INTERVIEW

Inequality and what to do about it: Thomas Piketty

interviewed by Martin O'Neill and Nick Pearce

Thomas Piketty's Capital in the Twenty-First Century *(Piketty, 2014) is the most talked about work of political economy to have appeared in recent years, if not decades. Since its publication in French last year (Piketty, 2013), and the subsequent publication, earlier this year, of its limpid translation into English by Arthur Goldhammer (Piketty, 2014), Piketty's book has received critical acclaim worldwide. Paul Krugman has described Piketty's book as 'magnificent, sweeping meditation on inequality', which has wrought 'a revolution in our understanding of long-term trends' (Krugman, 2014). Branko Milanovic, former lead economist of the World Bank, describes* Capital in the Twenty-First Century *as 'one of the watershed books in economic thinking' (Milanovic, 2014), while Jacob Hacker, progenitor of the idea of 'predistribution' (see Hacker, Jackson & O'Neill, 2013), has described Piketty as 'a Tocqueville for today' (Hacker and Pierson, 2014; see also Paul Segal's review essay in this issue of* Renewal*).*

Piketty's book has also begun to shape the way in which parties of the left think about the challenges they now face in creating a more just and equitable economic settlement. Shadow Cabinet member Stewart Wood, one of Ed Miliband's most thoughtful advisers, has described Piketty's work as 'providing an intellectual foundation' for many of the things that the next Labour government will hope to do in tackling inequality and falling living standards (Eaton and Wood, 2014; see also Pearce, 2014). Although Miliband has joked in interviews that he has read 'only a few pages' of Piketty's Capital*, the truth is that, as Miliband himself knows well (see e.g. Miliband, 2011, 2014; Eaton, 2014), social democratic politicians can only hope to triumph in the future if they get to grips with the full implications of Piketty's meticulous diagnosis of our current malaise of extreme and worsening inequality, and if they are prepared to take political steps to fight inequality that are of a scope and scale to match the daunting dimensions of the problem of inequality itself.*

Martin O'Neill of Renewal *and* Juncture's *Nick Pearce interviewed Professor Piketty on a recent visit to London (1).*

Nick Pearce: *Your book has received a huge amount of attention. Can we start with some of the central critiques of your core arguments? To begin with, there are those on the left who say that your treatment of the category of capital is a fairly orthodox one. It essentially puts together assets and their relative prices, instead of treating capital conceptually as constituted through relations of production and other structures of power, as it would be in Marxian and other heterodox traditions. (See, for example, Galbraith, 2014).*

Thomas Piketty: I have read that. I think that it is a bit unfair in the sense that I really try hard in the book to do justice to the multi-dimensionality of capital. The history of real estate is not the history of land, it is not the history of financial assets or business assets, or the public debt; all these different assets come with different power relationships, and with different social compromises to determine their rate of return, and the labour return that is used together with these assets.

At some point in the book I also take the sum of all of these assets, and use the market prices of these different assets to compute the total capital stock of the economy. But I try to make clear in the book that while this may be fine for some purposes – this addition of different kinds of capital, in computing the capital stock – one always needs to keep in mind that this is a pretty abstract operation. I certainly don't claim that you can summarise the multi-dimensionality of capital, and the inequality and power relationships that go with it, by making this gigantic operation of adding all of these categories together. In fact, in the book I have long parts in different chapters where I try to tell the story of the public debt, the story of real estate bubbles, the story of 'slave capital', which of course is a very particular kind of wealth, and of the power relationships that go along with it, and this all plays a role in the book. So, I find that this critique – although I can hear it – is not really justified in the sense that I do perfectly agree that capital is a multi-dimensional concept.

In particular, the market value of assets may not always coincide with their social values, so this does not mean that it is the only way to measure the value of capital. For instance, I have a long discussion about the value of German manufacturing companies and the fact that their market value may not be as large as British, American or French corporations, but apparently that does not prevent them from producing good cars (2). The market does a number of things, but there are also a number of things that the market does not do so well; and putting a price on assets is always a complicated business. Sometimes you put a higher price on an asset just because you have less access to power than other stakeholders or groups in society, and that might not be a good thing. So I try to do justice to this multi-dimensional view of capital and when I use the standard textbook economic model, with one type of capital and one type of good, and no relative price issues, I always try to make clear that I do not believe that this is a model that can adequately describe the structure of capital in any country. Still, I think that it is useful to use this model from time to time to refute the claim that, even if the world were operating like that, in this simple, benchmark textbook model then everything would go fine.

