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Book Review: Capital in the Twenty-First Century.

Thomas Piketty. Capital in the Twenty-First Century (Translated by Arthur Goldhammer). Belknap Press of Harvard University Press, USA 2014: 685 pages. ISBN: 978-0-674-4300-6

Piketty's book reserves some credits for bringing the issue of inequality back in the spotlight. Many economists do agree with him that adequate policies are urgently needed to contend the worst consequence of income inequality before the problem is growing out of hands. In order to understand the dynamics of inequality more clearly, we need to expand the scope of our policy studies to cover more on the political movements that directly and indirectly support the path of private capital accumulation, and also the formation of political process and policies that can lead any society to its appropriate level of social cooperation between public and private capitals

Capital in the Twenty-First Century by Piketty (2014) is one of a few books that attempt to provide intensive analysis, based on historical data, of the structural changes and the dynamics of income and wealth inequalities in different countries such as France, the British, and the US. Its final outcomes indicate clearly the rising trend of inequality, especially for the biggest economy like the US:

The top decile claimed as much as 45-50 percent by the end of the 1940s. Inequality then stabilized at that level from 1950 to 1970. We subsequently see a rapid rise in inequality in the 1980s, until by 2000 we have returned to a level on the order of 45-50 percent of national income.

The history of inequality is shaped by the way economic, social and political actors view what is just and what is not, as well as by the relative power of those actors and the collective choices that result.

Although Piketty and Marx shared some discomforting views about the long-term force of economic divergence, Piketty tried obviously to point out the main distinctions of his much-acclaimed Capital in the Twenty-First Century (2014) from Marx's first volume of Capital (1867).

Piketty rightly points out the rigidity of the principle of infinite accumulation used by Marx to obtain the inevitable collapse of capitalism. Piketty, on the other hand, states that rising inequality is generated by two different forces of divergence. The first divergent force is initiated by the way that the top earners set their own unlimited remuneration. The second divergent force is the result of the process of accumulation and concentration of wealth when growth is weak and the return on capital is high. If the rate of return on capital exceeds the growth rate of income, then inherited wealth will grow faster than the growth rate of the economy, resulting in higher inequality.

However, both divergent forces encounter serious drawbacks. For Piketty's first divergent force to persist in the long run, it must be also true that the unlimited top earner's compensation is implied by the principle of infinite accumulation that he initially tried to avoid. The second divergent force which is generated by the return of a high capital/income ratio is also criticized by Martin Feldstein of Harvard who claimed that the cumulative effect of bequests should be diluted by the existing estate taxes as well as by the number of the heirs who shared the bequests.

These criticisms undoubtedly undermine Piketty's main proposal of a progressive global tax on wealth. He himself also realized that the proposal of a global tax would require a very high and unrealistic level of international cooperation.

Nevertheless, Piketty's book still reserves some credits for bringing the issue of inequality back in the spotlight. Many economists do agree with him that adequate policies are urgently needed to contend the worst consequence of income inequality before the problem is growing out of hands. Robert Shiller of Yale suggested for the idea of "inequality insurance" as a practical plan to replace Piketty's global tax. Inequality insurance would require governments to establish very long term plans to make income tax rates automatically higher for high-income people in the future.

We need an alternative model to replace the existing model of a representative consumer in order to handle the problem of inequality more effectively. Piketty had criticized the limitation of this single representative type of neoclassical model but he fell short of developing one by himself. A new model needed to have at least two players as in the case of the Nash-equilibrium game. By this way, one will be able to systematically analyze both the convergent and divergent forces being generated by different policies and also their impacts on income distribution and the dynamics of rising inequality, based on a more solid micro-foundation.

Last but not least, Piketty also took some efforts to distinguish the difference between private capital and public capital and their contributions to the rising trend of inequality. He pointed out that German private wealth in 2010 was lower than private wealth in Britain and France. It is a paradox given the high level of German saving, as compared to other European countries. His explanations are partly related to low price of real estate in German as compared to other European countries, and also more importantly related to the low stock market valuation of German firms. He argued that the German's stakeholder model or model of shared social ownership is likely the main factor that leads to the lower market valuation. This last point illustrates the roles of private and public joint-ownership capital that could complicatedly affect the degree of inequality in different countries. Also on this same point, it may remind some of us to those beginning lines in Angus Deaton (2013), saying that:

Life is better now than at almost any time in history. More people are richer and fewer people live in dire poverty. Lives are longer and parents no longer routinely watch a quarter of their children die. Yet millions still experience the horrors of destitution and premature death. The world is hugely unequal.

My impression is that in order to understand the dynamics of inequality more clearly, we need to expand the scope of our policy studies to cover more on the political movements that directly and indirectly support the path of private capital accumulation, and also the formation of political process and policies that can lead any society to its appropriate level of social cooperation between public and private capitals.

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