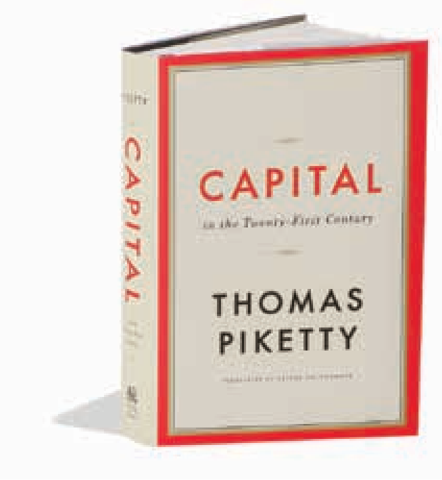
The Rise of the Top 1 Percent



Thomas Piketty

Capital in the Twenty-First Century

Belknap Press, Cambridge, Massachusetts, 2014, 685 pp., $39.95 (cloth).

This important and fascinating book surely ranks among the most influential economic analysis of recent decades. Much of the debate over inequality in recent years is the result of the work of Thomas Piketty and his fellow researchers.

Earlier research on inequality focused on data from household surveys described in terms of the "Gini" index, which measures the income distribution in a country. But the Gini misses much of the action at the top of the income distribution, partly because the very rich tend not to report all their income. And at best, these surveys measure income, not wealth.

Piketty has painstakingly drawn on new data sources to show that income inequality has risen sharply in recent decades to extremely high levels in the United States and, to a lesser extent, in a handful of other English-speaking countries. The rise has been driven mostly by wage inequality between the top 1 percent of the wealthiest in society, and everyone else. (I wish there had been room in this long book to address the critics who attribute these results to distortions in the data.)

A standard explanation is that education has failed to keep up with increasing demands for skilled labor. Unlikely, says Piketty. That doesn't explain why inequality increased sharply even among graduates from top colleges.

Could these sky-high salaries reflect top CEOs' ability to generate huge increases in value? No, winner-take-all forces would presumably also be at work in other developed economies such as Japan, France, and Germany, and we see no such relative wage increases.

Maybe these other countries have resisted the relative wage implications of technological change, precipitating the slowdown in growth observed in several of these countries around the time inequality started to rise in the United States in the late 1970s. But real per capita growth has been about the same in both sets of countries since about 1980.

For Piketty, the most plausible explanation—though here he has less clear evidence—is essentially cultural and political; that the political elite in the United States and the United Kingdom engaged in radical market-oriented reforms that lowered the top tax rates, kept minimum wages from rising, weakened unions, and contributed to a change in what is considered an acceptable pay differential.

With a corporate governance structure in which the elite choose each other's pay, little remained to constrain top wages. The solution, for Piketty, is to reverse those changes. He notes that growth did not increase in the United States and the United Kingdom as they lowered their marginal tax rates, relative to their continental peers.

Wage income inequality is limited to a handful of countries, but wealth is extremely unevenly distributed in all developed economies. Before World War I, however, things were even worse. The Great Depression and World War II brought about a huge leveling. At the same time, and continuing through the 1970s, public policy in the form of confiscatory top tax rates and high inheritance taxes kept the wealth distribution fairly stable.

But this may have been a temporary respite. The system is biased against the little guy: big fortunes earn higher returns than smaller ones, and the rich save more (presumably—Piketty doesn't say enough about saving rates). Meanwhile, population growth has halted and productivity growth is slowing, which imply a trend toward a 19th century–style society dominated by inherited wealth.

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For Piketty, such a society is inconsistent with the meritocratic and democratic values that underlie modern Western countries. Last time it took the cataclysms of the Great Depression and World War II to induce major change. But Piketty remains optimistic that ideas (and data) can influence policy. His main recommendation is a tax on all forms of capital, which would require international coordination and probably cross-border capital controls.

This book contains important lessons for economists. It is a (perhaps unwelcome) reminder that what they measure reflects political choices. It cautions them to be wary of viewing recent decades as some sort of "steady state"; the evolution of post–World War II incomes and wealth reflect the unwinding of earlier events, and the point is more general. And it reminds them of the rhetorical and explanatory power of simple comparisons of facts, once collected and arranged, relative to complex statistics and models.

Nobel Prize–winning economist Robert Lucas, Jr., commenting on questions of long-run economic growth, said that "once one starts to think about them, it is hard to think about anything else." But readers are left with the thought that it is the *distribution* of the product of growth that will shape the economic and political nature of society in 25 or 50 years—and that this is the issue that demands our attention.

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