based on deregulation. State intervention was becoming accepted among economists: the question reduced to the 'how', what immediate objectives were to be achieved and by what means. A crucial element of this theoretical and practical debate was the reordering of income relations. This issue was also raised with great force in Thomas Piketty's 2013 book Capital in the 21st Century. The book brought a methodological novelty to the economics literature, too, by rediscovering economic history and the humanities. He used a rich historical database to demonstrate the extreme swings in income inequality and used quotations from Balzac, Stendhal, and other writers as illustrations. His proposed solution and theoretical claims have been much debated, but his work has undoubtedly contributed to a more open economics. Milanovic's new work is related

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to this theme, but Milanovic has now examined income inequality from a theoretical perspective. This is noteworthy because the history of economics is no longer a compulsory subject in school curricula. With this book, Milanovic has begun to bring the discipline back into the mainstream of economics. This is not unique, as all disciplines have had their efforts to deal with their pasts. The discipline's past is also the direction of its future since the way needs emerge also determines the goals for which the discipline came into being.

The beginning of theoretical thinking on inequality is historically linked to the French Revolution and, theoretically, to the work of Francois Quesnay. This starting point is also a philosophical start in economics since Milanovic sees the class problem and its treatment as the most pressing issue of economics. This is, of course, an acceptable point of view, but it can be argued that the treatment of economic inequality has an earlier heritage in the history of culture, too. It was present in ancient Greek authors, above all Aristotle, or in mediaeval philosophy. The French Revolution's emergence from this line of thought also conveys the message that inequality can lead to revolution and that its avoidance defines economics. This is not unfounded, but it can also be described in positive terms: the common good is the goal of economics, which excessive income inequality can prevent.

Milanovic, however, has abandoned this technological, value-based aspect of economic inequality in his book and has a „tight focus on income distribution" (p. 1.), which is presented „from each author's own perspective". (p. 4.) The economists selected are, of course, emblematic – Francois Quesnay, Adam Smith, David Ricardo, Karl Marx, Vilfredo Pareto, and Simon Kuznets – and then, in Chapter 7, he describes the long silence on this issue that began in the 1970s and lasted essentially until the 2008 crisis. Nevertheless, Milanovic singles out Marx among the figures in the history of the theory and ultimately organises the discussion of all other views around him. Undoubtedly, this is a break not only with the last 30 years but perhaps with the last 75 years since Smith became the starting point in Western economics, mainly because of the invisible hand argument. It meant a way of justifying the operation of the harmonious market as opposed to the plan-rule model or the socialist view.

Milanovic's move towards the Marxian tradition is probably not the final step in rethinking the theory. Milanovic does not wish to follow the revolutionary tradition, so he concentrates only on the narrow economic problem; he presents the theories of the individual authors rather than the political action that resulted from their activities. He describes the positions as competing theories grouped into three major systems of view: „The first four – Quesnay, Smith, Ricardo, and Marx – see inequality as essentially a class phenomenon. The rest see things differently. In the case of Pareto, the key cleavage is between the elite and the rest of the population. In Kuznets's view, inequality is caused by the differences in incomes between rural and urban areas, or between agriculture and industry." (p. 12.) Although these are competing theories, they can be understood in a dialectical context.