One central point of the book is that even if you didn't have real estate bubbles, even if you didn't have any capital market 'imperfection', and even if you didn't have all this complex multi-dimensionality of capital assets, we would still have this fundamental inequality – that is, 'r > g' – of the rate of return to capital greater than the growth rate, and we would still have big problems of inequality to solve. I do not pretend that this model is sufficient to explain the world, but I am trying to make the point that even if it were, we would still have a complex inequality problem to solve. I think it is important that the way I use the benchmark of orthodox neo-classical economic models in this way is in order to refute some claims that are often made about the implications of this model, not because I believe in it – not because I believe that this is an accurate description of the structure of ownership in any country.

Martin O'Neill: *Another issue that has come up in the reception of your book, in Paul Krugman's very positive review in the* New York Review of Books *(Krugman, 2014), is that the phenomenon of the very high salaries of managers in the corporate sector, and particularly in the financial sector, is something that does not fit so easily with a model that is about returns increasing to capital, rather than to labour. Krugman suggested that you don't have as much of a story about that phenomenon as you do about increasing returns to capital. What is your response to Krugman?*

Thomas Piketty: I think that he has a point. I think that the book is too short – I should have made it longer [laughs] so that I could have spoken about all of this. But I think there is not enough about financial deregulation, so I think he has a point.

Now, there is not enough on this, but I do talk about financial deregulation and about the impact on inequality of finance. In particular, there are two important impacts to which I refer. One is that clearly it [financial deregulation] is a big contribution to rising top incomes in the financial sector. And the other part of the story, which plays a big role in the book, is the fact that increased financial sophistication has probably increased inequality in asset returns between different groups of people. For example, there is the fact that a very large portfolio can manage to get a 7 or 8 per cent return, whereas people with £100,000 can hardly get the inflation rate. I think that this huge inequality in rates of return to assets has a lot to do with the increased sophistication in financial markets.

According to the textbook model, it should not be like that. According to the textbook model, the perfect system of financial intermediation should give the same high return to everyone, so everyone should come with £100,000 and have their money invested in the highest yield project in China. So it [reality] doesn't seem to work this way. Apparently some people can get very sophisticated products at a high return and then they sell to the mass of the population assets that do not yield the same return. That plays quite a big role in the book – and I think that is quite novel and it's fairly important.

On the rise of high-end income in the finance sector, I could have spent more time talking about that, so Krugman has a point. Although if we look at the numbers for the United States, finance is about 10 per cent of GDP, and the share of finance in the top 0.1 per cent of income earners is about 20 per cent – so that's twice as much as their share in the economy. So, Krugman is right, but at the same time that means that 80 per cent [of the top 0.1 per cent] is outside finance, and is to do with very top managerial compensation in large non-financial corporations, so I think we should not overestimate the importance of the financial sector.

We have a paper with Emmanuel Saez and Stefanie Stantcheva where we try to explain the compensation packages of top executives in large companies across European countries, and in the US and Japan, and have tried to explain why it is that we have higher top managerial pay in the US and UK in particular (see, e.g., Piketty, Saez and Stantcheva, 2014). The financial sector indicators or company-size indicators do not seem to get you very far in explaining why the rise in top-end managerial compensation has been so much larger in the US (and also, but to a lesser extent, in the UK). The change in incentives due to the huge decline in top income tax rates seems to be more important, in the sense that we see the elasticity of managerial compensation with respect to windfall profits to rise specifically in these two countries when the top tax rate was reduced a lot.

So – yes, finance is important, but there is more to it than just finance.

