

Will 21^c capitalism be as unequal as 19^c capitalism?

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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^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^C, a more optimistic consensus emerged: “growth is a rising tide that lifts all boats” (Kuznets 1953; cold war context)

We need answers (contd')

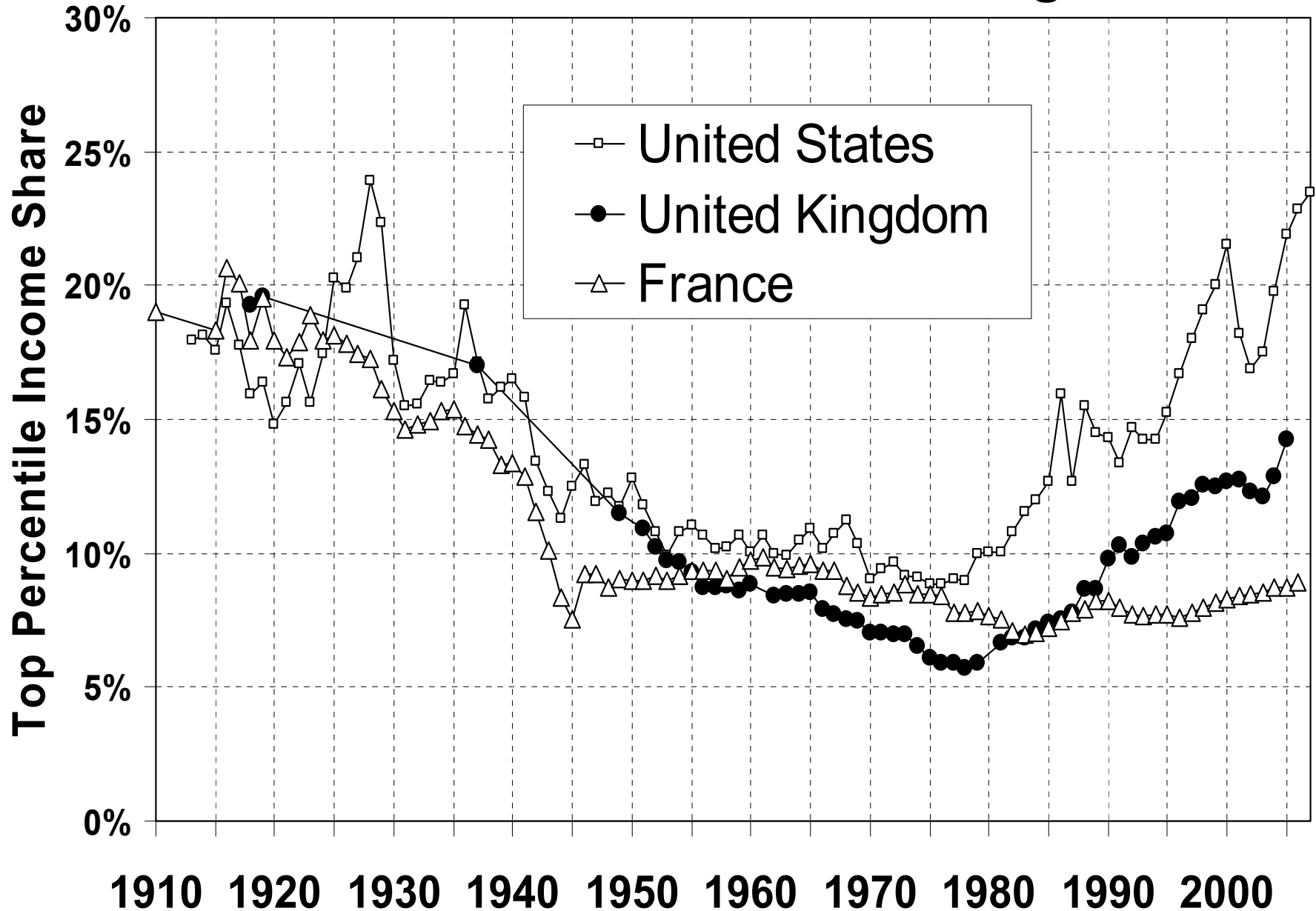
- But inequality ↑ since 1970s destroyed this fragile consensus (US 1977-2007: >50% of total growth was absorbed by top 1%)
→ 19^C economists raised the right questions; we need to address these questions again; we have no strong reason to believe in balanced development path
- 2007-2009 crisis also 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 21^C capitalism?