The first author is Francois Quesnay, Chapter *Social Classes in a Rich Agricultural Kingdom*. Quesnay is the originator of French physiocratic thought, and Milanovic incorporates this school into the economic policy debates of the time, the debate with mercantilism or its French version, Colbert. Mercantilism saw the development of industry as the primary goal over agriculture. It sought to develop industry and exports at the expense of agriculture. Quesnay and the physiocrats rejected this and sought a more harmonious economic structure. Harmony was the law, the natural law they argued for their position, which was distorted by faulty economic policy. „The natural laws of governance most advantageous to the humankind: respect of liberty and private property founded on the wealth-creating power of agriculture." (p. 31.) Distorted income distribution is a sign of imbalance, and Milanovic shows this in detail using historical data. He also argues that the French leadership deliberately sought to do this, which became their fundamental mistake. „French ruling elite pushed inequality as high as it could – for sure, not as close to the 100 per cent mark as was the case in many colonies, but not very far from it either. French income levels were lower than English levels." (p. 33.) The physiocrats did not focus their economic policy on taxation but on exploiting the productivity gains from agriculture. Fairness in income distribution, therefore, is an efficiency booster, which moves Milanovic away from the idea of mere redistribution. Interestingly, the model of the Physiocrats was China, a model they wanted to import to France and Europe as a whole. It is no coincidence that the Physiocrats were called reformers and not revolutionaries, as was the case with the philosophers of the Enlightenment since Quesnay also saw the Chinese model as guided by China's ability to maintain stability throughout its 4,000-year history. According to Quesnay, the source of productivity is the correct distribution of income in terms of the factor of production. He illustrates the income relationship between these classes in his famous table. In his initial work, he distinguished three classes: the peasantry, the industrialists, and the non-productive class. Milanovic developed this further by adding a separate class distinguishing between craftsmen and tenants. (p. 39.)

It is in the flow of income between these classes that an equilibrium is created, and this is the source of growth. „The structure of the society they describe, and the income numbers they provide, represent a somewhat embellished version of the French economy at the time. This is because the concealed objective of the physiocrats throughout their studies was to illustrate to the rulers – that is, to the king and the people around him – the prosperity that could be France's were the right policies adopted." (p. 46.) Milanovic also suggests that growth is conditional on the correct distribution of income, which became a thesis of 20th-century macroeconomics.

The next author is Adam Smith, on whom Milanovic's most important observation is that he also has a theory of income distribution, but that is hidden under the topics of abundance and wealth. To establish this, Milanovic first clarifies that Smith did not reject state intervention. „An augmentation of fortune is the means by which the greater part of men propose and wish to better their condition. He felt fortunate to have discovered that the system of "natural liberty" is the one that maximizes economic wealth – that is, best satisfies human passion. That, in turn, meant there was a natural coincidence between human freedom and economic growth. Smith has often been interpreted too narrowly as opposing almost any government interference in economic matters. This is not true: Smith himself gives many instances where the government's involvement is necessary (in matters of national security like the Navigation Act, protection of infant industry, prevention of monopoly, limiting the exploitation of labor, introducing financial regulation, and enacting anti-collusion policies, especially regarding employers scheming together against workers)." (p. 48.) This is a neoliberal misunderstanding. Smith reports descriptively on the invisible hand – he just claimed it was invisible – which is roughly equivalent to Kant's statement about the limits of cognition. Smith's other key advance was a global view. „Smith's interests, like the best development economists' research, spanned the entire globe." (p. 51.) He did not concentrate on just one country; he ranked countries in terms of their wealth, and the source of this ranking was the development of the division of labour. In the case of Smith, Milanovic also shows the inequality of the period in Britain, which shows the insurmountable income advantage of capitalists and landowners over the rest of society. The debate between Smith and the Physiocrats was based on the source of productivity and, hence, the correctness of the principles of efficient and equitable income distribution. For Smith, this source is the division of labour; adequate participation, though, needs a correct income distribution, too. „Noting that "servants, labourers and workmen of different kinds, make up the far greater part of every great political society," Smith added that "what improves the circumstance of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable." (p. 62.)

The question of how much income is required for participation is not so much the subject of The Wealth of Nations as of The Theory of Moral Sentiments since the impartial observer therein can judge it. Smith, unlike Mandeville, assigned a moral standard to the market and the division of labour. This moral norm is not inherent in the market. It is the task of the invisible hand to enforce this norm and to deviate from it in economic policy is a fundamental error. This is the case with monopolies; Smith, therefore, advocates that the state should not undertake them. „The government of an exclusive company of merchants is, perhaps, the worst of all governments for any country whatever." (p. 69.) The moral norm creates prosperity, and this prosperity, and the effort to maintain it, creates correct income distribution ratios. Smith is concerned that the incomes of the lowest social groups rise most strongly in wealthier developing societies. „Smith concludes that relative wages and relative profits – that is, the ranges of wages and of rates of Adam Smith return – are not affected by the advanced or declining state of society. All wages go up or down together without changing relative to each other, and the same is true for profits." (p. 74.) The link between growth and morality is not without landlords; even though so many neoliberals have distorted Smith's original writing, the fact is that Smith sees the role of landlords, not capitalists, as paramount. The role of landlords is to protect morality.

