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Capitalism and the Challenge of Inequality

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Capitalism and the Challenge of Inequality

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Rapidly rising income and wealth inequality in the United States and other Western countries has been commonly identified as an inherent and nefarious feature of the capitalist system. In fact, however, rising inequality within the economically advanced countries has been accompanied by both a significant relative improvement of the economic and social position of the previously disadvantaged groups, such as women and ethnic minorities, and an unprecedented reduction of the inequalities between the people living in the advanced countries and the rest of the world. This change is largely due to the phenomenon of globalization that brought the advantages of the capitalist economic system to the developing world. Rising inequality is also an effect of the deep technological transformation of Western economies in which an increasing share of national wealth is produced by a much smaller number of highly skilled and educated people than had ever been the case in the past. To be sure, the growing inequality does raise the specter of political instability and may call for some counteracting redistributive measures. But the most important condition of all such measures is not to base them on a theory that might undermine the legitimacy and the effectiveness of the capitalist market economy. A program of restituting to the descendants of American slaves the value of the labor unjustly taken from their ancestors might both alleviate some of the existing inequalities and reduce racial animosities, while at the same affirm the liberal commitment to the institutions of private property and inheritance. A provision of a certain amount of capital to each high-school-graduating student might widen and equalize their opportunities, while giving them a stake in the free market economy and redefining the concept of American citizenship.

Keywords: inequality, capitalism, liberalism, globalization, technology, restitution, stakeholder society.

To paraphrase a minor nineteenth-century economist, a specter is haunting the United States—the specter of inequality. The real story is quite complicated, but the lines most often heard are these:

During the last few decades, we are told, inequality has grown in a way that is unprecedented. Not only have the fortunes of a few skyrocketed, but they have also been accruing to an ever smaller fraction of the population (0.1%). The income of the rich as a multiple of that of the working people has gone up to astronomical levels, not seen in more than a century. Moreover, for the first time since the Great Depression, the wealth and income of the people below the top few percent is said to have been stagnant or diminishing over the last 40 years, and young people no longer expect to have the same or higher standard of living as their parents.

The cause of all this, we are often told, is the unbridled development of neoliberal capitalism and its capture of the political system in the United States. The new wealth of the few is said to be in large part a “rent” from monopolistic control of economic life, unprecedented state-enabled growth of corporate behemoths, and the destruction of the power of labor through globalization, with its huge offshoring of industrial production, and the consequent (as well as state-supported) demise of the unions. Inequality is not only systemic, we are told, it is also largely hereditary. Indeed, the intergenerational conveyance of inequality is said to be accomplished these days not just through inheritance law, but also (perhaps mainly) through pervasive lifetime transfers via educational privilege, social connections, and an increasingly corrupting role of money in the social and political spheres.

No surprise, then, that the long-disfavored word *socialism* has reappeared in American political vocabulary. This is not just a sign that McCarthyism no longer frightens people aspiring to political office. It is also a clear call for more state intervention in economic and social life, designed to restructure and reform the whole economic base of the American society and to assure a more just distribution of the national wealth. Democracy is no longer just a political concept—it is also increasingly seen as an economic desideratum.

The rise of income and wealth inequality between those at the top and those in the middle and at the bottom of the social scale is indeed an unquestionable fact in the United States, especially as compared with the earlier post–World War II period. But both the causes and the consequences, as well as the moral significance of this fact, are much more complicated than is usually presented.

While income and wealth inequality between the working classes and the rich has certainly increased, the same inequality between the traditionally disfavored groups, mainly women and ethnic minorities, and the “mainstream” population has quite dramatically decreased at the same time. Moreover, while racism and sexism have certainly not ceased to play a significant role in the American society, the weakening of labor unions, often seen as one of the main drivers of equality in the past, may in fact have had a lot to do with the opening of economic opportunities to people other than white men.

But most importantly, the increase of inequality in the United States and some other advanced economies has been dwarfed by the historically unprecedented increase in human equality on the global scale. While American industrial workers may be relatively less well off, as compared to their employers, world hunger has dramatically diminished in the very same period, and hundreds of millions, perhaps billions, of people around the world have moved from utter poverty and destitution into a relatively decent life standard.