We have more research

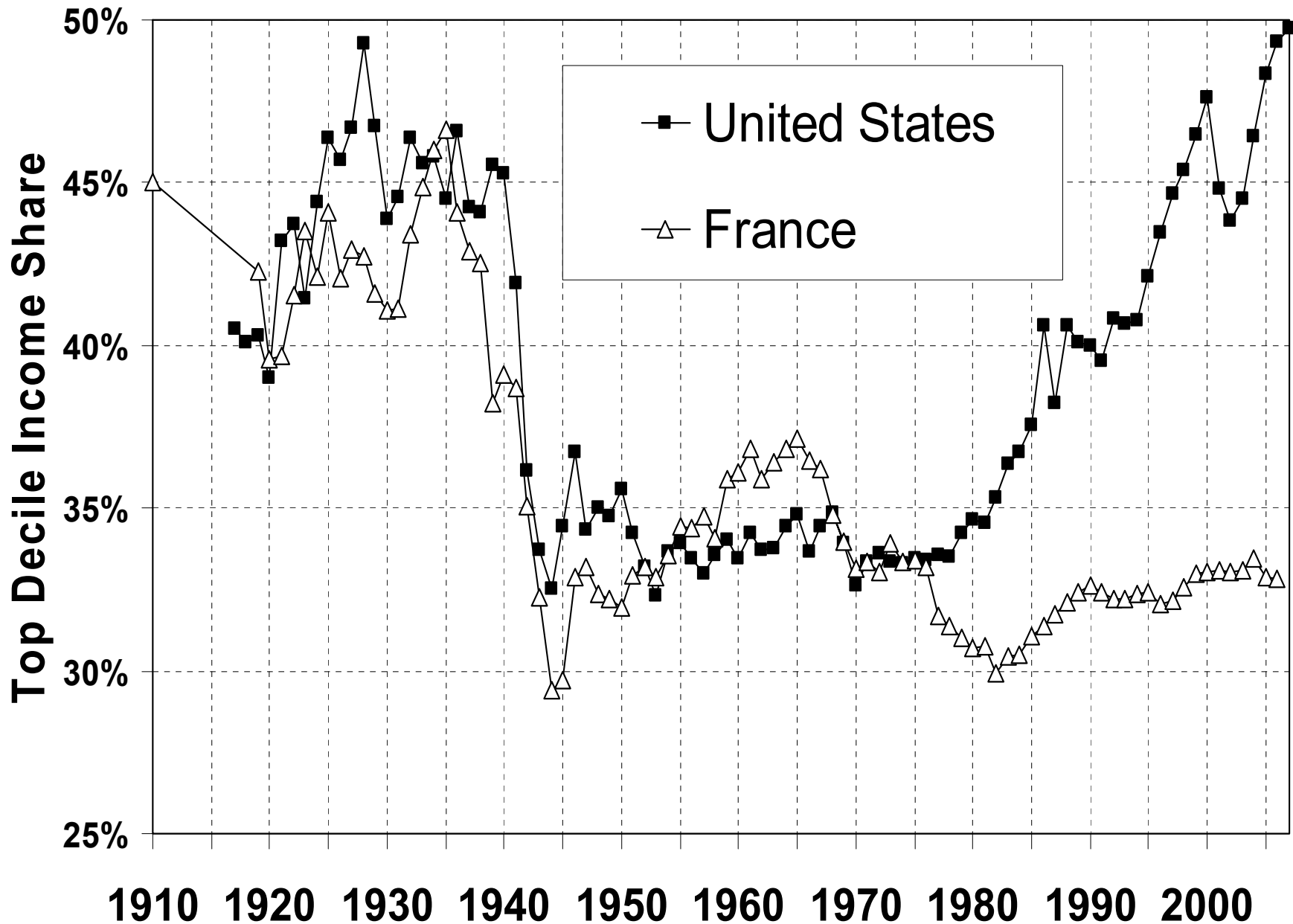
- Top income project: Piketty JPE'03, Piketty-Saez QJE'03, Atkinson-Piketty Oxford University Press 2007 & 2010
- series for 20+ countries over 20^C
- Wealth project:
 - Piketty-Postel-Vinay-Rosenthal “Wealth concentration in France 1807-1994” AER'06
 - “On the long-run evolution of inheritance, France 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 19^C inequality?
- **A.:** **Yes, and it can get even worse**
- (1): 20^C 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



Are the U.S. the Future?



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)
- $W/Y = 560\%$: on average individual wealth = about 5.5-6 years of income
- On average: $Y_L = 26\,000\text{€}$ & $Y_K = 9\,000\text{€}$
- capital share $\alpha = 25\%$
- 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 α stable around 30% since 19^c !
- But W/Y did follow a very pronounced U-shaped pattern during 20^c → long-lasting illusion