Martin O'Neill: *Do you think it might be conceptually difficult to divide labour income from capital income for top managers, given that it is hard to see their incomes as a reward their marginal productivity, but where it instead looks more like a de facto capture of something that seems more like a capital return (on a related note, see Wolff, 2014)? Do you think that puts any pressure on the distinction?*

Thomas Piketty: I think that the distinction is always difficult to draw; labour and capital are abstract notions. In the real world, it always takes some labour to manage your capital, and this has always been an important justification – even back in the eighteenth or nineteenth centuries you had land or capital owners who would insist that they undertake a great deal of hard labour in order to get a return. In some ways, the distinction is indeed always hard to draw.

In the case you mentioned, I think at least initially, at the beginning of the careers of top managers, the distinction is pretty clear, in the sense that this is not capital income because, although I'm not sure that it rewards productivity, it rewards some input that is not related to the capital stake in the firm, at least initially. Then of course, as time passes, through their compensation package they are able to have a capital stake. It then becomes complicated because they will be part of the shareholder board and decision-making process of the firm, as well as working for the firm. So there the distinction is difficult. Initially most top managers do not have a capital stake in the company, and even later on in their careers their capital stake can remain quite small. So, it is a reward for labour in the sense that it rewards being there as manager of the firm. Now, are they able to get more than their marginal contribution to the firm as suppliers of labour? Yes, I think that sometimes they are, but I think that it is excessive remuneration for the labour, but it is still labour income. I think that is clearer to analyse it as an excessive remuneration for labour income rather than calling it a return to capital. It is not because it is excessive that it is capital; capital income means that it corresponds to the remuneration of the initial capital stake that you have in the firm.

Nick Pearce: *One final point on the analysis. In this post-crisis era, the case has been made that advanced economies may be experiencing secular stagnation, as Larry Summers has put it (see Summers, 2013, 2014). And so the argument posed to your book, is that r [the rate of return on capital] is going to be low, or could potentially be very low, for a long period of time to come. I wonder what your response to that is. Do you think that this is just a temporary phenomenon and that the historical trends that you empirically document will* *return, or that we may be experiencing structural problems with demand in the advanced economies, which would mean that rates of return on capital will be harder to secure?*

Thomas Piketty: I think that here there is some confusion in these critiques between the interest rate and the rate of return to capital. The rate of return to capital is a much broader concept than just interest rates. If the rate of return on capital were really going to zero, as Summers seems to argue, then the capital share in GDP and the capital share in the economy would be going to zero. This has not been happening at all. Right now, including five years of total crisis, the capital share is much higher than it was twenty years ago in most developed countries.

So, what's in the capital share? With the capital share you can have interest payment, dividends, corporate profits (with some of it going into retained earnings which feeds capital gains), and you have rental income. If you make a sum of all these forms of capital payment, then the capital share has not been going to zero at all.

I think that it is just wrong to take the interest rate on public debt as an indicator of the rate of return. Public debt is a very particular kind of asset. It provides liquidity services – that is, you can easily sell your Treasury bonds – and that is partly why people accept having relatively low returns in comparison to other assets. Also, we are not completely out of the financial crisis yet and we have had a lot of creative monetary policies that have kept interest rates low.

I think that where Summers is right, and this is where he wants to get, is that we have been asking too much of creative monetary policies in recent years, pretty much everywhere – in the US, in the UK, and in the eurozone – because at the end of the day we have this very low interest rate on some assets such as public debt or certain categories of short-term or medium-term loans, but this is creating bubbles in other assets – in real estate and in some segments of the stock market – and so you have huge return on some other assets at the same time as you have zero interest rates on the public debt. So in fact, this is probably amplifying the inequality in rates of return, in this huge heterogeneity of rates of return.

My bottom line is that the average rate of return for all assets combined is not going to zero. It has been going down a little bit over the past twenty to thirty years because of the rise in the capital to income ratio, but it has declined less than the increase in the capital-income ratio, so that the capital share has actually increased. My second point is that you have a huge heterogeneity in rates of return between assets, and that having very low interest rates on certain assets, such as public debt in particular, is not necessarily a good thing because it stimulates very high bubbles in capital gains and rates of return on other assets at the same time.

