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Considering Thomas Piketty's *Capitalism in the Twenty-First Century*

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Thomas Piketty's *Le capital au XXIe siècle* is a world wide best seller. Ranked among the top 100 books on French Amazon for 214 days (as of October 5, 2014) and, in translation, among the top 100 of German Amazon, it at one point stood at the pinnacle of the *New York Times* best seller list and was displayed prominently at airport bookstores. The huge sales, however, do not make *Le capital au XXIe siècle* stand apart from other best sellers. What makes it different is that it could well change the direction of history and the social sciences, economics in particular—a double surprise because economics is shaped by articles, not books. How many other wildly successful books will do that—all that in prose that is unfailingly lucid for all of its 942 pages of text?

What Piketty aims to do is rethink our understanding of the relationship between inequality and economic growth. His attention to inequality (in an era of the Great Recession, Occupy Wall Street, and widening gaps in income and wealth) accounts for the book's popularity with the public, but not for its impact on economists. In fact, until recently, many economists gave inequality little thought, especially when it came to analyzing economic growth, because growth seemed far more important. Better to get an economy to grow, and then inequality would eventually disappear, as it had in Europe and the United States in the middle of the twentieth century. Simon Kuznets, the great Nobel Prize winning economist who pioneered the modern empirical study of growth and inequality, argued as much in 1954, and most economists believed him, even though Kuznets admitted that he may have been engaging in a bit of "wishful thinking" (pp. 34-37)

Yet that belief is simply wrong, as *Le capital au XXIe siècle* and previous work by Piketty and coauthors such as Emmanuel Saez and Anthony Atkinson show. Income inequality rose sharply after the 1970s in the United States, Britain, and Canada, and it has begun to edge upward in continental Europe too. The inequality of wealth has begun to increase as well, and *Le capital au XXIe siècle* predicts that it will climb even higher in the future. The twenty-first century will in fact likely see Europe and most of North America return to the inequality of 1900, leaving our grandchildren living amidst a handfull of rentiers who have inherited pharaonic wealth. That is the grim prospect, if nothing is done.

Why will things end up that way? According to Piketty, the reason is simple. Wealth tends to be concentrated in the hands of a minority, for many people have no assets, and even members of the middle class typically possess little wealth—no more than a car, a small bank account, and perhaps some equity in a house. Most of wealth in the society (land, real estate, bonds, stock, mineral rights, privately owned companies, etc., which is what Piketty means by capital) ends up being owned by a small number of people. In Europe and the United States, for example, the wealthiest 10 percent of the population own 60 to 70 percent of the capital in 2010 (p. 391).

Now if there is no tax on wealth and the rich do not consume their holdings (it is actually difficult for people with a huge amount of money to spend more than an insignificant fraction of their assets), then their wealth will grow in value at a rate equal to the average rate of return on capital, just as your

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Note: Page number references in this essay refer to the French edition of the book: Thomas Piketty, *Le capital au XXIe siècle* (Paris: Editions du Seuil, 2013).

savings would if you invested it with a diversified retirement plan. But that rate of return—and hence the growth rate of their wealth—has almost always been higher than the growth rate of national income, and this remains true even if taxes are taken into account, which would reduce the rate at which their fortunes increase (p. 565). The wealth owned by the rich therefore expands relative to economy as a whole, and as the rich pass on their holdings to their heirs, their descendents end up owning virtually everything.

That outcome, which has nothing to do with merit, seems shocking in a democracy, but it was the state of things in the past, and if nothing is done, it will come back to haunt us, even in our modern era of sustained economic growth. The sad truth is that this state of things is the norm; anything else is unusual. In fact, in the past few centuries—and perhaps in the last two millenia—the only time that it failed to prevail was during the years between World War I and the 1970s (p. 565). Those years, however, were exceptional. Wars, inflation, the Great Depression, nationalizations, and high tax rates destroyed capital held by the rich, diminished its value, or redistributed it to the rest of the population. The rate of return on capital therefore plummetted. And after World War II, economic growth soared, as income per person jumped and population growth exploded thanks to baby booms in Europe and the United States. In the late twentieth century, however, the older, and more normal state of affairs reemerged. The return on capital rose (in part thanks to tax cuts), population growth slackened in Europe and the United States, and so did the growth rate of per capita income. Capital began growing relative to the rest of the economy, and the result, if tax rates on capital do not rise, will be inequality in the year 2100 that will resemble that of the nineteenth century.