Wealth-income ratio in France 1820-2008



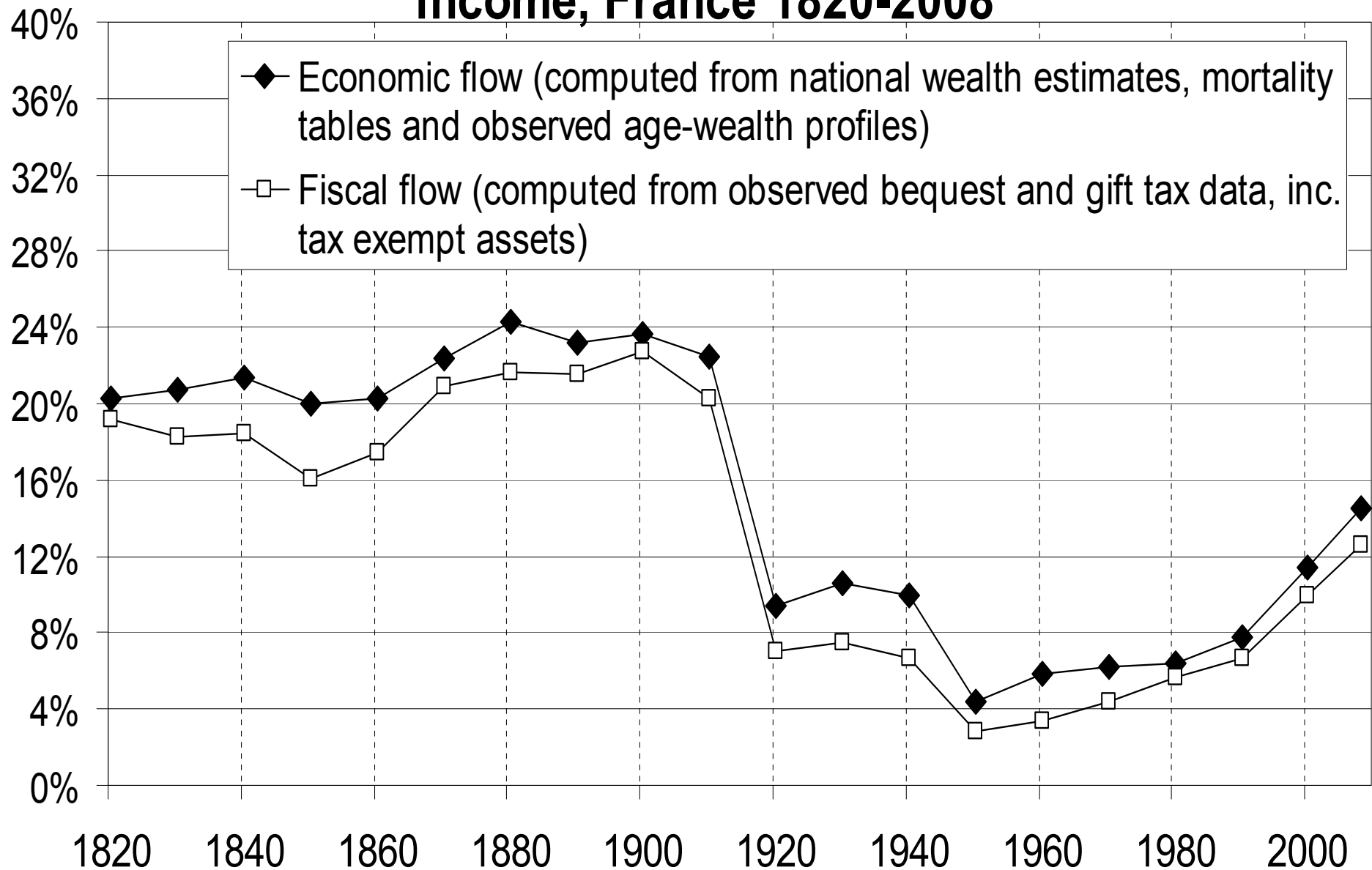
The « war of ages » illusion

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

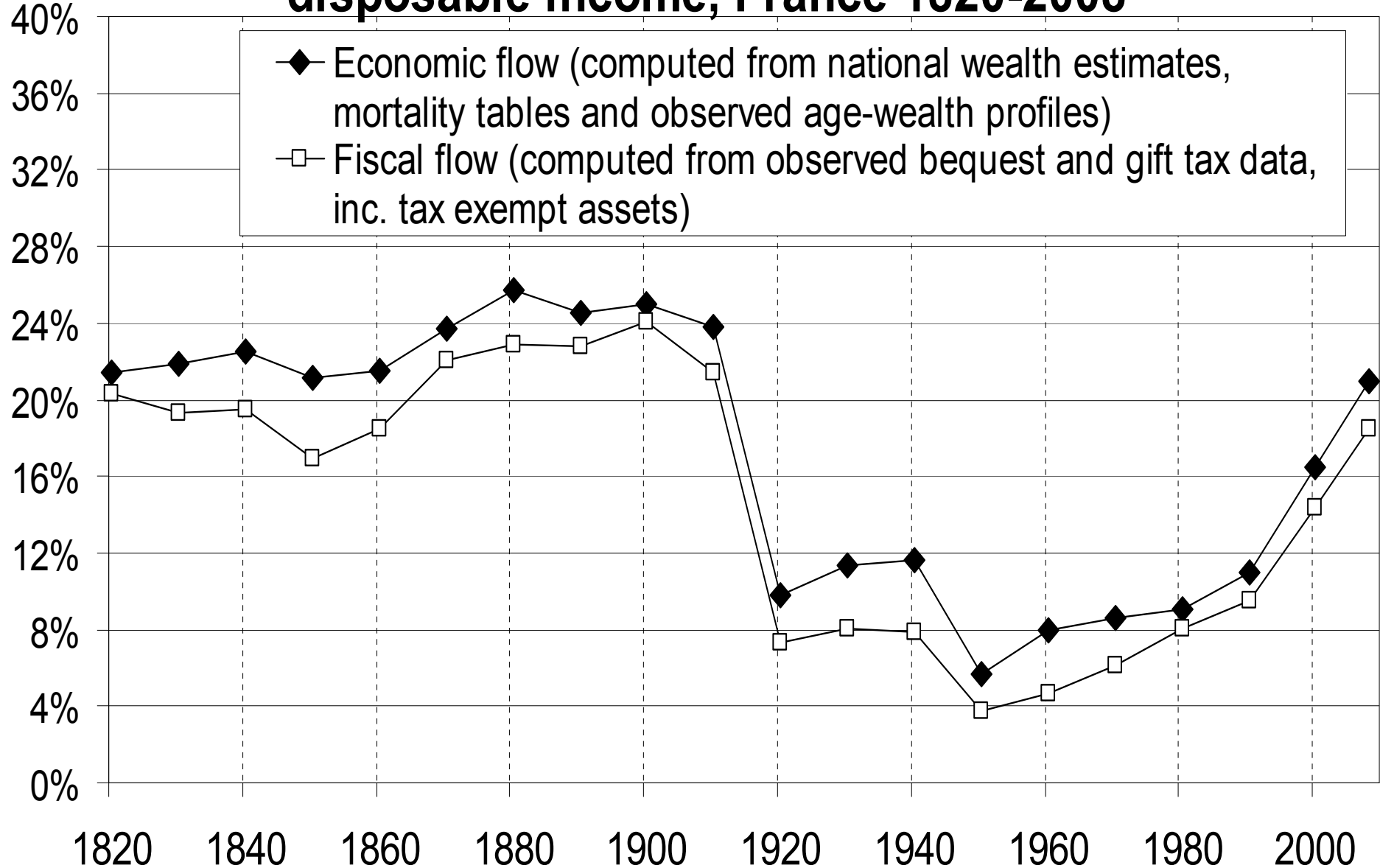
→ It is true that inheritance virtually disappeared during 1950s-60s; but this was a purely transitory phenomenon

