# **Picketty's Political Economy**

> In the course of hundreds of pages, we have witnessed a succession of marriages, births, divorces and deaths punctuating the decline of the initially robust family—a decline brought about…by the weakening of business acumen and ethics as the family succumbs to the entitlements of wealth, with its inevitable concomitants of sickly religiosity, artistic inclinations and disease.
>
> Theodore Ziolkowski's review of Buddenbrooks: The Decline of a Family by Thomas Mann, *New York Times*, 4/18/1993

> Thomas, the elder brother destined to take over the firm, sees it rise to its zenith and then watches helplessly as the times change and the market is governed by new factors, making the merchant middleman redundant.
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> Susan Doering, "Buddenbrooks Revisited," *The Vienna Review*, 2/1/2009

> When the rate of return on capital exceeds the rate of growth of output and income, as it did in the 19$^{th}$ century and seems quite likely to do again in the 21$^{st}$, capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based.
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> Thomas Piketty, *Capital in the 21$^{st}$ Century*, p. 1

In *Capital in the 21$^{st}$ Century*, Thomas Picketty, contradicting Kuznets and other mid-20$^{th}$ century economists—in addition to Thomas Mann--argues that there is no "naturally-occurring" tendency in capitalism for inequality to diminish over time. To the contrary, he sees an inherent tendency under capitalism promoting increasing levels of inequality. The period that shaped the views of the mid-20$^{th}$ century economists, 1914-1945, encompassed two world wars and the Great Depression. It was a period of extreme destruction of capital (the same as wealth for Picketty) and resulted in a sharp fall in the ratio of capital to national income. The "thirty glorious years" of relative equality and rapid growth following World

War II represented the exception to the high levels of inequality that capitalism normally engenders. During that period capital was rebuilt and since the 1970s, a growing inequality of income and wealth has reappeared, approaching levels comparable to those seen in the early part of the 20th century, prior to World War I.

The theoretical underpinning of this basic tendency, in Picketty's view, are the two "fundamental laws of capitalism." The first law is an accounting identity: the share of national income going to capital (as opposed to labor income) is equal to the rate of return on capital (r) times the total stock of wealth (capital) as a share of national income. If Y = national income, $\beta$ = the capital/income ratio (the net value of a country's wealth divided by its income), and $\alpha$ = the share of national income received by the owners of capital, then

$$\alpha = r \times \beta$$

The example Picketty provides is: if $\beta$ = 600% (the capital stock of a country is 6 times its national income) and r = 5%, then $\alpha = r \times \beta$ = 30% (p. 52). This example approximates the actual average conditions in the developed countries around 2010 (p. 53).

"The second fundamental law of capitalism: the higher the savings rate (s) and the lower the growth rate (g), the higher the capital income ratio ($\beta$) (p. 55)":

$$\beta = s/g \qquad \text{(p. 168)}$$

Picketty explains that this law is true only in the long run: "if a country saves a proportion of its income indefinitely, and if the rate of growth of its national income is g permanently, then its capital/income ratio will tend closer and closer to $\beta = s/g$ and stabilize at that level" (p. 168). He notes too that the law is valid only for forms of capital that people can accumulate, thus excluding natural resources such as land. Throughout the book, Picketty argues as well that slowing global demographic growth and other factors are likely to make the growth rate in the current century relatively sluggish, perhaps falling to the 1.5% area among the developed countries, thus placing upward pressure on the capital/income ratio. And the higher the capital/income ratio becomes, the greater the share of income accruing to inherited wealth, which in his view implies the increasing concentration of wealth and income. To avoid this outcome, Picketty proposes a progressive global tax on wealth, starting on a regional basis, as the 21st century counterpart to the 20th century's introduction of progressive taxation on income.

**Critiques of Picketty**

As might be expected, the financial press has not been welcoming to Picketty's analysis and his focus on a graduated (progressive) wealth tax as the solution to soaring inequality. In this section, I would like to consider these criticisms and react to them briefly. In the next—and concluding—section, I will present my own assessment, which of course will be partly anticipated by my reactions here to other critiques. The critiques on which I will focus include the following: (1) data problems; (2) methodology; (3) inconsistencies; (4) insufficient attention to the role of economic institutions; (5) mobility issues; and (6) policy practicality.

