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Piketty Gets It Wrong

Instead of berating capitalists, we need to make it easier for workers to join their ranks.

By Michael Tanner
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For those who believe in the redistribution of wealth, the hero of the hour is Thomas Piketty, the French economist whose book *Capital in the Twenty-First Century* provides a serious critique of inequality in modern capitalist economies and warns that market economies "are potentially threatening to democratic societies and to the values of social justice on which they are based." To remedy this, he argues for a globally imposed wealth tax and a U.S. tax rate of 80 percent on incomes over $500,000 per year.

The Left has been rapturous. In the last two months, Piketty's book has been cited more than a half-dozen times by the *New York Times,* something that has happened with no other book in recent memory. Paul Krugman hails it as "the most important economics book of the year." Martin Wolff, in the *Financial Times*, lauded it as "an extraordinarily important book."

Capital in the Twenty-First Century is well researched and contains much useful information and some important insights. But it is not unflawed. Some of the problems are technical — Piketty tends to underestimate the elasticity of returns on capital — but more are deeply philosophical. Piketty takes the evilness of inequality as a given, ignoring the broader question of whether the same conditions that lead to growing wealth at the top of the pyramid also improve material well-being for those at the bottom. In other words, does it matter if some people become super-rich as long as we reduce poverty along the way? Which matters more, equality or prosperity?

To cite just one example, Piketty devotes considerable effort to criticizing the rise of inequality in China over the past three decades as it has adopted market-oriented policies. But he largely glosses over the way those policies have lifted millions and millions of people out of poverty.

Piketty's proposed "solutions" are equally problematic. He seems to believe that "confiscatory taxes" (his term) can be imposed without changing incentives or discouraging innovation and wealth creation. Piketty's solutions would undoubtedly yield a more equal society, but also one that was remarkably poorer.

Still, Piketty makes some important points. In particular, he notes correctly that returns on capital nearly always exceed the return on labor. With capital held by a relatively narrow group, therefore, rising inequality is inevitable. Moreover, with the wealthy able to pass capital on to their heirs, that inequality will be perpetuated and even extended over generations.

One wonders why, then, Piketty’s fans ignore the obvious answer to this problem. Instead of attacking capital and capitalism, why not expand the number of people who participate in the benefits of having capital? In other words, let’s make more capitalists.

Yet, the Left is unremittingly hostile to exactly those policies that would give workers more access to capital.

Take, for example, 401(k) plans, which allow some 52 million American workers to own stocks and bonds as part of their retirement portfolios. Teresa Ghilarducci, director of the Schwartz Center for Economic Policy Analysis at the New School in New York, has argued before Congress that 401(k) plans should be abolished, and replaced by an expanded social-insurance system. Representative Jim McDermott (D., Wash.), who sits on the tax-writing Ways and Means Committee, has pronounced himself “intrigued” by Ghilarducci’s ideas. And retiring congressman George Miller (D., Calif.) has called for eliminating or reducing the tax break for 401(k) contributions. The Obama administration has also sought to limit tax breaks for 401(k)s, although primarily for wealthier participants. In a speech calling for the expansion of Social Security, Senator Elizabeth Warren (D., Mass.) criticized private retirement accounts like 401(k) plans “that leave the retiree at the mercy of a market that rises and falls, and, sometimes, at the mercy of dangerous investment products.”

No policy proposed in recent years would have done more to expand capital ownership than allowing younger workers to invest a portion of their Social Security taxes through personal accounts. One of the unsung benefits of such Social Security reform is that it would enable even the lowest-paid American worker to benefit from capital investment. Indeed, since the wealthy presumably already invest as much as they wish to, lower-income workers would be the primary beneficiaries of this new investment opportunity.

In Chile, for example, workers, through their pension accounts, own assets equal to approximately 60 percent of the country’s GDP. As José Piñera, the architect of Chile’s successful pension reform, points out, personal accounts “transform every worker into an owner of capital.”

Moreover, my Cato colleague Jagadeesh Gokhale has demonstrated that, because personal accounts would be inheritable, privatizing Social Security would significantly reduce inequality across generations.

It is this “democratization of capital” that attracted honest liberals like Daniel Patrick Moynihan to the idea. Yet, Democrats in Congress today would sooner sell their first-born to the Koch brothers than even consider it.

In the end, there are two ways to address inequality. You can bring the top down, or you can lift the bottom up. It is free-market capitalism that gives us a chance to do the latter. And if there is a problem today, it is more likely a result of too little capitalism, not too much.

That’s something that Piketty’s fans should think about.

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