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



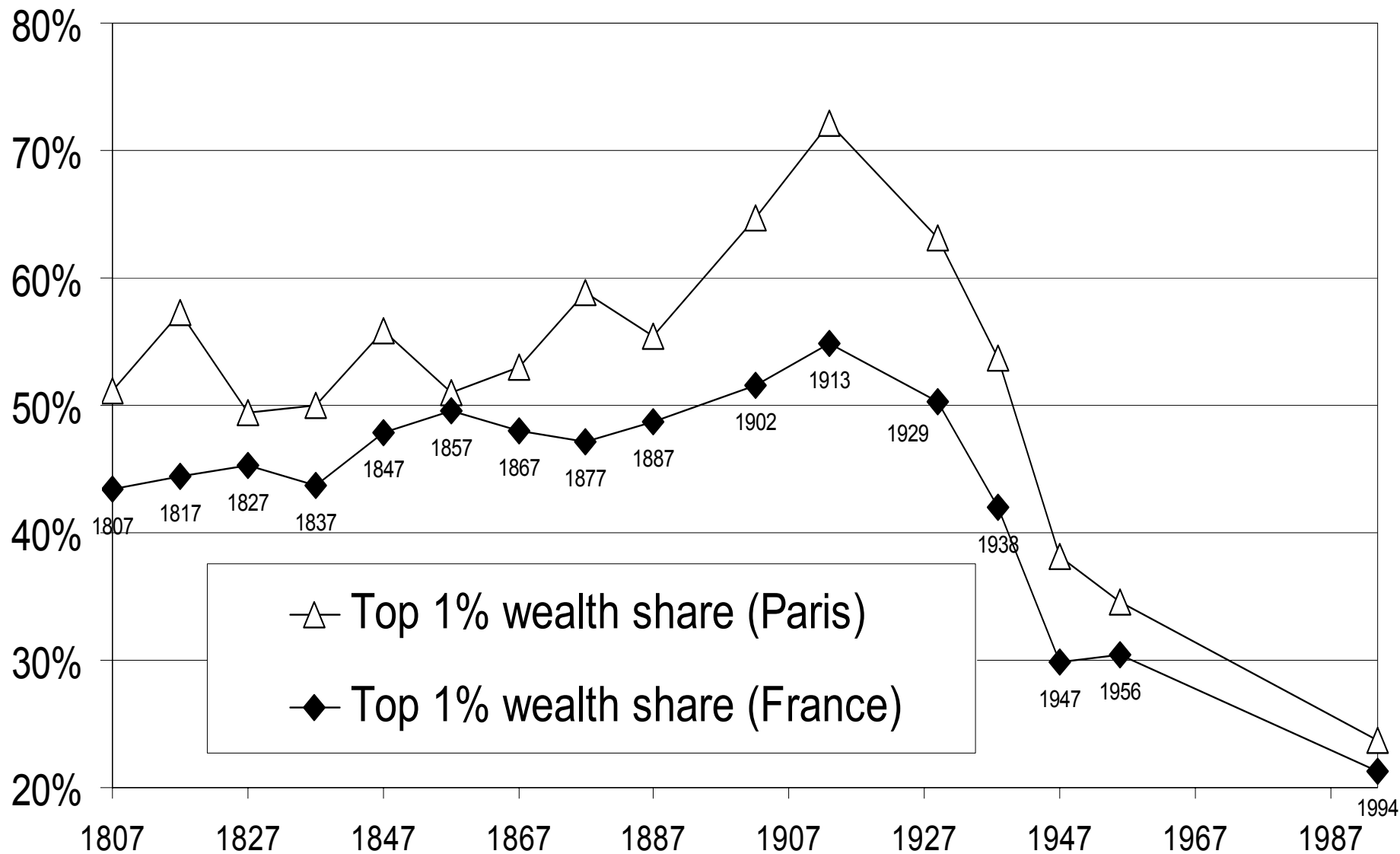
Annual inheritance flow as a fraction of disposable income, France 1820-2008



Can wealth inequality ↑ 19^C ?

