Will 21\textsuperscript{c} capitalism be as unequal as 19\textsuperscript{c} capitalism?

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Paris School of Economics
Lecture at Van Leer Jerusalem Institute
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• **Q.**: What do we know about the long run tendencies of income & wealth distribution in capitalist economies?

• **A.**: Very little! Heated discussions & theoretical speculations for centuries... But relatively little scientific knowledge & data collection so far

→ **in this lecture**, I will try however to provide the best educated guess about the future, for two reasons: (a) we need answers; (b) we have more research than ever before
We need answers

• Long run distributional trends = key question asked by 19\textsuperscript{c} economists
• Many came with apocalyptic answers
• Ricardo-Marx: a small group in society (land owners or capitalists) will capture an ever growing share of income & wealth; no balanced development path can occur
• During 20\textsuperscript{c}, a more optimistic consensus emerged: “growth is a rising tide that lifts all boats” (Kuznets 1953; cold war context)
We need answers (contd’)

• But inequality ↑ since 1970s destroyed this fragile consensus (US 1977-2007: >50% of total growth was absorbed by top 1%)
  → 19C economists raised the right questions; we need to address these questions again; we have no strong reason to believe in balanced development path

• 2007-2009 crisis also raised doubts about balanced devt path... will stock options & bonuses, or oil-rich countries & China, or tax havens, absorb an ever growing share of world resources in 21C capitalism?
We have more research

• Top income project: Piketty JPE’03, Piketty-Saez QJE’03, Atkinson-Piketty Oxford University Press 2007 & 2010
  → series for 20+ countries over 20C
• Wealth project:
  • Piketty-Postel-Vinay-Rosenthal “Wealth concentration in France 1807-1994” AER’06
  • “On the long-run evolution of inheritance, France 1820-2050”, WP’09
• On-going work UK & US with Atkinson-Saez
• Q.: What do we know about the long run tendencies of income & wealth distribution in capitalist economies? Can we return to 19C inequality?
• A.: Yes, and it can get even worst
• (1): 20C decline in inequality of inherited wealth = mostly accidental (1914-45 shocks); nothing structural
• (2): Since 1970s, inequality in labor income has reached unheard of levels; not much to do with merit; grabbing hand; not virtuous invisible hand
Fall of Rentiers & Rise of Working Rich

- United States
- United Kingdom
- France
There are two ways to get rich...

- \( Y = Y_K + Y_L \) & \( Y_K = r \ W \)

  With \( Y = \) total income
  \( Y_K = \) capital income & \( Y_L = \) labor income,
  \( W = \) total wealth (=K if closed econ, no govt)
  \( r = \) average rate of return

  → Typically: \( W/Y=600\% \), \( r=5\% \), so that
  capital share \( \alpha = Y_K/Y = 30\% \)

  → Inequality comes from inequality of labor income \( Y_L \) & inequality of inherited wealth \( W \) (but wealth also comes from savings)
Orders of magnitude for $Y$ & $W$

- France 2010: National income $Y = 1\,700$ billions € (i.e. 35 000€ per adult)
- $W = 9\,500$ billions € (200 000€ per adult)
  \[ W/Y = 560\%: \text{on average individual wealth} = \text{about 5.5-6 years of income} \]
- On average: $Y_L = 26\,000€ & Y_K = 9\,000€$
  \[ \text{capital share } \alpha = 25\% \]
  \[ \text{average rate of return } r = 4.5\% \]
- There are still two ways to get rich…
The human capital illusion

• Illusion n°1: « today human capital has replaced old-style capital »; « modern growth = decline of coupon-clipping rentiers & triumph of meritocracy »

• In fact, non-human wealth $W$ (i.e. real estate + financial assets) & capital income $Y_K$ (i.e. rent + dividend + interest) did not disappear at all: **capital share $\alpha$ stable around 30% since 19$^c$ !**

• But $W/Y$ did follow a very pronounced U-shaped pattern during 20$^c$ → long-lasting illusion
The « war of ages » illusion

• Illusion n°2: « today the war of generations has replaced old-style class war »; « modern wealth accumulation = life-cycle savings, not inherited wealth »

→ It is true that inheritance virtually disappeared during 1950s-60s; but this was a purely transitory phenomenon

**Key intuition**: with $r > g$ ($r=4-5\%$ vs $g=1-2\%$), wealth coming from the past is being capitalized faster than growth, and is bound to dominate wealth coming from labor savings
Annual inheritance flow as a fraction of national income, France 1820-2008

- Economic flow (computed from national wealth estimates, mortality tables and observed age-wealth profiles)
- Fiscal flow (computed from observed bequest and gift tax data, inc. tax exempt assets)
Annual inheritance flow as a fraction of disposable income, France 1820-2008

- **Economic flow**: (computed from national wealth estimates, mortality tables and observed age-wealth profiles)
- **Fiscal flow**: (computed from observed bequest and gift tax data, inc. tax exempt assets)
Can wealth inequality ↑ 19C?