Data problems

The most detailed critique of data problems in Picketty's work appears in an article by the Economics Editor of the Financial Times, Chris Giles.[1] Mr. Giles claims that by correcting Picketty's errors, he finds no evidence of a definitive rise in income inequality since 1980. He lists his data critique under the following categories: (a) Fat fingers; "Frequently… the source material is not the same as the numbers he (Picketty) publishes;" (b) Tweaks: Picketty sometimes adjusts the numbers in his sources without explaining his adjustments; (c) Averaging: Picketty constructs time-series of wealth inequality for 3 European countries: France, Sweden and the UK. He then uses a simple average of the 3. Since Sweden has about 1/7th the population of the other 2, it would be more appropriate to use a weighted average; (d) Constructed data: Since the information provided by the sources is often sketchy, Picketty makes assumptions to fill in the missing data points without explaining the basis of his assumptions; (e) Picking the wrong year for comparison: When data are lacking, picking a relatively close year may be reasonable, but Picketty sometimes does so when the required data are in his original source material; (f) Problems combining sources: Different sources are used to estimate wealth for different years in the US and for different countries, leading

[1] See Chris Giles, "Data Problems with Capital in the 21st Century," *Financial Times*, 5/23/14; and "Picking Holes in Picketty," *The Economist*, 5/31/14: 69.

to large possible biases; and (g) Cherry-picking data sources: There is little consistency displayed in combining different sources; the sources chosen show wealth inequality rising rather, as Giles argues, than staying constant (US) or falling (UK).

It is not possible here to consider this critique in detail. Picketty has responded that the article does not constitute a refutation of his book's thesis: that the "central contradiction of capitalism" is the inexorable concentration of wealth among the richest individuals. As noted above, Giles believes his critique does just that. What are we to make of this disagreement? My own view is that we have overwhelming evidence of a sharp increase in income inequality in most developed nations since 1980, as I will argue below, and it is simply inconceivable that this increase in income inequality would not have been accompanied by a parallel rise in wealth inequality. Picketty's work is a massive undertaking in economic history research, including the examination of historical data from more than 20 countries over some three centuries. The data are derived from historical tax tables and other sources whose primary function was not assessing the distribution of wealth. Inevitably, judgment is called for and creativity as well, as when Picketty uses 19th century literature to help in assessing the wealth required to sustain upper-class life styles. Despite its flaws, this is a monumental work, one with which future scholars of the dynamics of the capitalist system will have to contend.

Methodology

Picketty's study focuses on pretax cash income, excluding benefits and the impact of taxation. Phil Gramm and Michael Solon argue that for the US this greatly distorts the picture of inequality by failing to consider social security income, Medicare, Medicaid and over 100 means-tested programs.[2] Referring to a study in the *Southern Economic Journal*, they claim that when taxation and benefits are taken into account, the bottom quintile of the US income distribution did not lose 33% of their income between 1979 and 2007 but gained 32%, while the middle quintile gain was 37% rather than 22%. Moreover, important changes in the US tax code meant that the figures over this period were not directly comparable. In particular, taxes were cut more for individuals than for corporations, so that many businesses were changed from C-corporations (ordinary limited liability corporations which are legally separate from their owners) to chapter S-corporations, thus avoiding double taxation and allowing for taxation at a lower rate. In doing so, they increased the incomes of their owners, presumably high in the income and wealth distribution, at the expense of corporate income.

Much of Picketty's data cover the 18th and 19th centuries, prior to the broad institution of a progressive income tax in the West, so it is not unreasonable for him to have been consistent in using pretax data. The Gramm-Solon argument is of course correct in pointing out that the growth of inequality was modified by the exclusion of benefits in kind and the change in the tax system should presumably

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[2] Phil Gramm and Michael Solon, "How to Distort Income Inequality," *Wall Street Journal*, 11/12/14: A15. See also Alan Reynolds, "Why Picketty's Wealth Data Are Worthless," *Wall Street Journal*, 7/10/14: A11, and Martin Feldstein, "Picketty's Numbers don't Add Up," *Wall Street Journal*, 5/15/14: A15.

have exaggerated the rise in income of the wealthiest households. It is equally true that the evidence here bears directly on income rather than wealth, and that the growth in inequality, while being less extreme on a post-tax basis than Picketty's data appear to indicate, is nevertheless substantial. As an article in *The Economist* points out, "The most highly paid 1% of workers in Britain pay 28% of all income tax, while in America it is 46%. In 1979 those shares were 11% and 18% respectively."[3]

Inconsistencies

In a section entitled "The Rise of the Supermanager: An Anglo-Saxon Phenomenon," Picketty writes: "In all the English-speaking countries, the primary reason for increased income inequality in recent decades is the rise of the supermanager in both the financial and nonfinancial sectors" (p. 315). The focus of Picketty's work is on the increasing disparities in wealth, which he attributes to the growing share of income received by capital. Yet here he informs us that the growth in income inequality in the English-speaking countries is driven by widening inequalities in income from labor rather than income from capital. As Joseph Stiglitz points out, CEO incomes of major corporations are now some 295 times those of average workers, much higher than in the past.[4]

Insufficient attention to institutions

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[3] 9/20/14: 13, "Inequality and the narrowing of the tax base: too reliant on the few."
[4] *New York Times*, 6/29/14: SR 1.

