REVIEW ESSAY

The problem of riches

Capital in the Twenty-First Century

Thomas Piketty (translated by Arthur Goldhammer)

BELKNAP PRESS, 2014

Reviewed by Paul Segal

Capital in the Twenty-First Century is a very important book that is not really about capital, and is not really about the twenty-first century. It is predominantly a work of analytical economic history, focusing on the late nineteenth century to the present – with words of warning for the future, nestled among caveats regarding the pitfalls of economic predictions. And its subjects are the dynamics and distribution of incomes and wealth, where wealth is to capital what an hourly wage is to an hour of work: the market value, not the thing itself.

Inequality is the great challenge of our time. Still, Piketty's runaway public success was expected by no one – his publisher ran out of copies in the first few weeks – and is due in no small part to generous endorsements from uber-public intellectual Paul Krugman, Nobel Prize-winning economist and *New York Times* columnist (and who sportingly admitted to 'sheer, green-eyed professional jealousy' (Krugman, 2014)). Piketty's book has spawned countless reviews and commentaries. Yet this text of 577 pages plus endnotes is no easy conquest, and the public sphere is occupied by more opinions of Piketty than readers of Piketty. In addition, the combination of fame and the ideological nature of its subject has given him the status of Big Game to be hunted by ambitious economists and journalists – very publicly in a belligerent and careful-but-not-quite-careful-enough critique by the *Financial Times'* Chris Giles that turned out to be badly misguided (Giles and Giugliano, 2014 and Piketty, 2014). (Piketty points out that if Giles were correct it would imply that Britain today had one of the most equal distributions of wealth in modern history, which is risible).

They are the 1 per cent

Given this exposure it is ironic that one of Piketty's great contributions to the lexicon of public debate is not usually credited to him: through his unearthing of data on the incomes of the richest 1 per cent, he is ultimately responsible for the slogan 'we are the 99 per cent', for without him we would not know who does not fall into that category (1). Starting with France, Piketty used income tax data to reveal the incomes of the richest in society, which had previously been inaccessible. Following this work, Piketty and the great British economist of inequality Tony Atkinson led a project of dozens of researchers to collect top income data from around the world, which have been collated into a database that now covers 29 countries (2).

The key finding of this research is that the income share of the richest 1 per cent has risen dramatically in many countries around the world since the 1980s. In the US the richest 1 per cent received about 8 per cent of total income through the 1960s and 1970s. This share started to rise in the mid-1980s, reaching about 18 per cent in recent years. Britain followed a similar pattern, its share rising from a low of only 6 per cent in 1980 to 15 per cent. Famously egalitarian Sweden has become less so, having seen its top 1 per cent income share rising from only 4 per cent in the 1980s to 7 per cent. Still, it is important to note that major increases were not inevitable: in both France and Japan there has been only a modest rise, from about 7 per cent in the 1980s to about 9 per cent now.

The greatest increase in top incomes has occurred in Anglo-Saxon countries, and is due to the rise of the 'super-manager': senior executives in both finance and the rest of the corporate world whose salaries and bonuses have soared in the last three decades. The standard right-wing defence of huge top incomes is that they represent the marginal product, or value added, of their beneficiaries. As a scientific explanation this is standard neo-classical economics – if the heroic efforts of a super manager will add $10 million to a firm's shareholder value then its shareholders will be willing to pay anything up to $10 million to retain him (3).

Piketty gives a novel and convincing knock-down of this argument. He points out that in most cases there is simply no way to assess the value added by a manager. Consider the CEO of a multi-national firm with gross revenues of $10 billion. How much extra value does he produce compared to the next guy who might do the job? Is it $100,000, or $1 million, or $10 million? If revenues increase by 10 per cent, does it mean the CEO has himself created an additional $1 billion of revenue, or would it have happened without him? There is no objective and reasonable way to evaluate these questions that would not have a margin of error far larger than the salaries themselves. If shareholders really wanted to pay executives their marginal product, they would have no way of knowing how to calculate it.

The cause of rising executive pay is a matter of continuing debate, and Piketty's preferred argument is that the massive top-rate tax cuts in Anglo-Saxon countries in the 1980s increased the return to bargaining hard for higher incomes. Over 1932 to 1980 the top federal rate of income tax in the US averaged about 80 per cent, meaning an extra $100,000 of income netted you only $20,000 – for a senior executive, hardly worth fighting your shareholder bosses over. In the UK the top tax rate averaged 89 per cent. In the 1990s that tax rate had fallen to 40 per cent in both countries, more than tripling that net return to $60,000 dollars and thereby increasing the incentive to negotiate for higher pay. While this is unlikely to be the whole story, it is doubtless part of it.

