Piketty's Class-Warfare Tome: Bad Numbers, Bad Analysis

Daniel J. Mitchell
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Why do statists make so many mistakes with data? Paul Krugman, for instance, has butchered numbers when writing about fiscal policy in nations such asFrance, Estonia, Germany, and the United Kingdom.

But Krugman isn't alone. We also have Thomas Piketty, who was lionized by the left after publication of *Capital in the Twenty-First Century*.

Ever since his book was published, various experts have called into question the veracity of Piketty's numbers. Most recently, here's some of what Alan Reynolds, my colleague at the Cato Institute, wrote about his data for the *Wall Street Journal*.

> "Thomas Piketty…remains a hero on the left, but the honeymoon may be drawing to a sour close as evidence mounts that his numbers don't add up. …data are so misleading as to be worthless. They attempt to estimate top U.S. wealth shares on the basis of that portion of capital income reported on individual income tax returns—interest, dividends, rent and capital gains. This won't work because federal tax laws in 1981, 1986, 1997 and 2003 momentously changed (1) the rules about which sorts of capital income have to be reported, (2) the tax incentives to report business income on individual rather than corporate tax forms, and (3) the tax incentives for high-income taxpayers to respond to lower tax rates on capital gains and dividends by realizing more capital gains and holding more dividend-paying stocks."

Alan lists some of specific problems that exist when you try to make sweeping assertions based on tax return data.

> "For example, interest income from tax-exempt municipal bonds was unreported before 1987—so the subsequent reporting of income created an

> illusory increase in top incomes and wealth. Since 1997, by contrast, most capital gains on home sales have disappeared from the tax returns of middle-income couples, thanks to a $500,000 tax exemption. …since the mid-1980s, most capital income and capital gains of middle-income savers began to vanish from tax returns by migrating into IRAs, 401(k)s and other retirement and college savings plans. Balances in private retirement plans rose to $12.4 trillion in 2012 from $875 billion in 1984. …When individual tax rates dropped from 70% in 1980 to 28% in 1988, this provoked a massive shift: from retaining private business income inside C-corporations to letting earnings pass through to the owners' individual tax returns via partnerships, LLCs and Subchapter S corporations. …Although more frequent asset sales showed up as an increase in capital income, realized gains are no more valuable than unrealized gains so realization of gains tells us almost nothing about wealth. Similarly, a portfolio shift from municipal bonds, coins or cash into dividend-paying stocks after the tax on dividends fell to 15% in 2003 might look like more capital income when it was merely swapping an untaxed asset for a taxable one."

So what's the bottom line?

> "Mr. Piketty's premonition of soaring U.S. wealth shares for the top 1% finds no credible support in his book or elsewhere."

But let's now conduct a thought experiment. What if Piketty's data was right? Would that justify punitive class-warfare tax rates?

I've already explained that this would be the wrong approach.

And Diana Furchtgott-Roth of the Manhattan Institute cites some new academic research to make a similar point.

> "Meltzer and Richard show that using redistribution to ameliorate income inequality is not only ineffective, but worsens the problem that policy makers seek to cure. …Since workers' productivity levels increase with the more they produce, and because higher taxes create disincentives to working, taxes lead to lower economic growth. …Higher tax rates that fund transfer payments hamper economic growth. That's because they increase the number of people who depend on these payments and find it preferable not to work. There also is less learning-by-doing among those who work. …As taxes and transfers rise, hours of work and acquired skills decline, reducing economic growth. …it is this decline in hours worked for low-productivity workers that leads to more economic inequality — not the growth of technology nor the rent-seeking privileges of the rich, two causes cited by Piketty. Reduced effort by the rich in reaction to higher taxes comes at the expense of economic growth, which has the potential to raise everyone's living standards and increase economic opportunity. …Meltzer

> and Richard show that the growth of government is the true driver behind inequality."

In other words, the supposed solution of ever-higher tax rates from folks such as Piketty (and Obama) would be harmful to the overall economy and be especially damaging to those with lower incomes.

If we want to help the poor, the goal should be to achieve faster economic growth by enabling capitalism and entrepreneurship.

In other words, copy Hong Kong and Singapore, notFrance.

Here's the video I narrated for the Center for Freedom and Prosperity explaining why class-warfare tax policy is so misguided.

P.S. This isn't the first time that Alan Reynolds has debunked Piketty.

P.P.S. These two pizzas tell you everything you need to know about how the left would define success.

P.P.P.S. And Margaret Thatcher exposed why their definition of success is absurd.

Daniel J. Mitchell is a top expert on tax reform and supply-side tax policy at the Cato Institute.