

## The Piketty phenomenon and the future of inequality

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Economists and other social scientists tend to study “problems”. Issues not studied tend to be seen as “natural”. “Poverty” and the “poor” are problems, the subject of a vast social science literature. Inequality, income concentration, the behaviour and influence of the super-rich tend to be treated as part of the natural order of things, warranting no more than marginal social science attention. We have a “poor economics” but no “rich economics”.

Mainstream economists have tended to emphasise the need for inequality as a source of incentives for effort and creativity, from which the whole society benefits; and to agree that higher taxes on the rich and increased aid to the poor are likely to hurt economic growth.

Willem Buiter, former professor of European economics at the London School of Economics and currently chief economist, Citigroup, succinctly expressed a common nonchalance: “Poverty bothers me. Inequality does not. I just don’t care” (2007). The Nobel Prize economist Robert Lucas was more aggressive: “Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion, the most poisonous, is to focus on questions of distribution” (2004). Earlier the famous neoliberal economist Ludwig von Mises declared his love for the anti-egalitarian, anti-democratic message of Ayn Rand’s *Atlas Shrugged*. He wrote to Rand in 1958, “You have the courage to tell the masses what no politician told them: you are inferior and all the improvements in your conditions which you simply take for granted you owe to the efforts of men who are better than you” (in Frank, 2012: 147).

Conservative politicians have long celebrated inequality and trickle-down economics. Prime Minister Thatcher assured her public, “It is our job to glory in inequality and to see that talents and abilities are given vent and expression for the benefit of us all”. Prime Minister Blair, of the center-left, told one interviewer: “If you end up going after those people who are the most wealthy in society, what you actually end up doing is in fact not even helping those at the bottom end.”

The US Republican Party has been committed to defending the interests of the wealthy over those of ordinary families. The biggest tax cuts presided over by President George W. Bush were on income from investments and on heirs to large fortunes: the top rate on dividends fell from just under 40% to 15%, and the estate tax was eliminated. The Republican tax plan during the second Obama administration would enable someone living off investment income to pay no federal tax at all. In Britain, the Conservative Party’s Prime Minister David Cameron vetoed the idea of a “mansion tax” on the grounds that “our donors will never put up with it” (Eaton, 2014).

Many in the business world have welcomed this relaxed attitude towards the rich. Bernard Arnault, CEO of the French luxury group LVMH, boasted in 2000 (when he was said to be the 10<sup>th</sup> richest person in the world), “Business, especially international ones, have ever greater resources, and in Europe they have acquired the ability to compete with states.... Politicians’ real impact on the economic life of a country is more and more limited. Fortunately” (quoted in Halimi 2013).

## A publishing sensation

Thomas Piketty's book, *Capital in the Twenty-First Century*, was published in English translation in March 2014. As of April and May 2014 the book hit number one on Amazon's best-seller list (including fiction). BookData reports that UK sales in the eight weeks following late April were 14,445. The Economists' Bookshop, next to the London School of Economics, says it has never sold so many non-fiction hardbacks in the first months of publication. The nearest competitor is Steven Hawking's *A Brief History of Time*, from 1988. An economist friend who mentioned his occupation to his London taxi driver was surprised and pleased to be asked whether he had read this book by a Frenchman named Piketty. Yet Piketty's is no bedside reading: its 685 pages weigh 1.1 kilos.

Its success makes that of the earlier, slimmer (only 330-page) book about the costs of inequality, Richard Wilkinson and Kate Pickett's *The Spirit Level: Why More Equal Societies Almost Always Do Better*, look almost modest. *The Spirit Level* has sold "only" between 250,000 and 300,000 copies in 24 languages since publication in 2009. The publicity storm around *Capital* will die down; the question is whether the book will remain in the pantheon or disappear when – if – robust economic growth returns.

How can we explain the book's astounding success? One obvious reason is a slew of extravagant reviews, some very favourable, others deeply hostile. Martin Wolf of the *Financial Times*, one of the world's most influential economic commentators, described it as "an extraordinarily important book" (2014a). Paul Krugman, Nobel laureate in economics and columnist for the *New York Times*, hailed it as "awesome", "truly superb", "the most important book of the year – and maybe of the decade" (2014b). John Cassidy in the *New Yorker* said, "Piketty has written a book that nobody interested in a defining issue of our era can afford to ignore" (2014). Other reviewers trashed it. Clive Crook's review on *BloombergView* was titled "The most important book ever is all wrong" (2014a). Allister Heath's in *The Telegraph* described it as "horrendously flawed" (2014).

Beyond the review pages, four main reasons for the book's success stand out. First, the book makes a carefully documented challenge to the belief that inequality is not a problem for public policy attention (Wade, 2007, 2011, 2012, 2013, 2014). Second, the Great Crash of 2008 and its aftermath – when surges of unemployment and underemployment went with surges in senior executive remuneration and in the share of the top 1 percent in national income growth – boosted the salience of inequality as a "problem" in political debate; so the ground for the book's uptake was already prepared. Third, it clarifies, objectifies, legitimizes and provides a kind of catharsis for heightened middle-class anxieties during the Great Recession since 2008. Finally, the book is in important ways reassuringly conventional in its analysis and prescriptions, and so less threatening to familiar ways of thought. At the end I discuss the future of inequality, and an intellectual and policy agenda.