Should we believe this grim prediction? An economist reading the book might object that the rate of return on capital will fall as more and more assets are accumulated. But using historical data, Piketty mounts a convincing argument against such an escape from the process he analyzes. (The historical data here, I would stress, is absolutely first rate. It is carefully collected and made comparable across countries, as interested readers can discover by following up the references and consulting the book's technical appendix at Piketty's web site, which contains all of the evidence, data, calculations, models, and sources used in the book. That it can all be downloaded or consulted is one of the book's great virtues.) The before tax rate of return on capital has not dipped below 4 percent, despite great variations in the stock of capital. As for the growth rate of national income, if we average across every country, it will likely remain below 3.5 percent and stay below even that in developed western democracies. To get anything higher than 3.5 percent growth in national income would require either a sustained baby boom, which is highly unlikely (population growth is already minimal in rich countries and it is slowing in poor countries as well, as they go through the demographic transition), or per capita income growth that would strain credulity.

So Piketty's prediction for the year 2100 is plausible, so long as tax rates do not change. And the implications of his prediction go well beyond some arcane debate in economics. I will leave it to others to discuss the implications the book has for public policy, particularly tax policy, although I will mentioned that briefly. What I want to focus on instead is what the book says for the social sciences, and particularly for history.

To begin with, it is worth stressing that the subject matter of *Le capital au XXIe siècle* extends well beyond the economic argument about growing inequality in the twenty-first century. The book should in fact interest all historians, even those who have no interest in economics. With the book as a lens, the social impact of the World War I, World War II, and the Great Depression come into clear focus, as does the prosperity of *Les Trente Glorieuses*. For the nineteenth century, the book makes it clear how inequality made inheriting wealth or marrying into it a near obsession—a point that Piketty illustrates by drawing upon Balzac and Jane Austen.

The same preoccupation with inheriting wealth or marrying well permeates older societies—Old Regime France, for example. And it teaches an important lesson: lusting after wealth or trying to preserve it are hardly a modern phenomena, and they dictated much behavior in the past. Richelieu amassed a gigantic fortune, and Voltaire regularly consulted with notaries, bankers, and other intermediaries who helped him make the most of his financial holdings. Further down the social scale—but still among those with wealth—a prosperous peasant family outside Paris carefully assembled property in the seventeenth and eighteenth centuries and managed its children's marriages in order to increase the family's wealth.[1]

The behavior here teaches a second lesson too: historians should pay much more attention to what people do and perhaps pay a little less to what they say or think. The behavior of a Richelieu, Voltaire, and the peasant family reveals their concerns. Their actions do speak louder than their words—all the more so since people can lie, forget, or deceive themselves when they try to explain what it is they are thinking or concerned with. Their behavior may in fact be even better than the words they leave behind or even a document from the archives that we might think of as a smoking gun. The shift to cultural history has inclined many historians to write a great deal about language and symbols. Perhaps now it is time to pay more attention to behavior.

In what other ways can historians follow up on the insights of Piketty's book? One possibility would be to pick up where an older generation of historians left off and renew the social history of wealth, so that we could learn more about the assets of the people we study. Or historians could investigate how financial innovations eased estate management, allowed the wealthy to extract more income from their holdings, or tied the rich even more firmly to the political status quo.[2] Or they could push the study of inequality even further back into the past, not just to test Piketty's argument but to see how assets shifted and when elites of wealth might change.[3] If they do that, though, they should make sure their research is careful and systematic and attuned to the biases of the sources. Here Piketty's research on the evolution of wealth in Paris with Gilles Postel-Vinay and Jean-Laurent Rosenthal is a model.[4]

Historians of France, for instance, could determine whether the French Revolution reshuffled the wealthy elite. It would be surprising if it greatly changed the overall distribution of wealth, but it might well have opened the doors of wealthy elite to newcomers. The place to begin would be with a comparison of existing local studies of wealth and income before and after the Revolution. (Many studies of this sort exist, and some—Georges Lefebvre is an example—were done by masters.) The next

