BOOK REVIEW

CAPITAL IN THE 21ST CENTURY – THOMAS PIKETTY

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Once in a while there comes a book on economic thought that blazes a trail: Adam Smith's Wealth of Nations, David Ricardo's Principles of Political Economy and Taxation and Keynes' Theory of Employment Interest and Money. Thomas Piketty's Capital in the 21st Century belongs to this lofty genre. And like its predecessors, it is bound to initiate a new order of discourse.

The message of this weighty book is this: the time is opportune for a hard look at the consequences and ramifications of capital in today's world because with vast and more systematized data - estate and income tax - we are now better able to consider matters on which Karl Marx could only intuit and ponderously [if also shoddily] theorize when he wrote his Das Capital in 1867. Not that Piketty's deliberately chosen title for his book fails to bring out the genius of Karl Marx who was more clear-eyed than any economist of his time about the primordial question as to how the income from production is to be divided between capital and labour. Piketty's treatment of wealth and inequality and his conclusions are a world apart from Marx, but points of convergence are not lacking in their meditations on capital as the focal point of political economy.

In four thematic parts, the book attempts an extensive study of the growth of inequality and concentration of wealth in primarily the rich capitalist countries, France, UK, Germany, Japan and the U.S. and in general terms in twenty countries that represent a cross-section of the world. Part one is devoted to an examination of the concepts of income and capital, part two to the dynamics of the capital-income ratio [the basic hypothesis of the book] part three, to the situation of inequality at

national and global level and part four, to the measures that may be adopted to regulate capital in the twenty-fist century.

The prime attribute of the book is that it is an interwoven history of the evolution of income, wealth and inequality based on analysis of tax records going back to the early years of the twentieth century and, in the case of France, farther back to the eighteenth century. What that history tells is that while capital always has had a dominant share in the national income of European countries and the U.S., it dropped to historically low levels in the period from 1914 to 45 as a result of the interplay of several factors like the Great Depression, the capital-decimating two world wars and the high taxation on the rich for financing the war effort. Capital accumulation resumed in the post-second world war period, but was offset by rapid economic growth. This was an interlude, unlikely to happen again. Now the share of capital has been rising since the 1970s, drawing strength from the conservative revolution associated with the epochs of Margaret Thatcher and Ronald Reagan. By 2010 capital was prospering as it had not done since 1913, the whole phenomenon resembling an inverted bell curve. The nature of capital has also changed radically, from land and real estate to industrial and financial capital. The importance of capital in the wealthy countries today is owing to a slowdown of both demographic and productivity growth, coupled with the actions of governments that favour capital. This consideration will also apply to today's developing countries like China and India as they move up the path of economic advancement as part of the convergence to which the dynamics of global wealth distribution leads.

The reduction of the share of capital in national income and the consequent decline of inequality during 1914-45, as mentioned earlier, is viewed by the author as the real explanation for Simon Kuznets' famous theory in the 1950s that free market industrialization in its later stages automatically makes for a downtrend in inequality. Piketty's own thesis is that the most comprehensible way to understand changes in wealth distribution over time is through the application of two fundamental laws of capitalism [which are in fact the author's working hypotheses]. The first of these is that the share of capital in national income is equal to the average return on capital multiplied by the total stock of wealth as a share of the GDP. The second law is that

over long periods of time, the stock of capital as a percentage of national income should approach the rate of national savings rate to the economic growth rate.

To put it in simple terms, Piketty's argument is as follows: the historical tendency is for the rate of return on capital to be higher than the rate of growth of national output or income, thereby causing a fissure between the rich who profit from capital and the middle class who depend on labour. The result is concentration of capital. During the twentieth century the rate of return on capital had exceptionally fallen below the rate of growth of national income, but this might again surpass it in the twenty-first century. So the outlook is for wealth inequality to rise back to the nineteenth century levels.

Placing growth itself in a global and inter-temporal perspective, Piketty sets out a double bell curve of global growth comprising both population growth and per capita output, the pace of both gradually accelerating over the course of the eighteenth and nineteenth centuries. Presently, however, it is most likely returning to much lower levels for the remainder of the twenty-first century. As to the growth of per capita output, it remains close to zero throughout the eighteenth century and begins to climb only in the nineteen century, but not becoming a shared reality until the twentieth. Global growth in per capita output rises much above 2% in 1950-70 notably thanks to the European catch-up and again between 1990 and 2000 thanks to the Asian and especially Chinese catch-up. So this bell curve will peak much later than the first one, almost a century later in the middle of the twenty-first century and eventually settling to a level of just about 1% per year. Adding the two curves, Piketty plots a third curve of the rate of total globe output: always less than 2% per year until 1950 before rising to 4% during 1950-90 reflecting both the highest demographic growth rate in history and the highest growth rate in output per head. The rate of growth of global output then begins to fall, dropping below 3.5% in 1990-2012 despite extremely high growth rates in emerging countries. This rate will continue upto 2030 before dropping to 3% during 2030-50 and then to roughly 1.5% during the second half of the twenty-first century. Return to capital rises over the growth of output and accumulated wealth grows faster against this backdrop.

