A return to plutocracy? An overview of Piketty's *Capital in the Twenty-First Century*

Markus P. A. Schneider

Economics Department
University of Denver

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Outline

1. Major Points
2. Critiques
3. Other Readings

- **Classical Economics:** Distribution between classes was a central focus (Smith, Ricardo, Marx)
- **late-19th to mid-20th Century:** Less "class" focused, but distributional issues remain in focus (Marshall, Keynes, Kuznets)
- **later-20th century:** Inequality / Growth Trade-off; Supply-Side Economics (Friedman, Lucas)
- **early-21st century:** "We've been missing an incredible rise in inequality!" (Piketty / Saez)
- **Financial Crisis & After:** Return to an intense focus on inequality / distribution (and maybe class)

- **Radical anti-market:**
  - Markets are social constructs & encode social power relationship
  - Markets have socially deleterious effects on individuals & society
- **Pro-capitalist market skeptics:**
  - Markets offer decentralized solutions to allocation problems
  - Markets require active management to benefit society
- **Pro-capitalist government skeptics:**
  - "Government" is necessary to establish & maintain markets
  - "Government" impedes individual freedom & should be minimized
- **Radical pro-market:**
  - Market interactions are the pure expressions of individual freedom
  - Markets arise naturally / are "stable" – just don't mess with them
  - "Government" is unnecessary

MOST ECONOMISTS:

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(Although political rhetoric & those economists that make it onto TV skew towards the extremes.)

- **Perfect Markets vs. Imperfect Government:**
  - Perfect Information
    No Externalities
    No Price-Setting
    No Public Goods
  - Power and its abuse is restricted (mostly) to "Government"
- **Imperfect Markets vs. Imperfect Government:**
  - Imperfect Markets
  - Power and its abuse happen in both Government & Markets

- Perfect Markets vs. Imperfect Government:
  $\Rightarrow$ **Using "Government" to address distributional issues causes inefficiencies.**
- Imperfect Markets vs. Imperfect Government:
  $\Rightarrow$ **Markets are prone to inefficiencies & produce inequalities that Government (institutions) can mitigate.**

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    Late-stage economic development will result in strong institutions to counter market imperfections
    $\Rightarrow$ **Decreasing inequality** (eventually)
  - *Piketty*:
    Positive feedback due to growing inequality undermines strong institutions to counter market imperfections
    $\Rightarrow$ **Rising inequality** / persistent high inequality

Piketty:
"I want to insist on this point: the key issue is the justification of inequalities rather than their magnitude as such. That is why it is essential to analyze the structure of inequality." (p. 264)

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Moral Question

How we view rising inequality depends on what we think the cause is.

- Perfect Markets:
  Reflection of differences in contributions to society.
- Imperfect Markets:
  Rents – some gain at the cost to everyone!

Why does Piketty hold this view?

Data and *how* he measures inequality.