- 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



Changes in the wealth distribution 1900-2010: The Rise of the Middle Class

| | 1900 | 2010 |
|--|--------------------|--------------------|
| Top 10% "Upper Class" | 90% 1 800 000 € | 50% 1 000 000 € |
| Middle 40% "Middle Class" | 10% 50 000 € | 40% 200 000 € |
| Bottom 50% "Poor" | 0% 0 € | 10% 40 000 € |
| Share in total wealth <i>Average per adult wealth</i> | 100% 200 000 € | 100% 200 000 € |
| <i>Memo: Average per adult income</i> | 35 000 € | 35 000 € |

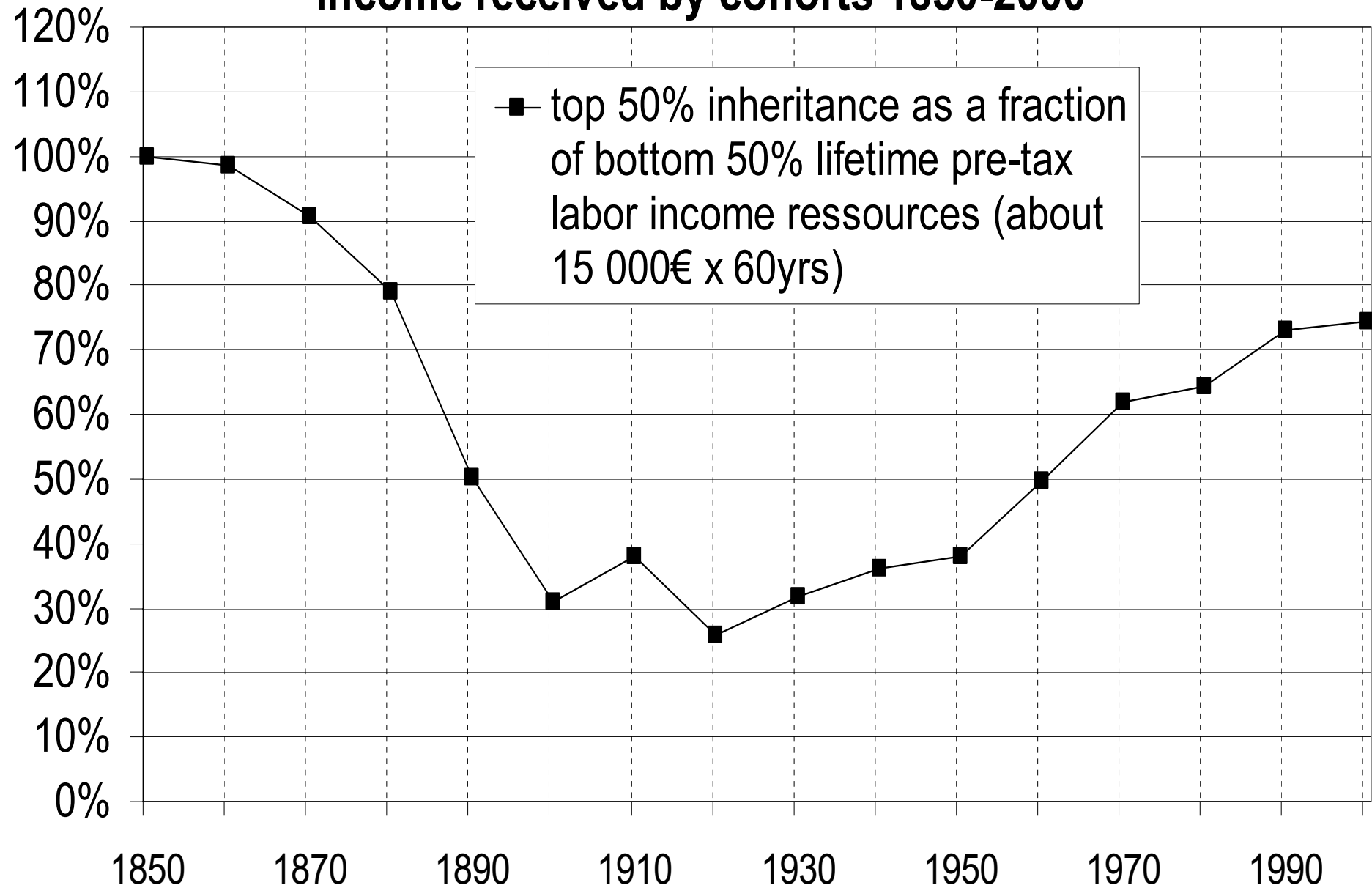
Changes in the wealth distribution 1900-2010 (contd')

| | 1900 | 2010 |
|--|-----------------------------------|----------------------------------|
| Top 10% "Upper Class" | 90% 1 800 000 € | 50% 1 000 000 € |
| <i>incl. Top 1% "Very Rich"</i> | <i>50%</i> <i>10 000 000 €</i> | <i>20%</i> <i>4 000 000 €</i> |
| <i>incl. Other 9% "Upper Middle Class"</i> | <i>40%</i> <i>900 000 €</i> | <i>30%</i> <i>700 000 €</i> |
| Middle 40% "Middle Class" | 10% 50 000 € | 40% 200 000 € |
| Bottom 50% "Poor" | 0% 0 € | 10% 40 000 € |
| Share in total wealth <i>Average per adult wealth</i> | 100% <i>200 000 €</i> | 100% <i>200 000 €</i> |