### 1. The book challenges dominant beliefs about elites and inequality

Piketty challenges the earlier-described insouciance about inequality in an easy-to-read but authoritatively scientific way. His central point is that viewed over centuries income and wealth have tended to concentrate in the top few percentiles of the population, with only modest restraint from self-equilibrating mechanisms like social mobility.

The long term trend has been checked from time to time by some combination of (a) wars, depressions, hyperinflations, (b) highly progressive tax rates, and (c) high growth of productivity and population. The first two have lowered the rate of return on capital ownership; the third has raised the rate of economic growth and so raised the rate of growth of average incomes.

Thanks to these forces, the middle decades of the twentieth century, from the 1930s to the 1970s, saw an exceptional inequality decline in the West. But in “normal” conditions, including the period since the 1970s, the tendency to rising inequality re-emerges. The owners of capital (broadly defined, to include land, real estate, as well as factories and financial assets) accrue a rising share of national income, the suppliers of “labour” accrue a falling share. Piketty suggests that many developed economies in the past few decades have been moving up towards (but remain some way short of) levels of income and wealth inequality last seen in the early twentieth century. He further suggests that the much higher levels of inequality in today’s “emerging markets” will persist rather than subside unless strong policy measures are taken to rein them in or unless they experience wars, depressions or hyperinflations.

Moreover, Piketty’s and other data show that income and wealth concentration typically increases the higher the position in the hierarchy: within the top 1% of the population the top 0.1% have a disproportionately large share; within the top 0.1% the top 0.01% have a disproportionately large share. This pattern fits Zipf’s Law, which characterizes not just income distributions but also city size distributions, word frequency distributions, and more.

Why does income and wealth concentration increase the higher towards the top? One reason is that the rate of return on fortunes *increases* with the size of fortunes. Another is inheritance, as fortunes are passed from generation to generation – fortunes not just in material assets but also in the self-confidence learned from being brought up as a superior in social hierarchies. Piketty draws on the novels of Jane Austin and Balzac to show how inheritance dominated income distribution – and marriage strategies – in the eighteenth and nineteenth centuries.

The upshot is that money begets money, and the more money the more begetting (Henwood 2014). In Piketty’s phrase, “The past devours the future”. The future may see a return to the “patrimonial capitalism” of the eighteenth and nineteenth centuries, in which income distribution is substantially shaped by the distribution of inherited wealth. This is a society at complete odds with understandings of the good society shared across most of the western political spectrum today.

However, Piketty’s data show that Northwest European countries and Japan have experienced much less increase in concentration at the top than the US, UK and other Anglo countries (also tiny Iceland: Sigurgeirsdottir and Wade, 2014). In the former, incomes of the middle class and the poor have increased faster than in the Anglo countries, while their economies grew more or less as fast and levels of material well-being for ordinary people kept pace.

From this we can conclude, first, that the trend towards rising concentration is not quite as hard-wired into capitalism as most (but not all) of Piketty’s book says. Policies, institutions and politics – all changeable – have more of a role in income distribution than the more fatalistic passages say. Second, more equal economies are not necessarily less dynamic, and more unequal economies are not necessarily better at raising mass living standards, contrary to

default thinking. In other words, Anglo levels of income concentration are not necessary for a well-functioning society.

That being said, pointing to Europe as a place of significantly lower income and wealth concentration than the US raises a data problem. Gabriel Zucman's new research suggests that the fraction of European wealth hidden away in tax havens is substantially higher than the fraction of American income and wealth, which reflects higher rates of tax on top incomes and capital gains in Europe and therefore a stronger incentive for concealment. So European income and wealth concentration may be relatively higher than the tax return data suggests, as compared to the corresponding adjustment for the US. Zucman finds that the overall numbers for income and wealth concealment are huge – around 8% of global wealth of households is held in tax havens, most of it unrecorded, and most of it owned by residents of developed countries, especially Europeans (Zucman, 2013).

As these findings suggest, one can raise plenty of queries (nit-pickettys) about Piketty's data, especially about trends in wealth concentration, which is the most original part of the data set. *The Financial Times* launched an assault on Piketty's main conclusions, saying in an editorial that errors and data problems "seem to undermine his conclusion that wealth inequality is rising in the US and Europe"; indeed, "undermine his thesis that capitalism has a natural tendency for wealth to become ever more concentrated in the hands of the rich" (*Financial Times*, 2014a).

However, the *Financial Times* conclusions have been substantially rejected by former World Bank economist Branko Milanovic, who knows as much about the data as anybody and has worked independently of Piketty (Milanovic, 2014, 2011). A re-analysis of Piketty and the *Financial Times* comes to conclusions close to Piketty's and far from the *Financial Times*'. It turns out that the *Financial Times* did not make allowances for several changes in the methodology used to measure wealth distribution in Britain over time (related especially to the difference between tax return data and household income survey data, the latter underestimating income and wealth at the top by even more than the tax return data). So it took at face value – without adjusting for the methodology changes – that the wealth share of the top 10% in the UK did fall, *in reality*, by 12 percentage points during the 1970s and by another 11 percentage points in 2005-06. Piketty made the adjustment for the changes in methodology, and found a much higher wealth share in the top 10% (Elliott, 2014).

The *Financial Times* emerged with a bloody nose, having also ignored its own coverage of other indicators of income and wealth concentration such as soaring prices of high-end real estate, booming market for luxury goods, and bubbling market for equities. In May 2014 Christie's contemporary art auction in New York returned the world's highest ever auction total for one day: \$744mn; enough to build quite a few schools and hospitals (Barker, 2014).