Table 2.2. Aligned and Unaligned Class Interests

	Landlords	Capitalists	Workers
With „improvement of society," the class...	Gains (as rents increase)	Loses (as profits drop)	Gains (as real wages rise)
The class's ability to persuade policy-markers is...	Low (due to indolence)	High (due to sophistry)	Low (due to lack of education)
Vis-à-vis the general public interest, the class's own interests are...	Aligned	Opposite	Aligned

(p. 77.)

The fault in British economic policy was not that it did not allow the freedom of capital but that the landlords saw their interests and not the public good as the guiding principle. This is why Britain lost the States of America.

In the next chapter, Milanovic deals with David Ricardo, who examined how capitalists can become guarantors of stability. Like Smith, Ricardo raised the question of the management of development, but Ricardo drew directly from this the problem of income distribution and taxation. The style of his book and its abstractness are not merely a matter of scientific rigour but of universalism. He seeks principles that can be applied everywhere, which are closely linked to the era of the post-Napoleonic War. The continent's unification was a fundamental requirement at that time that could be carried out legally; it was the Code Civil. The laws of economics can be universal, and that is what Ricardo's book is about. So Britain's superiority was because it enforced the universal laws of economics more consistently than other countries. The primary principle of this is the superiority of capitalists over landlords because capitalists are better at helping workers and society as a whole to develop. „Ricardo championed bourgeois production in so far as it [signified] the most unrestricted development of the social productive forces, unconcerned for the fate of those who participate in production, be they capitalists or workers. He insisted upon the historical justification and necessity of this stage of development. His very lack of a historical sense of the past meant that he regarded everything from the historical standpoint of his time." (p. 91.)

To justify this, Milanovic quotes Marx. Ricardo's connection to the British economic policy debates of the time was, above all, his rejection of the Corn Laws. Ricardo argued that these laws distorted the correct distribution of income towards landlords and that this reduced efficiency and productivity. In the case of the annuity, Smith was still in favour of an absolute annuity, but Ricardo had already clearly rejected it. Ricardo's argument goes back to the capital-labour relationship, namely that profit can only increase at the expense of wages. „It has been my endeavour to show throughout this work that the rate of profits can never be increased but by a fall in wages, and that there can be no permanent fall of wages but in consequence of a fall of the necessaries on which wages are expended." (p. 96.) The level of the wage, however, is regulated by natural law, later called the 'Iron law of wages', since the wage cannot be less than the amount of money needed to buy the goods necessary for the worker's subsistence, above all grain. If the price of grain is kept higher by tariffs and other means, a higher wage level follows, but this higher wage level does not raise the standard of living, and this ultimately means that the landlords only take profits from the capitalists. The argument about the improvement of the working class is disingenuous, Ricardo argues, because the landlords are protecting themselves, not the workers, with high tariffs. There is, of course, a rent in Ricardo's system, but this rent is generated by the landlord's exploitation of the land. Ricardo has, in effect, turned the landlord into a capitalist. Ricardo also argued that the source of workers' development and enrichment is properly managed capital. The capitalist is the one who protects the worker, and there is no class conflict between the two classes. In conclusion, Ricardo created the first integration of income distribution and economic growth, linked a growing economy with high capitalist incomes, and argued that capitalists could play their role of active agents only if their profits were sufficiently high. But he did not see class conflict as primarily between capital and labour." (p. 105.)