Now these two phenomena—the increase in world equality and domestic inequality—are not unrelated because they are both tied to the phenomenon of globalization, another *bête noire* often blamed for the poor state of the American working people. But even though American workers are no longer paid as many multiples of the wages of their equally or more productive counterparts in other parts of the world as they used to be, they are still hugely privileged by living in the richest country in the world. Contrary to what we hear all around, their life standard, while it has not been growing as fast as in the earlier postwar period, is actually significantly higher, not lower, than it was at the height of postwar prosperity.¹

It is in fact arguable, indeed plausible, that the period of increased globalization has been one of the highest points in the US moral leadership of the peacetime international order. The only historical period parallel that comes to mind is that of the Marshall Plan, when the United States, having won the war that had fatally undermined the old European imperialist order, not only did not use its victory to keep the Europeans weak but also taxed itself to an unprecedented extent in order to make sure that the enemies and allied rivals of yesterday could restore their prosperity. But while the original Marshall Plan was directed toward helping mostly white Europeans, its more recent counterpart in the form of globalization benefitted primarily Third World countries, including the rising rivals aspiring to reduce the American influence in the world.

The jury is still out on whether globalization will follow the Marshall Plan in also leading to a genuine democratization of its beneficiaries. There is, however, no doubt that, with all its warts, China today is way more tolerant than its Maoist predecessor and that the Chinese people live infinitely better and enjoy infinitely more personal freedom than in, say, 1980. Like the European prosperity of the 1950s, the economic rise of China, India, and others has also contributed mightily to the well-being of most Americans. True, some jobs have moved offshore and the wages of some American workers may not be as high as they would have been under the old protectionist system. But we have less unemployment than we had for most of the postwar period, while globalization has provided Americans with access to all kinds of high-quality and lower-priced industrial goods.

Globalization is only one of the causes of increased domestic inequality. The other, in the long term likely more fundamental, is the deep structural change of the whole economic order. In this respect, the most significant development of the last four decades is not, after all, globalization or the rise of the neoliberal Washington Consensus, which enshrined the free market as the most successful model of economic growth. The main factor underlying the widening scope of inequality is probably the technological revolution transforming every corner of economic life. A single cheap computer replaced hundreds of paper-shifting clerical jobs of the 1980, to say nothing of how computers transformed the face of modern finance, insurance, education, and so on. The motion picture and other cultural products of today are

¹ Between 1980 (Reagan's election) and 2023, worker's wages in the US grew by 17.5%. Since 1960, the wage growth averaged 6.20%. The claims that wages have been stagnant or even fell in recent decades are grounded in cherry-picking the comparison dates: If you pick the highest pre-Reagan point (1973) and compare it to 2023, the wage levels do in fact appear stagnant (and even fall if you end before 2020). But this is largely due to a secular decline between 1974 and the mid-1990s as a result of the prolonged stagflation in the wake of the Great Society and the Vietnam War. The real wage growth since 1995 has been high and nearly constant (over 20% total in constant dollars and close to 40% using the personal consumption expenditure price index). For more on this question of recent wage stagnation, see Strain 2022.

produced and delivered to the consumer in ways that were unimaginable 50 years ago. Soon even a car will likely become unrecognizable to someone who might have gone into a deep sleep only a few years ago.

The recent technological revolution has not yet led to far-reaching automation and an attendant dramatic reduction in available jobs; it has not *in this way* shifted economic power from labor to capital and management. To be sure, computerization, like all technological progress, eliminated some jobs, but the overall number of jobs today is greater, not smaller, than it ever was, even correcting for population growth, and unemployment is at historically low levels. Some say that artificial intelligence may soon make the Luddite hypothesis truer than it was in the past, but whether or not this happens, automation is so far *not* among the main reasons of the growing gap between the rich and the working people.

What technology did in the last few decades is to create a world in which fewer and fewer people are responsible for a greater and greater share of the overall wealth production. Some fatuous critics notwithstanding, Steve Jobs, Bill Gates, Mark Zuckerberg, Larry Page, Jeff Bezos, Elon Musk, and yes, even George Soros did not make their fortunes by getting state monopolies, underpaying the people who work for them, or stealing from consumers. They, together with an army of inventive and highly technologically savvy entrepreneurs, analysts, programmers, and so on, started with no or very little nonhuman capital and within an incredibly short time created the most dynamic part of the world's richest and most productive economy.

The reason why this is happening is because technology has moved us into a largely new economic reality (the postindustrial era?). Technological progress was always decisive on the frontiers of economic development. But while previously this progress consisted largely in making relatively unskilled industrial labor more productive, twenty-first-century innovations can often result in a very valuable product being brought to consumers in next to no time and with very little need for unskilled labor along the way. What changed is not the need for labor in producing industrial goods and traditional services that are still consumed daily by most of the population. What changed is that the *frontiers* of development moved, at least in a significant part, beyond the employment of any but the most highly sophisticated and often unique form of human labor. It is here that much of the new wealth is produced, and the rates of return are enormous.