Some critics dismiss the *future* relevance of the trends Piketty identifies, on two grounds. First, the intense rate of technological change (internet, mobile telecoms, digital economy) will accelerate economic growth in the West to the point where growth stays above the rate of return to capital; and this will drive income and wealth concentration down "by itself". Second, the whole world economy will grow faster thanks to growth in the "emerging markets", and this too will help to keep the concentration of income and wealth down. The message is, "this time is (or will be) different" (Worstall, 2014). But we have heard this message during every boom, and most insistently between 2000 and 2008.

## 2. Inequality became a heated topic after 2008

Piketty's challenge on its own cannot explain the book's success, because his broad findings are not new. Sharp increases in inequality in developed countries since the late 1970s, especially in the United States but also in other Anglo countries (including New Zealand: Rashbrooke 2013), have been well documented by others, though less comprehensively and without much data on wealth as distinct from income. They include Larry Mishel and co-authors at the Economic Policy Institute in Washington DC, who have documented rising income inequality in the US in periodic publications since the late 1980s. James K. Galbraith and colleagues at the University of Texas, Austin have used data on wages to examine trends in distribution since the 1960s, across developed and developing countries. As have Anthony Atkinson at Oxford and Gabriel Palma at Cambridge. The popular Nobel Prize-winning economist Joseph Stiglitz drew on a lot of existing evidence of fast-rising inequality for a recent book, *The Price of Inequality*, published in 2012; but it did not take off in the way that Piketty's has. With these and other cases in mind, I published an essay in 2012 called "Why has income inequality remained on the sidelines of public policy for so long?" (Wade, 2012; also Wade, 2014.)

Timing matters. Had the book been published before 2008 it would have been much less successful. So the second reason for *Capital's* success is that inequality and concentration had already risen up the public and political attention cycle by the time of its publication in early 2014. Many Americans, who used to dismiss concern about inequality as "the politics of envy", were stung by the excesses of Wall Street and dismayed that they could no longer borrow against rising house prices; and began talking of inequality more negatively than for decades. President Obama declared inequality to be "the defining challenge of our time" (Obama, 2013). Pope Francis tweeted that "inequality is the root of social evil" (quoted in Brown, 2014). The World Economic Forum's panel of global risk experts ranked "severe income disparity" as the second equal global risk over the next decade (World Economic Forum, 2012). The Occupy Protests framed the issue as the "top 1% vs. bottom 99%", as they occupied key sites in nearly a thousand cities in more than 80 countries in 2011-12 under the banner of "We are the 99%". Even Alan Greenspan, the former Fed chairman who calls himself a life-long libertarian Republican and devotee of Ayn Rand, has recently cited inequality as the "most dangerous" trend afflicting America (Tett, 2014).

Prominent figures among the super-rich hit back, furious at this questioning of their role in society as job creators for the common good, innovators for social betterment, and problem-solving philanthropists (Konczal, 2014). Prominent Wall Streeters accused President Obama of "demonizing" and "persecuting" the rich. Stephen Schwarzman, CEO of Blackstone Group (an American multinational private equity firm), declared that proposals to eliminate tax loopholes for hedge funds and private equity managers were "like when Hitler invaded Poland in 1939". Venture capitalist Tom Perkins wrote to *The Wall Street Journal*, "I would call attention to the parallels of Nazi Germany to its war on its 'one percent', namely its Jews, to the progressive war on the American one percent, namely the 'rich'" (both quotations in Krugman, 2014a). A sizable section of the American public supported the wealthy in their push-back out of anti-government sentiment. The Tea Party insurgency – financed largely by billionaires – preached that government measures of progressive taxation and social protection undermined the moral fabric of society by enabling some to free-ride on the hard work and creativity of others. By 2010 Friedrich von Hayek's *The Road to Serfdom* stood at 241 on the Amazon best-sellers list, exceptional for a book first published almost 70 years

before. It was propelled to these heights by seethingly conservative TV hosts advertising it as a guide to what the Obama government was trying to do to America through its efforts to reduce the great divides in access to health care, health status and life expectancy (Farrant and McPhail, 2010).

### **3. The book clarifies, objectifies and legitimizes middle-class anxieties after 2008**

The third reason for *Capital's* success is that it objectifies and legitimizes the anxiety that has pervaded large swathes of western societies since 2008. And crucially, it does so from within a conventional capitalist discourse; Piketty is not an outsider, a member of a heterodox sect who can easily be dismissed. His work serves the same purpose as a psychotherapist – it helps people to recognize that their experiences and feelings are legitimate.

The World Economic Forum's *Global Risks 2012* reports, "*On an unprecedented scale around the world*, there is a sense of receding hope for future prospects. Gallup polling data in 2011 reveal that, globally, people perceive their living standards to be falling, and they express diminishing confidence in the ability of their government to reverse this trend. This discontent is exacerbated by the starkness of income disparities" (2012: 18, emphasis added).

In the US, only 36% of respondents in 2011 said economic globalization is a positive development, down from 60% in 2001. A Gallup poll in 2011 asked respondents in many countries the question, "Does globalization bring more problems than it solves?". In Western Europe, 59% agreed or agreed strongly; in Asia and Pacific, 64% agreed or agreed strongly.

Employment in the US has been increasing since early 2010; but four mostly precarious, low-skilled jobs have been created in hotels, restaurants, healthcare and social assistance for every new job in manufacturing (Norris, 2014).