Martin O'Neill: *In his review of your book in the* Financial Times, *Martin Wolf (Wolf, 2014) said that your book had a weakness in that it didn't actually explain why wealth inequality matters, or why we should care about the economic path that we seem to be on. Now, that struck me as rather an unfair line of criticism, but I wondered how exactly you would respond to Wolf's critique. One thing that you discuss are problems of how wealth inequality can bleed into political inequality, but do you think that this is the main reason that we should worry about inequality of wealth, or are there other important reasons to be concerned about growing inequalities of wealth?*

Thomas Piketty: Why do we care about growing inequality in the distribution of wealth? From my viewpoint there is no problem with inequality per se. I think that inequality is okay up to a certain point, as long as it is in the common interest, as long as it promotes growth, innovation and entrepreneurship, and as long as it benefits in particular the most disadvantaged groups in society (3). But extreme inequality is not useful.

One of the lessons of the twentieth century was that the kind of extreme concentration of wealth that we saw in the nineteenth century was just not useful. This inequality disappeared in the twentieth century, largely due to shocks but also as a result of higher levels of taxation, and this did not prevent growth from happening. In fact, in the post-war period growth was higher.

We do not want to return to this extreme, nineteenth century concentration of wealth, because when inequality is too extreme, it's not useful any more for growth, and it can be bad because it tends to perpetuate inequality over time and across generations. And when it is really extreme, inequality can be a real threat for our democratic institutions.

I am not saying that we are there yet, particularly in Europe, but I think that on the other side of the Atlantic this has become an issue. The influence of private money in politics has become quite frightening. In Europe, the rise in inequality has been less extreme, and we also have rules governing the financing of political parties. These rules are important, and we should not take them for granted.

I would say that, while markets and private property are great at producing innovation and producing new wealth, extreme inequality of income and wealth is not only useless for growth but is bad for the basic working of our democratic institutions.

Martin O'Neill: *Moving on to how we could fight back against rising inequality and 'patrimonial capitalism', you have a fascinating footnote in which you describe your project as 'following in the footsteps of James Meade' (Piketty, 2014, p. 582, fn. 36). But one interesting difference between your approach and Meade's is that you spend more time talking about strategies involving redistributive taxation, whereas Meade also gives a lot of weight to ways of dispersing ownership over capital, and also finding ways of having public capital or forms of democratic wealth (see Meade, 1964 and, for discussion, Jackson, 2012; O'Neill, 2012; Cummine, 2014; and White, 2014; see also Guinan, 2012).*

You discuss these issues very briefly in part four of your book (see, Piketty, 2014, Part IV, especially ch. 16, pp. 540-70), but do you think that the response to the increase in inequality might be one that explores the sorts of avenues that Meade opened up, and doesn't just rely on mechanisms of redistribution through the tax system?

Thomas Piketty: Yes, I think that you are right – I am glad that you have asked this question. First I would like to pay tribute to James Meade and this long tradition of British economists, including Tony Atkinson, with whom we have been working with a lot and who is largely the godfather of historical studies of income and wealth. Tony wrote a great book in 1978 on the history of the inequality of wealth in this country – and this has been a source of inspiration to me along with others (see Atkinson and Harrison, 1978; see also Atkinson, 1983).

James Meade, just like me, believed that progressive taxation *and* the development of other forms of property relationships and of other forms of governance are complementary institutions. In the book I probably place too much emphasis on progressive taxation, but I do talk about the development of new forms of governance and property structure, but probably not sufficiently. So I agree with that – that can be for volume two!

Let me make the point that these are complementary institutions, because progressive taxation of wealth will always be necessary even if we manage to develop these other alternative forms of property. Also progressive taxation of wealth comes with increased financial transparency – transparency of assets and company accounts – and that is very important because, if you want workers to be involved in the management of their company and if you want people more generally to be involved in the management of the economy, then you want access to information. You want to know who earns what in the company, and you want to know who owns the shares. When you have financial opacity about property and shareholder structures of the company, and you don't have access to proper accounts, then you don't have the information that you need.

Financial opacity is the worst enemy of economic democracy; so you need transparency if you want to have economic democracy.

As I have shown in my book, there are large variations in the way that companies are governed, including in the manufacturing sector. In Germany, workers have voting rights on the boards of companies, even if they do not hold shares in those companies, and as I've said, this does not prevent them from producing good cars and exporting them. So I think it is important to think again about these issues of economic governance. If you go outside the manufacturing sector, if you look at the education system, or at the media, you certainly do not want full power to shareholders. Nobody has proposed to change Harvard University into a shareholder company. In the media sector we see new forms of foundations, which separate governance from those who held the capital initially. The powers of capital holders generally are very important issues for the future.

