

Capitalism, inequality, and Piketty

Dr Woody Brock | SED | 24 October 2014

Thomas Piketty's "Capital in the Twenty-First Century" is certainly the economics book of the year. The author introduces arguments that provide a new perspective on the phenomenon of rising inequality, a topic that may well define politics in many OECD nations for the next half century. Since his book appeared in English, we have been asked numerous times to appraise his ideas, and in this we shall do so. What follows is not so much "another review" of this new book, but rather an investigation of (1) topics pertinent to Piketty's thesis that he altogether failed to address, and (2) problems besetting his principal analytical arguments.

SUMMARY

Part 1 discusses Piketty's failure to identify the tradeoff between the societal goals of reduced income/wealth inequality on the one hand, and higher economic growth and living standards on the other. This was a serious oversight.

Part 2 identifies significant flaws in his fundamental argument that the rate of return r on wealth has generally been and will be higher than the growth in income. Four arguments are set forth as to why this claim may not hold up in the future, arguments largely due to Lawrence Summers' penetrating review of the new book.

Part 3 highlights two important dimensions of the concept of economic inequality that Piketty ignores, and where historical data imply that there has been a much smaller increase in inequality than his own data demonstrate. In particular, the distribution of consumption is more equal than ever before, regardless of the distribution of income – *and consumption is what matters*. This finding undermines several of Piketty's arguments for greater equality via stiff progressive taxes on net worth.

Part 4 addresses a foundational issue that Piketty surprisingly ignores, namely the moral and economic reasons why wealth *should* in fact be redistributed from the wealthy to the poor. Simply to document inequality and assert that it is bad is not sufficient to make a persuasive case for a wealth tax. We make a very persuasive case.

FUNDAMENTAL IMPORTANCE OF PIKETTY'S BOOK

Before proceeding with our review, we wish to highlight the two most important contributions Piketty has made in this new book. First, he has brought "growth theory" into contemporary economic debate as no one has done before. Growth theory was always

essential for understanding much less forecasting future levels of growth, of earnings, of wealth, and even of political stability. In numerous past PROFILES, we have drawn upon growth theory and stressed its importance. Only four months ago, in our essay "The Low Growth Hoax," we proposed a reformulation of macroeconomics in which policies for optimal long-term growth become as central to macroeconomics as fiscal and monetary policy have been during the past six decades. Yet our own emphasis on growth theory during past years is very uncommon. For despite the subject's importance, *especially to investors concerned about the growth rate of wealth*, financial commentators write as if growth theory is either unimportant or non-existent. All that seems to matter anymore is monetary policy – Janet this, and Janet that.

Second, Piketty has elevated the importance of the subject of economic equality to the high ground in contemporary policy debate. More specifically, he has recast discussions about the "right degree" of economic inequality in terms of growth theory concepts (savings rates, productivity growth, demographics) that *imply* varying levels of inequality. That is, he establishes *causal links* between fundamental economic concepts and the degrees of inequality they imply. This is a major accomplishment and a great improvement over the sloppy analysis of economic inequality that has been the norm for decades. The degree to which economists have ignored distributional issues during the past half century is as perplexing as it is irresponsible. For as the economist Kenneth Arrow once wrote, "What ultimately does an economy produce? It produces a distribution of income and living standards." Period.

[Read "Capitalism, inequality, and Piketty"](#)



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