In Britain the Labour Party since 2012 has campaigned under the banner of "the cost of living crisis", meaning the long stagnation of middle-class incomes, uncertain career prospects for middle-class children, and job growth biased, as in the US, to internships, part-time and minimum-wage activities (the "precarariat").

In Germany, according to Markus Pohlmann, professor of sociology at Heidelberg University, "For the older generation [of managers], there was a kind of social pact by which the search for a consensus tempered the overriding obligation to pursue profit. That concept has vanished. Today it is the principle of human capital that prevails, according to which every individual is responsible for his or her own fate" (quoted in Cyran, 2013). The president of the powerful Federation of German Industry, Michael Rogowski, explained in 2005, "Labour has a price, just like pork. In the business cycle, prices are high when pork is hard to come by. Where there is a lot of pork about, prices fall" (in Cyran, 2013).

In the Eurozone the adult unemployment rate in Spain has been over 20 percent for three years, in Italy over 10 percent; and the biggest economic bloc in the world has languished in recession since 2008.

The other side of the zeitgeist is rage against the rich, fuelled by daily revelations of corporate wrongdoing combined with immense personal enrichment and immunity from prosecution. In 2009-12 some 93% of the increase in US national income accrued to the top 1% – in a stable democracy, not a kleptocracy like Equatorial Guinea (Klitgaard, 1991).

Anger and anxiety about living and employment conditions feed into a concatenation of other sources, including immigration, obesity, failing public health services, failing public schools, bankers' bonuses, unaccountable governments, dead-end Congress, globalization, terrorism, Islamic threat to our way of life, Russia swallowing its neighbors, "rising powers" challenging western rule, and weird weather. Every day in 2014 has woken to another intake of bad news.

In this context *Capital* has the appeal of a dystopian novel like *Nineteen Eighty Four* and *Brave New World*, by indicating the destination we are headed for if we do not change now. In that future the wealthy lift off from the rest of society and perpetuate their wealth from generation to generation like the nobility of old.

Then, having painted a dystopian future, the book ends with catharsis: an escape route to a fairer and more stable world. The trend of rising concentration at the top is not destiny; it can be changed by political choices, short of wars, depressions, and Apocalypse. The past need not devour the future (see below).

#### **4. The book remains reassuringly conventional**

A fourth reason for the book's success is that its basic "lens" or paradigm is reassuringly conventional. If the book had been called *Capitalism in the Twenty First Century* it would have been less popular, for "capitalism" easily slides to Marx, while "capital" has generally positive connotations. Even so, when a top-level executive of Deutsche Bank in London entered the office of a researcher and spotted *Capital*, he spat out, "Regurgitated Marxism!", leaving the researcher convinced he should not be seen around Deutsche with the book in hand (personal communication, June 2014).

Like neoclassical economics in general, the book concentrates on income and wealth distribution and says little about production – about the structure of power relations in the world of employment, notably between the owners and managers of capital and the rest. One does not have to be a Marxist to see that these power relations in production are a prime cause of pre-tax income distribution. To the limited extent that Piketty tries to *explain* income and wealth distribution he uses a fairly standard neoclassical marginal productivity explanation for distribution below the top one percent, and a sketchy "grab everything you can" for the latter. Thomas Palley comments, the mostly neoclassical framing "creates a *gattopardo* opportunity whereby inequality is folded back into mainstream economic theory which remains unchanged" (2014). *Gattopardo* refers to the famous line in *The Leopard*, "For things to remain the same, everything must change".

Piketty's re-distribution policy solutions – including a wealth tax – are also of a comfortingly conventional neoclassical kind (though they call for a much stronger redistribution of market income than has been achieved through current rates of tax progressivity, wage subsidies and social assistance). Had Piketty emphasised "pre-distribution" – changes in institutions and policies to make *pre-tax* income distribution less unequal, including in corporate governance law and trade union law – he would have been seen as more radical, more threatening, more marginal (Baker, 2011).

## The costs of inequality

It is striking that in the course of more than 600 pages, Piketty devoted almost no attention to *why* inequality matters. That would mean asking questions like: when are the rich too rich? When do the social costs of reducing their share outweigh likely social benefits?

For reasons suggested earlier, these have been largely taboo topics. But recently researchers in the International Monetary Fund – a pillar of global orthodoxy – have published findings about the macroeconomic costs of inequality (Ostry et al., 2014), findings which Martin Wolf of the *Financial Times* describes as “strikingly clear” (2014b). First, *countries with higher inequality tend to experience lower and more volatile growth*; countries with lower inequality tend to experience higher and less volatile growth, other things being equal. Second, *there is little if any trade-off between redistribution and growth*; so the growth costs of redistribution measures (like higher taxes) are typically less than the growth benefits of lower inequality.

The implication of the IMF’s and other evidence is that current levels of inequality in the Anglo countries make it difficult to achieve *adequate economic growth with financial stability* (unless by the unsustainable German route of repressed wages plus large export surpluses). High and rising income concentration generates savings glut at the top and underconsumption below. Governments are constantly tempted to engineer credit and asset booms. Credit remains too cheap and debt remains too high, and central banks then become reluctant to damage the debt-heavy economy by tightening monetary policy. Meanwhile *fiscal* tightening is hobbled by political paralysis and visceral rejection of “Keynesianism”. When the boom turns to bust, governments and central banks try to ease the ensuing hangover with loose monetary policy. But the bust is likely to usher in a “balance sheet recession”, when households and firms labour under far too much debt relative to income, as in Japan through the 1990s and 2000s and much of the West since 2008. Balance sheet recessions are difficult to escape from, because the chief objective of households and firms becomes to pay down debt; so private demand shrinks and monetary policy becomes ineffective. It can take years for the deleveraging process to be complete enough for economic growth to resume without riding on the back of more borrowing and still more financial instability. As *The Financial Times*’ Wolfgang Munchau says about Europe gripped by a balance sheet recession (which very low interest rates have not cured), “The most likely trajectory is a long period of slow growth, low inflation, and a constant threat of insolvency and political insurrection” (2014:13).