Marx disputed this claim and proved, according to Milanovic, that the rate of profit is constantly falling, with a consequent permanent pressure on the working class. As opposed to what Ricardo claimed, there is no harmony between capitalists and workers; therefore, class struggle is inevitable, and the expropriators must be appropriated. Marx's hatred of the capitalists is backed up by Milanovic's biographical data, which does add colour to the book but may not be of academic value. He details the extreme income inequality of the 19th century, not only in England but also in Marx's native Trier. This income inequality was reflected not only by Marx but also by the whole labour movement. In analysing Marx's work, Milanovic takes historical analysis as the methodological starting point, which means that the laws of distribution are not timeless but are subordinate to particular historical periods and modes of production. Consequently, it is not the distribution that is the fundamental issue, i.e., merely changing income relations will not transform the mode of production, such as capitalism, but changing the mode of production will result in a better, more equitable distribution. The system cannot be improved; this is the Marxian argument; therefore, class struggle is the central problem, as is the determination of conflict over wages and profits. Therefore, from this point of view, capital is the form of domination, the operation of violence in production. Marx's class analysis is more subtle than Ricardo's, not only in the sense that there are more classes but also in the sense that Marx further subdivides the classes and shows the relations within them. Milanovic also makes criticisms. Marx lacks bureaucrats, a fundamental problem for 20th-century development. Milanovic argues that in his theory of income distribution, Marx followed the Ricardo model, with wages adjusted to subsistence goods. He refines this a bit: not only do subsistence goods matter, but there is also a historical, moral element behind wage setting, but this is only a subtle deviation because it does not significantly affect wage levels.

The analysis of capital and profit is the main novelty. The rate of profit is levelled out by competition, which is also a Ricardian argument, but profit is projected onto total capital as the sum of variable and fixed capital. However, only floating capital is the source of profit; sunk capital does not produce profit; in Marx's terms, surplus value. Only labour—that part of capital spent on wages—makes profit and value. The contradiction is that the direction of the development of production and technology is to use ever-larger machines because these machines are creating more and more jobs, therefore squeezing more and more value out of workers. This is the concept of economy of scale. This, in turn, means that the proportion of floating capital in total capital is getting smaller and smaller. The result is that the rate of profit falls, forcing capital to squeeze workers more and more. This is what Marx called the absolute oppression of the working class. Constant mechanisation will, therefore, have a double effect: on the one hand, keeping wages at or temporarily below the minimum wage, and on the other hand, replacing work and creating unemployment in the industrial reserve. „The general movements of wages are exclusively regulated by the expansion and contraction of the industrial reserve army, and this in turn corresponds to the periodic alternations of the industrial cycle." (p. 153.)

This is what Marx calls the industrial reserve army created by capitalist production. Marx sensuously points out that it is not the population that has surpluses or shortages but the production that causes this surplus. The only way to break out of this is to end the accumulation characteristic of the capitalist mode of production, i.e., the law of development, which makes the worker dependent on the machine and its growth, ultimately the direction of technological development. Milanovic, based on this latter tendency, argues that the capital's concentration began at the end of the 19th century, which led later to Pareto's theory.

The theory developed by Vilfredo Pareto is based on Marxism, which he never denied. However, his experience differed from Marx's, as he was influenced by anarchism and the desire for personal freedom. Milanovic summarised the economic theory of this approach. Pareto's work also highlighted the income distribution issues and extreme tendencies of his time, which included not only economic inequality but also anarchist violence, such as assassinations. To address these problems, Pareto proposed two solutions: research on inequality and the Pareto principle, which has become known in sociology. According to Pareto, the concept of inequality can be better understood by looking at individual utility. He believed that individuals have their own aspirations for happiness and advancement, which drive social processes. In his view, there are no social groups, only individuals with their own utilities. However, the increase in utility needs to be balanced with political stability maintained by the state. Pareto saw the economy and politics as contradictory. While economic performance can reduce individual utility, it must be limited to ensure political stability. To achieve this balance, the political leadership (known as the elite) must be changed from time to time to maintain stability, as they can sometimes lose their sense of stability and cause upheaval. „Pareto's sociological theory of the "circulation of the elites" was reinforced by his finding of a fundamentally stable distribution of incomes (regardless of political institutions). This meant that, while the type of ruling elite, its origin, and its characteristics might vary, the underlying distribution of wealth and income could not be affected." (p. 176.)