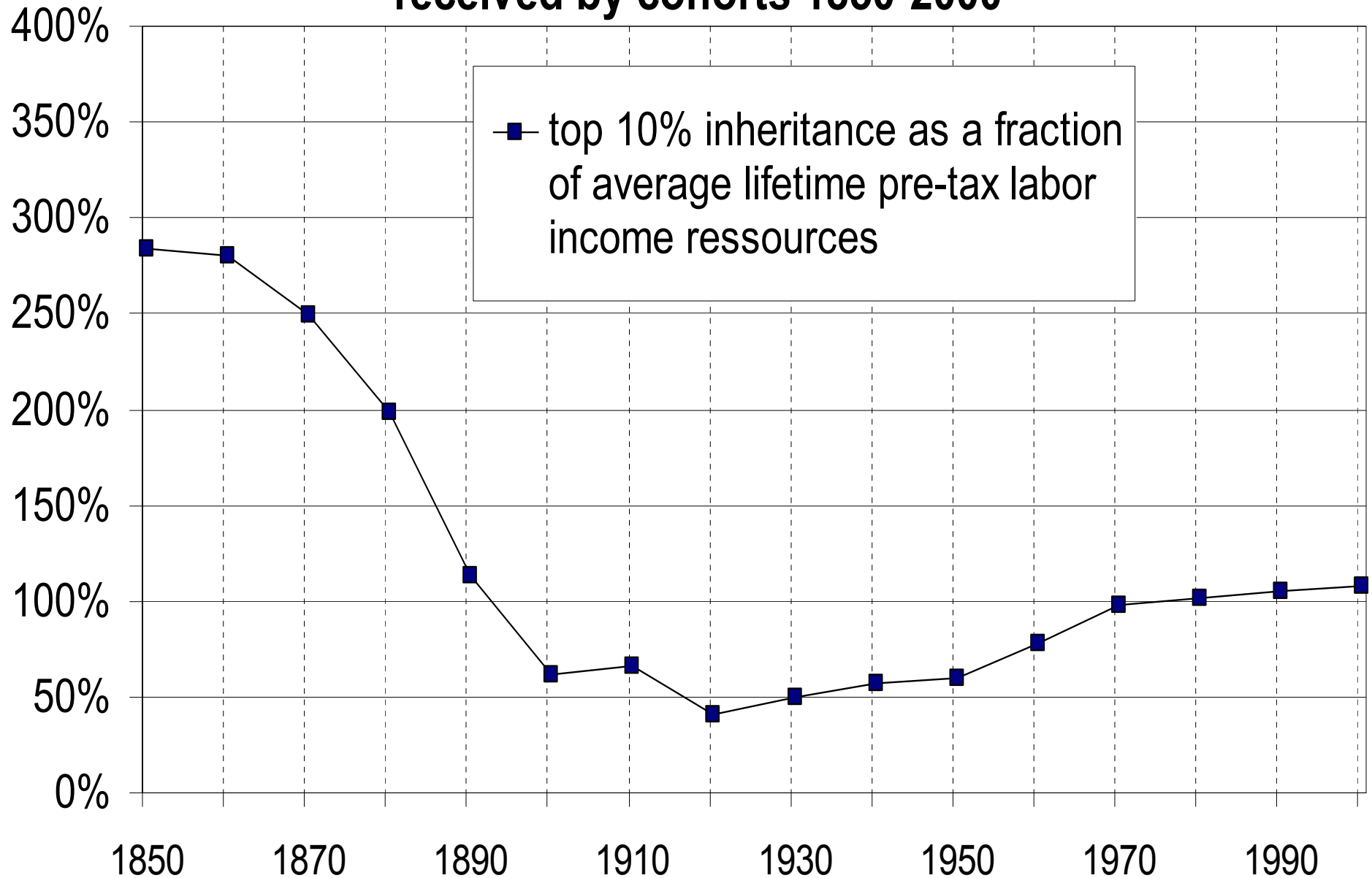
Top Heirs vs Top Labor Earners

- 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 19^C
- Top 10% heirs vs Average labor income
→ we are still far from 19^C... but we are on the way

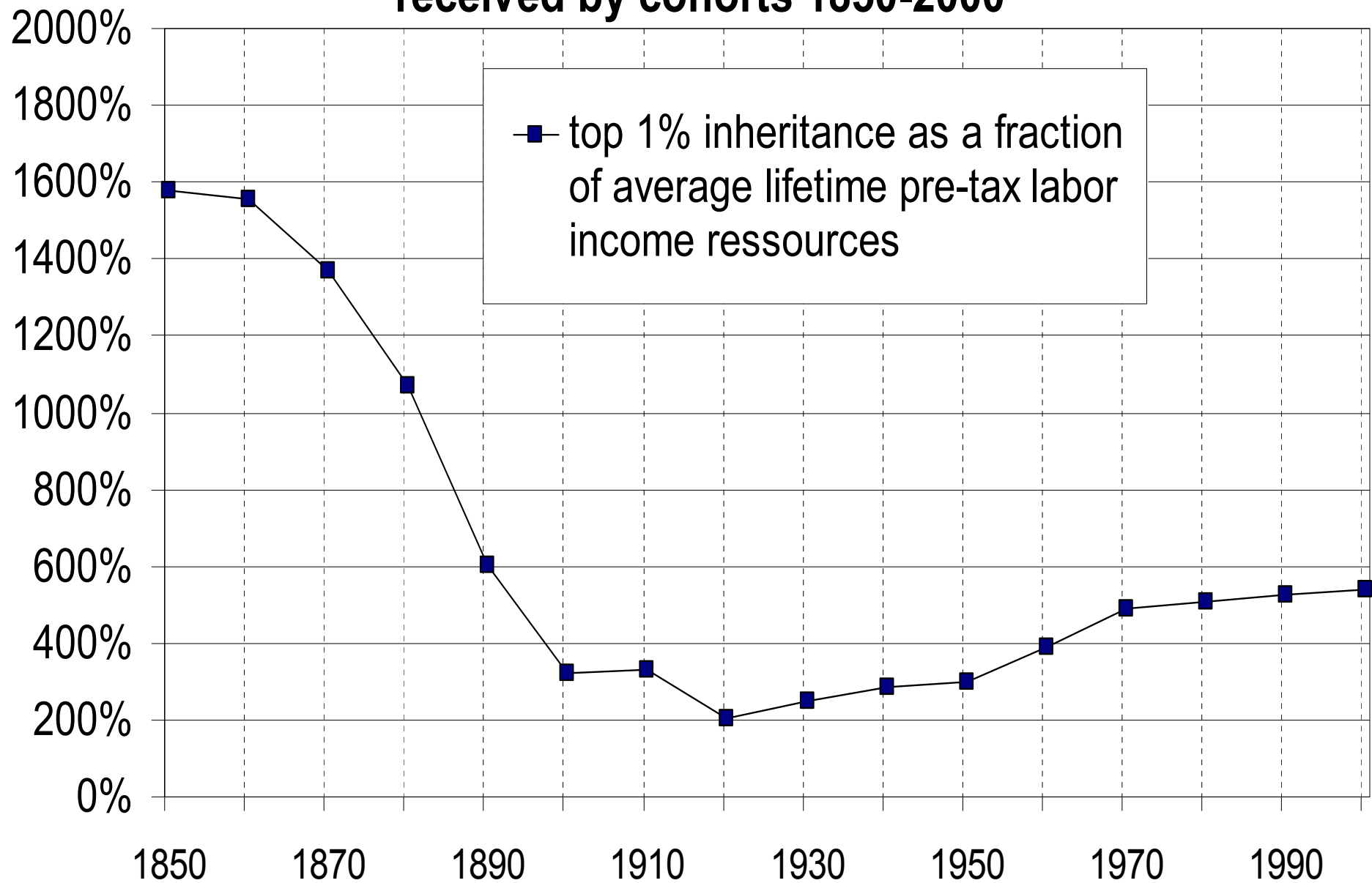
Top 50% inheritance vs bottom 50% lifetime labor income received by cohorts 1850-2000



