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ECONOMY

A Relentless Widening of Disparity in Wealth

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ECONOMIC SCENE

What if inequality were to continue growing years or decades into the future? Say the richest 1 percent of the population amassed a quarter of the nation's income, up from about a fifth today. What about half?

To believe Thomas Piketty of the Paris School of Economics, this future is not just possible. It is likely.

In his bracing "Capital in the Twenty-First Century," which hit bookstores on Monday, Professor Piketty provides a fresh and sweeping analysis of the world's economic history that puts into question many of our core beliefs about the organization of market economies.

His most startling news is that the belief that inequality will eventually stabilize and subside on its own, a long-held tenet of free market capitalism, is wrong. Rather, the economic forces concentrating more and more wealth into the hands of the fortunate few are almost sure to prevail for a very long time.

It is possible to slow, or even reverse, the trend, if political leaders like President Obama, who proposed that income inequality was the "defining challenge of our time," really push.

"Political action can make this go in the other direction," Professor Piketty told me. But he also adds that history does not offer much hope that political action will, in fact, turn the tide: “Universal suffrage and democratic institutions have not been enough to make the system react.”

Professor Piketty’s description of inexorably rising inequality probably fits many Americans’ intuitive understanding of how the world works today. But it cuts hard against the grain of economic orthodoxy that prevailed throughout the second half of the 20th century and still holds sway today. It was shaped during the early years of the Cold War by the Belorussian-born American economist Simon Kuznets.

Painstakingly assembling data from tax returns, Mr. Kuznets estimated that between 1913, when the income tax was first introduced in the United States, and shortly after the end of World War II in 1948, the slice of the nation’s income absorbed by the richest 10 percent of Americans declined sharply, to about a third, from a little under half.

In his presidential address at the annual meeting of the American Economic Association in Detroit in 1954, he sketched out what came to be known as inequality’s “Kuznets curve”: “Widening in the early phases of economic growth when the transition from the preindustrial to the industrial civilization was most rapid; becoming stabilized for a while; and then narrowing in the later phases.”

Mr. Kuznets’s conclusion provided a huge moral lift to capitalism as the United States faced off with the Soviet Union. It suggested that the market economy could distribute its fruits equitably, without any heavy-handed intervention of the state.

And it more or less put an end to economists’ interest in the topic. Economic theorists assumed that in a balanced economy, wages and profits rose at the same pace and turned their attention to the ups and downs of the business cycle.

The deep concern about the distribution of income and wealth that inspired 19th-century thinkers like David Ricardo and Karl Marx was attributed to a misunderstanding of the dynamics of growth leavened with the natural pessimism that would come from living in a time of enormous wealth and deep squalor, an era that gave us “Les Misérables” and “Oliver Twist.”

Today, of course, it’s far from obvious that the 19th-century pessimists were entirely wrong.

Glancing back across history from the present-day United States, it looks as if Kuznets's curve swerved way off target. Wages have been depressed for years. Profits account for the largest share of national income since the 1930s. The richest 10 percent of Americans take a larger slice of the economic pie than they did in 1913, at the peak of the Gilded Age.

This is not solely an American phenomenon. Across many other developed nations, the distribution of economic rewards in the 21st century is taking on decidedly 19th-century features.

In "Capital in the Twenty-First Century," Professor Piketty offers a general theory of capitalism that returns distribution to the center of the analysis. Branko Milanovic, an expert on the global distribution of income at the City University of New York's Graduate Center, called it "one of the watershed books in economic thinking."

Like Kuznets's analysis, Mr. Piketty's is based on data. He just has much more: centuries' worth, from dozens of countries. He distills from them a simple historical regularity. The rate of return to capital — understood broadly to include machinery, land, financial instruments, housing and everything else — is usually higher than economic growth.

This was particularly true before the Industrial Revolution, when economies didn't really grow, but it prevailed even after economic growth took off in the 19th century.

This means that the income from wealth usually grows faster than wages. As returns from capital are reinvested, inherited wealth will grow faster than the economy, concentrating more and more into the hands of few. This will go on until capital owners decide to consume most of their income and stop reinvesting as much.

Kuznets's misleading curve is easy to understand in this light. He used data from one exceptional period in history, when a depression, two world wars and high inflation destroyed a large chunk of the world's capital stock. Combined with fast growth after World War II and high taxes on the rich, this flattened the distribution of income until the 1970s.

But this exceptional period long ago ran its course.

During the Gilded Age — a period of enormous concentration of income and wealth — the stock of the world's privately held capital amounted to some five years' worth of global income, by Professor Piketty's estimate. By 1950, it had fallen to below three, but by 2010, it was back at four. And by the end of this century, Mr. Piketty projects, it will amount to almost seven.

Americans will argue that this description does not fit the United States. Wealth here is largely earned, not inherited, we say. The American rich are "creators," like Bill Gates of Microsoft or Lloyd Blankfein of Goldman Sachs, rewarded for their economic contributions to society.

Mr. Piketty doubts that the enormous remuneration of top executives and financiers in the United States — enhanced by the decline of top income tax rates since the 1980s — really reflects their contributions. What's more, he points out, inherited inequality has been lower in the United States mainly because its population has grown so fast — from three million at the time of independence to 300 million today — driving a vast economic expansion.

But this population boom will not repeat itself. The share of national income absorbed by corporate profits, a major component of capital's share, is already rising sharply.

If anything, this means future inequality in the United States will be driven by two forces. A growing share of national income will go to the owners of capital. Of the remaining labor income, a growing share will also go to the top executives and highly compensated stars at the pinnacle of the earnings scale.

Is there a politically feasible antidote? Professor Piketty notes that the standard recipe — education for all — is no match against the powerful forces driving inherited wealth ever higher.

Taxes are, of course, the most feasible counterweight. Progressive wealth taxes could reduce the after-tax return to capital so that it equaled the rate of economic growth.

But politically, "the fiscal institutions to redistribute incomes in a balanced and equitable way have been badly damaged," Professor Piketty told me.

The holders of wealth, hardly a powerless bunch, will oppose any such move, even if that's what is needed to preserve capitalism against the populist impulses of those left behind.

Professor Piketty offers early-20th-century France as an example. "France was a democracy and yet the system did not respond to an incredible concentration of wealth and an incredible level of inequality," he said. "The elites just refused to see it. They kept claiming that the free market was going to solve everything."

It didn't.

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