Thomas Piketty foresees a continued rise in inequality.

Tax man's gloomy message: the rich will get richer

With a massive database of income tax records, a French superstar challenges conventional wisdom on inequality

By **Eliot Marshall**

On a rain-soaked 15 April—U.S. income tax day—Thomas Piketty arrived early at a think tank in Washington, D.C., with a stack of boxes containing his new book, *Capital in the Twenty-First Century*. The 43-year-old French economist had come to talk about his radical ideas. The room was packed with young policy wonks and grizzled journalists, lawyers, political aides, and even a former U.S. representative, David Obey, who once chaired a key spending committee in the House of Representatives. Piketty, who sometimes apologizes to audiences for his strong accent, presented his data and predictions for capitalist economies and gently brushed aside criticisms. Dressed in a rumpled jacket and open collar, he looked a bit like a busy graduate student rather than a world-famous economics guru. By the time he was done, his supply of books had sold out. Young and old were lining up for an autograph.

Scenes like this played out many times this spring as Piketty toured North America. Amazon.com now ranks his book its number-one best-seller, and the publisher, Harvard University Press, reports that the first-year sales of *Capital* are more than for any title in its 101-year history.

Despite Piketty's popularity, his message is harsh. He labels as "a fairy tale" the long-accepted idea that wealth and income will be more evenly distributed within nations as they develop, and suggests that even the best run capitalist economies concentrate riches at the top. The reason: In the long run, he says, the return paid to owners of capital is higher than the rate of economic growth.

These provocative conclusions are based primarily on a huge database of tax records that Piketty and a team of 30 researchers around the globe have assembled from more than 20 countries, including the United States. From atop this mountain of data, Piketty is able to offer a 2-century retrospective view of capitalism and make predictions about its future. The database is, Piketty writes, "the largest historical database concerning the evolution of income inequality."

It is also the cornerstone of his credibility. Even economists who disagree with Piketty's message acknowledge the importance of his data. The chair of Harvard University's economics department, N. Gregory Mankiw, called it "[t]he best data we have on the upper tail of the income distribution" in a 2013 essay called *Defending the One Percent* that runs counter to Piketty's views.

Piketty began this project in the late 1990s, when he dug into old tax records for a book on the distribution of wealth in France. He had received his Ph.D. in 1993 at age 22 from the School for Advanced Studies in Social Sciences (EHESS), then moved to the Massachusetts Institute of Technology (MIT) as an assistant professor of economics. But he quit 3 years later—"I did not find the work of U.S. economists entirely convincing," he writes in *Capital*. Back home in Paris, he is now an economics professor at EHESS and the Paris School of Economics.

Piketty unearthed French data on wealth going back to the 1789 French Revolution, as well as a century's worth of income tax data that hadn't been analyzed systematically. Many such records have been ignored, he writes: "The historical and statistical study of tax records falls into a sort of academic no-man's-land, too historical for economists and too economic for historians."

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Extending the tax data analysis to Britain and the United States, Piketty teamed up with economists Anthony Atkinson of the University of Oxford and Emmanuel Saez of the University of California, Berkeley. Saez and colleagues gained rare direct access to U.S. tax records, enabling them to include new data from the world's top economy in the expanding database (see p. 836).

The team sifted through 100 years of tax records and stored standardized data in a resource they call the World Top Incomes Database (topincomes.g-mond.parisschoolofeconomics.eu). In addition to the more than 20 nations now represented, the website claims that about 45 more are "under study" and will be added when the work is complete.

In his book, Piketty combines income, inheritance, and national wealth data to reach a striking conclusion. Capitalism concentrates riches at the top of society, Piketty argues, because the rate of return to capital (labeled r) is higher than the overall rate of economic growth (labeled g) over the long run. This simple formula ($r > g$) means that families who own capital tend to acquire more and more wealth.

