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Q&A: Thomas Piketty on the Wealth Divide

By EDUARDO PORTER

Income inequality moved with astonishing speed from the boring backwaters of economic studies to "the defining challenge of our time." It found Thomas Piketty waiting for it.

A young professor at the Paris School of Economics, he is one of a handful of economists who have devoted their careers to understanding the dynamics driving the concentration of income and wealth into the hands of the few. He has distilled his findings into a new book, "Capital in the Twenty-First Century," which is being published this week. In the book, Mr. Piketty provides a sort of unified theory of capitalism that explains its lopsided distribution of rewards.

Eduardo Porter's Economic Scene column this week discusses Mr. Piketty's work. Following is the transcript of an email interview he conducted with Mr. Piketty last week, lightly edited for length and clarity.

Q.

Your book fits oddly into the canon of contemporary economics. It focuses not on growth and its determinants, but on how the spoils of growth are divided. In that sense, it reminds us of similar concerns in a book of similar title written 150 years ago: Karl Marx's "Capital." What parallels would you draw between the two?

A.

I am trying to put the distributional question and the study of long-run trends back at the heart of economic analysis. In that sense, I am pursuing a tradition which was pioneered by the economists of the 19th century, including David Ricardo and Karl Marx. One key difference is that I have a lot more historical data. With the help of Tony Atkinson, Emmanuel Saez, Facundo Alvaredo, Gilles Postel-Vinay, Jean-Laurent Rosenthal, Gabriel Zucman and many other scholars, we have been able to collect a unique set of data covering three centuries and over 20 countries. This is by far the most extensive database available in regard to the historical evolution of income and wealth. This book proposes an interpretative synthesis based upon this collective data collection project.

Q.

For much of the last century, economists told us that we didn't have to worry about income inequality. The market economy would naturally spread riches fairly, lifting all boats. Is this not true? Are you arguing that income inequality could grow forever? How so?

A.

History tells us that there are powerful forces going in both directions. Which one will prevail depends on the institutions and policies that we will collectively adopt. Historically, the main equalizing force — both between and within countries — has been the diffusion of knowledge and skills. However, this virtuous process cannot work properly without inclusive educational institutions and continuous investment in skills. This is a major challenge for all countries in the century underway.

In the very long run, the most powerful force pushing in the direction of rising inequality is the tendency of the rate of return to capital r to exceed the rate of output growth g. That is, when r exceeds g, as it did in the 19th century and seems quite likely to do again in the 21st, initial wealth inequalities tend to amplify and to converge towards extreme levels. The top few percents of the wealth hierarchy tend to appropriate a very large share of national wealth, at the expense of the middle and lower classes. This is what happened in the past, and this could well happen again in the future.

Q.

Inequality declined in the so-called industrial world through much of the 20th century. How did that happen? Does this not argue against the notion of ever-increasing inequality?

A.

The reduction in inequality was mostly due to the capital shocks of the 1914-1945 period (destruction, inflation, crises) and to the new fiscal and social institutions that were set up in the aftermath of the World Wars and of the Great Depression. There was no natural tendency toward a decline in inequality prior to World War I. During the 20th century, rates of return were severely reduced by capital shocks and taxation, and growth rates were exceptionally high in the reconstruction period. This largely explains why inequality remained low in the 1950-1980 period.

Q.

Why are you confident that the economy will grow slower than returns on capital?

A.

Over the 1700-2012 period, world output has grown at 1.6 percent per year on average, including 0.8 percent due to population growth and 0.8 percent due to per capita output growth. This may seem small, but in actual fact this was sufficient to multiply the world population by more than 10 — from 600 million to seven billion inhabitants. According to U.N. population forecasts, this seems unlikely to happen again in the coming decades and centuries. Indeed population has already started to stabilize or even decline in a number of European and Asian countries. Productivity growth can certainly continue forever, assuming we invent clean energy. But in any case it will probably not be faster than 1 to 1.5 percent. It is only in exceptional periods, e.g. when countries are catching up with other countries, that productivity growth rates reach very high levels — say 4 to 5 percent or even higher.

In contrast, rates of return on capital can be 4 to 5 percent over centuries, or even higher for risky assets and high wealth portfolios. Contrarily to what Karl Marx and other believed, there is no natural reason why rates of return should fall in the long run. According to Forbes's global billionaires list, very top wealth holders have risen at 6 to 7 percent per year over the 1987-2013 period, i.e. more than three times faster than per capita wealth and income at the world level. Wealth concentration will probably stabilize at some point, but this can happen at a very high level.

Q.

The concentration of wealth and income in the United States seems to follow a different pattern than it does in Europe and other wealthy countries. Why does it look so different?

A.

Historically, and to some extent until the present day, higher population growth is the key force that has reduced the relative importance of inherited wealth in the U.S. as compared to Europe. In contrast, one observes in the recent period an unprecedented rise of top managerial compensation in the United States. This is a new form of inequality, which I attempt to explain in terms of the particular U.S. history of the social and fiscal norms over the past century.

Q.

Some economists argue that inequality, in the United States, at least, is a good thing. It acts as an incentive for entrepreneurs to take risks and innovate, thus driving economic growth. Is there anything to that argument?

A.

In theory, yes. But in practice you see inequality everywhere, except in the productivity statistics. The rate of productivity growth has not been particularly good in the U.S. since 1980. Inequality is desirable up to a point. But beyond a certain level it is useless. One of the key lessons of the 20th century is that you can have high growth without the inequality of the 19th century.

Q.

Might inequality in the United States be less damaging than it is in Europe because the very rich were not born into wealth, but earned their money by creating new products, services and technologies?

A.

This is what the winners of the game like to claim. But for the losers this can be the worst of all worlds: They have a diminishing share of income and wealth, and at the same time they are depicted as undeserving.

Q.

What are the risks from allowing an ever-increasing concentration of wealth and incomes? Is there a point when inequality becomes intolerable? Does history offer any lessons in this regard?

A.

U.S. inequality is now close to the levels of income concentration that prevailed in Europe around 1900-10. History suggests that this kind of inequality level is not only useless for growth, it can also lead to a capture of the political process by a tiny high-income and high-wealth elite. This directly threatens our democratic institutions and values.

Q.

You noted that the concentration of wealth was stopped in the 20th century by war, hyperinflation and growth. Are there other options? What could we do now to counteract the current accumulation of wealth into very few hands?

A.

The ideal solution is a progressive tax on individual net wealth. This will foster wealth mobility and keep concentration under control and under public scrutiny. Of course other institutions and policies can also play an important role: Inflation can reduce the value of public debt, reform of patent law can limit wealth concentration, etc.

Q.

Owners of wealth are unlikely to like this solution. And they probably have the political power to stop it. In this sense, do you think our democratic systems will be able to address and slow this trend?

A.

The experience of Europe in the early 20th century does not lead to optimism: The democratic systems did not respond peacefully to rising inequality, which was halted only by wars and violent social conflicts. But hopefully we can do better next time. At the end of the day, it is in the common interest to find peaceful solutions. Otherwise there is a serious risk that growing parts of the public opinion turn against globalization.