- Wealth inequality: astronomical levels around 1900-1910: Top 1% share ≈ 50%; Top 10% share ≈ 90%; tiny middle class
- Inequality started ↓ only after 1914
- Today: Top 1% ≈ 20%, Top 10% ≈ 50%, Middle 40% ≈ 40%, Bottom 50% < 10%...
- Why no recovery since 1945? Progressive tax & income growth? This can change
- & today’s top wealth shares are probably under-estimated: tax havens etc.
- Impact of ’07-’09 crisis on W inequality? ↑?
Wealth concentration, Paris and France, 1807-1994

Top 1% wealth share (Paris)

Top 1% wealth share (France)
<table>
<thead>
<tr>
<th>Category</th>
<th>1900</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 10% &quot;Upper Class&quot;</td>
<td>90% 1 800 000 €</td>
<td>50% 1 000 000 €</td>
</tr>
<tr>
<td>Middle 40% &quot;Middle Class&quot;</td>
<td>10% 50 000 €</td>
<td>40% 200 000 €</td>
</tr>
<tr>
<td>Bottom 50% &quot;Poor&quot;</td>
<td>0% 0 €</td>
<td>10% 40 000 €</td>
</tr>
<tr>
<td>Share in total wealth</td>
<td>100% 200 000 €</td>
<td>100% 200 000 €</td>
</tr>
</tbody>
</table>

*Memo: Average per adult income 35 000 €*
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<tr>
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<th>1900</th>
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<td><strong>Top 10%</strong></td>
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<td><strong>50%</strong></td>
</tr>
<tr>
<td>&quot;Upper Class&quot;</td>
<td>1 800 000 €</td>
<td>1 000 000 €</td>
</tr>
<tr>
<td>incl. Top 1%</td>
<td><strong>50%</strong></td>
<td><strong>20%</strong></td>
</tr>
<tr>
<td>&quot;Very Rich&quot;</td>
<td>10 000 000 €</td>
<td>4 000 000 €</td>
</tr>
<tr>
<td>incl. Other 9%</td>
<td><strong>40%</strong></td>
<td><strong>30%</strong></td>
</tr>
<tr>
<td>&quot;Upper Middle Class&quot;</td>
<td>900 000 €</td>
<td>700 000 €</td>
</tr>
<tr>
<td><strong>Middle 40%</strong></td>
<td><strong>10%</strong></td>
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Top Heirs vs Top Labor Earners

• What is the best way to get rich? Inheritance or labor income?
• Lifetime perspective on inequality
• Bottom 50% labor earners vs Top 50% heirs → we are already back to 19C
• Top 10% heirs vs Average labor income → we are still far from 19C… but we are on the way
Top 50% inheritance vs bottom 50% lifetime labor income received by cohorts 1850-2000

- top 50% inheritance as a fraction of bottom 50% lifetime pre-tax labor income resources (about 15,000€ x 60yrs)
Top 10% inheritance vs average lifetime labor income received by cohorts 1850-2000

- top 10% inheritance as a fraction of average lifetime pre-tax labor income resources
Top 1% inheritance vs average lifetime labor income received by cohorts 1850-2000

d-- top 1% inheritance as a fraction of average lifetime pre-tax labor income resources
The Working Rich Illusion

• US ’77-’07: >50% of total growth was absorbed by top 1%
• Technological story: « This is because the marginal product of the working rich has risen enormously »…
→ Very naïve view of the top labor market!
• Grabbing hand story: When pay setters set their own pay, there are no limits to rent extraction… unless confiscatory marginal tax rates at the very top
• Memo: US top rate (1m$+) 1932-80 : 82%
Are the U.S. the Future? (contd')

- Top 1% (incomes above $398,900 in 2007)
- Top 5-1% (incomes between $155,400 and $398,900)
- Top 10-5% (incomes between $109,600 and $155,400)
<table>
<thead>
<tr>
<th>Period</th>
<th>Average Income Real Annual Growth</th>
<th>Top 1% Incomes Real Annual Growth</th>
<th>Bottom 99% Incomes Real Annual Growth</th>
<th>Fraction of total growth captured by top 1%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976-2007</td>
<td>1.2%</td>
<td>4.4%</td>
<td>0.6%</td>
<td>58%</td>
</tr>
<tr>
<td>Clinton Expansion</td>
<td>4.0%</td>
<td>10.3%</td>
<td>2.7%</td>
<td>45%</td>
</tr>
<tr>
<td>1993-2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bush Expansion</td>
<td>3.0%</td>
<td>10.1%</td>
<td>1.3%</td>
<td>65%</td>
</tr>
<tr>
<td>2002-2007</td>
<td></td>
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Why do we care?

• **Lenin 1916**: WW1 as the product of 19C capitalist inequality

_Imperialism, the highest stage of capitalism:_ nationalism as working class opium; imperialism due to competition over foreign assets between capitalists)

→ a bit simplistic, but not completely wrong: unregulated capitalism knows no limit and can create huge social & political tensions; the level of inequality around 1900-1910 was truly astonishing
Why do we care? (contd’)

- **21\textsuperscript{c} capitalism can be even worst**: rentier-type 19\textsuperscript{c} inequality + working-rich inequality + global scale, weak govts, tax havens...
- Democracies rely on meritocratic values; capitalism can destroy these values; Golden-age postwar meritocratic societies were built upon transitory illusions ; they are fragile & can disappear
- Some of today’s economists seem ready to accept & justify any inequality level (just like mainstream economists around 1900); but societies won’t accept
What shall we do?

• I turned 18 in 1989; I don’t want USSR; I believe in markets for efficiency & freedom

• **But we need tough regulation & tax policy**; this will require violent fights against tax havens & the rich; not just a few quiet G20 summits

• $20^\circ$C inequality compression = temporary illusion due to the wars: old wealth destruction + war-induced political reaction

• Let’s try to make $21^\circ$C anti-inequality policies less violent & more durable