Wilkinson and Pickett’s *The Spirit Level* (2009) pulls together evidence on social and health costs, under the headings of life expectancy, child mortality, obesity, homicides, imprisonment rates, mental illness, teenage births, social mobility and trust. Using samples of more than 20 “advanced” economies and the fifty US states (the social mobility index is excluded for US states), it finds that the levels on all these variables correlate fairly closely with levels of income inequality, much closer than with average income. (It measures inequality as after-tax-and-benefit income of the richest 20 percent over the poorest 20 percent, or the Gini coefficient.) The striking finding is not just that health and social problems are more frequent among the poorer people in the more unequal societies; the overall burden of these problems is much higher in the more unequal societies.

Lawrence Katz’s recent research finds that US generational educational inequality is higher than almost all other industrialized countries, measured as the inverse of the percentage of adults who have a higher level of education than their parents; and that educational inequality



has increased (the proportion with education at higher levels than parents is lowest in the 25-34 year old cohort). (Katz, 2014; Porter, 2014)

Political scientists have found a startlingly high degree of “representational bias” or “representational inequality” in recent US politics. The finding is all the more dramatic because the “median voter” model (public policy responds to the preferences of the median voter in a well-functioning democracy) has been almost as central to political science as the competitive market model to economics. Martin Gilens summarizes: “Under most circumstances, the preferences of the vast majority of Americans appear to have essentially no impact on which policies the government does or doesn’t adopt” (2012:1). More specifically, when the preferences of the wealthy differ from those of the general public (on economic, financial, social welfare issues), public policy reflects the preferences of the wealthy, except in rare moments of radical social movements, such as the two “big bangs” of US social welfare policy in the 1930s and 1960s.

Research across European countries also finds a high degree of representational bias in favour of the wealthy. But it is typically less than in America, the difference probably reflecting more public financing for candidates, parties and media in Europe and therefore somewhat less dependence on private donors (Rosset et al., 2011; Mandle, 2004).

On both sides of the Atlantic we seem to be caught in a vicious circle, such that economic inequality generates inequality of governmental responsiveness, producing policies which favour the wealthy and disfavour poorer citizens, most of the time (Bartels, 2008; Hager, 2009). Breakaway nationalism, alienation, and antagonism to immigrants, minorities and governments are the all too common responses. Long ago Louis Brandeis (justice of the US Supreme Court from 1916 to 1939) urged: “We must make our choice. We may have democracy, or we may have wealth concentrated in the hands of a few, but we can’t have both.”

Wealth concentrated in the hands of a few reinforces institutional arrangements which keep sluicing pre-tax incomes upwards, often by enabling interlocking elites to create self-serving arrangements for themselves (far from “free markets”). Think of the elite networks of Wall Street, Washington, big agriculture, big energy, big universities (Brooks, 2014; Wedel, 2009). These privilege-protecting networks extend far beyond national boundaries, and coordinate national politics to advance the interests of the owners and managers of capital in high profits and low taxes, everywhere. The “mega-regional” trade deal currently under negotiation called the Transatlantic Trade and Investment Partnership (TTIP) is a case in point. Corporations on both sides of the Atlantic, including European giants like Siemens and France’s Veolia, are pressing for new privileges to take direct action against states that dare to threaten their profits by protecting employment, the environment and health rights. The deal is intended to strengthen the ratchet under corporate profits; to boost western business’ “ability to compete with states” and limit “politicians’ real impact on the economic life of a country”, in Bernard Arnault’s approving words.

Another part of the same syndrome is expanding acceptability of tax avoidance and wealth concealment. Rich people at London dinner parties boast that they pay almost no tax anywhere; and their tax lawyers boast that they can ensure this result with no risk of penalties (personal communications, June 2014). They seem entirely untroubled by the social implications of their actions. Zucman’s research reported earlier testifies to the magnitude of this behaviour.

## The future of inequality

For all the recent national and global attention to inequality, the chances that it will be curbed to a significant degree appear to be slim. The policies and institutions of the post-war decades which helped to drive inequality down – including high upper-bracket tax rates, laws protecting trade union bargaining power, financial sector constraints, capital controls, fixed exchange rates, and Left political parties which were left-wing (in contrast to today) – could not have happened without *elites being deeply fearful* of mass unrest, based on fresh memories of the Depression and war, strong trade unions, and the nuclear-armed Soviet Union providing an apparently plausible alternative to capitalism. As these fears waned, higher capital mobility generated competition between jurisdictions to offer favourable conditions, including “light touch” regulation, free capital mobility, privatization (of housing, energy, transport, children’s homes, adult social care), anti-union laws, pro-CEO-remuneration laws, and tax cuts on the rich and rises in indirect taxes (including the energy and water fees customers pay to the now-privatized utilities).