This pattern broke down, Piketty concedes, in the mid-20th century. Two world wars and the Great Depression destroyed a huge swath of Western wealth. Following World War II, as nations began to rebuild, they distributed the new wealth more equitably, Piketty finds. Aid programs and progressive tax schemes also decreased inequality, while a concurrent rise in industrial productivity and a population boom boosted economies and benefited the middle class. This golden era lasted roughly from 1950 to 1980, triggering a pause in the concentration of wealth.

Piketty insists the pause was an aberration. Capital resumed its dominant place in the 1980s, and wealth is again being concentrated at the top of society, he demonstrates. Today, Piketty says, inequality in the developed economies and particularly in the United States has reached an "extreme" point that could lead to "terrifying" disparities in the future and threaten democracy.

The concentration of wealth will continue, Piketty says, because economic growth is likely to be no more than 2% a year, limited in part by a widely predicted decline in birth rates. He predicts that the rate of return for capital will remain about what it has been historically, 4% to 5%. "It would be an incredible coincidence if the number of children we have and the number of innovations we make push the growth rate up" enough to counterbalance the return on capital, he says. "There's no logical or historical reason why this should happen," he adds in an e-mail.

Piketty's analysis offers "a new way of looking at the functioning of a capitalist economy."

Branko Milanovic,
Luxembourg Income Study Center

These ideas are important, said economist Robert Solow, a 1987 Nobel Prize awardee and professor emeritus at MIT, who spoke after the first of Piketty's several tax day talks and, in a book review, called his work a "new and powerful contribution" to economics. Economist Branko Milanovic, a former World Bank researcher on inequality now at the Luxembourg Income Study Center of the City University of New York in New York City, says Piketty has pulled several strands of research together into a single framework that offers "a new way of looking at the functioning of a capitalist economy."

In France, Piketty (*far left*) endorsed left-wing political candidates like Ségolène Royal because other choices were worse, he says.

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Critics are sharpening their knives, however. Economist Kevin Hassett of the conservative American Enterprise Institute in Washington, D.C., for example, questions Piketty's reliance on income tax data. Hassett argued at one of the tax day talks that Piketty's approach fails to count the billions of dollars in government "transfers" that flow to citizens for benefits such as medical care and income support. Hassett prefers to rely on U.S. economic consumption data from household surveys run by the U.S. Bureau of Labor Statistics, which he says reveal spending in lower income households that may not even file tax returns. Those surveys don't show an alarming disparity between wealthy and nonwealthy Americans, Hassett says.

Piketty maintains that tax records give a truer picture of wealth and income at the top. On surveys, people tend to understate their income, while taxpayers are likely to be more truthful because they can be punished if they lie, he says. As for transfer payments, Piketty suggested that these funds increasingly pay for health care in the United States. With a smile, he said it would be interesting to know whether such transfers do more to benefit individuals or health care providers.

But Piketty's remedy for inequality—a universal tax on wealth that takes little from the bottom of the scale and a lot from the top—has drawn fire from left and right, in part because it would be so difficult to impose. Legislators don't seem ready to try it, doubters point out, and if they did, the super-rich could threaten to move to more tax-friendly climes. At Piketty's first stop, several economists suggested what they consider better and more achievable ways to counter inequality, such as investing in public education, job creation, and infrastructure. At another seminar, economist Dean Baker, co-director of the Center for Economic and Policy Research in Washington, D.C., suggested other remedies. He would tax financial transactions, limit patents to reduce drug company profits, break up monopolies, and more.

Piketty agreed with those suggestions but said they are not enough to change the fundamental dynamic of $r > g$. But as the first seminar on tax day came to a close, Solow and others mused on the implausibility of Piketty's scheme—requiring all the world's nations to agree in concert to boost taxes on their wealthiest citizens. Sounding a "pessimistic note," Solow reminded Piketty and the audience that the United States "is a country that can't even sustain an inheritance tax."

Piketty anticipated the pessimism. "In 1900," he said, "most people would have said a progressive income tax would never happen." But it happened. ■

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