Inequality in America : The 1% in International and Historical Perspective

Thomas Piketty
Paris School of Economics

UPenn Policy Forum, November 9 2012

Inequality & capitalism in the long run

- Long run distributional trends = key question asked by 19^{C} economists
- Many came with apocalyptic answers
- Ricardo-Marx: a small group in society (land owners or capitalists) will capture an ever growing share of income & wealth

→ no "balanced development path" can occur

- During 20^{C}, a more optimistic consensus emerged: "growth is a rising tide that lifts all boats"

  (Kuznets 1953; cold war context)

- But inequality ↑ since 1970s destroyed this fragile consensus (US 1976-2007: ≈60% of total growth was absorbed by top 1%)

→ 19^{C} economists raised the right questions; we need to adress these questions again; we have no strong reason to believe in balanced development path

- 2007-2012 world financial crisis also raised doubts about balanced devt path… will stock options & bonuses, or oil-rich countries, or China, or tax havens, absorb an ever growing share of world ressources in 21^{C} capitalism?

Convergence vs divergence

- **Convergence forces do exist**: diffusion of knowledge btw countries (fostered by econ & fin integration)

& wth countries (fostered by adequate educ institutions)

- **But divergence forces can be stronger**:

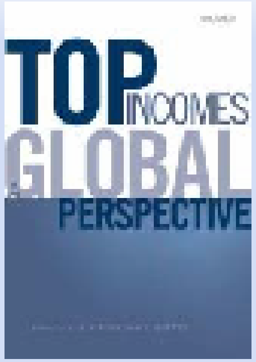
(1) When top earners set their own pay, there's no limit to rent extraction → top income shares can diverge

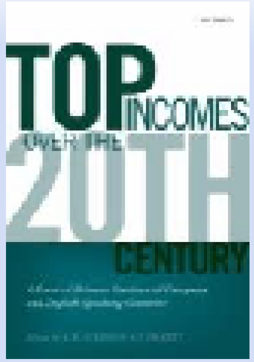
(2) The wealth accumulation process contains several divergence forces, especially with $r > g$ → a lot depends on the net-of-tax global rate of return r on large diversified portfolios : if r=5%-6% in 2010-2050 (=what we observe in 1980-2010 for large Forbes fortunes, or Abu Dhabi sovereign fund, or Harvard endowment), then global wealth divergence is very likely

This lecture: Inequality in America

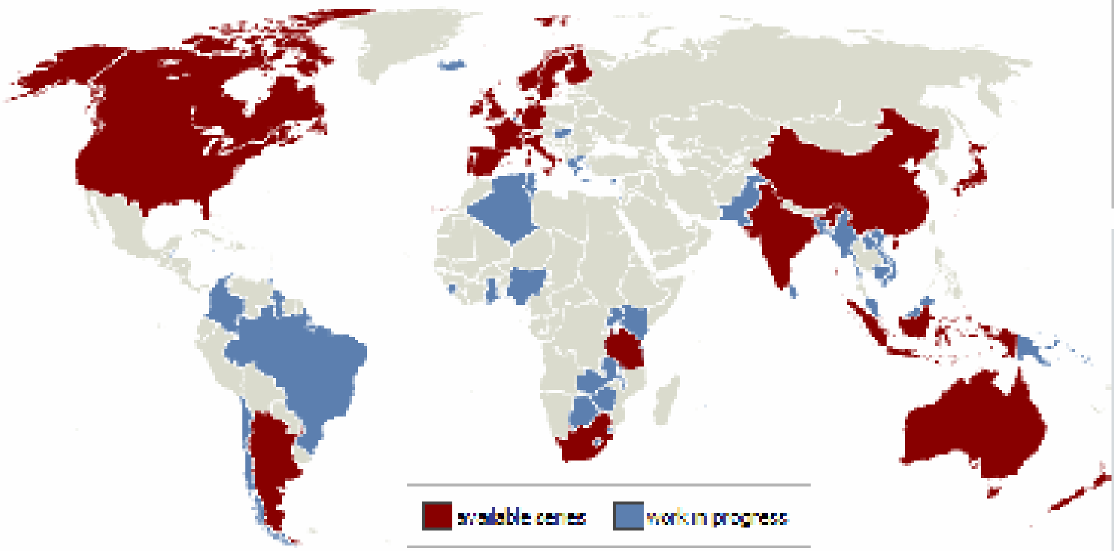
- **Inequality in the US is now larger than ever before in American history.** About 50% of national income goes to the top 10% (incl. 20% to top 1%), i.e. approximately the same record high level as UK or France around 1910.
- **Does US inequality keep a distinctive meritocratic character, or is the New World simply becoming like Old Europe ?**
- As compared to UK or France 1910, current US inequality has a different structure: it is more based upon labor income and less upon inherited wealth. But:
- This difference is a matter of degree and should not be exagerated. US wealth concentration is very large. US wealth-income ratios might also reach record levels in the future. Key difference with Europe = population growth.
- The enormous rise in top labor incomes has little to do with merit. Modern US inequality puts enormous pressure on loosers (meritocratic extremism). At least Belle Epoque or Ancien Régime inequality did not really pretend to be fair.