Picketty is well aware that institutions and policies can significantly affect the distribution of wealth, and he devotes one section of his book to policy prescriptions. And the very title of his book, *Capital in the Twenty-first Century*, indicates an awareness of the changing nature of capitalism over time. Indeed, modern-day capitalism differs dramatically from the capitalism of the 18th and 19th centuries, and even from the capitalism of the mid-20th century. As I will argue below, capitalism saves itself from crises by repeatedly reinventing itself through institutional change. And in its current iteration, the dynamics of capitalism are indeed generating growing disparities in income and wealth, but the forces at work are in many ways quite different from those that prevailed in earlier centuries. This in turn suggests that policies rather different from those Picketty proposes may be most appropriate.

<u>Mobility issues</u>

Picketty provides a number of examples of great wealth compounding, including Warren Buffet, Bill Gates Jr., and Lillian Betancourt. It is of interest to note that neither Buffet nor Gates inherited their wealth, but it is also proper to note that capitalism is a dynamic system in which considerable fortunes are made and lost on a regular basis. Consider the Reichmann family of Canada, real estate developers and owners whose fortune was boosted by purchasing New York City real estate during a troubled period in the 1970s.[5] The family then invested heavily in the

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[5] See, for example, "Paul Reichmann, Olympia & York Family's 'Idea Man,' Dies at 83," *Bloomberg.com*, 10/25/13, and "Paul Reichmann," *Wikipedia*.

earliest stages of developing London's Canary Wharf, in which process they lost the greater part of their fortune, correctly envisioning the future but acting too early—before the demand for office space there was realized. Ruchir Sharma cites Larry Summers as pointing out that very few of those listed on Forbes magazine's billionaire list of 1982 are on the 2012 list, evidence against the inevitable expansion of inherited wealth. Sharma writes "In the developed world, tycoons who largely inherited their fortunes account for as little as 12% of total billionaire wealth in Japan, or as much as 76% in Germany. In the U.S. they account for 33%. In the emerging world the inherited share ranges from near zero in Russia and China to 84% in South Korea."[6] These differences can be understood only in the context of differences in policies and institutions in different countries, and the mobility of individuals into and out of the wealthiest segments of the population raise some doubt over the portrait drawn by Picketty of a rentier class being recreated akin to those of earlier centuries.

Policy practicality

Kenneth Rogoff argues that Picketty's wealth tax is "next to impossible to implement."[7] In a world with something on the order of 200 different countries, very high taxes on income or wealth can simply prompt those affected to move to another country if hiding their wealth abroad does not suffice. Picketty does recognize this problem, but suggests that regions such as the euro-zone can

[6] *Wall Street Journal*, 10/9/14: A17.
[7] *Bloomberg Business Week*, "Thomas Picketty and the Data on Inequality," 5/23/14, pp. 42-47.

implement a wealth tax until such time as a global wealth tax can be implemented. I remain highly skeptical of the practicality of such a solution, which in any event fails to address the equally large issue of the impact of a highly progressive wealth tax on innovation and entrepreneurship.

The *raison d'aitre* of capitalism and the reason for which capitalism is the first system in human history to bring about systematic growth above subsistence is the role of accumulation at its core. The accumulation of capital--the process by which capital investment sustains the production of commodities which are sold above their costs of production, with a significant share of this profit being reinvested in a never-ending cycle—is at the very core of the capitalist system. Picketty's proposal for a steeply progressive wealth tax is simply not compatible with the capitalist system. Although it may prove compatible with the system that succeeds capitalism, that may not appear until the entire world has attained developed status, perhaps not for another couple of centuries.[8]

**Picketty's analysis**

In his analysis of capital in the 21st century, Picketty presents redistribution via taxation as a solution to the challenge presented by the growing inequalities of wealth, a challenge generated by returns to capital growing faster than national income, a challenge which strikes at the "meritocratic values on which democratic

[8] See my argument which is developed more fully in *Capitalism* (2005).

societies are based" (p. 1). It seems to me, first of all, that the core point at which these values are challenged is the point at which wealth is inherited. It is completely reasonable, therefore, to tax inheritances at extremely steep rates up to and including 100%. Picketty's proposal for a progressive global tax on wealth, however, is highly impractical. It assumes a degree of international cooperation in taxation that is unlikely to be realized—even in the distant future. It raises problems of valuation and liquidity, moreover, since assessed valuations would involve a high degree of subjectivity, and most wealth is not held in liquid form. Before considering alternatives, however, a closer look at Picketty's historical studies and analysis is in order.