So, when I talk about progressive taxation, I am not saying that this is all that we need. It has to go together with a whole set of other policy responses.

I think that taxation is always about more than taxation; it's a way to produce legal categories to produce financial transparency and democratic accountability. When you did not have taxation of corporate profits there was no account of profits, so now, it is not that today's book accounts are always accurate, but at least they exist, and it is the same for taxation of wealth, which requires ideally a global registry of financial assets, or at least closer registration of assets and property rights. This is complementary with more democratic and inclusive governance.

Nick Pearce: *Just to take that further, in the book you take taxation on wealth to the eurozone. You recently signed a letter with Pierre Rosanvallon and others calling for greater democracy in the eurozone and also for the introduction of a tax base at the eurozone level (see Piketty, Rosanvallon, et al., 2014). There has been a critique of you from both the left and the right that global wealth taxes are never going to happen – and you acknowledge that in how you set up the argument – but is it your view then that ultimately these things will happen at some level by international agreement with regards to transparency, but that actual taxation will take place nationally and regionally, in places like the eurozone? Is that your political agenda?*

Thomas Piketty: I think that it doesn't have to be global – a lot of progress can be made at the national level. Then it is even better if you have more global cooperation. There is a whole continuum of solutions between the perfect global tax system and the full nationalist response where there is no cooperation at all. The real world is somewhere in between – there are hundreds and thousands of ways of trying to push it further in the direction of cooperation.

But it is perfectly possible at the national level to transform our traditional forms of property taxation, which are typically proportional and which do not take into account financial assets and financial liabilities, because they were set up in the nineteenth century when most property was real estate property, so they do not take into account financial wealth and liabilities. This can be turned into a progressive tax on net wealth, which basically would be a way to reduce property tax – council tax in the UK – for the vast majority of the population. Typically, if you have a house that is worth £500,000 but you have a mortgage of £490,000 you are not rich – you have a net wealth of £10,000 so you should pay less than someone who has no mortgage or who paid off his or her mortgage many years ago.

Having a progressive tax on net wealth, and a higher tax rate for people who have millions of pounds in big mansions, is something that you can do in the UK, or the US or France, where you don't need to ask permission from other countries. If you want to go all the way to having very high progressivity at the very top end for financial assets, then if you want to move further in this direction you need more coordination. That could be between eurozone countries. I of course would very much welcome the UK to join in, to step in, and I think that on this issue of the fight against tax havens, the UK can indeed play a role. To some extent it is an issue that goes beyond 'left and right'. There has been a lot of talk about fighting tax havens. There has been little success in European countries, but when the US stepped in and introduced sanctions against the Swiss banks, some progress was made.

Five years ago people would say that nothing would ever happen on tax havens, and then things happen, so I am not terribly impressed by people who 'know' in advance what is or is not going to happen. The whole history of taxation is full of surprises, including the recent past – nobody would have guessed that things would have changed with the Swiss banks five years ago, and so I am just a bit sad that European countries including Britain, France and Germany did not take action and had to wait for the US to step in to challenge this because in a way, European countries have a lot more to lose than does the US from Swiss banks and bank secrecy. So it is a bit sad that we're not able to act. But I think that we can do better within and outside the eurozone.

Martin O'Neill: *Can I ask you about labour unions? One might think that unions had an important role during* Les Trente Glorieuses *in moderating inequality and ensuring that labour got a decent share of economic growth. What role do you think that unions might have in the future, in trying to avoid the dystopian path that we might end up on if the trends that you have described continue?*

Thomas Piketty: That is a tough question, and probably the book does not do justice to this question, and doesn't deal enough with this question. It is interesting to see that, in the past ten years a number of countries that did not use national minimum wages in the past have begun to do so – e.g. in Britain, and Germany is doing that as well. And there has been an increased discussion in the US about using the laws of minimum wage, which was introduced a long time before, but for a long time it had not really increased very much. One reason for the renewal of the national minimum wage is that in a world where we have increasing employment in the services and declining employment in manufacturing companies, unions do not quite have the impact and bite that they used to have. This does not however mean that unions are not part of the solution, but that we need to also think of other policies that have an impact upon wages, and the minimum wage is one of them, as are investments in education and skills. It is easier to increase the minimum wage if you increase the skills and access to education, and thereby the access to higher paying jobs, for the bottom segments of the population. So again this is complementary.