The World Top Incomes Database





- **Home**
- **Introduction**
- **The Database**
- **Graphics**
- **Country Information**
- **Work in Progress**
- **Acknowledgments**



Institute for New Economic Thinking

Center for Equitable Growth

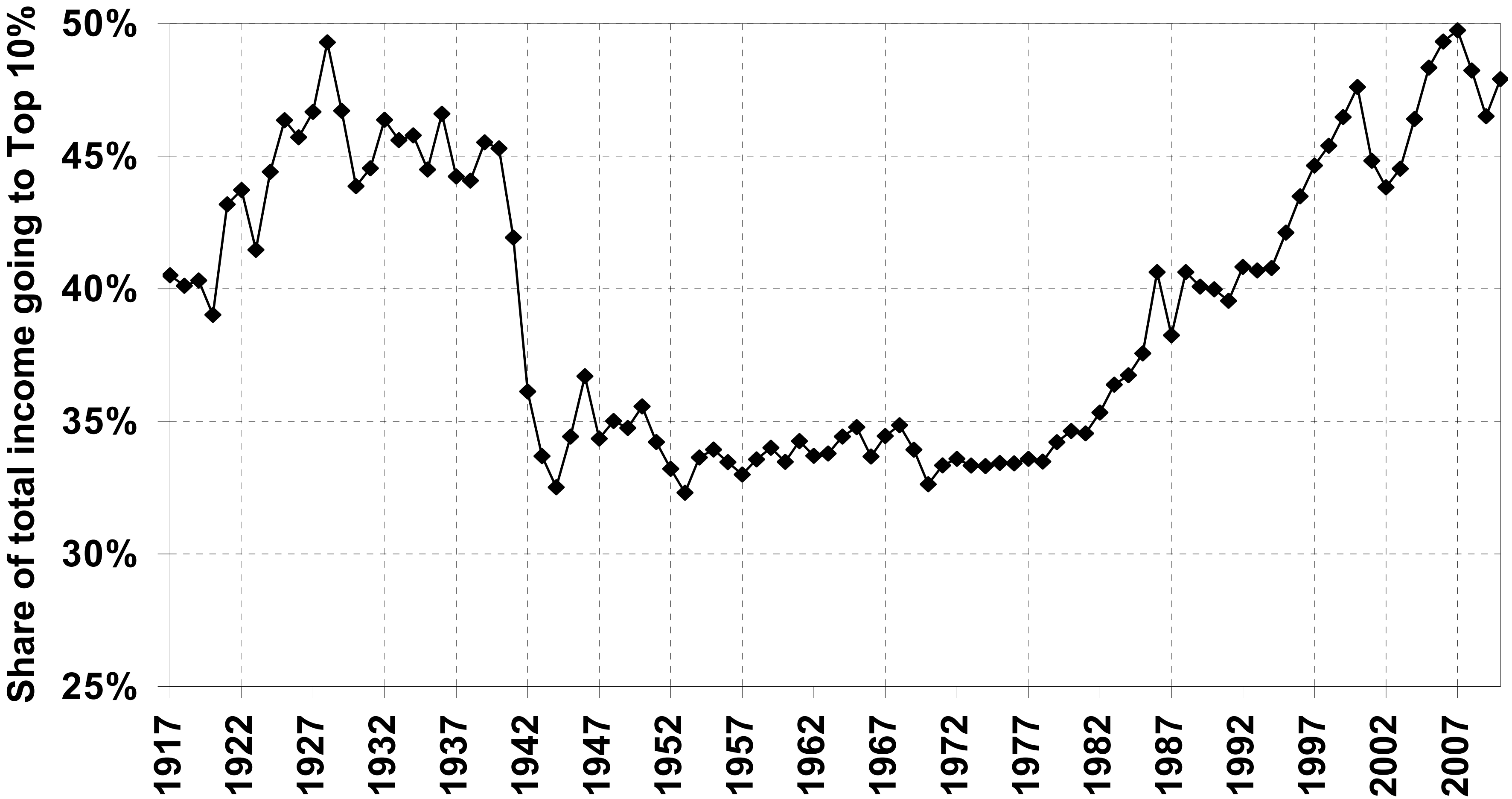


FIGURE 1
The Top Decile Income Share in the United States, 1917-2010

Source: Piketty and Saez (2003), series updated to 2010.
Income is defined as market income including realized capital gains (excludes government transfers).