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[1] For these examples, see Joseph Bergin, *Cardinal Richelieu: Power and the Pursuit of Wealth* (New Haven: Yale, 1985); Philip T. Hoffman, Gilles Postel-Vinay, and Jean-Laurent Rosenthal, *Des Marchés sans prix: Une économie du crédit à Paris*, 1660-1870 (Paris: Ecole des Hautes Etudes en Sciences Sociales, 2001, p. 153); and Jean-Marc Moriceau and Gilles Postel-Vinay, *Ferme, entreprise, famille* (Paris: Ecole des Hautes Etudes en Sciences Sociales, 1992).

[2] For a wonderful example of what I have in mind here, see Katia Béguin, *Financer la guerre au XVIIe siècle: La dette publique et les rentiers de l'absolutisme* (Paris: Champ Vallon, 2012).

[3] Nathan Sussman, for instance has analyzed inequality in Paris circa 1300, although his source omits the very rich: Nathan Sussman, "Income inequality in Paris in the heyday of the commercial revolution," paper delivered at the 2006 Conference for the Canadian Network of Economic Historians, Vancouver, Canada.

[4] Thomas Piketty, Gilles Postel-Vinay, and Jean-Laurent Rosenthal, "Wealth concentration in a developing economy: Paris and France, 1807-1994," *American Economic Review* 96 (March, 2006): 236-256.

step would be to compare wealth, income, and the composition of elites using estate documents, tax records (the *taille tarifée* would be particularly useful here), and the archives of the *enregistrement* and in its eighteenth-century predecessor, the *contrôle des actes*.[5] It would not be easy because most of the Old-Regime tax records leave out the nobility, and Paris was exempt from the the *enregistrement*. But it might be possible to overcome those problems by careful use of multiple sources.

One final challenge historians could take on, in the light of Piketty's book, would be to analyze how and why taxes have changed. It may surprise historians to learn that the United States was a pioneer in raising taxes on income and wealth to high levels in the first half of the twentieth century: it (and Britain too) had top tax rates on wealth, for example, that were much higher than in France or Germany. But beginning in 1970s, the top tax rates in the United States and Britain were cut. The ostensible reason, as Piketty points out, was the argument that both countries were falling behind economically, with the premise being that high taxes lead to a loss of efficiency. Piketty has argued against this assumption elsewhere, but his book provides a persuasive rejoinder: if high taxes cause huge efficiency losses or cause an economy to stagnate, why was economic growth so rapid in the post war period, when taxes were so high?[6]

So why did the United States and Britain get the tax cuts? It is not just Reagan and Thatcher—other leaders took part—and in any case voters had to be persuaded. Nor was it simply that the rich (as a small pressure group) can more easily organize and lobby for lower taxes. They can always do that. Why did they not block higher taxes in the first place? And why did France and Germany fail to cut their own tax rates when their economic growth slowed? The politics and ideas behind the tax cuts deserve to be analyzed, and especially how and when movements to change taxes moved from country to country.

Helping to spread ideas about taxes from country to country to country will be essential in any effort to lowering inequality, for if taxes are raised in one economy in order to reduce disparities of wealth, the rich will simply move their holdings to low tax economies. Piketty's proposed solution here is financial transparency plus a world wide progressive tax on both income and wealth. As he knows, such a solution will not be easy. But putting it into place will require that ideas such as his cross borders and gain a hearing among political leaders throughout the world.

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[5] For the *taille tarifée*, see Mireille Touzery, *L'invention de l'impôt sur le revenu. La taille tarifée 1715-1789* (Paris: Comité pour l'histoire économique et financière de la France, 1994).

[6] For the economic argument against this assumption, see, for instance, Thomas Piketty and Emmanuel Saez, "A Theory of Optimal Inheritance Taxation," *Econometrica* 81 (September, 2013): 1851-1886, which backs up a robust and persuasive theoretical model with data and concludes that the optimal inheritance tax rate might be 50 percent or even more.

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