Wealth and inheritance

A central theme of *Capital in the Twenty-First Century* is that income inequality is inextricably connected to wealth inequality, and much of Piketty's narrative concerns the fall and rise of wealth. Up until the First World War, the total value of all wealth was equal to about seven times national income in each of Britain, France and Germany. The world wars and the Great Depression dealt an enormous blow to wealth in Europe, with the result that its value had fallen to two to three times national income by 1950. Social democrats take note: much of the mid-century egalitarianism to which we look back with nostalgia was due to a blunt levelling-down caused by physical and economic destruction. But – to quote another paper co-authored by Piketty – capital is back: since 1950 the value of wealth in the economies of Europe has been rising and currently stands at five to six times national income in Britain and France, and four times national income in Germany.

While rising wealth sounds rather pleasant, the problem, of course, is that wealth is distributed extremely unevenly – much more so than income. While the richest 10 per cent enjoy 28 per cent of total income in a relatively egalitarian country like Sweden, the wealthiest 10 per cent own around 60 per cent of all wealth. In the US the top 10 per cent receive nearly 50 per cent of all income, but own 70 per cent of all wealth.

Wealth is not only distributed more unequally than income, but more of it is also clearly unearned. In France – the only country with comprehensive data on inheritance and gifts, though other rich countries have probably had similar experiences

– nearly 70 per cent of all wealth today was acquired by inheritance. Among the cohort born in the 1970s, a historically-unprecedented 12 per cent of individuals will inherit more money than the average person in the bottom half of the income distribution can expect to earn over a lifetime. This is roughly equivalent to 'a life at minimum wage' (p. 420), or about 750,000 euros (£600,000) (4). This 12 per cent is higher than during the even more unequal *Belle Epoque*, because lower wealth inequality means that there are fewer extraordinary fortunes passed down, and more merely substantial ones. Indeed, that amount will buy you a house in London, but not a large one, nor even a modest one in fashionable Islington (5).

This reviewer felt his ears prick on reading that 'those born in the 1970s and 1980s, have already experienced (to a certain extent) the important role that inheritance will once again play in their lives and the lives of their relatives and friends'. Indeed: for those of us in our 30s, owning property in London has become something of an inherited privilege. While most of our parents have not passed away, some of them have scaled down their own homes and gifted the difference to their children, enabling them to buy in the capital. My only acquaintance of my age with the means to buy a house in London without parental help is a brilliant financial trader, whose job is to ensure his firm receives a slightly better price in every financial transaction – thus making money for them only at the expense of other similar firms, the net effect producing no discernible social value.

Theorising inequality

Piketty is not content with producing and reporting new data on incomes and wealth. He theorizes the dynamics of wealth and incomes through an analysis of the net return to wealth, r, and the growth rate of total incomes, g. For the first time in history, through much of the twentieth century g was higher than r, both because of high growth and, owing to financial regulations and taxes, a low r. This contributed to the decline of wealth relative to incomes.

Now, however, we have returned to a world with $r > g$, which he calls a 'fundamental force for divergence'. His argument is that when $r > g$, wealth will grow faster than incomes, leading to a rising wealth-income ratio. This rising wealth-income ratio affects inequality through what he calls the 'first fundamental law of capitalism': an accounting identity stating that capital's (i.e. wealth's) share of national income is equal to the wealth-income ratio times the return to wealth r. Thus if the value of wealth is 600 per cent of national income and $r = 5$ per cent, then capital receives 30 per cent of national income. This yields the logic of rising inequality: when wealth grows faster than incomes, capital's share of national income rises, and since capital (wealth) is so unequally distributed, this will lead to rising inequality (6).

Piketty's '$r > g$' and its implications for inequality have become controversial among economists because at times he appears to neglect the role of savings. In the 1950s and 1960s Keynesian economists such as Nicholas Kaldor and James Meade discussed the dynamics of wealth and incomes, and pointed out that savings rates are fundamental – they matter both to the wealth-income ratio, and to inequality. First, no matter what the return to wealth r, the amount of wealth will rise only if enough of it is saved. If the wealthy consume all their income, including from their capital, then their wealth will not increase. Indeed, Piketty shows us that this was the case for the wealthiest Parisians in the inter-war years, who continued to live as they had become accustomed during the *Belle Epoque* but, because of the decline in r, consumed some of their wealth in order to do so – thereby bequeathing diminished fortunes to their children. Second, wealth inequality will rise only if the rich save a higher share of their incomes than the poor – which they generally do. While Piketty is well aware of the role of saving and refers to it numerous times, he too often skates over it. Still, $r > g$ certainly matters because high r means the wealthy have high incomes and are therefore likely to save a higher share – that is, as the Parisian example suggests, the savings rate of the rich itself depends on r – while low g means that everyone else's incomes are growing slowly.