This has another important consequence that is not often observed. While mass education has been long seen as the main hope for improving the skills and the life standards of working people, and thus as a driver of social mobility and decreasing inequality, the levels of skill required on the frontiers of today's economy may have become so high as to be beyond anything that a *mass* education system can deliver. Education will still be very important of course, both to train people for traditional jobs and to nurture the new entrepreneurial elite, but it is unlikely that today's inequality is due to working people's artificially limited access to education or the low quality of the one that is available. More likely our expectations with respect to the role of education as the economic "great equalizer" need themselves to be modified.

Let's make it clear: All this does not change the fact that inequality has indeed dramatically increased in recent decades and that this increase may have all kinds of undesirable economic, social, and political consequences. Even if generated by legitimate economic activity, striking inequality of results may produce resentment and provide fertile ground for

demagoguery that can seriously threaten both political stability and economic prosperity. No matter how questionable, the calls to “soak the rich” have been known to cause problems (and indeed revolutions) in the past. In this sense, the recent populist and authoritarian political developments make it especially foolish to put too much faith in the old theory that “it can’t happen here.” In fact, we may perhaps be approaching a point at which the cost of not dealing with the problem may ultimately lead to a greater decrease in the freedom and economic well-being of everyone than a rigid adherence to the principles of liberalism.²

* * *

So how are we supposed to react to the challenge of the rising inequality?

In the context of today’s politics, the main danger is succumbing to the collectivist perspective on the link between inequality and capitalism. To be sure, capitalism, unless supplemented by a social policy of redistribution, does inherently produce inequality: diverse and unequal individual contributions to the collective wealth in a market society based on voluntary transactions among free individuals inherently result in an uneven wealth and income distribution. But in the anti-liberal perspective, unequal results are quickly identified as caused by the allegedly illegitimate and unfair advantages that some people have over others in market exchanges under capitalism, so that inequality of result by itself becomes indistinguishable from injustice. A fuller presentation of my argument would include a refutation of this dangerous ethical position, which ignores the unavoidable trade-offs between freedom and equality and threatens the very basis of a free society. But time does not allow me to go into this issue today.

What I want to focus on today is a less ideological response to the problem of inequality, which contains two basic elements. The first is to recognize that some forms of inequality are indeed due to injustice and their remedy ought to be an important part of the liberal agenda. Some of these injustices may be due to various well-known market imperfections, but others, such as the heritage of slavery or the persistence of racism, sexism, and xenophobia, have very little to do with the economic order and are due to various social and political factors, sometimes deeply rooted in the past. So policies directed at undoing these inequities may have the effect of lessening inequality while also contributing to the perception of the legitimacy of the status quo and thereby increasing political stability, without at the same time undermining the productivity of the capitalist economy.

The second part of the liberal strategy of facing inequality should be a pragmatic recognition that even if there is nothing deeply wrong with the inequalities produced by a well-running market economy—that is, even if the protests against inequality are mostly driven by resentment or difficult-to-justify ideological commitments—there may be a clear political danger of doing nothing about it. In fact, it may make perfect sense to adopt certain redistributive policies that not only “buy” greater political peace but also potentially transform the social and cultural constitution of American life by redefining the relation between work

² The word *liberalism* is most often used in the US with reference to a left-of-center political position committed to social justice and far-reaching economic equality. Throughout this paper, I am using *liberalism* in its more traditional sense, referring to the worldview committed to political individualism, economic freedom, and a relatively narrow role of the state. Liberalism, in this sense, is also strongly committed to equality of opportunity, but it stresses the dangers to freedom from a pursuit of an extensive equality of results.

and leisure. Such an approach could give a new meaning to the concept of citizenship, perhaps providing the young with a material stake in the maintenance of the economic and political order. This strategy might of course carry a significant financial cost, and the real challenge is to design the relevant policies in a way that strengthens, rather than undermines, the capitalist foundation of the economy, and does not weaken the material basis of the whole American social order. In other words, we should reject the idea of a radical revamping of the economic order and focus of social policy measures, making sure that both the nature and the cost of these measures are tailored in such a way as not to kill the economic goose that lays the golden eggs.³