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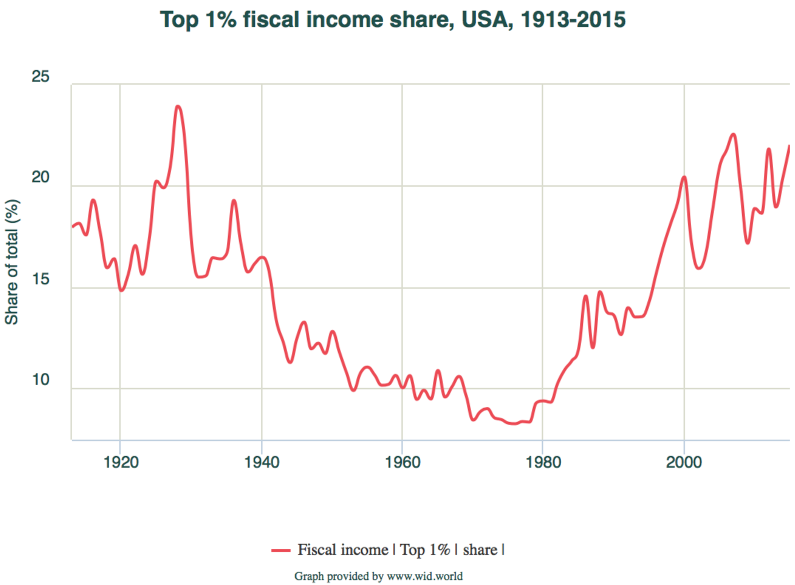
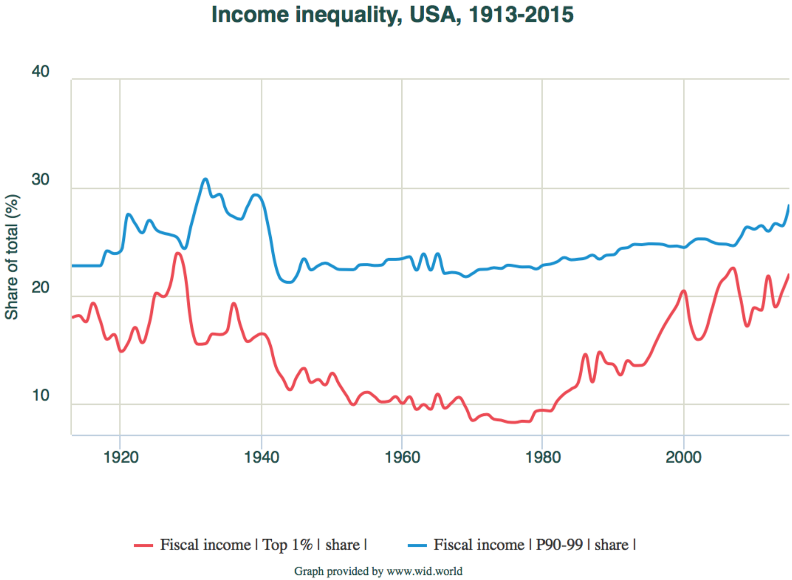
Data and *how* he measures inequality.

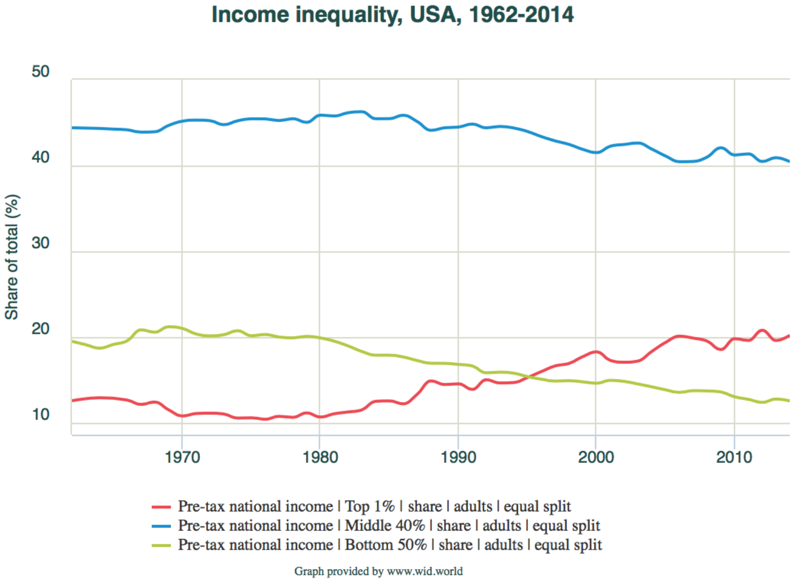
Piketty: **"The way one tries to measure inequality is never neutral"** (p. 270)

