The New York Times

# Piketty's Arguments Still Hold Up, After Taxes

By Jared Bernstein

May 9, 2014

One critique of Thomas Piketty's influential new book on wealth accumulation through the ages is that his analysis is solely of market incomes and wealth. He largely ignores systems of taxes and transfers and the extent to which they offset inequality.

Alan Reynolds from the libertarian Cato Institute, in criticizing earlier work by Piketty and his frequent co-author Emmanuel Saez, correctly points out that their income data leave out Social Security, unemployment and disability benefits, food stamps and Medicaid — and ignore "huge Obamacare subsidies next year."

Scott Winship, an inequality analyst at the Manhattan Institute, makes similar points in discussing Piketty's findings, calling for "more comprehensive definitions of household income" to more accurately capture trends in income concentration.

I call these arguments the transfer defense. Such critics acknowledge that Mr. Piketty shows large increases in income and wealth inequality. But in the United States, and even more so in other advanced economies, progressive systems of taxes and income transfers, like Social Security or Medicare, at least partly offset these inequalities. The primary distribution (market incomes) is considerably more unequal than the secondary distribution (taxes and transfers).

The transfer defense makes an important point, though it's less a critique of Mr. Piketty, who is quite clear that he's examining the increase in income and wealth concentration *before* taxes and transfers. His book is about market income, which seems to me the right place to start. Since the guy appears to write faster than I read, I suspect and hope he'll extend his work into this after-tax, post-market distribution as well.

But there are important issues to consider regarding this critique. First, it's very strange for conservatives to be complaining that Mr. Piketty fails to account for the inequality-reducing function of taxes and transfers. Whether it's the House Republican budget, which gets 70 percent of its spending cuts from low-income programs, attacks on social insurance and Obamacare, or the description of the safety net as a hammock that's preventing the poor from trying harder to earn more income, it is odd to favorably cite the impacts of transfers in the inequality debate while trying to significantly shrink them in the fiscal debate.

Second, the implications of this critique are politically unsustainable. If the argument is “don’t worry about market outcomes — we’ll fix the inequalities of the primary distribution in the secondary one,” then every year that market inequality goes up, we’ll have to ratchet up the redistribution function. It is theoretically conceivable that a beneficent top 1 percent might be fine with that, but practically speaking, there’s a limit to such an aggressive strategy of income redistribution.

In fact, comprehensive income data assembled by the Congressional Budget Office show that for middle-income households, transfers and lower taxes explain the vast majority of their income growth in recent decades. Their earnings have declined in real terms 7 percent from 1979 to 2010, but Social Security, Medicare, unemployment insurance and lower taxes have more than made up the difference.

The C.B.O. data include not just market income (wages, interest, dividends, capital gains) but government transfers and also the value of employer-provided health benefits (since the latter are favored by the tax code, they are a close cousin of more direct transfers).

After accounting for taxes, middle incomes rose about 36 percent, from 1979 to 2010. But here’s the kicker: 90 percent of that increase came from higher transfers (74 percent) and lower taxes (16 percent). And remember, we’re talking middle-class families here, not poor ones.