As well as demography, Piketty addresses inflation as a force that can alter the distribution of wealth, noting that it is a twentieth century phenomenon; following two centuries in which prices had barely moved in Britain and the US there was 3% annual inflation from 1913 to 1950. The role of inflation in terms of capital today is seen by Piketty as contingent on situations like that of the EU where resort can be made to it for reduction of public debt and for the consequent attenuation of the power of capital owning such debt which may not be a bad thing. There is a parallel in the way Britain which was indebted for more than 200% of GDP by 1950 but managed to bring it down to around 50% of GDP through the inflation of the 1950s. Similar was the situation in France which cancelled out the enormous deficits of the Liberation with inflation above 50% per year from 1945 to 1948.

Raising the question of the growing power of human capital, [a subject close to the heart of management science], Piketty expresses the view that technological changes over the very long run will slightly favour human labour over capital, thus lowering the return on capital and the capital share. But that having said, he also believes that this long-term effect seems limited and possibly it will be more than compensated by other forces tending in the opposite direction such as the creation of increasingly sophisticated systems of financial intermediation and international competition for capital. In a fundamental sense, "modern growth based on growth of productivity and the diffusion of knowledge, while making it possible to avoid the apocalypse predicted by Marx and to balance the process of capital........... has not altered the deep structures of capital or at any rate has not truly reduced the macroeconomic importance of capital relative to labour".

It is Piketty's analysis of the world-wide inequality of income on the one hand and of capital ownership on the other that is much the most publicised part of the book. According to Pikettty, while income from labour generally accounts for two-thirds to three-fourths of national income, there are substantial differences between countries in that regard. In low inequality countries like those in Scandinavia, the top 10% most well-paid receive about 20% of the total wages and the bottom 50% least well-paid about 35%. In countries where wage inequality is average including most European countries, the first group claims 25-30% of the total

wages and the second around 30%. And finally in the most in-egalitarian countries such as the US the top decile gets 35% of the total whereas the bottom half gets only 25%. Summing up the evolution in this context, Piketty says: "the US was less in-egalitarian than Europe in 1900-1910, slightly more in-egalitarian in 1950-60 and much more in-egalitarian in 2000-2010". The US, where the increase in wage inequality is due mainly to increased pay at the very top 1% and even 0.1% may well set a new record around 2030 if wage inequality continues to increase through "meritocratic extremism". [A statistic reported in 2007 but not mentioned in the book is instructive in this context: CEOs at large American corporations earned weekly pay that was seven times the average worker's annual salary].

The most widely accepted theory about wage inequality being greater in some societies and periods than in others would attribute it to a race between education and technology. Piketty, however, rejects this theory particularly because it does not offer a satisfactory explanation for the current rise of the 'super manager' who is paid so many times more than employees at lower levels not so much because such managers merit it on account of marginal productivity or unique skills as because they have the facility to fix the salary for themselves in the prevailing corporate culture and the government on its part has tended to favour them with a lower level of taxes, thereby providing an incentive to seek ever increasing emoluments. Although increasing executive rewards are now tending to be a universal feature, the super managers in Piketty's view are more an American phenomenon and to counter increased wage inequality, the US would need to invest heavily in education and skills.

Piketty's analysis of inequalities of income in developing countries, particularly India, will be read with interest. His finding is that the upper centile's share of national income in poor and emerging economies is roughly the same as in the rich countries. Measured by the top percentile income share, income inequality rose in the 1980s and at the present time it is about 15% of national income – and in the case of India 12-13% as against 7% in 1975. In the case of China, despite a low base effect, the top centile's share of national income has been rapidly rising over

the past several decades, albeit with the upper centile's share being less than in India.

As for inequality of wealth, Piketty's historical narrative of it starts off with the postulate that extreme concentration of wealth was a European phenomenon [also replicated in most other societies] in the eighteenth and nineteenth centuries and well on into the eve of World War I, while in all known societies the top decile of the wealth hierarchy owned a clear majority of what is there to own. The shocks of 1914-1945, the World Wars, the Great Depression and so on, caused the upper decile's share of total wealth in the wealthy countries [except that the change was of a lower order in the US which was less in-egalitarian throughout the period] to drop from 60% in 1910-1920 to 20-30% in 1950-70. At the present time, inequality of wealth stands significantly below its level of a century ago in all wealthy countries; the top decile's share is much lower at 60-65% than at the belle époque [1871-1910]. The essential difference however, is that presently there is a patrimonial middle class [40% of the wealth hierarchy] which owns about a third of national wealth. Piketty considers the rise of this patrimonial middle class as a development of great moment. And as for the US, the top decile's share of the total wealth exceeded 70% in 2010 and the top centile's share was close to 35%.