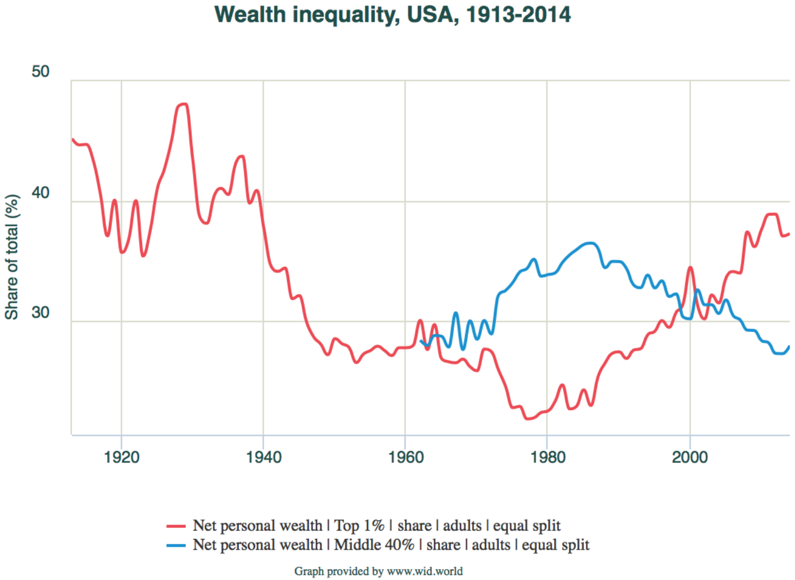
How inequality is measured matters!

- **Gini Coefficient:**
  Understates rising inequality due to changes at the extremes
- **Top 1% Income Share:**
  Highlights changes at the upper extreme (though not other changes)


Top 1% fiscal income share, USA, 1913-2015
25
20
15
10
Share of total (%)
1920
1940
1960
1980
2000
Fiscal income | Top 1% | share |
Graph provided by www.wid.world

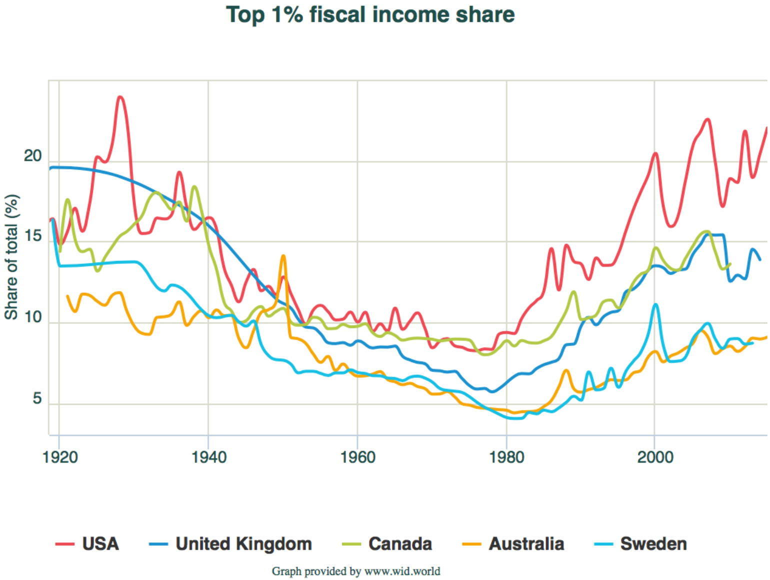

Income inequality, USA, 1913-2015
40
30
20
10
Share of total (%)
1920
1940
1960
1980
2000
Fiscal income | Top 1% | share |
Fiscal income | P90-99 | share |
Graph provided by www.wid.world

