A Reply to William Lazonick's comment on our "Neoliberal Managerial Capitalism: Another Reading of Piketty's, Saez's, and Zucman's Data"

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ABSTRACT:

This paper is a reply to William Lazonick's criticism of our analysis of managerial capitalism and its latter phase in neoliberalism, based on the data on income distribution put forward by Th. Piketty, E. Saez, and G. Zucman. Two of these criticisms are the expressions of basic misunderstandings. First, we do not believe the managerial revolution occurred against the will of capitalist classes, although, various decades later, the income and wealth of these classes were dramatically diminished in the New Deal after World War II. Second, we see in the maximization of shareholder value a central feature of neoliberal capitalism, as Lazonick does. The difference is that we address this feature in the broader context of variegated tendencies jointly expressing the class nature of neoliberalism, a social order targeted to the maximizing of the income and wealth of upper classes. What Lazonick says of the taxation of stock options stresses some of the ambiguous features of the distinction between "wages" and capital income at the top that we fully acknowledge, but does not question our interpretation of the new trends in the income of the broader managerial class.

KEYWORDS: managerial capitalism, managerial revolution, social classes, social orders, neoliberalism, stock options, income inequality.

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William Lazonick's comment on our paper points to a threefold "misunderstanding" underlying our analysis of managerial capitalism and its neoliberal phase: "a) when, how, and in whose interests managerial capitalism took root in the first half of the twentieth century; b) the reasons for the growing importance of the "salaries" component in the incomes of corporate executives who occupy positions in the highest-income fractiles in the Piketty et al. data set; and c) the particular neoliberal ideology, known as "maximizing shareholder value" (MSV), that has legitimized a mode of corporate resource allocation that since the mid-1980s has been integral to both the explosion of executive pay and the erosion of the American middle class." We will answer to these criticisms considering first points (a) and (c) in our first and second sections focusing on the nature and transformation of capitalism in the 20th and 21st centuries. In a more technical fashion, point (b) relates to the taxation of stock options, and will be discussed in the third section. A fourth section is devoted to the common aspects and differences that, in our opinion, underlie Lazonick's and our more general frameworks.

Although Lazonick's detailed restatement of his own analysis will be useful to a reader not familiar with his work, we believe the criticisms in (a) and (c) are actually based on a misunderstanding of our own work on contemporary capitalism and its history, notably managerial and neoliberal capitalism, to such a point that Lazonick fails to see the common points between his and our approaches. What should be the beginning of a productive debate on a number of important issues finally takes the unfortunate form of misdirected criticisms.

We recall that our paper does not provide a thorough presentation of our historical framework. As stated in the title, the ambition is the demonstration that the research of Thomas Piketty, Emmanuel Saez, and Gabriel Zucman (PSZ) shed important light on our interpretation of the dynamics of capitalism. Although we already made a broad use of Piketty's and Saez's data in earlier studies, we thought that time was ripe for a more systematic attempt at this demonstration (notably referring to the new estimates of wealth by Saez and Zucman since the publication of *Capital in the Twenty-First Century*).[1] In particular, in previous studies, we had never documented the increase in the share of wages within the top 1 percent of the hierarchy of incomes as in Figure 3, a vivid empirical illustration of the rise of managers in managerial capitalism from a position of middle class to the matured status of new upper class.

I. The emergence of managerial capitalism in the early 20th century

Lazonick recalls: “D&L argue that since the early twentieth century, capitalism has seen a gradual rise of a class of managers who have formed an alliance with the capitalist class that protects the interests of these two upper classes from the threat of popular struggle.” Nonetheless, he does not see that we always present the transformation of the institutions of capitalism at the transition between the 19th and 20th century as a triple revolution, namely the financial, corporate and managerial revolutions (as summarized in *The Crisis of Neoliberalism*, pp. 12-13). In this context, we define “Finance” as the upper fractions of capitalist classes and their financial institutions. When these revolutions took place, the development of management within firms had already made considerable progress, and the new capitalist class (as in Finance) was a key agent of this metamorphosis in the institutions of ownership and management.