The problem on which Picketty focuses is the existence of forces within the capitalist system that tend to generate increasing inequality in the distribution of wealth and income, a problem that stems from returns on capital exceeding the growth rate of national income—in accord with the two basic "laws" of capitalism that he discusses. Throughout his work, however, Picketty reveals an awareness that the growth in inequality is not inevitable, that forces promoting convergence (greater equality) contend with those promoting divergence (greater inequality). In this section, I turn to quotations from his work demonstrating this awareness and clarifying the substance of his argument; I follow each quotation with my own comment. My own comments are meant to pave the way to the alternative approach to the problem of growing inequality that is presented in the concluding section of this paper.

(1) "The second conclusion, which is the heart of the book, is that the dynamics of wealth distribution reveal powerful mechanisms pushing alternately toward convergence and divergence (greater equality and inequality in the distribution of wealth and income). Furthermore, there is no natural, spontaneous process to prevent destabilizing, inegalitarian forces from prevailing permanently." (p. 21)

Although Picketty's focus is on forces promoting inequality, he recognizes that there are countervailing forces, which he later notes did indeed prevail during the 20th century.

(2) "The main forces for convergence are the diffusion of knowledge and investment in training and skills….Knowledge and skill diffusion is the key to overall productivity growth as well as the reduction of inequality both within and between countries." (p. 21; see also p. 71)

Here Picketty specifies the main force promoting greater equality. Although the concluding policy thrust of his book is on a progressive wealth tax to promote greater equality, he presents here the potential basis for an alternative approach.

(3) "I will show that this spectacular increase in inequality (in US income, from the 1970s to the 2000s) largely reflects an unprecedented explosion of very elevated incomes from labor, a veritable separation of the top managers of large firms from the rest of the population." (p. 24)

The surge in income inequality in the US in recent decades stems largely from an increase in incomes from labor rather than from capital. Yet Picketty's policy focus is largely on incomes from capital.

(4) "If…the rate of return on capital (r) remains significantly above the growth rate (g) for an extended period of time…then the risk of divergence in the distribution of wealth is very high." (p. 25)

Note that Picketty here speaks of the "risk of divergence." There is nothing automatic about the process.

(5) "The fact that the return on capital is unpredictable and arbitrary, so that wealth can be enhanced in a variety of ways, also poses a challenge to the meritocratic model." (pp. 26-27)

If the return on capital is unpredictable and arbitrary, how can one assert, as Picketty does, that r > g?

(6) "In the model I propose, divergence is not perpetual and is only one of several possible future directions for the distribution of wealth. But the possibilities are not heartening. Specifically, it is important to note that the fundamental r > g inequality, the main force of divergence in my theory, has nothing to do with any market imperfection. It is possible to imagine public institutions and policies that would counter the effects of this implacable logic: for instance, a progressive global tax on capital….It is unfortunately likely that actual responses to the problem…will in practice be far more modest and less effective. (p. 27)

Here Picketty reminds us that the "implacable logic" underlying his expectation of rising inequality and concentration of wealth is only one possible outcome. Public institutions and policies, which do not play a large part in his analysis (although they do in his proposed solution), can remedy the tendency to growing inequality.

(7) "…capital's share (excluding human capital) in the early decades of the twenty-first century is only slightly smaller than it was in the beginning of the 19th century. The importance of capital in the wealthy countries today is primarily due to a slowing of both demographic growth and productivity growth, coupled with political regimes that objectively favor private capital." (p. 42)

Although Picketty's work focuses on the manner in which his two "fundamental laws" of capitalism tend to drive a growing share of capital relative to labor in national income, he observes here that over the last two centuries, labor's share of income has grown relative to that of capital. Moreover, one factor making the position of capital deteriorate less than it might have is the role of policy.

(8) "The share of income going to the wealthy countries has been declining steadily since the 1970s." (p. 67)

Picketty's focus is, of course, on the distribution of income within countries rather than among them. Even so, If one is concerned with global inequality and global poverty, the vast improvements since the 1970s are remarkable. Is it possible that the global reductions in inequality and poverty are a consequence of the same forces that gave rise to increased inequality within the wealthy countries? And concomitantly, that the eventual catching up of the less developed countries will weaken the forces promoting inequality in the richer ones? Without denying that measures to address the growth in inequality are needed now, I suggest in the final section below that that may well be the case. Moreover, by focusing on the interaction between globalization and technological change as major forces promoting growing inequality in the wealthy countries, I find policies and institutions that are likely to be both more practical and more efficacious than Picketty's progressive global wealth tax.