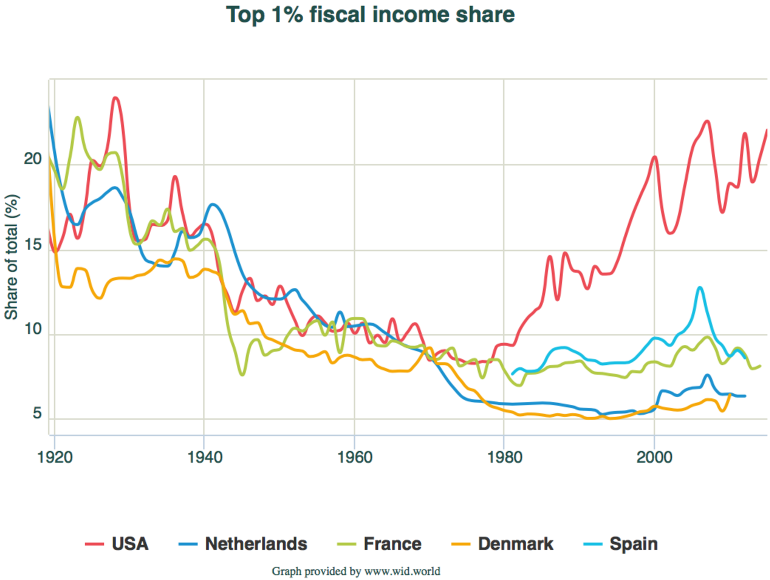

Income inequality, USA, 1962-2014
50
40
30
20
10
Share of total (%)
1970
1980
1990
2000
2010
Pre-tax national income | Top 1% | share | adults | equal split
Pre-tax national income | Middle 40% | share | adults | equal split
Pre-tax national income | Bottom 50% | share | adults | equal split
Graph provided by www.wid.world


Wealth inequality, USA, 1913-2014
50
40
30
Share of total (%)
1920
1940
1960
1980
2000
Net personal wealth | Top 1% | share | adults | equal split
Net personal wealth | Middle 40% | share | adults | equal split
Graph provided by www.wid.world

Only sources of inequality: income from work + income from wealth

1. Primary driver of growing inequality $\Rightarrow$ income from wealth
2. Inequality in income from work also contributes (esp. in the US)


Top 1% fiscal income share
Share of total (%)
20
15
10
5
1920
1940
1960
1980
2000
USA
United Kingdom
Canada
Australia
Sweden
Graph provided by www.wid.world


Top 1% fiscal income share
Share of total (%)
20
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1920
1940
1960
1980
2000
USA
Netherlands
France
Denmark
Spain
Graph provided by www.wid.world

Empirics: other key points

- Returns to wealth rise with the level of wealth (university data)
- Rising compensation of “supermanagers” (CEO pay; esp. in US)
- Growing importance of inheritance

Empirics: back to value judgement

1. Inequality in labor income

2. Inequality in capital income

3. Inequality in inheritance

1. Inequality in labor income
   - Due to effort / merit[1] $\rightarrow$ "hypermeritocracy" . . .
   - Due to imperfect markets (e.g. non-competitive CEO pay) . . .
   - Due to wealth income masquerading as labor income (e.g. stock-based bonuses) . . .
2. Inequality in capital income
3. Inequality in inheritance

[1] Though history & race matters here, too!

1. Inequality in labor income
2. Inequality in capital income
    - Due to entrepreneurial brilliance / creation of new capital . . .
    - Due to anti-competitive behavior . . .
    - Due to transfers of wealth (middle to top or public to private) . . .
3. Inequality in inheritance

1. Inequality in labor income
2. Inequality in capital income
3. Inequality in inheritance
   - Choosing the right parents.
   - Forbes 400: $\approx$ 2/3 of fortunes listed at least partially inherited . . .

Piketty: **“The problem is simply that the entrepreneurial argument cannot justify all inequalities of wealth . . . Money tends to reproduce itself.”**

Illustrative Annecdotes

- Between 1990 and 2010, Bill Gates and Lilian Bettencourt saw very similar growth in their wealth.

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- Apple, Microsoft, Amazon are emblems of entrepreneurial success, but all also engage in anti-competitive tactics.
  - Piketty: Within a lifetime, an individual can be both an entrepreneur and a rentier.
  - Tim Cooks, Bill Gates, and Jeff Bezos: entrepreneurial brilliance inseparable from “rents” (e.g. predatory pricing, monopoly power, monopsony power in the supply chain)
  - Waltons, Kochs, Trumps: they are all heirs to fortunes that fund and insure their entrepreneurial activities.

