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

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Economic’s changing focus

- **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)
Economic’s ideological spectrum

- **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
Economic’s ideological spectrum

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(Although political rhetoric & those economists that make it onto TV skew towards the extremes.)
Economics's Core Disagreement

- **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
Economic’s Core Disagreement

- Perfect Markets vs. Imperfect Government:
  ⇒ Using “Government” to address distributional issues causes inefficiencies.

- Imperfect Markets vs. Imperfect Government:
  ⇒ Markets are prone to inefficiencies & produce inequalities that Government (institutions) can mitigate.
Economic’s Core Disagreement

- Perfect Markets vs. Imperfect Government
- Imperfect Markets vs. Imperfect Government:
  - *Kuznets & Piketty*: Economic development / growth evolves accompanying institutions

Kuznets (middle of the 20th century): Late-stage economic development will result in strong institutions to counter market imperfections ⇒ Decreasing inequality (eventually)

Piketty: Positive feedback due to growing inequality undermines strong institutions to counter market imperfections ⇒ Rising inequality / persistent high inequality
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    ⇒ **Decreasing inequality** (eventually)
  - *Piketty:*
    Positive feedback due to growing inequality undermines strong institutions to counter market imperfections
    ⇒ **Rising inequality** / persistent high inequality
Piketty:  
“\begin{quote}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.\end{quote}” (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.

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)
Empirics: change in metric

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Top 1% fiscal income share, USA, 1913-2015

- Fiscal income
- Top 1% share

Graph provided by www.wid.world
Empirics: rising inequality in income & wealth

Income inequality, USA, 1913-2015

Graph provided by www.wid.world
Empirics: rising inequality in income & wealth

Income inequality, USA, 1962-2014

Graph provided by www.wid.world
Empirics: rising inequality in income & wealth

Wealth inequality, USA, 1913-2014

- Red line: Net personal wealth | Top 1% | share | adults | equal split
- Blue line: Net personal wealth | Middle 40% | share | adults | equal split

Graph provided by www.wid.world
Empirics: Piketty’s Conclusions

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)
Empirics: Global Picture

Top 1% fiscal income share

Graph provided by www.wid.world

USA  Netherlands  France  Denmark  Spain
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
1. Inequality in labor income

2. Inequality in capital income

3. Inequality in inheritance
Inequality in labor income
- Due to effort / merit → “hypermeritocracy” . . .
- Due to imperfect markets (e.g. non-competitive CEO pay) . . .
- Due to wealth income masquerading as labor income (e.g. stock-based bonuses) . . .

Inequality in capital income

Inequality in inheritance

¹ Though history & race matters here, too!
Empirics: back to value judgement

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
Empirics: back to value judgement

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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  - 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
- Work and merit appeared to matter more than wealth

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1 For white men, at least.
End-1970s to now: recapturing of wealth by the top

- Public wealth → private wealth (privatization)
- Middle-class wealth → 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%\(^2\)

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\(^1\)Estimated $64k in 2013.

\(^2\)Top 1%, 2013: debt-to-inc. = 38% & debt-to-net worth = 2.6%.
Piketty: The “Golden Age” was a historical anomaly.
Piketty’s Prediction

Piketty: The “Golden Age” was a historical anomaly.

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, which they will use to maintain high level of wealth & income concentration.

2. 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, ...**
The Great Gatsby Curve

The Relationship between Income Inequality and Social Mobility

Around the world, high income inequality is associated with low social mobility.

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.
Critiques of *Capital in the Twenty-First Century*

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
Critiques of *Capital in the Twenty-First Century*

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
Critiques of *Capital in the Twenty-First Century*

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
Gini and JV-Ginis (G₀ and G₁) US 1921-2012
Based on IRS SOI Reports

G₀ is the Gini for the bottom 2/3 of income earners
G₁ is the Gini for the top 1/3 of income earners
\[ \alpha = r \times \beta: \]
“Share of capital income in national income equals rate of return times the ratio of capital to income”
⇒ Accounting Identity
1. \( \alpha = r \times \beta \):
“Share of capital income in national income equals rate of return times the ratio of capital to income”
\( \Rightarrow \) Accounting Identity

2. \( \beta = \frac{s}{g} \):
“Ratio of capital to income equals ratio of savings to growth rate”
\( \Rightarrow \) Simplistic dynamic . . . likely too simple!
   - \( s \) and \( g \) are unlikely to independently determined
   - Wealth / capital confusion changes the meaning
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$r > g$:
“The inevitable acceleration towards plutocracy depends on the rate of return being greater than the growth rate.”
⇒ 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)
Further Readings

- Branko Milanovic: *Global Inequality* (2016)
- Peter Temin: *The Vanishing Middle Class* (2017)
Deaton: Consequences of Unequal Economic Development

Deaton's Onward and Upward Curve
Life Expectancy at Birth vs. GDP per Capita in 1960 and 2010
Deaton: Consequences of Unequal Economic Development

White deaths are rising...
Mortality rate by race, ages 50-54

...in contrast to elsewhere...
Mortality rate for all causes, ages 45-54

...due in part to increases in 'deaths of despair'.
Mortality rate due to alcohol, drugs and suicide, ages 50-54

Anne Case & Angus Deaton (2015)
Real Income Growth by Percentile, 1980 and 2016


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.
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- Branko Milanovic: *Global Inequality* (2016)
- **Peter Temin**: *The Vanishing Middle Class* (2017) ⇒ US focus
Thank you!