So let me mention briefly a couple of redistributive social policies that I think we should consider. I want to begin with one that few conservatives support, but which I think is very much in tune with the liberal values underlying the American project, mainly because it is aimed at rectifying a clear past injustice, one that is neither seriously questionable nor a pretext for a broader ideological restructuring of the economic order. In the American context, the most important historical injustice still scarring our present is of course slavery. Its lingering effects are, on the one hand, indubitable but, on the other hand, difficult to define and delimit, which makes them politically very charged. We have had, however, in recent years, an increasingly lively conversation about the idea of simply paying the descendants of the American slaves the present value of the labor that was forcibly taken from their enslaved ancestors without any compensation (beyond the miserable subsistence allowed by the slave owners). The idea may seem strange at first, given that slavery was abolished over 150 years ago, but it resonates well with the values embodied in the very institution of private property at the core of a liberal capitalist society. The laws of inheritance are also very deeply embedded in the American legal system. So, extending somewhat the usual prescription period, restitution of the value of the labor stolen from the slaves is not that different from the widely accepted idea of returning Jewish property taken by the Nazis to the descendants of the victims.⁴ The reparations system, if taken seriously, might not drastically diminish many forms of inequality and it might be quite costly for a while. But it would also reaffirm the commitment to the value system of the capitalist society and be both more effective and less subject to partisan struggles than any welfare payments. It could also potentially help cure the extremely costly racial divisions in the United States that still poison the political life of the country.

Another redistributive policy that liberals might consider to counteract the negative effects of rising inequality is of a broader significance. Most Western societies have long recognized that a certain amount of redistribution, designed to make sure that all members of the society have the minimum resources enabling them to live in dignity and be free to make

³ I am not saying, of course, that there is nothing that can be done to improve the US economic performance or curtail some abuses of economic power. But I do think it is very important to realize not only that there is nothing fundamentally wrong with the American economic system, but also that, despite the various social problems arising as a result of the incredible pace of innovation and despite the occasional hiccups often misrepresented as major “crises,” the American economic system has performed as well or better in recent decades as at any other time in the country’s—and the world’s—history. Both in terms of life standards and in terms of international justice, we are doing pretty well.

⁴ Not only did the Nazi crimes involved take place over 75 years ago, which is longer than most prescription periods, but the restitution is also made these days mostly to people who were not even born at the time the dispossession occurred.

the most important life decisions, is not only compatible with the liberal theory but is also a deeply rooted imperative of human solidarity. The problem with this general commitment, however, is that what constitutes such a minimum is sometimes extremely controversial. Some on the left will not be satisfied by anything short of nearly total economic equality. Many on the right and in the liberal center fear that providing generous, yet unconditional and work-unrelated, benefits (such as a universal minimum income) to a broad spectrum of individuals will destroy the work ethic, create a culture of dependency, and ultimately result in a dramatic loss of social wealth and an overwhelmingly dominant role of the state. Nevertheless, perhaps a universal program that, like Social Security, does not narrowly target assistance to nonworking (or even just poor) individuals but delivers important benefits to an otherwise defined large segment of the population, might not be unrealistic. Some, like Ned Phelps, would advocate subsidizing wages of the working people whose earnings are too low to provide a dignified form of life. Others might prefer endowing all young people at the threshold of their working life (perhaps at the time of high school graduation) with a certain amount of capital that they could use over their lifetimes to start a business, improve their education, make a down payment on a house, and so on (Ackerman and Alstott 1999). A grant of this kind might widely increase the opportunities available to the young people generally and give them a stake in a society committed to individual initiative and entrepreneurship, as well as perhaps transform in the liberal direction the whole concept of American citizenship.

There may of course be other redistributive social programs to alleviate social inequality without undermining the productivity of the capitalist economy. As AI increases productivity and perhaps reduces the need for labor at nearly all levels of skill, the position of the working people may indeed come to be more seriously threatened than in the past, and this might lead to a deeper redefinition of the existing social relations. A significantly shorter work week, introduced as a response to the lesser demand for labor, would protect employment while also offering an opportunity to rethink the role of leisure as more than just a rest. Greater educational opportunities for adult population might restore the role of learning as more than just a form of job training. Increasing state subsidies to cultural institutions may contribute to the good life of future Americans. But it is not my purpose here to design an elaborate system of social improvement. My only purpose has been to argue that the inequality produced by the capitalist system can be recognized as a problem calling for new social policies designed to reduce its destabilizing effect without weakening the extremely productive and freedom-enhancing capitalist system. Indeed, it might offer an opportunity to creatively rethink our view of citizenship and the conditions of human flourishing.

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