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    - Tim Cooks, Bill Gates, and Jeff Bezos: entrepreneurial brilliance inseparable from “rents” (e.g. predatory pricing, monopoly power, monopsony power in the supply chain)
    - Waltons, Kochs, Trumps: they are all heirs to fortunes that fund and insure their entrepreneurial activities.
- Transfers of public wealth to private hands is **not** entrepreneurial!
    - NY Times yesterday: “[M]ore than 12.8 million acres of federally controlled oil and gas parcels were offered for lease . . . triple the average offered during President Barack Obama’s second term.”

- **Most of history:** wealth mattered more than work or merit.

- **Golden Age:**
  destruction of wealth + anti-capitalist sentiment + worker power = emergence of wealth-holding middle class
  - Fast growth undermined importance of inheritance
  - Increased mobility from low-income up[1]
  - Work and merit appeared to matter more than wealth

[1] For white men, at least.

- **End-1970s to now:** recapturing of wealth by the top
  - Public wealth $\rightarrow$ private wealth (privatization)
  - Middle-class wealth $\rightarrow$ Top 1% (top 0.1% and top 0.01%) wealth
    Ed Wolff (NYU): median net worth[1] down 18% from 1983 to 2013
  - Avg. household debt-to-Income increased from 68.4% to 107.1%[2]

[1] Estimated $64k in 2013.

[2] Top 1%, 2013: debt-to-inc. = 38% & debt-to-net worth = 2.6%.

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We are about to see the rise of a new **plutocracy**.

1. Growing concentration of wealth & importance of inheritance gives excessive social, political, and economic influence to the wealthy,
2. which they will use to maintain high level of wealth & income concentration.

To the detriment of everyone!

Commensurate Policy

Ed Wolff (and Piketty):
Composition of wealth is very different for the top 1% vs. bottom 90%.

- Avg. Household: Almost 90% of wealth is their house + monetary savings (incl. pensions)
- Top 1%: Only 9% of wealth is accounted for by housing; 75% is investment real estate, stock holdings, etc.

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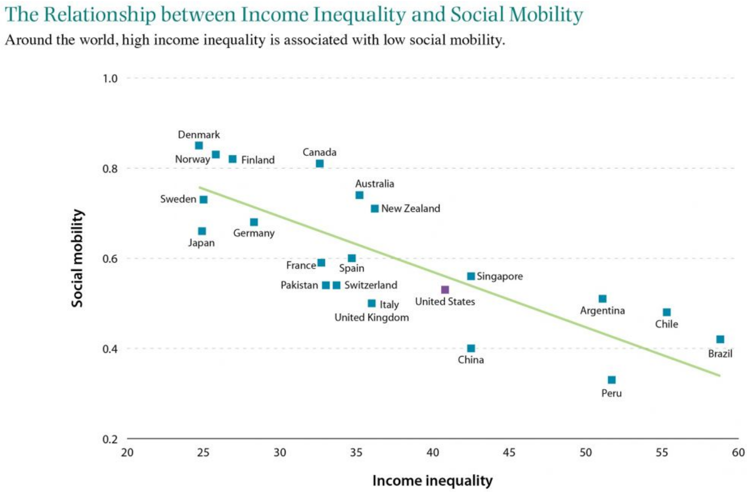
Against mortgage debt relief, tougher bankruptcy laws, tax cuts (top marginal rate, capital gains, corporate taxes), greater / cheaper access to public lands / resources, privatization of government functions, . . .



Source: Corak (2013); World Bank (2013).

