Capital, Now and in the Future

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Review of **CAPITAL IN THE TWENTY-FIRST CENTURY BY THOMAS PIKETTY (TR. ARTHUR GOLDHAMMER). BOSTON: BELKNAP, 2014.**

IT has been more than a year since Thomas Piketty's *Capital in the Twenty-First Century* was published in French, transforming the world of economics in the process. It is perhaps the greatest success of an economics book since John Maynard Keynes' *General Theory of Employment, Interest and Money* was published some 80 years ago. Of course, a question can legitimately be asked: will it remain as influential in 10 or 20 years? To begin answering this question requires not only a review of the book itself, but also an examination of what we have learned in the year since the book was published. In this regard, three basic topics should be considered: first, why has *Capital in the Twenty-First Century* been so popular; second, what are the potential issues or critiques one could make; and, third, how should we think about the recommendations it makes?

Instant Popularity

Why was the book so popular? As always, in such judgments, one has to distinguish objective from subjective factors.

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Thomas Piketty at the 2014 Frankfurt Book Fair

Only the first, in principle, ensure the long-run sustainability and influence of a book. But to have had the huge short-run success that *Capital in the Twenty-First Century* certainly enjoyed, one needs the confluence of the two. On the objective side, the book was written by a well-known economist who has already distinguished himself through 15 years of first-rate papers and books. Then, the book provides a relatively simple, yet powerful, model that "unifies" the economics of growth, functional income distribution (labor versus capital), and personal income distribution (inequality among individuals). This was bound to appeal to those economists who love great syntheses. And, indeed, very few people before Piketty—at least in the recent history of the profession—were able or brave enough to put things together on such a grand scale. Economists have lost the habit of 'system-related' thought (that is, of looking at capitalism as a 'system'). Driven by the general parcelization of the field, they have preferred to focus on rather small issues (e.g. does the minimum wage reduce the number of jobs, do tariffs harm output, how do subsidies distort incentives, and so on).

Moreover, the broad systemic thinking offered by Piketty is based on a huge and detailed historical database. Thus, the model presented, plus the underlying data, have made it very difficult for Piketty's detractors to have an easy go at him. They could legitimately disagree with his model and its implications, but they could not overturn his data. Alternatively, they could nitpick about this or that data point, but they could not propose an alternative worldview. Finally, among the "objective" reasons, I should mention that the book is very well written. It can be read basically as a history book. It also does not shy away from taking strong positions or criticizing famous economists. Piketty's book was written with conviction and no fear. Readers can sense that.

On the subjective side, I think that one can list the timing. With the onset of a recession that had by then lasted six years, unhappiness about the real wage stagnation in both the United States and Europe, and runaway income inequality driven by huge income gains at the top, any book that would seriously claim to explain these phenomena was guaranteed a good reception. So much the more given that it is truly an excellent work, steeped in history, and written by one of the world's top economists. Nonetheless, had *Capital in the Twenty-First Century* been published in 2006, I have little doubt that it would have been successful among economists, but it would have stood no chance of becoming a *New York Times* bestseller.

Also among subjective factors, one can, strangely, list that the book was originally published in French. This would ordinarily be a minus, since the global market of ideas is essentially monopolized by English language publications (incidentally, this is why this review is written in the language of the Bard). But here Piketty was lucky. The fame of his book spread very quickly to the United States, despite its rather lukewarm first reception in France. The fact that the book was not available in English for six months made the waiting and anticipation excruciating and all the more keen; people found themselves saying 'the final, ultimate answer to all our problems has been discovered,

> *The book's importance might very well outlast this century.*

and it is only the language barrier that prevents us from finding out about it right now!' I half expected (and I think in some cases this indeed happened) that student study groups would form to simultaneously learn French and read Piketty. In fact, it reminded me of the story of Russian students in Europe who got together in 1867 to learn German in order to read Marx's *Capital.* This anticipation made the publication of the book in English, marvelously translated by Arthur Goldhammer (a premier American translator of French non-fiction), a real explosion in the worlds of science, punditry, and popular culture.

Leaving it to the end, I cannot simply ignore the fact that several people thought that Piketty's good looks, straight-talking, French accent and general American *engouement* with French thinkers were also helpful in wooing the American public. And once you had the American public on your side, the world was your oyster.

In short, this is why the book became a hit.