Top 10% inheritance vs average lifetime labor income received by cohorts 1850-2000



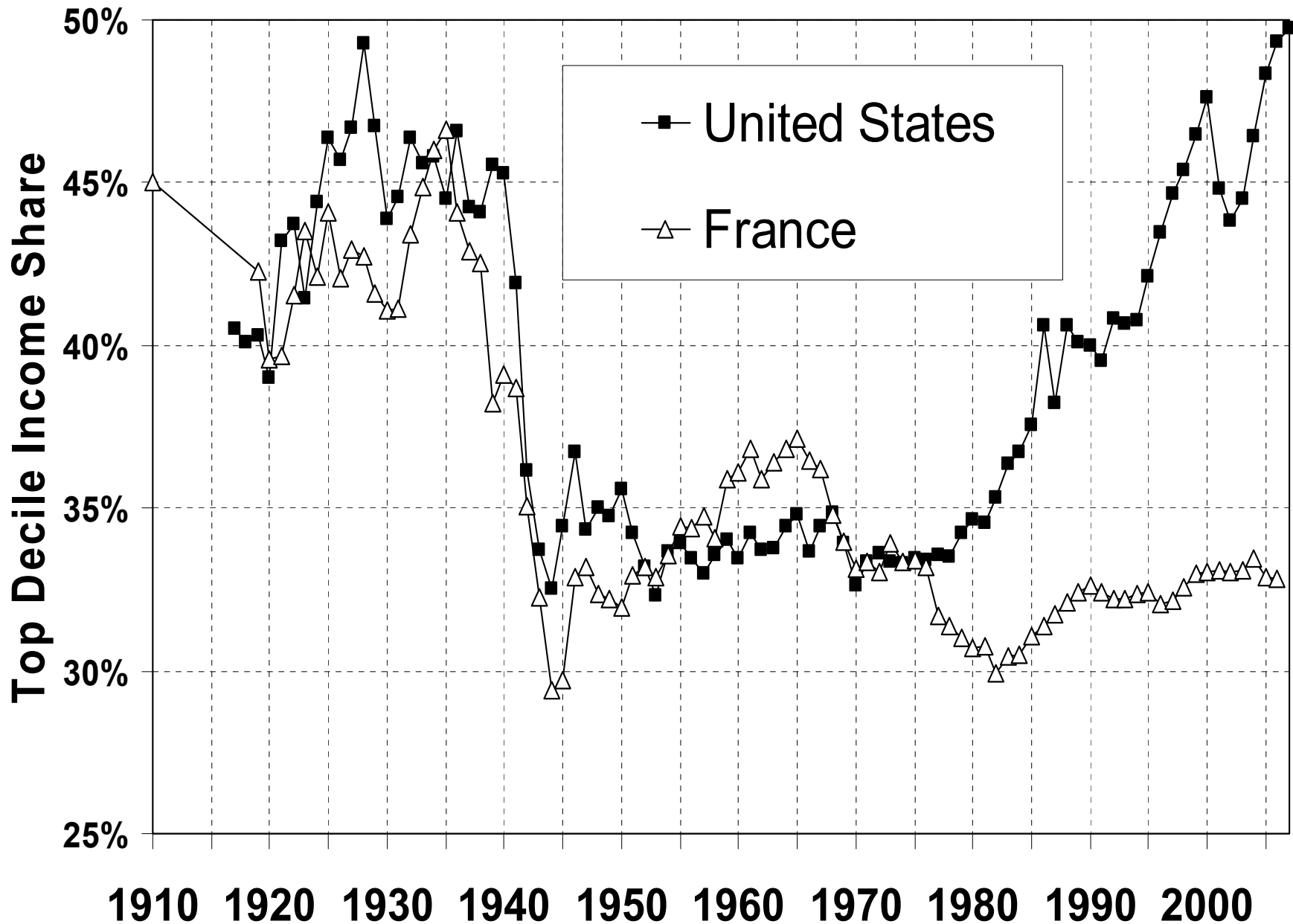
Top 1% inheritance vs average lifetime labor income received by cohorts 1850-2000