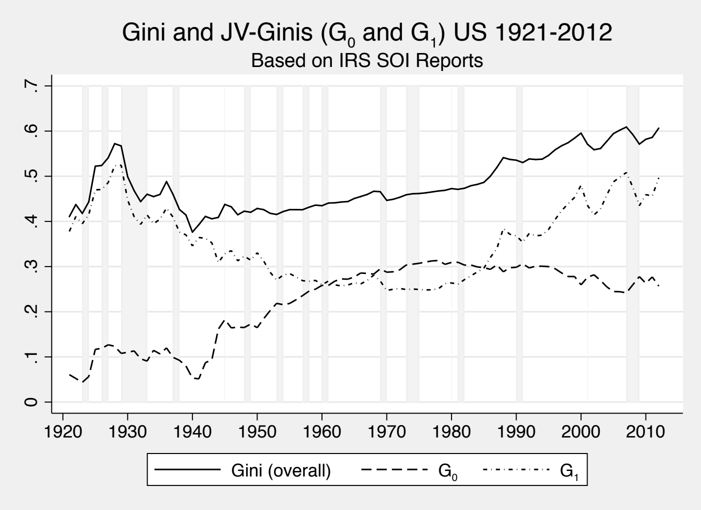
Note: Reproduction of figure 2 from Corak (2013). Data points for Italy and the United Kingdom overlap. The x-axis shows Gini coefficients as reported by the World Bank. The y-axis is a measure of social mobility and is equal to 1 minus the intergenerational earnings elasticity for each country.

THE HAMILTON PROJECT BROOKINGS

1. The empirics: How does the data work hold up?
2. Wealth vs. Capital
3. Piketty's "Fundamental Laws"
4. Economic Determinism and the role of institutions

1. The empirics: How does the data work hold up?
   - **Overall: very well!**
   - Some ambiguity re: role of inheritance.
   - Several spurious attempts to undermine findings.
2. Wealth vs. Capital
3. Piketty's "Fundamental Laws"
4. Economic Determinism and the role of institutions

1. The empirics: How does the data work hold up?
2. Wealth vs. Capital
   - Stiglitz: Growing gap between wealth & capital – and low investment – signs of increasing importance of “rents”.
3. Piketty’s “Fundamental Laws”
4. Economic Determinism and the role of institutions



G_0 is the Gini for the bottom 2/3 of income earners
G_1 is the Gini for the top 1/3 of income earners

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   "Share of capital income in national income equals rate of return times the ratio of capital to income"
   $\Rightarrow$ Accounting Identity

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3. $r > g$:
   "The inevitable acceleration towards plutocracy depends on the rate of return being greater than the growth rate."
   $\Rightarrow$ Probably not true (theoretically or empirically)
   - Doesn't mean Piketty's narrative is wrong per se;
     just maybe not as simple ...

Perceived Claim:
"If $r > g$, institutions will evolve to support a new plutocracy."
(i.e. economic forces determine the supporting institutions)

Critique

Institutions (Politics) matter and can shape / tame the economic forces!