Lasting Influence

Will it have a lasting influence, and what are its possible shortcomings? Being the hit of the year is not sufficient for a book to have lasting influence. I believe, however, Piketty's *Capital in the Twenty-First Century* will be with us for a very long time.

On some optimistic days I even think Piketty might have made a mistake by featuring the twenty-first century so clearly in his title. The book's importance might very well outlast this century, and people in the next century might be reluctant to read something whose validity appears time-bound. Perhaps *Capital Now and in the Future* or *The Rise of Patrimonial Capitalism* might have been better titles.

The influence of the book will remain for all the objective reasons that have made it a hit, but also because the basic conflict between income earned from ownership (and which does not require labor, as we economists understand the term) and income earned through labor will remain for the foreseeable future.

In effect, capitalist societies are structured in such a way that this is a central conflict, however hard apologists try to mask it. Moreover, this conflict, in an ironic twist, will be (as Piketty shows) the sharper the richer the society. For being a rich society essentially means having more capital. Thus, richer societies' capital/income ratios (by now this has become known as Piketty's beta) are greater, which means that relatively more income is generated from ownership (compared to labor) than in poorer societies. Since ownership of capital has always been—and is likely to remain—very concentrated, the issue of having a significant percentage of the population both rich and not working either for the entirety of their income (rentiers), or for a large chunk of it ("working capitalists") will remain a problem of first importance—both politically and ethically. This is why the messages from this book will not go away.

Conflating Wealth & Capital

But does the book have problems, which, one year after the publication, literally hundreds of reviews have uncovered? Indeed it does, and I would like to point to a couple. A technical one is Piketty's use of the terms 'capital' and 'wealth' as if thay were the same thing. In French, the terms are *patrimoine, richesse*, and *capital,* and Piketty uses them interchangeably.

Now, it is perfectly logical to focus on wealth and to consider wealth as everything that is bringing an explicit or implicit income over a period of time—from stocks and shares to housing ownership and patent rights. This is what Piketty does when he defines the share of wealth-related income in current total income (his alpha). The problem arises when that wealth is, as it were, introduced in the neo-classical production function (and Piketty needs to do this in order to combine his theory of income distribution with the theory of growth), where it really takes the place of productive capital (the *K* from economics). In other words, *W* has been conflated with (or treated as the same as) *K*. The results obtained regarding the rate of growth of output or the role of technological progress are derived from the world where *K* stands for productive capital, but applied to the world where "non-earned" income is obtained from wealth (*W*), a concept much broader than *K*. Thus, for example, the crucial condition that ensures that the rate of return on capital *r* does not decline much as the *K/Y* ratio rises (so that *r* can be treated as more or less fixed)—namely, that the elasticity of substitution between capital and labor is greater than 1—is derived from the *K* world. But Piketty applies it to the *W* world.

This problem could become similar to the Marxian "transformation problem"—not in substance, but in questioning the logical foundations of the analysis. This crucial technical point is already being debated and it will be, I am sure, debated even more in the time to come.

Rich World Focus

The second main issue is Piketty's exclusive focus on the rich world. In the era of globalization we need books that deal with the world as a whole. Indeed, it could be argued that we focus on the rich world because its developments are the developments through which the poor (or emerging) economies will have to go through as they develop. This is a linear conception of economic history, which however may not be true. In addition, the income gaps between countries like China and the rich world are rapidly closing. Does Piketty's book have much to say about China? It seems not, and this is a major omission.

Consider simply the following fact, couched entirely within the Pikettian framework. If globalization means the freer movement of capital, then we can expect a worldwide equalization of *r*. In the rich world where economic growth (*g*) will be low, the *r>g* relationship should, according to Piketty, imply growing income inequality. But in China, a much higher growth rate will overturn this relation, and *r<g* should lead to *decreasing* inequality. Thus, the world of the future may be characterized by one part (rich countries) where inequality increases and another part (emerging economies) where it decreases, with its growth—like in post-World War II Western Europe—driven by convergence economics. Moreover, in the emerging or poor world, Piketty's famous policy recommendation of capital taxation may not make much sense.

We move to that next.

Global Tax on Capital

What to make of the global tax on capital? This proposal has manifestly attracted most attention, even from those who have never read a single page of the book. In short, Piketty calls for a global tax on capital of one percent on wealth in excess of one million euros, and two percent on private wealth in excess of €5 million.