(9) ""…constant growth…means that new functions are constantly being created and new skills are needed in every generation. Insofar as tastes and capabilities are only partially transmitted from generation to generation…growth can thus increase social mobility for individuals whose parents did not belong to the elite of the previous generation. This increased social mobility need not imply decreased income inequality, but in theory it does limit the reproduction and amplification of inequalities of wealth and therefore over the long run also limits income inequality to a certain extent." (p. 85)

Picketty here recognizes that growth can in part offset the tendency toward growing inequality that he anticipates for the 21st century, and rapid growth can do even more. He argues, however, that growth in the 21st century is likely to slow appreciably, something I take exception to below. This passage is also of interest because in it he observes that increased mobility can limit inequality. In most of his work, however, he pays very little attention to the issue of mobility. Rather, the implicit assumption in his model (which is sometimes made explicit), is that the owners of capital, receiving greater income growth than wage-earners (r > g), can save and accumulate more capital than the latter, capital which is passed on to the next generation in an unending cycle, leading to an ever-growing inequality of wealth. If there is upward and downward mobility to some extent, however, with fortunes gained and squandered (or given to charity), then the forces promoting the concentration of wealth may not be as powerful as Picketty imagines. What is significant is that he doesn't really explore the issue of mobility in any depth. And the degree of mobility is very much tied to national institutions and policies.

(10) "Capital is never quiet: it is always risk-oriented and entrepreneurial, a least at its inception, yet it always tends to transform itself into rents as it accumulates in large enough amounts—that is its vocation, its logical destination." (pp. 115-116)

Picketty here shows an important insight into the nature of capital. Initially risk-oriented and entrepreneurial, it eventually transforms itself into rents. Picketty does not, however, explore the relation between these two stages of capital, an omission which becomes critical when he turns to policy prescriptions—his graduated wealth tax in particular. Picketty means to control/limit capital as rent-seeking, but his tax would also affect capital in its earlier incarnation as entrepreurial and risk-taking.

(11) "Many people believe that what characterizes the process of development and economic growth is the increased importance of human labor, skill and know-how in the production process. Although this hypothesis is not always formulated in explicit terms, one reasonable interpretation would be that technology has changed

in such a way that the labor factor now plays a greater role. Indeed, it seems plausible to interpret in this way the decrease in capital's share of income over the very long run, from 35-40 percent in 1800-1810 to 25-30 percent in 2000-2010, with a corresponding increase in labor's share from 60-65 percent to 70-75 percent. …If this interpretation is correct, then the transformation to which it points was indeed quite significant. Caution is in order, however. For one thing…we do not have sufficient perspective at this point in history to reach an adequate judgment about the very long-run evolution of capital's share of income" (p. 223)

Once again, Picketty recognizes the possibility that labor's share of national income may have a tendency to rise in the very long-run. To the extent that this is true, this would prove an offset, at least in part, to the tendency of capital's share to rise in his model.

(12) "The rise of a propertied middle class was accompanied by a very sharp decrease in the wealth of the upper centile, which fell by more than half, going from more than 50 percent in Europe at the turn of the 20th century to around 20-25 percent at the end of the century and beginning of the next." (p. 262)

This passage at least raises the possibility that further growth in the middle classes globally would further promote global equality of income and wealth, both within and among countries. The growth of the middle classes in developing countries has indeed been a global phenomenon since World War II, and with reforms undertaken in Africa and South Asia, it seems likely to continue. Indeed, facilitating a transition from underclass to middle class status in both wealthy and developing countries through institutional reform and policy initiatives appears to be a promising alternative to Picketty's graduated wealth tax, especially since such a tax would be likely to diminish economic growth (via its effects on entrepreneurship and risk-taking), undermining the possibilities for such a transition.