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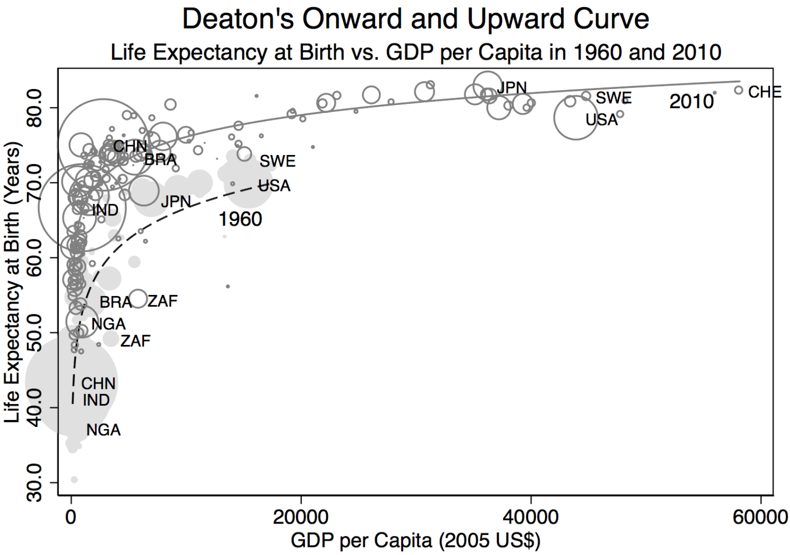
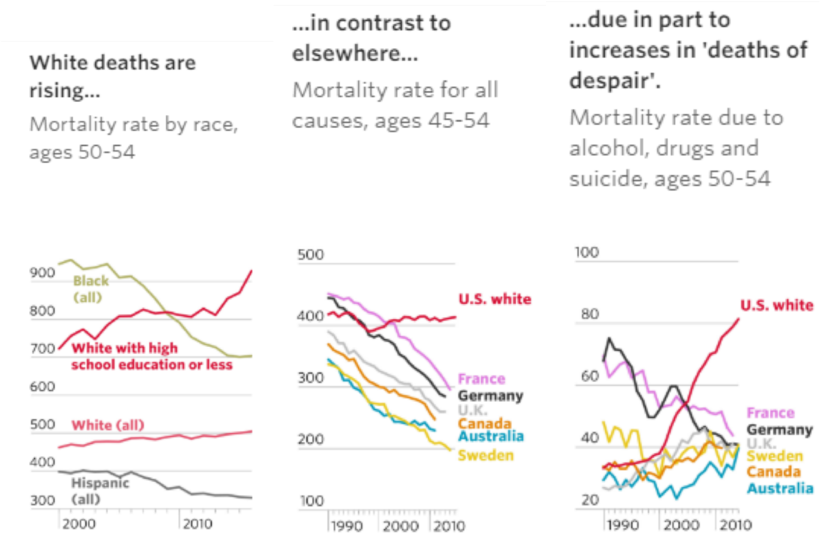
Growing inequality is not an "inevitable consequence of market forces – not simply the result of the 'laws of nature' or the 'laws of economics' … Largely the result of policy, of how we structure markets … **In that sense, inequality has been a choice**" (Stiglitz, 2018)

"I much prefer the expression 'political economy,' which . . . conveys the only thing that sets economics apart from the other social sciences: its political, normative, and moral purpose." (p. 574)

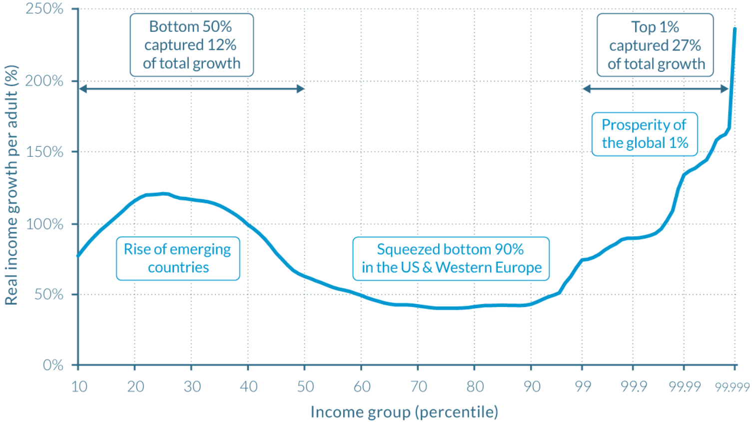
- Angus Deaton: *The Great Escape* (2013)
- Branko Milanovic: *Global Inequality* (2016)
- Peter Temin: *The Vanishing Middle Class* (2017)


Deaton's Onward and Upward Curve
Life Expectancy at Birth vs. GDP per Capita in 1960 and 2010
Life Expectancy at Birth (Years)
30.0
40.0
50.0
60.0
70.0
80.0
GDP per Capita (2005 US$)
0
20000
40000
60000
JPN
SWE
USA
CHE
2010
CHN
BRA
SWE
USA
JPN
IND
1960
BRA
ZAF
NGA
ZAF
CHN
IND
NGA



Anne Case & Angus Deaton (2015)

Real Income Growth by Percentile, 1980 and 2016



Source: WID.world (2017). See wir2018.wid.world/methodology.html for more details.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%), growth was 74% between 1980 and 2016. The Top 1% captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

- Angus Deaton: *The Great Escape* (2013)
- Branko Milanovic: *Global Inequality* (2016)
- **Peter Temin:** *The Vanishing Middle Class* (2017) $\Rightarrow$ US focus

Thank you!