To the extent that western elites after the 1970s identified inequality as a problem, they domesticated it as “poverty”; reducing inequality meant reducing poverty. The middle-class professionals who staff the commentariate, the higher offices of state and the agenda-setting organizations like the OECD, the IMF and the World Bank are comfortable talking about helping “the poor”, “the other”; and all the major religions, as well as secular humanist philosophy, enjoin help for “the (deserving) poor”. Providing universal access to basic services and safety nets allows them to airbrush away the larger distribution structure. For if that larger structure is presented as a problem, then they themselves are part of the problem. Reducing inequality might mean taxing them and lifting up those not far below in the hierarchy, reducing the gap – threatening their status.

This helps to explain why self-styled centre-left parties have in recent decades made a tactical choice not to emphasise dangers of rising inequality. In the words of Roger Liddle, one of the principal strategists of the British New Labour Party:

“In the mid-1990s, the leaders of New Labour made a fundamental policy choice. In government [they had been out of government since 1979] they would not explicitly prioritise a lessening of inequalities between top and bottom. Instead their social justice priorities would be to tackle poverty, worklessness and economic and social exclusion.

Several reasons were clearly important in Labour making this choice.... [First, a sense] that intellectually Thatcherite neoliberalism was triumphant, and that the post-war welfare state consensus had irretrievably broken down and could only be rebuilt on a basis that incentivised (and did not penalise) hard work at all levels of society.

[Second], New Labour ... seized on the discourse of globalisation to provide a deeper intellectual rationale.... New Labour portrayed globalisation as an inexorable force of nature beyond political control – making irrelevant old egalitarian and interventionist social democratic responses and requiring a thorough rethink of the means of achieving social justice, if not a redefinition of its goals” (2007: 2).

But it was not just a matter of tactics. Leading centre-left figures really did believe in a moral society similar to that of conservatives: one in which, to quote two British theorists of the “Third Way”, “the key to justice as fairness can be seen in terms of the procedural securing of *opportunities* rather than a substantive commitment to patterned relative *outcomes*” (Buckler and Dolowitz, 2000, emphasis added).

Another leading intellectual on the British centre-left, Will Hutton, likewise defines “fairness” as rewarding individuals in proportion to the amount of discretionary effort they deploy to achieve socially useful results, provided they actually achieve them. The aim of a centre-left government should be to make access to riches dependent on “talent, effort and virtue”, as distinct from making outcomes more equal (Hutton, 2010).

But for all that it has been vital to the center-left’s defence for ignoring inequality of outcomes, the rationale for prioritising equality of opportunity over outcomes bears little scrutiny. Research shows children of wealthy parents have far wider market opportunities than children of poor or middle-class parents, through multiple channels (Summers, 2014; Boucher, 2013).

## **An agenda**

The key lesson from Piketty’s book is that, at present and likely future levels of income and wealth concentration, capitalism is losing its core claim to legitimacy – that it provides incentives for hard work, entrepreneurialism and innovation while at the same time it defends individual liberties and ensures a sufficiently equal distribution of material benefits to sustain a social compact between classes and protection to those near the bottom of the income scale. The evidence is fairly clear that income concentration at or above present Anglo levels tends to depress economic growth; worsens public health and a range of social problems across the society, not just among the poor; and strengthens political capture by the rich, whose policy preferences tend to reinforce income inequality. The evidence is also fairly clear that inequality can be reduced without the societal costs of doing so outweighing the societal benefits.

Piketty’s main proposal – a global wealth tax – is easily dismissed as utopian. *The Economist* sniffs that “Mr Piketty’s focus on soaking the rich smacks of socialist ideology, not scholarship” (*Economist*, 2014). But it is not as utopian as might be thought at first glance. The US government taxes citizens wherever they live and work in the world. In recent years the government has elicited “cooperation” from several key foreign jurisdictions, notably Switzerland, to comply with US standards and hand over bank details of American citizens. A global wealth tax could build on this cooperation (Crook, 2014b). A necessary condition is a global registry of wealth similar to land registries, which countries have had for centuries. Recording who owns the world’s equities and bonds would make tax evasion a lot more difficult (Zucman, 2013).

Also, national governments could feasibly do more to tax wealth than at present without waiting for international cooperation across tax jurisdictions – and then cut income tax or value-added tax (Morgan and Guthrie, 2011). For example, the UK tax system presently encourages people to own big houses, because high value houses are taxed (by Council Tax) much less as a proportion of their market price than cheap ones (Dixon, 2014). It would be quite feasible for the government to levy a flat percent of the price of the house; or at least

place an extra levy on Council Tax for houses owned by “non-doms” who live in the UK but are not domiciled for tax purposes. New York City’s former mayor Michael Bloomberg pays property taxes on his \$20 million London house of a mere \$3,430 a year. The government should also place an extra levy on empty properties, which currently enjoy a Council Tax *discount*. The latter is particularly egregious, because – in wealthier parts of London – houses and apartments have become a place for the world’s super-rich to park their money at an annual rate of return of 10 percent, rather than a place to live. The minimal tax paid by those treating real estate like a global reserve currency gets reflected in failing public services, including a school capacity shortfall in London projected to be 90,000 places by 2015 (Goldfarb, 2013).

However, the focus on wealth distribution does miss an important point. If we take Piketty’s figures at face value and put aside Zucman’s evidence on income and wealth concealment, then only about a third of the income of the top 1% (in US) is capital income; two thirds is “labour” income – e.g. super-salaries and super-bonuses. Trends in market income distribution (before tax) are driven more by the determinants of labour income distribution than wealth distribution, so far. Remedies for soaring income concentration have to tackle labour income concentration, which is not directly hit by wealth taxes.