(13) "The first of these two ways of achieving such high inequality is through a "hyperpatrimonial society" (or "society of rentiers"): a society in which inherited wealth is very important and where the concentration of wealth attains extreme

levels (with the upper decile owning typically 90 percent of all wealth, with 50 percent belonging to the upper centile alone). The total income hierarchy is then dominated by very high incomes from capital, especially inherited capital. This is the pattern we see in Ancien Regime France and in Europe during the Belle Epoque….The second way of achieving such high inequality is relatively new. It was largely created by the United States over the past few decades. Here we see that a very high level of total income inequality can be the result of a "hypermeritocratic society" (or at any rate a society that people at the top like to describe as hypermeritocratic). One might also call this a "society of superstars" (or perhaps "supermanagers," a somewhat different characterization). In other words, this is a very inegalitarian society, but one in which the peak of the income hierarchy is dominated by very high incomes from labor rather than by inherited wealth." (pp. 264-265)

Once again we see a clear recognition by Picketty that inequality may have different sources. As I will argue below, if inequality is from labor incomes then a different set of policies than those Picketty proposes may be appropriate.

(14) In France, "the significant compression of income inequality over the course of the 20th century was due entirely to diminished top incomes from capital. If we ignore income from capital and concentrate on wage inequality, we find that the distribution remained quite stable over the long run….No generalized structural process of inequality compression (and particularly wage inequality compression) seems to have operated over the long run, contrary to the optimistic predictions of Kuznets's theory….the factual picture is more or less the same in all developed countries. " (pp. 272-274)

There are two key points made in this passage. First, as I have already noted, Picketty points out that the shocks of the two world wars and the Great Depression destroyed considerable wealth in the first half of the 20$^{th}$ century. In the concluding section of this paper, I will argue that the forces of capital destruction need not be limited to those encountered in the 20$^{th}$ century, moderating expectations of increasing inequality of wealth and the income it provides. The second key point concerns Kuznets's expectation of growing labor income relative to capital as development proceeds. Picketty's observation that this is not necessarily true theoretically and has not been demonstrated historically is undoubtedly correct, but a focus on the issue Kuznets raised does suggest alternative policies to diminish the inequality of income and wealth.

(15) "To a large extent, we have gone (in France) from a society of rentiers to a society of managers, that is, from a society in which the top centile is dominated by rentiers (people who own enough capital to live on the annual income from their wealth) to a society in which the top of the income hierarchy, including (the) upper centile, consists mainly of highly paid individuals who live on income from labor. It is important, however, to be clear that this major upheaval came about, in France, at any rate, without any expansion of the wage hierarchy…it was due entirely to the decrease in high incomes from capital." (p. 278)

Capitalism is a dynamic system which has proven that it can repeatedly survive its crises by reinventing itself. Picketty here recognizes the shift in the income sources for those at the top of the hierarchy of income and wealth. It's of interest to note that the policy he advocates to forestall the recreation of inequality in the distribution of income and wealth akin to that which prevailed in 19th century Europe, might well have a partially offsetting effect. To the extent that a highly progressive wealth tax discourages innovation and accumulation, it would reduce economic growth and enhance the importance of inherited capital.

(16) In the US, "…the vast majority (60 to 70 percent…) of the top 0.1 percent of the income hierarchy in 2000-2010 consists of top managers. By comparison, athletes, actors, and artists of all kinds make up less than 5 percent of this group. In this sense, the new US inequality has much more to do with the advent of "supermanagers" than with that of "superstars." (pp. 302-303)

Since the income of the top 1 percent in the US is associated with supermanager status rather than inheritance, measures appropriate to addressing the growth of inequality would presumably be different than the wealth tax on which Piketty focuses. Moreover, since the rise of the supermanager is essentially an Anglo-Saxon phenomenon, one not shared by most of Europe, potential models already exist for addressing the inequality to which the phenomenon has given rise.

(17) "In the long run, the best way to reduce inequalities with respect to labor as well as to increase the average productivity of the labor force and the overall growth of the economy is surely to invest in education….Over the long run, education and technology are the decisive determinants of wage levels….All signs are that the Scandinavian countries, where wage inequality is more moderate than elsewhere, owe this result in large part to the fact that their educational system is relatively egalitarian and inclusive….the main problem with the theory of marginal productivity (determining wage levels) is quite simply that it fails to explain the diversity of the wage distributions that we observe in different countries at different times. In order to understand the dynamics of wage inequality, we must introduce other factors, such as the institutions and rules that govern the operation of the labor market in each society." (pp. 306-308)

Surely Picketty is right on in his observation of the forces governing inequality in the distribution of income from labor. His writing here is of particular importance since it is the inequality of labor incomes rather than the inequality of capital incomes that has been driving overall inequality since the 20th century. His concern with inequalities of income from capital is not entirely misplaced since he identifies the conditions under which the growing inequality of wealth has become an increasing problem since late in the last century. Even so, given the rise of the "supermanager" and "superstar" incomes over the same time period, and given the fact that instiutional differences explain the Anglo-Saxon supermanager phenomenon (p. 315), policy changes other than his signature progressive tax on wealth may deserve a greater role in formulating corrective policy and institutions.

