Book Review: Capital in the Twenty-First Century by Thomas Piketty

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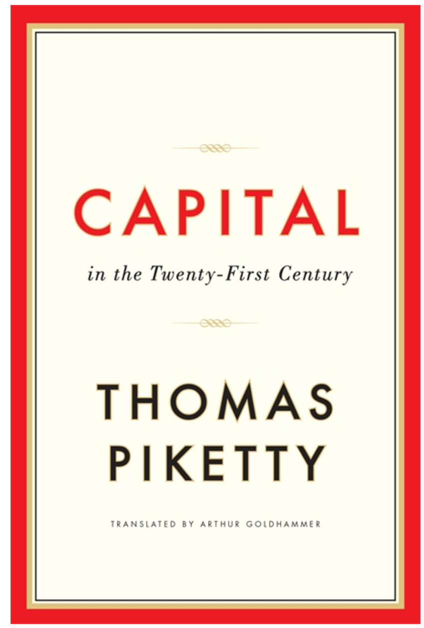
*Questions about the long-term evolution of inequality, the concentration of wealth, and the prospects for economic growth lie at the heart of political economy. But satisfactory answers have been hard to find for lack of adequate data and clear guiding theories. In **Capital in the Twenty-First Century**, **Thomas Piketty** seeks to analyse a unique collection of data from twenty countries, ranging as far back as the eighteenth century, to uncover key economic and social patterns. Piketty shows himself to be not only a supereconomist but also a skilled politician, writes **Christel Lane**. No wonder his thoughts have resonated even at the highest political levels. One can only hope that his work will actually influence adoption of his policy recommendations.*

Capital in the Twenty-First Century. Thomas Piketty. Harvard University Press. March 2014.



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Thomas Piketty's book has received enormous attention and lavish praise from academics and policy-makers alike, including Mark Carney and Christine Lagarde. At first, I found this hard to understand. The book has more than 500 pages and is often repetitive, as well as being full of formulas and graphs which for non-economists are off-putting.

However, I soon found that the perseverance required was extremely worthwhile. This is a truly path-breaking book offering a hard-hitting and well-founded critique of capitalism in the twenty-first century. Piketty is concerned with the dynamics of income and wealth since the eighteenth century to draw lessons for the century ahead. The book has an admirably wide scope, offering systematic comparisons not only across advanced and emerging economies, but also across modern history. While mainly focusing on national pictures it does not lack a global scope. Moreover, notwithstanding some of the criticisms that have found faults in his calculations, it is an exceptionally well-researched book. His sources are well documented. Piketty's overall analysis and conclusions cannot be waved away by those who feel threatened by the book's analysis and policy recommendations.

Piketty is a somewhat unusual economist who considers his work to be in the tradition of political economy and economics a social science. There is no mathematical modelling in this book. The author is always careful to point to the limits of his quantitative estimates, as well as being cautious in drawing his conclusions. His writing is admirably clear (compliments to his translator Arthur Goldhammer). Additionally, the notion that literature is a mirror of society forms a thread going throughout his book. Jane Austen and Honoré Balzac, as well as Orhan Pamuk and Naguib Nahfouz, do not figure in many economists' books!

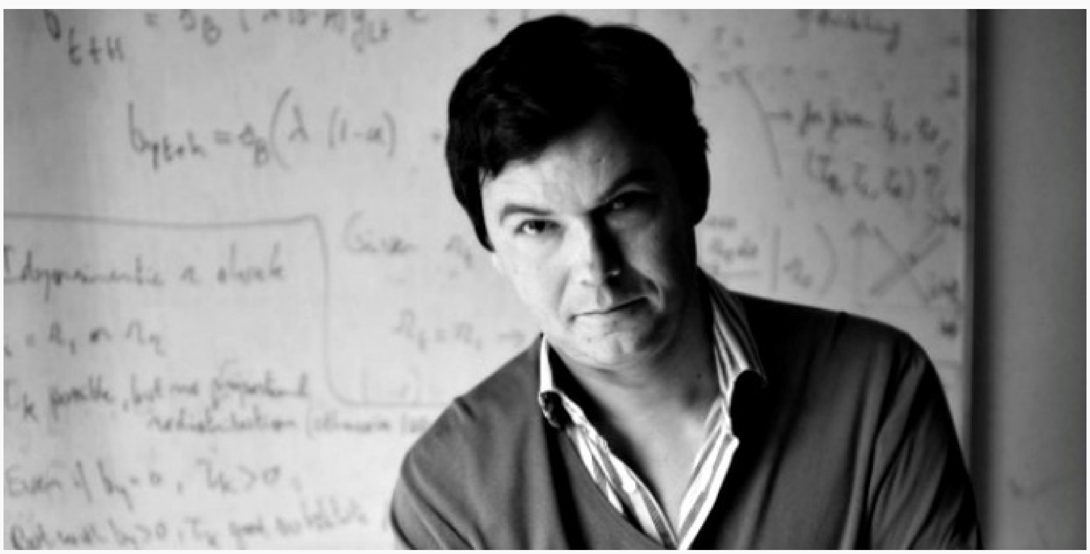
Piketty presents no less than two new fundamental laws of capitalism. He uncovers structural contradictions which, while present in most historical phases of capitalism, are likely to grow to such a degree that they threaten to overwhelm societies and politics in the twenty-first century. The central contradiction of capitalism for Piketty is that return on capital, for long periods of history, tends to be greater than national output or growth and, through inheritance, is bound to create tremendous inequality of wealth. As both the rate of economic and demographic growth are slowing down (with only a little delay in emerging economies), this inequality becomes exacerbated.