Indeed, the net savings rate s takes pride of place in his 'second fundamental law of capitalism', which states that the wealth-income ratio in the long run is equal to s/g. Thus if $s = 12$ per cent and $g = 2$ per cent, then the wealth-income ratio will settle at 600 per cent. Here is how to think about this relationship: s tells us what share of income gets added to the stock of wealth next year, while g tells us how much bigger incomes are next year. If the wealth-income ratio is less than 600 per cent, then 12 per cent of income represents more than 2 per cent of wealth, meaning that wealth grows by more than 2 per cent – leading to a rise in the wealth-income ratio. If the ratio is more than 600 per cent then 12 per cent of income represents less than 2 per cent of wealth and the ratio will fall. So the long-run equilibrium is 600 per cent. And this is why wealth-income ratios have risen since mid-century, when the ratio dropped below its equilibrium level.

Historical indeterminism

Despite his interest in economic theory, Piketty is a strong believer in the roles of historical events, policies and institutions in determining inequality (a fact curiously ignored by some reviewers who have inexplicably accused him of 'economic determinism'). Even if he calls the inequality $r > g$ 'the fundamental structural contradiction of capitalism' (p. 572), he shows that this 'force of divergence' was massively overtaken in the twentieth century by two world wars, a crisis of capitalism, and several decades of governments' ensuing regulatory responses. He remarks that 'a quick glance at the curves describing income and wealth inequality or the capital/income ratio is enough to show that politics is ubiquitous and that economic and political changes are inextricably intertwined and must be studied together' (p. 577). The point works across countries as well as across time: the details of 'Rhenish capitalism', including worker representation and voting power on boards, help to explain Germany's lower wealth-income ratio, as broader stakeholder representation makes capital less valuable to its owners (though not to society).

Political change does not just drive economic change. Piketty's hope is that the recent surge in inequality will in turn engender a political response. Just as the growing importance of inherited wealth sits very uncomfortably with the ideal of social mobility, Piketty's 'fundamental force for divergence' $r > g$ is a social problem even when applied to those who earned their wealth. One of the best lines in the book is that 'The logic of $r > g$ implies that the entrepreneur always tends to turn into a rentier', because 'the fact that a person has good ideas at age thirty or forty does not imply that she will still be having them at seventy or eighty, yet her wealth will continue to increase by itself' (pp. 395-6).

Just like inherited wealth, this is a fundamental challenge to the idea of the good society under capitalism, as the latter assumes that people deserve most of the differential rewards of their labours. It is the counterpart of the concern that, as Tony Atkinson has put it, 'inequality of outcome in one generation leads to inequality of opportunity in the next' (Atkinson, 1998, vi). Rentiers can be born or made, and we ought to be concerned in either case.

(I am reminded of the unedifying sight of Jethro Tull's Ian Anderson (2006) begging in the *Financial Times* for an extension of music copyright protection from 50 years to 70 years – an extreme form of government-sponsored rentierism – citing the need to pay 'nursing home bills'. (Rock stars are supposed to be shameless, but surely not in this way). Apparently artists shouldn't have to make provision for their pensions, unlike the rest of us. Lamenting 'the loss of this huge cultural and financial asset to the exchequer and the copyright owners' as copyrights expire, he failed to notice, as the rich so often do, that his loss was necessarily a gain to the public. Sadly for almost everyone, the European Commission and the British government took a similar view and duly extended these unnatural monopoly rights).

As inequality rises and wealth becomes increasingly unearned, how can a democratic capitalist society respond? Regarding income inequality, Piketty advocates taxing incomes above $500,000 or $1 million at a rate of 80 per cent. Importantly, the point is not to bring in revenue, because it would probably bring in very little – remuneration at the top end would probably fall dramatically, given the small return to higher salaries. But given that taxes at this rate did not slow down growth in the past, and that countries that still have high top income tax rates have not fallen behind the US and the UK, the evidence indicates that their loss would be everyone else's gain.