(18) "Are there deep reasons why the return on capital should be systematically higher than the rate of growth? To be clear, I take this to be a historical fact, not a logical necessity." (p. 353)

"Ultimately, we find that in the 20th century, both fiscal and nonfiscal shocks created a situation in which for the first time in history, the net return on capital was less than the growth rate. A concatenation of circumstances (wartime destruction, progressive tax policies made possible by the shocks of 1914-1945, and exceptional growth during the three decades following the end of WW II) thus created a historically unprecedented situation, which lasted for nearly a century. All signs are, however, that it is about to end." (p. 356)

"…the reason why wealth today is not as unequally distributed as in the past is simply that not enough time has passed since 1945….What structural changes occurred between 1914 and 1945, and more generally during the 20th century, that are preventing the concentration of wealth from regaining its previous heights, even though private wealth overall is prospering almost as handsomely as in the past? The most natural and important explanation is that governments in the 20th century began taxing capital and its income at significant rates….Until World War I there was no tax on capital income or corporate profits. In the rare cases in which such taxes did exist, they were assessed at very low rates. Hence conditions were ideal for the accumulation and transmission of considerable fortunes and for living on the income of those fortunes. In the 20th century, taxes of various kinds were imposed on dividends, interest, profits and rents, and this changed things radically." (pp. 372-373)

Picketty here makes clear his argument that his two fundamental laws of capitalism do not necessitate returns on capital being higher than the rate of growth. That has been the case historically except for the 20th century, when a unique combination of events made the growth rate higher than returns on capital. Since late in the 20th century, however, conditions have been recreated under which the returns on capital are once again greater than the growth rates of national income in the wealthy countries. This will continue to lead over time to growing inequality of wealth and income unless new policies and institutions intervene. Picketty's signature policy/institutional intervention is the global wealth tax, which he discusses in chapter 15, pp. 515-539. I turn in the next section to my own assessment of the forces generating the growing inequality of income and wealth and the suitable policy measures that analysis suggests. I juxtapose that analysis and policy measures to those of Picketty, and suggest that differences in our understanding of capitalism and its evolution over time influence our understanding of appropriate institutional changes and policy measures.

**An alternative approach to the growing inequality of income and wealth**

Picketty sees the destruction of capital in the 1914-1945 period as the key to understanding the "abnormal" decrease in inequality that characterized the 20th century. I would like to suggest, however, that the destruction of existing capital in the Schumpeterian sense is an ongoing feature of the capitalist system; it is not something that appears only under the most extreme crises and world wars. During more normal times, however, the destruction of capital takes place in the context of innovation that displaces its functions. As a result of this, there is some degree of mobility into and out of the ranks of the super-wealthy, rather than a straight-line accumulation of ever-greater wealth on the part of a few families. That said, in a meritocratic and democratic society, there is a public interest in preventing outsized rewards to some on the basis of birth rather than achievement or effort. It is quite appropriate to make use of steeply progressive inheritance taxes to forestall undeserved rewards—and of course since gifts are being used to avoid inheritance taxes, those gifts must also be taxed steeply.

The idea of taxing wealth itself, however, is problematic for a number of reasons. First of all, people can and do move their domiciles to avoid such taxes. Picketty of course recognizes this problem, but the progressive global tax on wealth he advocates assumes a level of cooperation among nations that is unlikely to be achieved within the foreseeable future. Second, valuing wealth necessarily involves subjective judgments on current market values, making equitable assessments problematic. Third, to the extent that wealth is not in liquid form—and much or most is not—new problems would arise such as people being forced out of their homes. And fourth, heavy taxes on wealth would surely discourage innovation and accumulation, hindering economic growth. That in turn could well limit employment opportunities for those less well off. Taken together, and considering that steeply progressive income and inheritance taxes could achieve much of the objective of a progressive global wealth tax, Picketty's solution to the problem of growing inequality hardly seems appropriate. Moreover, there are alternative approaches to reducing inequality that bear promise, approaches that focus on improving the lot of those lower down in the income hierarchy rather than dragging down those at the top. Considering the current sources of inequality can help to make this clear.

In the current era, the forces of technological change and globalization have combined to make a powerful contribution to growing inequality in the wealthy countries. After World War II, the expansion of manufacturing and construction offered relatively well-paying opportunities to workers with limited skills. This was true soon after the war in the U.S. and the need for reconstruction from the war damage eventually had a similar effect overseas. At present, however, jobs have been lost to countries with lower labor costs and technological change has made factory production ever more automated. In principle, we can think that most factory jobs can be fully automated as robots and other machinery replace workers.

