Thomas Piketty's latest bright idea [1]

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You're going to hear a great deal about Thomas Piketty's latest bright idea in this coming year. And remember when you do that I pointed out this inconvenient fact first. If he's right then the entire story we've been told about inequality reductions and changes over the past century is wrong. And there's something very important about that story being wrong.

Piketty's basic claim is that he's found the two golden rules that explain wealth inequality (and do note that it is wealth, not income, that he's talking about). They are [3]:

> The wars and depressions between 1914 and 1950 dragged the wealthy back to earth. Wars brought physical destruction of capital, nationalisation, taxation and inflation, while the Great Depression destroyed fortunes through capital losses and bankruptcy. Yet capital has been rebuilt, and the owners of capital have prospered once more. From the 1970s the ratio of wealth to income has grown along with income inequality, and levels of wealth concentration are approaching those of the pre-war era.
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> Mr Piketty describes these trends through what he calls two ?fundamental laws of capitalism?. The first explains variations in capital?s share of income (as opposed to the share going to wages). It is a simple accounting identity: at all times, capital?s share is equal to the rate of return on capital multiplied by the total stock of wealth as a share of GDP. The rate of return is the sum of all income flowing to capital?rents, dividends and profits?as a percentage of the value of all capital.
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> The second law is more a rough rule of thumb: over long periods and under the right circumstances the stock of capital, as a percentage of national income, should approach the ratio of the national-savings rate to the economic growth rate. With a savings rate of 8% (roughly that of the American economy) and GDP growth of 2%, wealth should rise to 400% of annual output, for example, while a drop in long-run growth to 1% would push up expected wealth to 800% of GDP. Whether this is a ?law? or not, the important point is that a lower growth rate is conducive to higher concentrations of wealth.
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> In Mr Piketty?s narrative, rapid growth?from large productivity gains or a growing population?is a force for economic convergence. Prior wealth casts less of an economic and political shadow over the new income generated each year. And population growth is a critical component of economic growth, accounting for about half of average global GDP growth between 1700 and 2012. America?s breakneck population and GDP growth in the 19th century eroded the power of old fortunes while throwing up a steady supply of new ones.

Leave aside for a moment whether these things are true (I have some doubts: Piketty has a habit of not looking at consumption inequality which is the thing we might actually be worried about). Just assume that they are for a moment.

Our first reaction therefore would be that if we desire less inequality then we must have faster growth. We must therefore have a supply side revolution, tearing down much of the bureaucratic state that limits said growth. Excellent.

But perhaps people don't want to do that: so, what could we do about this rising inequality? Well, we'll get the usual litany, won't we? Strengthen unions, redistribute more, higher inheritance taxation and so on. The argument will be that after all, as the usual story goes, these are the things that reduced wealth inequality before so they will again.

Ah, but that story doesn't work. For look at what Piketty is actually saying: the reduction in inequality wasn't as a result of unions, taxation, minimum wages or redistribution. It was simply that growth was faster than the increase in old wealth. So we cannot point to those supposedly tried and trusted methods of reducing inequality. For the very research that tells us that inequality is going to keep rising is the very same research that tells us that those methods didn't reduce it last time around.

This obvious point is one that's not going to register with anyone at all unfortunately. Even though it is also true as well as being obvious. Everyone to the left of us (which is, to be fair, quite a large number of people) is going to entirely ignore this uncomfortable point. Their very proof that wealth inequality is going to increase will also be the very proof that the standard prescriptions for reducing wealth inequality don't work.

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