Based on the existence of an early literature devoted to the possible consequences of the separation between ownership and management—as well expressed, for example, in Berle’s title *Power without property* (1959) and more recently discussed in the studies devoted to the relationship *principal-agent*—we wrote incidentally in *The Crisis of Neoliberalism*, with a dash of humor, that the threat inherent in the separation “finally materialized” after the Great Depression and World War II, as capitalist classes lost a considerable fraction of their power and wealth in what we denote as the “postwar social order”, a compromise between managerial and popular classes (sometimes denoted as “financial repression”). From this, Lazonick infers that we contend that capitalist classes did not support or promote the managerial revolution, as these classes saw in the managerial revolution a new development “contrary to their interests”, a basic misunderstanding of our analysis. The actual divergence relates to the interpretations of the post-depression and postwar societies, as in our notion of “social order” discussed in the fourth section below.

After making this misdirected criticism, Lazonick goes on: “the critical constraint on the growth of major industrial enterprises was not access to finance capital, but rather the management of organizational capabilities that could develop and utilize productive resources (see Lazonick 2012). Salaried managers who possessed these capabilities rose to positions of power over resource allocation in the major U.S. industrial corporations of the early twentieth century.”

The relationship between the managerial revolution and technical change has been an early feature of our work (see, for example, our 1993 book *The Economics of the Profit rate*, Chapter 18, “Profitability and Management”, and Lazonick should welcome the reference to Chandler). We are happy to discover how close our analysis is to Lazonick’s, when he writes in another study: “The managerial revolution in American business was a powerful engine of economic growth, especially in corporations that invested in deep technological capabilities. Even in the Great Depression, when, for lack of product demand, major industrial corporations laid off production workers, they continued to invest in their research capabilities. During World War II and the post-war decades, these investments enabled U.S. industrial corporations to be integral to what in 1961 President Dwight Eisenhower would call the “military-industrial complex.[2]” Even a superficial examination of our work shows that there are no basic disagreements in these respects. Besides the transformation of the institutions of modern capitalism and its consequences on class patterns and the working of

[1] We do not repeat here references given in our paper.

[2] "Stock buybacks: From retain-and-reinvest to downsize-and-distribute", Center for Effective Public Management at Brookings, http://www.brookings.edu/~/media/research/files/papers/2015/04/17-stock-buybacks-lazonick/lazonick.pdf.

capitalism, a considerable fraction of our work focused on the relationship between the corporate and managerial revolutions, on the one hand, and the favorable pattern of technological change in the United States and the subsequent elimination of the traditional business community during the Great Depression, on the other.

II. Neoliberalism and upper classes

One of the utterly misplaced criticisms made by Lazonick is certainly his reference to our lack of understanding of the centrality of the creation of shareholder value in neoliberalism: "For D&L, neoliberal ideology – defined as a return to market mechanisms promoted by government policy – underpins the erosion of managerial autonomy over the past three or four decades as financial capitalists have sought to extract value from the economic system. Yet D&L fail to mention the most pervasive and powerful neoliberal ideology of them all: the ideology that companies should be run to "maximize shareholder value" (MSV). "

Our basic viewpoint concerning neoliberal capitalism is that the new social order was implemented in order to restore and increase the power, income, and wealth of upper classes, notably capitalist classes. (Just looking at the table of contents of *The Crisis of Neoliberalism*, one can notice a chapter entitled: "The Apotheosis of Capital".) Institutions, management, policies were radically transformed, in the context of deregulation, financialization, and globalization (notably financial globalization). New practices were devised notably the move from "retain-and-reinvest" to "downsize-and-distribute" and the buybacks of their own shares by corporations. In our two Harvard's books (2004 and 2011), we not only discuss these mechanisms, but document them empirically in Charts. Contrary to what Lazonick believes, we do use the expression "maximizing shareholder value" (for example, in *The Crisis of Neoliberalism*), since it is a key to the understanding of the new social order, as the new forms of management (the new corporate governance) are a central aspect of neoliberalism. We tend, however, to favor broader formulations (as "maximizing income of upper classes") encompassing the broad variety of mechanisms actually involved.

