Inequalities reloaded*

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Thomas Piketty
Capital in the Twenty-First Century

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Initially published in 2013 under the title "*Le Capital au XXI*[e] *siècle*", the English language edition of *Thomas Piketty*'s book garnered enormous attention in the international economist community and public discourse, and gained remarkable popularity despite its genre. Although the book also elicited strong criticism, it has the undisputable merit of setting off a dialogue on the topic of inequalities, and laying the groundwork for the debate on clear-cut, scientific terms. Indeed, the distribution of wealth (and income) has become an increasingly topical issue, although we still have a limited understanding of its long-term dynamics. *"Capital in the Twenty-First Century"* is based on a decade-long analysis of a uniquely comprehensive, exhaustive data set collected from twenty countries over the span of nearly three centuries. The main focus of the research is the developed world, shedding light, in particular, on developments in Western Europe and the USA. However, the work is not restricted to a complex mathematical and statistical analysis. *Piketty* strongly believes that the inclusion of a broad range of social sciences is indispensable for a more thorough understanding of the processes at hand. With that in mind, his analysis is strongly interwoven with illustrative examples and lessons drawn from history and its reflection, literature, which makes his book, within the boundaries of its genre, an easy read.

The central argument of the book is that the emergence of wealth inequalities can be mainly attributed to differences between the return on capital and the growth rate of the economy. With all else being equal, when the average rate of return on capital is significantly higher than the rate of economic growth over the long term, the result is an

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inevitable increase in the unequal distribution of wealth, as inherited wealth accumulates faster than output and incomes. This process in itself generates an endless inegalitarian spiral as it implies a continuously increasing concentration of capital that yields additional income and return, the reinvestment of which will only boost the accumulated capital further. *Piketty* finds that today's economy is so diversified that capital can continue to accumulate practically ad infinitum without a radical decline in return over the long term.

The relationship between the two variables has been shaped by opposing forces which, depending on their number and impact, can shift processes toward convergence or divergence. From the aspect of these processes, the period covered by the research can be basically divided into three distinct phases. Dominated by a lack of, or a very low inflation and a low rate of growth, the trend throughout the period from the end of the 18th century until World War I pointed to divergence. This period was characterised by extremely high and persistently rising levels of inequality, and this pattern was not disrupted until 1914.

The events in the nearly 70 years after World War I, including the physical destruction of the World Wars, economic crises and post-war (economic) policy measures, had a profound impact on capital, both in terms of volume and rate of return. *Piketty* refers to these factors as shocks. The adoption of new taxes on excessive wealth and incomes reduced inequalities in and of itself, but it also allowed for an increased involvement of the state and the establishment of the social state, the instruments of which – such as equal access to education – also facilitate greater equality in societies. The most important force pushing toward convergence, however, was growth itself, which accelerated to unprecedented rates while the return on capital, owing to the factors mentioned above, fell to depths never seen before. This resulted in a period theretofore unprecedented in history: the growth rate of the economy exceeded the return on capital to such a degree that it led to a significant compression of inequalities. As a result of one of the most profound social transformations seen in the 20th century, the "patrimonial middle class" emerged. This process sparked unrealistic optimism and the false illusion that the basic logic of capitalism had become null and void, and that the resulting structural transformation would ensure that the inequalities in income and wealth could never revert to their former trajectory. This, however, is far from the truth. The correlation between growth and the return on capital remains valid, and *Piketty* maintains that the reduction of inequalities observed had strictly political and institutional, rather than structural, reasons.

From the 1970s and 1980s, the persistently falling trends reversed course, and factors pointing to divergence intensified once again. The convergence of the defeated countries after the World Wars came to an end, and as the demographic transition in developed economies advanced further, growth started to decelerate. Economies responded by a radical change in the economic policy environment, first and foremost, in Anglo-Saxon countries. The spread of neoliberal economic policies, in particular, the drastic reduction of taxes imposed on the highest incomes, was a key contributor to the renewed increase in inequalities by widening the gap between the highest and the lowest incomes. The decline in taxes on the highest incomes observed between 1980 and today strongly correlates with the growing share of GDP of the top decile and centile of the income hierarchy during the same period.

One of *Piketty*'s most noteworthy results is the exploration of the reasons behind the sharp, far higher-than-average rise in incomes of "supermanagers". According to the highly popular explanation, while the outsized compensation of super managers might be attributed to their higher-than-average skills and productivity, it is far more likely – and is backed by statistical evidences – that the growth occurred nearly irrespective of this. The author finds that the drastic reduction of income taxes transformed managerial wage-setting practices nearly completely. The precise and objective assessment of a top manager's performance is nearly impossible in an economy that has become increasingly "weightless" and "elusive"; therefore, the consideration of subjective criteria in compensation decisions is inevitable. Motivated by falling tax rates, top managers took advantage of their persuasion skills to exert an increasingly strong influence on the predominantly subjective decisions regarding their own pay, and as a result, their earnings and benefits have risen to unprecedented heights.

Forces of divergence have intensified since the 1970s. Rising capital stocks, the deceleration of economic and demographic growth, the widening gap between the highest and lowest incomes, as well as the prevailing economic policy, and the expansion of globalisation and financial capitalism all point to the revival of inequalities. The author finds the emergence of an order similar to that of the 19th century is increasingly likely, where the role of inherited wealth will become increasingly important, wealth becomes more and more concentrated, income inequalities rise sharply and the middle class continues to shrink. Inequalities in income and wealth not only harmful from social and economic aspects, but also undermine the meritocratic values on which democracy is based. Such unsustainable inequalities must not be ignored especially in view of the fact that growth, the natural and the most powerful process that reduces inequalities, is expected to be far slower than any time seen in the 20th century.

Piketty's main recommendation – which attracted plenty of criticism and is considered utopian by himself as well – is the adoption of a progressive annual tax on global wealth. Such a measure would decelerate the inegalitarian spiral, efficiently regulate the global economy, and ensure a fair distribution of wealth in societies, while it would also secure the openness of the economy and the freedom of the market, protect the engine of capital accumulation, and demand, but also ensure a high level of international financial transparency.