Piketty and Wealth Inequality: R before G, Except After C

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Inequality is a difficult subject to attempt to remedy with economic policy. Thomas Piketty's 2014 book, *Capital in the Twenty-First Century,* is perhaps the most important addition to economic understandings of inequality in, well, the twenty-first century. While much of the research undergirding Piketty's claims extend beyond the scope of this book, the essence of Piketty's most central claim is that the rate of return on wealth exceeds the overall growth of the economy, and as global economic growth slows, global inequality is destined to increase without significant and coordinated international intervention. Piketty's proposed economic policy to address this is a global wealth tax, in which people and families whose personal wealth exceeds a certain value would be required to pay a portion of that wealth each year in additional taxes. Piketty claims that such a policy would serve as a countervailing force against wealth's effect on overall inequality.

Capital's 696 pages (when translated into English) lay out a comprehensive argument for Piketty's view of inequality in a capitalist society. Piketty has compiled one of the richest datasets on wealth and inequality ever collected in an effort to make his case. Piketty's arguments can be further summarized thusly: that in a capitalist society, the returns on capital (r, which Piketty defines broadly to mean private wealth) exceed the returns on labor (g, the growth of the economy), and that this disparity will lead to worsening inequality as those with wealth will see their wealth increase at a rate faster than those whose income is primarily derived from labor. Piketty likens the outcome of this process to that of the Victorian era or the late industrial revolution, where society's wealth was concentrated in the hands of dynastic families, and the wealthiest in society were not necessarily the most successful entrepreneurs but rather the hereditary elite. Piketty claims that the 20th century was an anomaly: the World Wars destroyed much of the developed world's inherited wealth, and high economic growth in the years following the Second World War helped mask this inevitable outcome of capitalist society. But as global growth rates continue to fall, the developed world will be in increasing peril of returning to a neo-Victorian class-system characterized by rampant inequality, stagnant wages, and dynastic wealth.

Piketty's predicted future is something that nearly all policymakers on the left, right, and center, should aim to avoid. Where consensus breaks down is in how to avoid such an outcome and, of course, if the prediction that this process is unavoidable has merit. This chapter has discussed many of the ways in which policymakers can seek to address inequality. We've also outlined that economic policymakers prefer to address income inequality rather than wealth inequality. Proponents of Piketty's work often point to this distinction as a red-herring—the unchecked presence of wealth inequality contributes to income inequality as the returns on wealth tend to outpace the rate of growth in the economy. Thus, Piketty's proposals are often aimed more directly at addressing wealth inequality. The most notable and therefore controversial of Piketty's proposals is the progressive, global annual tax on wealth. This would, in his view, serve to bridge the gap between the returns on wealth and global growth, slowing down the growth of wealth inequality.

Piketty's claims have their skeptics in the economic community. Mankiw (2015) has argued against both the significance of Piketty's assertion and the efficacy of his proposed economic policy remedies. Mankiw claims that, even if we accept Piketty's argument that R exceeds G, once you account for consumption, procreation, and taxes, R would have to exceed G by roughly seven percentage points a year for it to drive perpetually worsening inequality. Moreover, Mankiw's analysis of the effects of

Piketty's wealth tax show that redistribution could be better effected by instituting a consumption tax rather than a wealth tax.

Other economists have examined the more technical elements of Piketty's assertions. One of Piketty's arguments relies on a model which holds net savings constant rather than gross savings, which is traditionally held constant in most macroeconomic models. Research by Krussel and Smith (2015) has since served to undermine the validity of this assumption. Likewise, Piketty's economic arguments may hold true only when the elasticity of substitution between capital and labor is significantly higher than what research by Rognlie (2014, 2016) has found to be plausible.

The debate over Piketty's *Capital* has helped illustrate the difficulty in addressing an economic issue like inequality. There is hardly agreement in the economic community regarding the veracity of his economic assertions, let alone any consensus regarding pertinent policy recommendations. To some, Piketty's findings present a compelling case for his core policy proposal of a global wealth tax. As already demonstrated, this proposal has drawn much criticism, both politically and economically motivated. Joining the chorus of dissent, Shuyler (2014) has argued that the effects of an annual wealth tax in the United States could contract the economy by 6% while having a minimal effect on increasing tax revenue, and that any benefits from redistribution would be drastically outweighed by the overall decline in societal welfare from the lower rate of economic growth. Similarly, Lawrence (2015) has posited that Rognlie's aforementioned findings actually support Piketty's proposed capital tax having the opposite of its intended effect—that it would instead increase capital's share of national income and in effect worsen the trajectory of inequality.

Despite the dissent, Piketty's claims hold merit with a significant portion of the economic community, and he is undoubtedly still considered one of the foremost experts on economic inequality. More recently, Piketty was part of a panel of economists who released the *World Inequality Report 2018*, which builds off of not only Piketty's work on inequality, but the work of other notable economists in the space, including Emmanuel Saez, Gabriel Zucman, and Lucas Chancel. Their findings flesh out much of Piketty's initial contributions to the economic literature surrounding inequality. Among their recommendations is that of a one-time flat tax on accumulated wealth. This proposal could be implemented in conjunction with other progressive tax policies as an approach to combat wealth inequality. It would also have significantly different implications for the economy than Piketty's proposed annual wealth tax.

One important assertion from the 2018 *Report* is that rising income inequality "is not inevitable in the future" (287). This claim is qualified by the admission that adequately tackling inequality "requires important shifts in national and global tax policies". While this may be undeniably true, reversing global inequality trends might first predicate consensus among the economic community about the best course of action to take. As the debate surrounding Piketty's *Capital* illustrates, such consensus is unlikely to be reached any time soon.

Discussion Questions:

1. Based on your understandings of the workings of inequality, which do you find more concerning: income inequality or wealth inequality? Why?
2. Pick two countries—one developed and one developing—and analyze the state of their economies with respect to both wealth and income inequality. What policies would you recommend to address their situations, and why?

3. Research Gregory Mankiw's full response to Piketty's *Capital.* Discuss the differences between a wealth tax and a consumption tax. How would each be used to address inequality? What distortions would each cause?

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