I think that the issue of effective participation in company decision-making, and in board and shareholder meetings, is going to be discussed more and more in the coming years, given the success of Germany in particular. In France it used to be the case that unions and workers would only have a consultative vote in board meetings and not have a decisive vote. But now a new law is going to grant a limited number of decisive votes in board meetings because – and it has always been like that in Germany – in effect it brings the unions to be more closely associated with the management and running of the company. This seems to be working quite well in some ways. All of these issues are referred to in the book but not sufficiently.

Nick Pearce: *To finish, in the mid-twentieth century, when inequality was reduced, the organised working class, both in trade unions and through political parties, had an* *economic and political clout that gave energy and momentum to egalitarian movements. The decline of the organised working class leaves a gap which progressives have subsequently found very difficult to fill. If you are to make these big arguments for reducing inequality, for introducing new taxes, for trying to democratise capital, then where are the societal forces that could push behind progressive politicians? At the moment, they do not appear to be there and so they find it incredibly difficult to mobilise electoral coalitions – which is happening in France at the moment – and so for politicians who might agree with your analysis, how would you suggest that they mobilise a coalition behind this solution?*

Thomas Piketty: So, 'Is Twitter going to be enough?' – that's your question. I am not sure. I think that there are new forms of mobilisation and mass participation that are yet to be invented. I do not have a full answer to that. Unions certainly do not belong only to the past, but there are other forms of mobilisation that belong together with unions for the future and which we don't fully know yet.

I am not as pessimistic as a number of observers and reviewers seem to be after reading my book, and so I am sorry if my book made them pessimistic. The development of information technology and the internet also opens up new ways of spreading information, and new ways of mobilisation. I also believe in the power of ideas and books – and this can also contribute to the diffusion of information, and can try to contribute to a wider political mobilisation.

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Notes

1. A shorter version of this interview has been published in *Juncture* (O'Neill and Pearce, 2014). The present version contains additional material, not included in the *Juncture* version, which draws on further exchanges between O'Neill and Piketty. Video and audio clips of this interview can be found via the IPPR's website here: 'Thomas Piketty on capital, labour, growth and inequality', at http://www.ippr.org/juncture/juncture-interview-thomas-piketty-on-capital-in-the-twenty-first-century.
2. For further discussion of Germany's political economy, and of the way in which German forms of corporate governance – with workers on corporate boards and the 'codetermination' of industrial policy ('*Mitbestimmung*') – allows more of the value of firms to be captured by stakeholders other than shareholders, as interestingly demonstrated by the differences between the stock market value and 'book value' of German firms, see Piketty, 2014, 140-146 on 'Rhenish Capitalism and Social Ownership', esp. 145-6.
3. It is interesting to note that Piketty's claim that inequalities are permissible only if they 'benefit in particular the most disadvantaged groups in society', closely echoes Rawls's 'difference principle' (see Rawls, 1999 and Rawls, 2001; for exegesis of Rawls's idea, see e.g. Wenar, 2012, or, in more detail, Van Parijs, 2003). In discussing the central idea of 'common utility' invoked in Article 1 of the *Declaration of the Rights of Man and of the Citizen* passed by France's revolutionary National Constituent Assembly in 1789, Piketty suggests that 'one reasonable interpretation is that social inequalities are acceptable only

if they are in the interest of all and in particular of the most disadvantaged social groups', noting that 'the "difference principle" introduced by the US philosopher John Rawls in his *A Theory of Justice* is similar in intent' (Piketty, 2014, 480, and 631, fn. 22). For some suggestive remarks on the relationship between Piketty and Rawls, see Chris Bertram's post on the *Crooked Timber* blog on 'Teaching Rawls after Piketty' (Bertram, 2014).