The proposal is fully consistent with his main message. If runaway growth of capital and its high concentration in relatively few hands are the main causes of inequality, then taxing capital and reducing *r* is a way to deal with inequality. But that recommendation hardly applies to China, India, and other emerging economies, for several reasons.

For instance, the growth rate of the economy in countries such as these may be, as we just saw, higher than *r*, and second, capital/output ratios are low; if indeed *r<g*, they will be decreasing further. The *K/Y* ratios, calculated from the Global Wealth Report 2013, are about 5.0 for rich countries, like the United States and Switzerland, but only 2.7 for China, 2.0 for India, and even lower for South Africa and Brazil. Thus, the "inequality threat"

from capital is much less in these countries: inequality may increase there as well; but if it does, it would be driven by factors other than the private ownership of capital. Piketty's recommendations hardly seem relevant for the emerging world.

But it gets worse. For Piketty's tax to make sense, one needs heightened international coordination, and if that international coordination is not forthcoming from countries such as China, India, South Africa, and Brazil, a global tax on capital is doomed. Even if the OECD agrees to impose it, capital might flee to the emerging world. And that very possibility will be sufficient for the rich world not to impose the proposed tax.

But would such a tax be as onerous as some detractors argue? In reality, it would not: it would not affect that many people, yet it would cover a lot of capital. According to the Global Wealth Report for 2013, there are 32 million adults in the world with net assets of over $1 million, and they collectively own almost $100 trillion of wealth.

We can assume (at least in a back-of-the-envelope sort of way) that the average tax rate would be about 1.6 to 1.7 percent (to simplify matters, I take it that $1= €1), since the distribution of wealth among the very rich is extremely skewed: there are many fewer people than 32 million with net assets above $5 million, but many of them are extraordinarily rich and, thus, would be assessed at the higher rate of two percent. To be clear: according to the 2014 Forbes list, there are 1,645 individuals with a net worth exceeding $1 billion; their combined wealth is $6.4 trillion, or six percent of global wealth as estimated by Credit Suisse; they alone would pay some $130 billion in Piketty's tax.

Total receipts from the tax may be, thus, estimated at $1.5 trillion per year, which is about two percent of global GDP. Thus, even if the number of people who would be subject to the tax is small (less than 1 percent of the world's adult population), its yield would be huge. This is hardly surprising, for it simply reflects today's immense differences in wealth between the top of the global economic pyramid and practically everybody else.

Just as a reminder, even in the richest countries of the world, such as the United States or Germany, respectively 20 and 30 percent of households have zero or negative net wealth. The fact that relatively few people would

be subject to the Piketty global tax on capital seems to suggest, at first glance, that the tax may be politically feasible.

This, however, is not the full story. The reason why this tax is unlikely to be imposed is that it would not be appealing at all to the emerging market economies, and because those who would be subject to taxation are sufficiently politically powerful to block it. It is, therefore, highly likely that the tax will fail to gain traction on political grounds.

Long-term Impact

What to conclude? One year is a sufficiently long period to have a preliminary idea about the longer term impact of a book. In the case of Piketty's, like many others in the annals of great works of economics, we have to distinguish between its analytics, its recommendations, and its forecasts.

Indeed, one can agree with Piketty's analytics without agreeing with his recommendations—the opposite is also possible. In my opinion, the analytics proposed in the book will be influential for many years, in large measure because they fit quite well the likely evolution of the rich world in the decades to come. Teaching economics without a mention of *Capital in the Twenty-First Century* would be difficult to imagine. The book will affect not only how we think of income distribution and capitalism in the future, but also how we think about economic history, from Ancient Rome to pre-Revolutionary France. It will also drive our economic thinking in directions that were not even envisaged in the book. For example, if the concentration of capital is the main culprit for increasing inequality, then much more widely-spread ownership of capital (in the form of worker ownership) may be a solution.

But when it comes to Piketty's recommendations and policies, I do not think his book will have an impact equal to that of Keynes' *General Theory.* Admittedly, the two works were written with different objectives in mind. Keynes' was in reality the last great "cameralist" treatise, destined to convince policymakers of what needed to be done (it was also the first book on macroeconomics); Piketty's *Capital in the Twenty-First Century* is much more in the tradition of classical political economy: description and analysis of the capitalist system. And as long as that system is with us, I do not think Piketty's book will be forgotten.