To have a hope of reversing the trends we must aim to limit the scope for the owners and managers of big capital to control society in their search for higher productivity and expansion into new areas of geographic and sectoral commercialization. That means rejecting or reframing a set of commonplace ideas that have served to obscure this fundamental point. They include: economics is a value-neutral study of choice in conditions of scarcity (DeMartino and McCloskey, 2014); the economy is a self-equilibrium system into which the state sometimes “intervenes”, often dysfunctionally; more equality of “opportunity” can substitute for more equality of outcomes; “labour” is a commodity, as in “labour has a price, just like pork”; austerity is expansionary, as in “Austerity is the only cure for the Eurozone”, in the words of German Finance Minister Wolfgang Schauble (2011); financial markets, including currency markets, “get the prices right”, in the same way as normal goods markets; more equality of income is to be achieved by “redistribution” through the tax and benefit system and not by “predistribution” to change the policies, laws and institutions that shape market income; and finally, “we must go beyond left and right”.

Finance must be curbed, but in simple ways, not in the manner of the Dodd-Frank Act, whose 848 pages contain holes big enough to drive a coach and horses through. The core de-financialization prescription is simple: end the subsidies to banks thought too big to fail (the Bank of England calculates that the world’s 29 most significant banks received around half of their profits from these subsidies in 2002-2007); and more broadly, “force banks to fund themselves with equity to a far greater extent than they do today”, with a true leverage ceiling no greater than 10 to one (Wolf, 2014c; also Alcaly, 2014).

The danger in the current orgy of law- and rulemaking around finance and monetary policy is not only that it makes things too complex to work. It is also that it focuses on only one wing of the bird. The other more neglected wing is the global monetary system. The magnitude of the booms in housing and other asset markets through the 2000s in the US and southern Europe could not have occurred without giant current account deficits and accompanying capital inflows. The protracted recession in the Eurozone since 2008 has been caused in significant part by Germany’s chronic black hole of demand, in the form of ballooning current account

surpluses, which in 2014 might amount to 8 percent of GDP; yet the German government holds up Germany as a model for others to emulate.

The magnitude of the booms over the 2000s in many other countries could not have occurred without vast short-term capital carried from low interest rate countries to countries with inflation-fighting high interest rates, thereby appreciating the currency of the latter and worsening their current account deficits (Wade, 2009). (Iceland is a classic case: Sigurgeirsdottir and Wade, 2014.) The *Financial Times* highlights the problem in an editorial which begins, “The past couple of months have been one of those rare and precious times when foreign exchange markets move the way they are supposed to” (*Financial Times*, 2014b).

No amount of Dodd-Frank-type financial regulation could have done much to check the destabilizing effects coming from unreformed international capital markets.

So regulation of the financial sector must be complemented by substantial reforms in the global monetary system aimed at limiting the size of current account imbalances and limiting the movement of exchange rates in the wrong direction. This means further legitimizing national governments’ use of quantitative restrictions on capital mobility, and moving to “a system of managed flexible exchange rates which aims for a rate that is consistent with a sustainable current-account position” (UNCTAD, 2009:127).

At a more abstract level of analysis, we must reframe the whole discussion of state and market, in at least two ways. First, change the prevailing narrative of “deregulation” as “more free market” and “regulation” as “more state”. Even people on the left use this framing, as in: “We need regulation to curb the dangers of free markets.” But it is misleading. The issue is not regulation or deregulation, because there is no such thing as a free or unregulated market. The crucial but neglected question is: regulation to benefit whom, regulation in line with broadly shared social values or in line with the preferences of the wealthy elite? The call for “market deregulation” is often a smokescreen; it tends to conceal continuing state actions (policies and institutions of the “pre-distribution” kind) that directly and indirectly drive money and power up. Second, insist that “market” means not only private (profit-maximizing) companies but also social enterprises, cooperatives and limited liability low-profit companies; and insist that public bodies outsourcing contracts weigh not just the cheapness of the bid but also the benefits of mutualism, permanence and participation. An expanding sector of social enterprises and low-profit companies is a bottom-up means of limiting the power of capital to control society.

But at least in the United States and the United Kingdom, the twin centers of global finance and setters of global rules, much of this agenda will remain written on sand until there are tighter limits on private spending for political parties, candidates and electoral advertising. Without tighter limits on private spending democratic politics will continue to produce strong representational bias in favour of the wealthy, as wealth begets influence and influence begets wealth. Yet when the UK Committee on Standards in Public Life published “Political Party Finance: Ending the Big Donor Culture” in November 2011, and the prime minister presented it to parliament, the report died on the day of presentation. None of the parties wanted to run with its proposals for limiting the role of big donors.

So we come back to the essentially political question: if the inequality-reducing measures of the 1930s to the 1960s came about because governing elites were fearful, what kinds of

threats might induce a similar response today? The system we call “capitalism” has demonstrated a striking ability to adapt, and within its capacious boundaries are varieties a lot less prone to rising inequality than the Anglo variety has been. But pessimistic news about reining in Anglo inequality comes recently from Amazon. For years Hawkings’ *A Brief History of Time* held the record for least number of pages read (on e-books); the average reader quit around page 16. Piketty has broken the record; the average reader quits around page 12 (<http://online.wsj.com/articles/the-summers-most-unread-book-is-1404417569>).