'Inequality of capital ownership' is one of the most penetrating parts of this remarkable book, exploring as it does why the unprecedented era of 1913-2012 during which the net return on capital was less than the growth rate has since ended and the inequality of r-g, leading to concentration of wealth that has been true throughout most of history, would probably be true again in the twenty-first century. That is to say, the return on capital being distinctly and persistently greater than the growth is a powerful force and when the world reverts to that in the years to come, the outlook is for an increase in concentration of wealth and a more unequal distribution of wealth. At any rate, says Piketty, "it is an illusion to think that something about the nature of modern growth or the laws of the market economy ensures that inequality will decrease and harmonious stability will be achieved".

That affirmation is addressed to the proponents of the Kuznets curve and its theory about continuing economic growth benefitting all sections of society and bringing

down inequality through an automatic process. Piketty pursues the theme of inequality by examining the role of inheritance and saving in capital formation. His data indicate that inheritance flow accounted for 20-25% of national income every year in the nineteenth century. In 1910 the flow was somewhat higher than 25%; there was a spectacular decrease between 1910 and 1950, followed by a steady rebound thereafter with an acceleration in the 1920s. To a large extent the evolution reflected changes in the structure of inequality. Taking France as a typical example, inherited wealth represented nearly two-thirds of private capital in 2010, with the likelihood, if present trends continued, of exceeding 70% by 2020 and approaching 80% in the 2030s. Piketty's conclusion is that the u-shaped curve of inherited flows in France in the twentieth century actually reflects the reality everywhere in Europe and that inherited wealth probably accounted for a least 50-60% of total private capital in the US. All said, the global rebound of inherited wealth will no doubt be an important feature of the twenty-fist century, but for some decades to come it will affect mainly Europe and to a lesser degree the U.S.

The chapter on 'global inequality of wealth in the twenty-first century' makes some important projections. Global inequality of wealth, accentuated by the existence of 1400 billionaires with 5400 billion dollars of wealth appears to be comparable in magnitude to that observed in Europe in 1900-10. The top thousandth seems to own nearly 20% of the total global wealth today, the top centile about 50% and the top decile somewhere between 80 and 90%. The bottom half of the global wealth distribution owns just less than 5% of the global wealth.

Apart from the billionaires are the sovereign wealth funds of countries with total investments worth a little over $5.3 Tr. in 2013 of which petroleum exporters holdings are $3.27 Tr. Piketty does not, however, visualize sovereign wealth funds achieving decisive importance before the second half of the twenty-first century. For there is the prospect of sovereign funds owning 10-20% or more of global capital by 2030-40 with the likelihood of the western countries finding it increasingly difficult to accept the idea of being substantially owned by the sovereign funds and political reactions being triggered as a result. And then, horror of horrors, if China saves 20% of its national income until 2100, while Europe and

US save only 10% of theirs, there is the possibility of a large part of the old and new worlds being owned by enormous Chinese pension funds. "Logically possible", says Piketty, "but not plausible". The threat of international divergence due to such foreign ownership, according to him, seems less credible and dangerous than "an oligarchic type of divergence, a process in which the rich countries would come to be owned by their billionaires or all countries to be owned more and more by the planet's billionaires.......... a process already well under way".

With global growth slowing and international competition for capital heating up, Piketty says that "there is every reason to believe that r [rate of return on capital] will be much greater than g [growth of national output] output in the decades ahead and all the ingredients are in place for the top centile and thousandth of the global distribution to pull farther and farther ahead of the rest". Are there any risk mitigation measures? Piketty's own solution is, in brief, a global wealth tax grounded in international understanding, also involving more transparency and control of tax havens. In the past, such taxes on income and estate, even at confiscatory rates, have curbed the growth of excessive wealth within nations. Piketty says that the same measure adopted globally and enforced effectively offers the only chance. A whole lot of Piketty's critics disagree, terming the proposal utopian or impractical.

I for one am on Piketty's side.

Criticisms of Piketty's theories have been varied: that the evidence for rising inequality of incomes is more clear than that for rising inequality of wealth; that such inequality of incomes is evidenced more in the US than elsewhere; that in the US itself it is a function of soaring salaries at the very top rather than rising incomes from capital as such and that Piketty does not demonstrate how the greater income going to the top 1% - a Pikettian statistic that has not been contested – hurts everyone else. In addition, there has been criticism of a nit-picking kind about the statistical side of the work and more seriously about the way Piketty has defined capital and capitalism and about his assumption that future evolution will hew close to the past. In Pikettys' own country, France, the book has been assailed by

leftist opinion for its omission of social and cultural domination, violence and class struggle.

None of these, however, detract from the value of the book as a monumental work on capital and inequality.

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