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## Piketty's Arguments Still Hold Up, After Taxes

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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

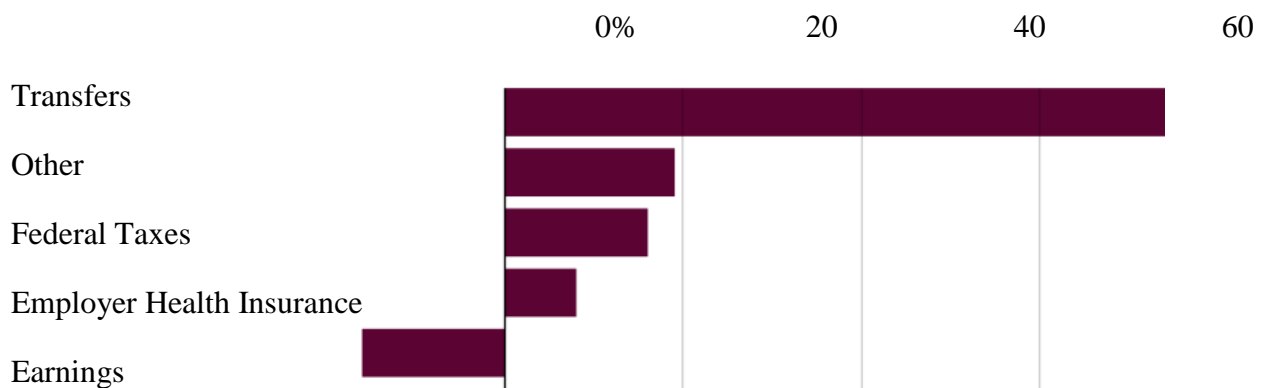
redistribution function. It is theoretically conceivable that a beneficent top 1 percent might be fine with that, but practically speaking, there's a limit to such an aggressive strategy of income redistribution.

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.

### **Middle-Class Income Growth Didn't Come From Earnings**

*Most of it came from government programs.*

Income growth after taxes and transfers, 1979 to 2010



*Source: Congressional Budget Office*

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.

Another factor in play in these middle-income trends is aging boomer households that increasingly depend on nonmarket incomes. [New data](#) from the Social Security Administration show that for the average elderly household that receives retirement benefits from the program, Social Security provides just under two-thirds of income. For 90 percent of households, this guaranteed public pension accounts for 36 percent of income.

Medicare and Medicaid also play increasingly large roles in the incomes of the middle class, though part of this is an artifact of C.B.O.'s methods, which credits families' incomes with

excesses in health care spending that don't actually improve their well-being, like overpriced drugs and high physician salaries.

Finally, while the progressive taxes and transfers that don't show up in Mr. Piketty's data reduce the level of inequality at any point in time, they don't have that much impact on its growth. The share of comprehensive income going to the top 1 percent grew 6 percentage points before taxes and transfers from 1979 to 2010, and 5.4 points after taxes and transfers. (If one stops at 2007, before the recession, the same comparison yields an increase of 9.8 points before tax and 9.3 after).

So, yes, critics are correct that inequality analysts, including Mr. Piketty, should look at the impact of taxes and transfers. But if they're fact driven, what they find will not alter their view about the upward trajectory of inequality. Instead, the extent of wage stagnation and its corollary, the increased role of transfer income and tax cuts in raising middle-income living standards, should alarm them. Instead of hacking away at the safety net, the data reveal the need to preserve it while increasing the quantity and quality of employment opportunities and the real growth rate of earnings for the majority of the work force.

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