Pareto's utmost merit, according to Milanovic, is that he found economic inequality compatible with the concept of socialism. He saw socialism as an increase in utility, not as an ideal society. At the same time, unlike Marx, Pareto did not think that income distribution ratios should be interpreted historically. Individuals behave similarly regardless of the historical circumstances. „To put it in stronger terms, Pareto did not think that income distribution would change under different social arrangements or that it would change with greater average wealth or economic development." (p. 187.)

In the realm of income distribution during the 20th century, Simon Kuznets emerged as another influential economist, as highlighted by Milanovic. Kuznets, who delved into post-World War II income distribution, made significant strides in economic statistics. Leveraging the statistical infrastructure of the 20th century, he constructed a database of unparalleled quality, surpassing that of his predecessors by orders of magnitude. Notably, Kuznets became the pioneer in assembling a global database, shifting the focus from national comparisons to examining individuals worldwide. Through this approach, Kuznets illustrated the emergence of a substantial middle class in the developed world while underscoring the persisting gap between developed and developing nations. Kuznets grappled with the question of narrowing this divide, aligning with Smith's perspective on industrialization as the solution. However, he expanded upon Smith's theory by introducing a phased approach to the industrialization process. „It seems plausible to assume that in the process of growth, the earlier periods are characterized by (...) forces that may have widened the inequality (...) for a while because of the rapid growth of the non-A [non-agricultural] sector and wider inequality within it. It is even more plausible to argue that the recent narrowing in income inequality observed in the developed countries was due to a combination of the narrowing inter-sectoral inequalities in product per worker [between agriculture and manufacturing], the decline in the share of property incomes in total incomes of households, and the institutional changes that reflect decisions concerning social security and full employment." (p. 196.) The thesis that growth is the solution to inequality, in which there is a transitional phase of rising inequality, was first formulated based on Kuznets' argument. This will be inevitable, Kuznets argued, but afterwards, greater equality will re-emerge, as the example of the United States demonstrates. Automatism has been criticised by many in his time, but it is undoubtedly in line with the view espoused by Walt Rostow. According to Rostow, the direction of development is high mass consumption; therefore, it is worth following the Western development pattern. It is now more apparent that the Kuznets curve is not the result of automatism but of a conscious economic policy that focuses both on productivity growth and on a harmonious distribution of income. However, Milanovic considers Kuznets' great merit to be his success in demonstrating the link between structural change and income distribution. „The great contributions of the Kuznets hypothesis were its more explicit statement of what changes in inequality could be expected in times of structural change, and its fairly plausible identification of the mechanism involved." (p. 212.)

After Kuznets, the preoccupation with income distribution ceased until the emergence of Thomas Piketty, Emmanuel Saez, and, of course, Milanovic. This was partly due to the economics of the Eastern Bloc, since in a society where the working class was in power, inequality between workers and managers seemed unthinkable. Although unthinkable in theory, it was very much present in practice. According to Milanovic, this could only be explained by the concept of state capitalism, which was linked to socialist ideology, causing deep damage to academic work. At the same time, in developed countries, from the mid-seventies onwards, a new era began in which inequality became permissible and desirable. The theoretical basis for this was the thesis that inequality is the driving force of development. Empirical results on inequality were produced, but they had no relevance for economic policy. Regrettably, Milanovic did not analyse the philosophical background of John Rawls' theory.

'The New Beginning' is the title of Milanovic's epilogue, which begins after the 2008 crisis, as the number of publications in this field has increased significantly since then. However, Milanovic does not end his work by outlining a theoretical solution, only by arguing for the need to analyse inequality within countries, between countries, and globally, and to allow a global elite to operate to find a solution to address inequality, with which one can agree, insofar as Milanovic argues for the importance of global governance.

In "Visions of Inequality," Branko Milanovic not only navigates the complex tapestry of economic disparities with scholarly finesse but also leaves even non-academic readers with a profound contemplation on the evolving dynamics of its literature. Milanovic's insightful analysis challenges us to confront inequality head-on, showing the dialectic aspects of it, but instead of urging for a collective pursuit of equitable solutions, he calls us to analyse the question further. Without this aspect of the movement, we cannot speak of an epoch-making analysis; nevertheless, the book may be regularly used for teaching or research purposes, as it is highly relevant and thorough work. ■