Moreover, advances in information and communications technology are increasingly facilitating the replacing and outsourcing of white-collar jobs as well.

In principle, factory, construction and similar semi-skilled jobs can be replaced by other types of jobs. Unfortunately, however, the education and training of those displaced is often inadequate to prepare them for the new types of jobs. Many of the new job possibilities are in fields in technology or that use technology, but many are also in fields that involve personal care and education, jobs in healthcare, childcare, teaching and so forth. The public provision of education and training, starting with preschool right through postgraduate study would surely improve the equality of income distribution. Picketty himself acknowledges this when he attributes the relative equality found in Scandinavian countries to extensive support for public education. Financial support for retraining in new skills when old ones become outmoded is much deeper in Europe generally than in the U.S., moreover, and that is something else that can help to reduce inequality by improving living standards for those relatively low in the income scale.

One can also argue more broadly that within the wealthy countries the systems of educations themselves require reform. In Germany, for example, students at the high school level who do not choose an academic course of study choose among a large number of occupations and combine internships with their high school studies, qualifying them as skilled workers when they graduate and normally find employment within the firms in which they interned. Institutions like this that have grown up organically in Germany cannot simply be reproduced elsewhere (as the UK is learning), but they are indicative of the institutional possibilities for reform that exist.

Economic displacement is an ongoing characteristic of capitalism. We can think in the not-too-distant future of household robots, self-driving cars, and other innovations becoming increasingly commonplace. We can see today the spread of the "sharing economy" as individuals provide transportation in their cars or rooms for travelers in their houses. All of these changes will prove disruptive to some as for example, cab drivers or hotel staff find their jobs undermined. The point is not to block change, but to provide people with the skills to adapt to it. One approach to addressing this situation is to identify the areas of current skill shortages and those that are likely to emerge, and to orient education and training to meeting those needs. Skilled childcare is an example of a current shortage in the U.S. and rapidly aging populations characterize all of the wealthy nations and China, suggesting growing needs for people pursuing healthcare-related and personal assistance professions.

There are, of course, many institutional reforms capable of promoting a more equal society. Assistance for those finding themselves deeply in debt after financing their college and professional educations and winding up with low-paying jobs or no jobs at all, could take the form of educational financing reforms that gear repayment requirements to income earned. Wealth at the low end of the scale could be built up by establishing mandatory saving and or pension schemes out of income earned, preferably with matching contributions by employee and employer to supplement—not supplant--social security.

Ultimately, in any society, the degree of inequality in wealth and income depends on the level of development and the institutions established by each society. If a greater degree of equality is desired, it most come about through a modification of its existing institutions or the introduction of new ones. Joseph Stiglitz puts it somewhat differently, "If it is not the inexorable laws of economics that have led to America's great divide, what is it? The straightforward answer: our policies and our politics."[9] Ultimately, these are what shape our institutions.

Historically, the capitalist system has escaped from crises by repeatedly reinventing itself. In the business cycle, a recession moves into crisis when recovery requires institutional change. The New Deal, for example, ushered in a series of institutional reforms that facilitated eventual recovery from the Great Depression. In similar fashion, if on a more moderate scale, recovery from the Great Recession has been facilitated by institutional reforms in the U.S. ranging from financial reform (regulatory reform, Dodd-Frank, quantitative easing, among others) to healthcare reform. Europe, which needs more flexible labor markets and greater European Union cooperation on monetary and fiscal policy, has found it difficult to proceed with the needed reforms and its economy continues to struggle as a result.

The growth of inequality in the wealthy countries, if it is not contained through a process of institutional reform, threatens to undermine the capitalist

[9] *New York Times*, 6/29/14: SR 1.

system in several ways. Stagnant incomes for the lower and middle classes limit their purchasing power and therefore final sales in the economy. Stagnant incomes, moreover, promise to intensify downturns when they come and lead to serious disaffection in large portions of the population, which in turn can and has contributed to populist movements based on fear and ignorance that have the potential to damage the economy and the country. In this regard, examples such as antagonism to immigration and immigrants, misplaced belief in balancing the budget in the midst of widespread unemployment, and willingness to default on the national debt come to mind. In these ways, growth in inequality is doing just what Picketty suggested, threatening the preservation of an open, democratic and meritocratic society. Addressing this problem is of great importance, therefore, calling for serious efforts at institutional reform. Rather than rely on a highly progressive global tax on wealth, however, a combination of significant increases in inheritance taxes with a substantial expansion of public support for and reform in education appear to be a preferred approach.