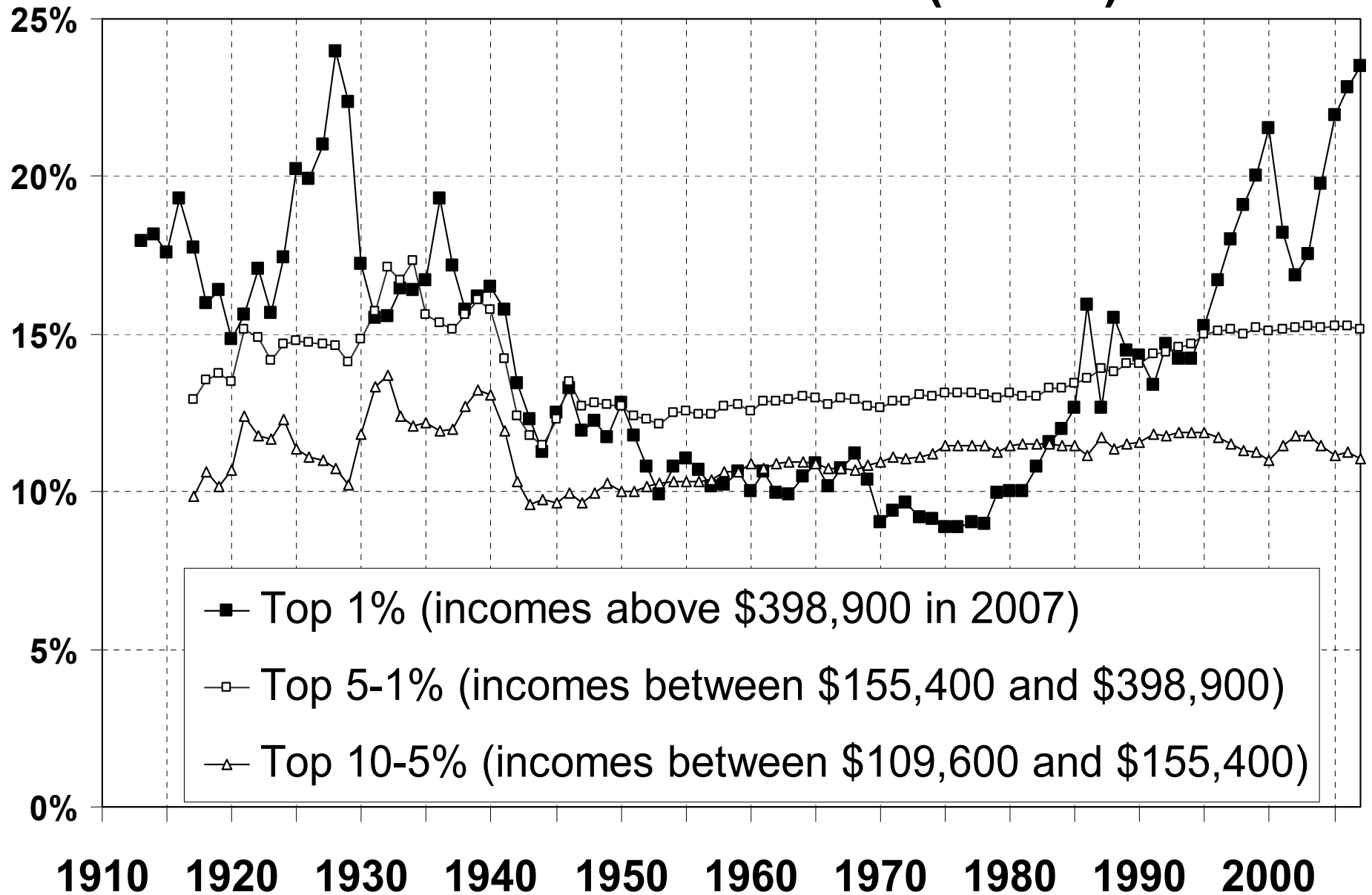
The Working Rich Illusion

- 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?



Are the U.S. the Future? (contd')



Growth & Inequality in the US 1976-2007

| | Average Income Real Annual Growth | Top 1% Incomes Real Annual Growth | Bottom 99% Incomes Real Annual Growth | Fraction of total growth captured by top 1% |
|-----------------------------------|--|--|--|--|
| Period 1976-2007 | 1.2% | 4.4% | 0.6% | 58% |
| Clinton Expansion 1993-2000 | 4.0% | 10.3% | 2.7% | 45% |
| Bush Expansion 2002-2007 | 3.0% | 10.1% | 1.3% | 65% |

Why do we care?

- **Lenin 1916:** WW1 as the product of 19^C 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^c capitalism can be even worst:** rentier-type 19^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^C inequality compression = temporary illusion due to the wars: old wealth destruction + war-induced political reaction
- Let's try to make 21^C anti-inequality policies less violent & more durable