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Piketty challenges the earlier-described insouciance about inequality in an easy-to-read but authoritatively scientific way. His central point is that viewed over centuries income and wealth have tended to concentrate in the top few percentiles of the population, with only modest restraint from self-equilibrating mechanisms like social mobility. Then, having painted a dystopian future, the book ends with catharsis: an escape route to a fairer and more stable world. The trend of rising concentration at the top is not destiny; it can be changed by political choices, short of wars, depressions, and Apocalypse. The Piketty phenomenon needs no introduction: *Capital in the Twenty-First Century* (2014) remains the best-selling book ever published by Harvard University Press, and since it appeared in English in 2014, Thomas Piketty and his small group of frequent collaborators have turned up everywhere. There is Piketty, writing a column in *Le Monde*, or anatomizing the rise of private capital in China, or charting the emergence of Russian oligarchs. For all its ambition and the enthusiasm of its reception, *The Great Leveler* probably does not show us the future of studying inequality, and not only because Scheidel's erudition would be difficult to emulate. Unrepeatable and unexpandable, *The Great Leveler* seems to allow for no further development, nowhere left to go. Why has Piketty's *Capital* become a publishing sensation? Not for revolutionary findings; its message that western societies have experienced | Find, read and cite all the research you need on ResearchGate. Besides its reception in academia, *Capital* has also been described as a 'media event' as the book and the issue of socio-economic inequality has been reviewed and discussed numerous times in blogs, newspapers and online media. Wade (2014) suggests that an important factor for the high interest is the timing of the book's publication as it falls in the changing debate after the 2008 crisis where issues of inequality, secular stagnation and the current trajectories of capitalist developments have become more prominent. Thomas Piketty's voluminous 2013 book, *Capital in the Twenty-First Century*, created a rare academic frenzy in this country and beyond. It did so by playing a major role in offering a specific explanation for growing inequality, supported by an incredible amount of historical and statistical evidence going back to the 18th century in France, the United States, Britain, and Germany. Increasing inequality is thus part of the very nature of capitalism, Piketty observed, and can only be checked through various kinds of state intervention. Critics of Piketty's book abound in all parts of the political spectrum, but it cannot be denied that *Capital in the Twenty-First Century* symbolized an emerging ethos in the wake of the 2008 financial crisis. Professor Robert Wade has contributed the lead article to the latest issue of the *Real-World Economics Review*, a special issue on Thomas Piketty's 2014 book *Capital in the Twenty-First Century*. Read the full article for free on the *Real-World Economics Review* website. Share this

Inequality is not driven by young hip professionals who arm their kids with every advantage and get them into competitive colleges; it's driven by hedge fund oligarchs. Well, of course, this book is going to set off a fervor that some have likened to Beatlemania. The book is very good and interesting, but it has pretty obvious weaknesses. Though economists are really not good at predicting the future, Piketty makes a series of educated guesses about the next century. Piketty predicts that growth will be low for a century, though there seems to be a lot of innovation around. He predicts that the Professor Thomas Piketty is Professor of Economics at Paris-based School of Advanced Studies in the Social Sciences and at the Paris School of Economics and Co-Director at the World Inequality Lab and World Inequality Database. It is in this context that the seminal work of Professor Thomas Piketty on the phenomenon of economic inequality gains additional significance today. Here he shares his perspective on this subject, including on its relevance to India. Host: Narayan Lakshman, Associate Editor, The Hindu. Find the In Focus podcast on Spotify, Apple Podcasts and Stitcher. Search for In Focus by The Hindu. Write to us with comments and feedback at [socmed4@thehindu.co.in](mailto:socmed4@thehindu.co.in). A letter from the Editor. Dear reader Thomas Piketty's new book examines historical and modern inequality, suggesting a "potentially terrifying" trajectory. I'll go further into that discussion in future posts, but first I thought it might be useful to portray the gist of Piketty's story in a series of charts. The charts aren't merely illustrative: they are an essential part of Piketty's contribution. The Piketty group didn't invent this way of looking at things. Other economists, such as Ed Wolff, of New York University, and Jared Bernstein and Larry Mishel, the creators of the invaluable State of Working America series, have long used similar charts and tables in their publications. Why has Piketty's Capital become a publishing sensation? Not for revolutionary findings; its message that western societies have experienced | Find, read and cite all the research you need on ResearchGate. Besides its reception in academia, Capital has also been described as a 'media event' as the book and the issue of socio-economic inequality has been reviewed and discussed numerous times in blogs, newspapers and online media. Wade (2014) suggests that an important factor for the high interest is the timing of the book's publication as it falls in the changing debate after the 2008 crisis where issues of inequality, secular stagnation and the current trajectories of capitalist developments have become more prominent. Piketty's (2014) Capital in the Twenty-First Century is the latest contribution in this line of work, especially with the new data it provides on capital and wealth. Piketty also proposes a framework for describing the underlying forces that affect inequality and wealth, and unlikely as it seems, a bit of algebra that plays an important role in Piketty's book has even been seen on T-shirts:  $r > g$ . I first highlight some of the key facts related to each type of inequality. Then I use economic theory to shed light on these facts. The theory that Piketty develops to interpret these data and make predictions about the future is best viewed as a first attempt to make sense of the evidence. Much like Marx, Piketty plays the role of provocateur, forcing us to think about new ideas and new possibilities.