In the 1990s, we put forward the class interpretation of neoliberalism (first published in English in 2000), emphasizing, among other features, the transformation of management and the performances reached in the stock market. It took us some time to really define the class foundations of neoliberalism as an *alliance* between capitalist classes and "managerial classes" (a notion to which we give a broader extension than Lazonick). From the beginning, we put forward this class interpretation as a rebuttal of the definition of neoliberalism as the "ideology" of the "free market" that was the dominant interpretation during those years. Strangely enough, Lazonick apparently suggests in the above quotation that this reference to the return to the ideology of the market defines our own understanding of neoliberalism!

Jointly considered, the themes in the previous and present sections reveal a very broad convergence between Lazonick's and our interpretations of managerial and neoliberal capitalism. There are certainly differences, in particular in emphasis or, as contended in the fourth section below, in the basic historical framework of analysis. But Lazonick criticisms in (a) and (c) are misdirected.

III. The taxation of stock options

A considerable fraction of Lazonick's papers is devoted to the taxation of stock options. A first remark is that the transformation of taxation in the wake of the Great Depression and World War II was a key feature of the postwar social compromise, with very large tax rates on high incomes. It is also well known that neoliberalism thoroughly transformed taxation to the benefit of upper income brackets. This is one additional illustration of the mechanisms that support our preference for broader class characterizations of neoliberalism, besides the maximizing of shareholder value. It is also well known that neoliberal financial globalization and the free international movements of capital allowed rich households and corporations to evade taxation in tax havens.

The detailed account given by Lazonick of the history of the taxation of stock options illustrate the fact that the border between “wages” and “capital incomes” in neoliberalism is difficult to draw within PSZ’s top fractiles. The conclusion of Section V.1 of our paper emphasizes this difficulty: “The dual nature of relations of production is here manifest and difficult to decipher. On the one hand, these groups [the top fractiles, such as the 0.1 percent] can be classified as capitalist owners; on the other hand, they are part of broader overall managerial dynamics. The amazing wages they receive is also a major source of capital accumulation and, symmetrically, their social status as owners can also be one of the foundations of their position in the hierarchies of management.”

Lazonick focuses on top income bracket (as the top 0.1 percent) as opposed to “middle classes”. In our own work, we denote as “managerial classes” a much broader group than the top 0.1 percent, more in the sense given by Piketty to the term “managers” (rather than “super-managers”). Lazonick fails to notice that the diverging trends prevailing during the three social orders in our paper, as in our Figures 1 or 4, are not typical of only very narrow social categories at the top. The fascinating rise of income inequality in these figures is actually a general feature of the upper 90-100 fractile of income distribution.

IV. Historical frameworks

The key difference between Lazonick’s and our approach lies in the central role given to class patterns, struggles, alliances and dominations in our interpretation of the history of capitalism (both the secular trend toward managerial capitalism and the neoliberalism phase during the latter decades).

In the periodization of capitalism, we use two main criteria. The first category of mechanisms hacks back to the long-term trends of “socialization of production” (in Marx’s sense) and the transformation of relations of production. “Managerial capitalism”, the key notion, which we share with Lazonick, belongs to this timeframe and, given the reluctance of Marxist economists to accept this new feature of relations of production, this common point must be emphasized. The second category of mechanisms is the succession of “social orders” (Section IV of our paper). From what we know of Lazonick’s work, this notion is alien to his framework. In our approach, each social order is defined by a specific configuration of class dominations and alliances. Thus, the common aspect between the first social orders, the first hegemony of Finance, and the third social order, the second hegemony of Finance, is clearly set out (despite the continuous growing importance of managerial classes). Correspondingly, the sharp contrast between the second social order, the Keynesian or “social-democrat” compromise from the Great Depression to the 1970s, tends to be overlooked in Lazonick’s analysis.

With respect to class patterns, in managerial capitalism, there are clearly specific and crucial features of top managers (briefly sketched in Section V.2 of our paper). We use the phrase “interface between ownership and management” to refer to the institutional relationship between financial institutions and corporations, in which the top managers of the financial and nonfinancial sectors play a central role. This is the field of Lazonick’s investigation.

At the end of his paper, Lazonick put forward the wish that these remarks will help “move [our] analysis closer to the scene of the crime”. Our view is that the “scene of the crime”, as defined by Lazonick, needs to be contextualized, and we hope a new opportunity will be found for a constructive exchange, given our common interest on managerial capitalism and its new phase in neoliberalism.