How does this work? The knock-on effect of top incomes on everyone else's incomes, or what economists call general equilibrium effects, are rarely acknowledged, and indeed Piketty does not spell them out. But next time you hear someone suggest that a concern with top incomes can only be driven by envy, recall that, one way or another, the rest of us have to pay for those incomes: as workers, higher pay at the top means our salaries have to be lower; or as consumers, it raises the prices we face; or as pension-holders, it lowers share prices and profits that fund our retirement. Again, since the evidence shows that excessive pay at the top does not increase the size of the pie, their ever-growing slice comes at everyone else's expense, and trimming it would leave more for the rest of us.

Piketty's most radical idea is a global tax on wealth. He admits it to be utopian, but that is because of a lack of political will, not because of any insurmountable practical barriers. Like a much-higher top income tax, the most important step for him is not to raise large revenues. It is essential, instead, to ensure that all wealth is registered so that democratic societies at least know what they are dealing with. That is, it will allow us 'to regulate capitalism'. To those who find it too far-fetched, he points out that a national progressive income tax seemed a utopian ideal in the nineteenth century.

Piketty's book, and his work more generally, represent a leap forward in our understanding of what may be the greatest problem facing our society. His data and analysis are essential prerequisites to allow democratic processes to address it. Unfortunately, Piketty has also shown that the great mid-century fall in inequality that enabled the creation of social democracy was due to multiple crises, and that 'there was no gradual, consensual, conflict-free evolution toward greater equality' (p.

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275). Many hoped that the financial crisis of 2008 and the ensuing recession would help to shake up today's neo-Gilded Age economic structures. But it took more than just the Great Depression to do the job last time. The global rich are well aware of the stakes: at the 2012 World Economic Forum meeting at Davos, 'severe income disparity' was featured as the single most likely global risk, and with one of the highest potential impacts (World Economic Forum, 2012). In 1913, just before the outbreak of the First World War, the historian and socialist theorist R. H. Tawney observed that 'what thoughtful rich people call the problem of poverty, thoughtful poor people call with equal justice a problem of riches' (Tawney, 1913, 10). Let us hope that this time around we find a solution to the problem of riches that does not require global catastrophe.

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Notes

1. The Wikipedia site on the phrase (accessed 18.7.2014) credits an article by Joseph Stiglitz titled 'Of the 1%, by the 1%, for the 1%', but Stiglitz was citing figures for the US produced by Piketty and his co-author Emmanuel Saez (Piketty and Saez, 2003).
2. With co-authors Facundo Alvaredo and Eduardo Saez they have collected these data at the World Top Incomes Database: http://topincomes.g-mond.parisschoolofeconomics.eu/.
3. It is, of course, possible to believe that this is the explanation for high salaries without believing that such salaries are thereby morally justified.
4. This interpretation also works in the UK, where 50 years of full-time work at the current minimum wage of £6.31 yields a total of approximately £600,000.
5. In April 2014 the average price of a detached house in Greater London was £767,150, and that of a terraced house in Islington was £925,445 (source: www.landregistry.gov.uk).
6. Though *r* might be expected to decline as total wealth rises (the standard economic presumption of diminishing marginal returns to capital), Piketty argues it is unlikely to decline sufficiently to counteract the rising wealth-income ratio.

And there are many articles out there outlining the rich people problems that include a list of things like length of boat, which country to visit next, what charity cause to invest in, dealing with all the people hired to do regular things, etc. But here I want to talk about the actual problems. Not the stuff that shows how money makes you greedy and pretentious, or how it lets you feel invincible and superior to others. But the real worries that go together with having a lot of money and living the lifestyle of a rich person. Iâ€™ve seen things and have my opinion. Here I want to share my thou Volume 36 Issue 1. A Problem of Riches: Towards a English | FranÃ§ais. Journal of Social Policy.Â DIAMOND, PATRICK 2008. S. Lansley (2006), Rich Britain: The Rise and Rise of the New Super Wealthy. London: Politico. Â£18.99, pp. 265, hbk.. Journal of Social Policy, Vol. 37, Issue. Crazy Rich Asians. China Rich Girlfriend. This novel is a work of fiction. Names, characters, businesses, organizations, places, events, and incidents either are the products of the authorâ€™s imagination or are used fictitiously. Any resemblance to actual persons, living or dead, events, or locales is entirely coincidental. Copyright Â© 2017 by Tyersall Park Ltd. All rights reserved. Published in the United States by Doubleday, a division of Penguin Random House LLC, New York. www.doubleday.com.Â Detail right. PROBLEM NO. 1. Your regular table at the fabulous restaurant on the exclusive island where you own a beach house is unavailable. Harbour island, the bahamas, january 21, 2015.