Whereas the return on capital will increase to around 4-5 per cent in the coming decades, growth will be a mere 1 to 1.3 per cent. (The currently high growth rates of emerging economies will stop once catch-up is accomplished). The resulting divergence in wealth from capital ownership from that of income from labour is occurring on a global scale. Hence the first fundamental law of capitalism is that the share of capital from national income equals the return on capital times the capital/income ratio.

Piketty's historical comparisons – their length in time depend on data availability – mostly start around the last quarter of the nineteenth century (but much earlier in France). They suggest that inequality in private wealth holding, notwithstanding the radical transformation in the composition of wealth over time, is threatening to return to the extremely high levels of that early period. The decrease in wealth inequality experienced between 1914 and 1970 is held to be exceptional, due to the long-term effects of capital destruction during two world wars, as well as to the high levels of taxation introduced during this period. (These consequences, of course, mainly affected Europe and Japan and had much less effect on the USA). By 2010, despite the 2008 financial crisis, 'capital was prospering as it had not done since 1913' (p. 42).

Piketty also investigates the evolution of public wealth and shows that, once national debts are considered, there is almost no public wealth left, since the privatization from the early 1980s onwards.

Concerning the historical capital/labour split in income, he calculates that capital's share was between 35-40 per cent from the late eighteenth through the nineteenth centuries; it fell to 25-30 per cent in the mid-twentieth century and rose again to 25-30 per cent in the late twentieth and early twenty-first centuries. The income from capital is just as unequal in emerging countries, although there are slight differences in extent between them. He puts Columbia and Argentina at the higher end of the range and China at its lower end.



Thomas Piketty. Credit: Harvard Press.

Piketty's second fundamental law of capitalism inserts national savings into the equation and shows that in countries which save a lot and have low demographic growth capital inequality will become particularly pronounced.

Piketty also deals with income inequality from labour which, although significant, for him pales in comparison with wealth inequality. Concerning earned income, the 1914-1970 period saw a significant redistribution of income, leading to the growth of a new large middle class. Although the growth of knowledge and technology led to a significant redistribution of income, the resulting inequality is not nearly as large as that of wealth and hence not as destabilising of democracy in the long run as the latter. He considers that the apparent shift towards labour during this period, despite some significant changes, must be considered an exceptional occurrence. 'The post-war years of social democracy created an illusion that the contradictions of capitalism had been overcome' (p.19). Capital has enjoyed a real comeback during the recent low-growth period.

But make no mistake, inequality between different classes, based on income from labour, is still large and has been growing since 1980. Piketty points to and substantiates a phenomenon already well-known – the appearance of supermanagers (his term). These have become particularly prominent in the US and the UK, and their income – including stock options and bonuses – puts them now in the top centile of earners, rivalling the income from capital of all but the wealthiest rentiers. Piketty shows convincingly that their obscenely high incomes are not based on any outstanding economic contribution they have made, nor are they necessary for growth. They have been awarded by often incestuous company boards, and encouragement for their award has come from the low level of taxation of such top earners experienced during the period of Neoliberalism. Although Piketty notes the fact that salaries have not risen to the same extent in other advanced societies, he fails to explain this. One explanation surely must be the divergent composition of share ownership, with companies in the Anglo-Saxon countries being exceptionally widely held and thereby mooting shareholder opposition to such disproportionately high salaries. He finally shows that these astronomical incomes of supermanagers in the Anglo-Saxon countries go hand-in-hand with stagnating and exceptionally low incomes from labour for the bottom 50 per cent of their societies, particularly in the US.

In addition to uncovering these fundamental contradictions of capitalism and documenting the ensuing inequality in great detail, Piketty's book contains a large number of less central, but nevertheless very arresting insights and findings. These range from a review of the world's wealthiest individuals – the billionaires of the Forbes index; the connection between inequality and the recent financial crisis; a discussion of the social state; over the revelation that inequality in the US has not always been that high, nor progressive taxation that absent; to both methodological critiques of Marx's work and the finding that the Gini coefficient widely used to measure inequality is very misleading (it lumps together income from wealth and income), to name only a few of his insights.

It seems almost churlish to try and find fault with this monumental work. If there is any weakness in the book it is mainly Piketty's almost exclusive focus on structural forces and his virtual neglect of agency, as well as the interaction between the two. One could also object that many of his findings are not new for social scientists. However, never before have they been as well substantiated and marshalled towards a policy program.

Finally and very importantly, Piketty goes beyond uncovering the dynamics of capitalism and the ensuing inequalities and goes on to suggest policy measures to arrest/reverse them. These are not merely an afterthought but form a significant and well-reasoned part of the book. His favoured remedy is quite simply a return to progressive taxation, abandoned from the early 1980s onwards. To make such taxation comprehensive and just it requires an exceptionally wide gathering of information of who earns what, and this information base has to be almost global. The nation state is no longer up to gathering such data during a time of extensive foreign capital ownership, nor to implementation of progressive taxation, given the strong tax competition between states. He realises that a global approach may be utopian but believes that it may constitute a bench mark towards which to work. Piketty suggests making a start in large countries such as the US and China, as well as in the EU, suitably transformed to become adequate to the task, . He states specific rates of progressive taxation, to be imposed on various top sections of the wealth and income hierarchies and shows their varying effects. Piketty anticipates the enraged opposition his analysis and policy responses will elicit and points out that his proposals are far less radical than were Marx's. They are liberal in tenor and will preserve entrepreneurialism, while stopping a further escalation of inequality. Piketty shows himself to be not only a supereconomist but also a skilled politician. No wonder his thoughts have resonated even at the highest political levels. One can only hope that his work will actually influence adoption of his policy recommendations.

Christel Lane is Emeritus Professor of Economic Sociology at the University of Cambridge. Read more reviews by Christel.

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