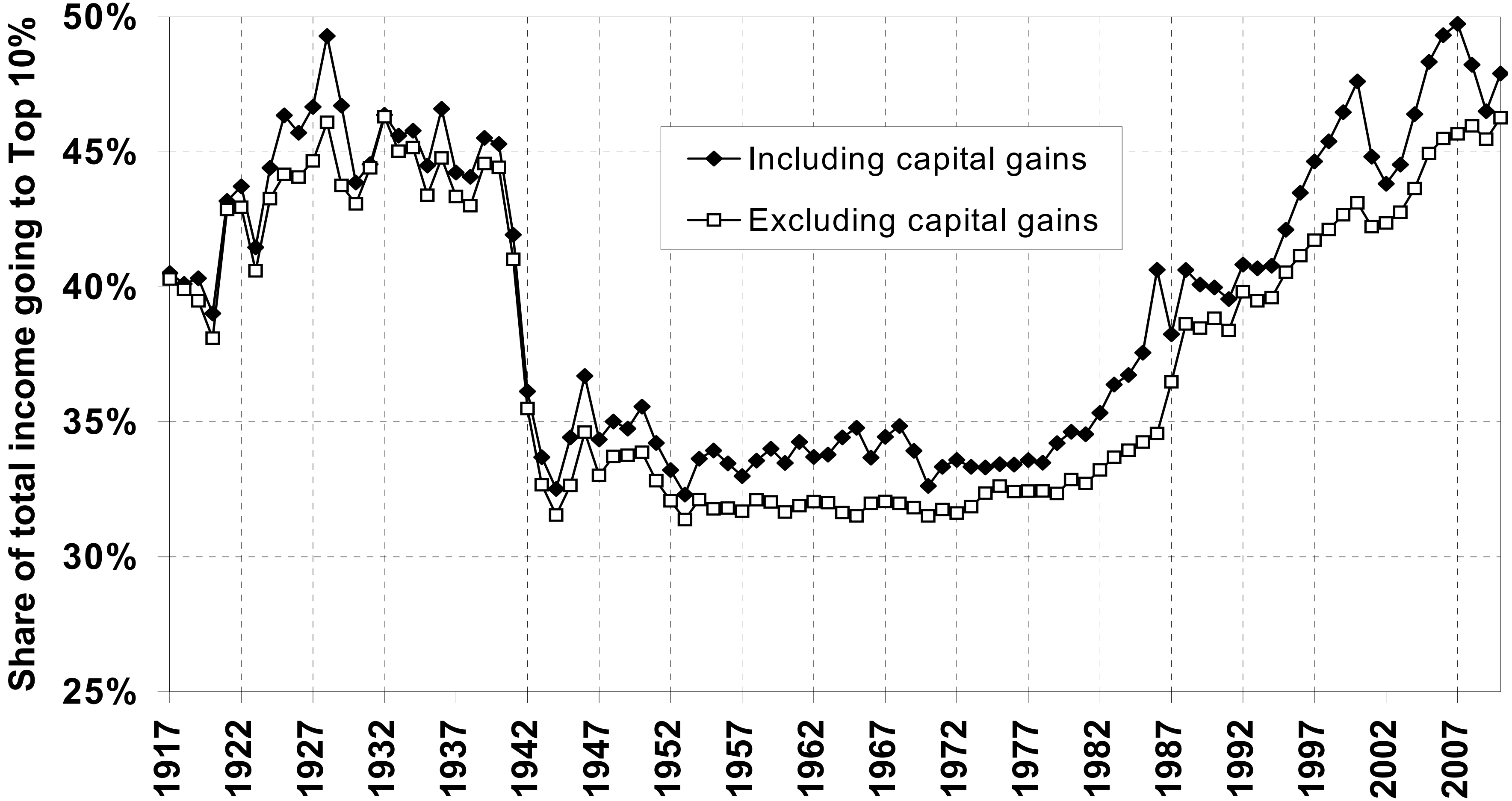


FIGURE 1

The Top Decile Income Share in the United States, 1917-2010

Source: Piketty and Saez (2003), series updated to 2010.
Income is defined as market income including realized capital gains (excludes government transfers).

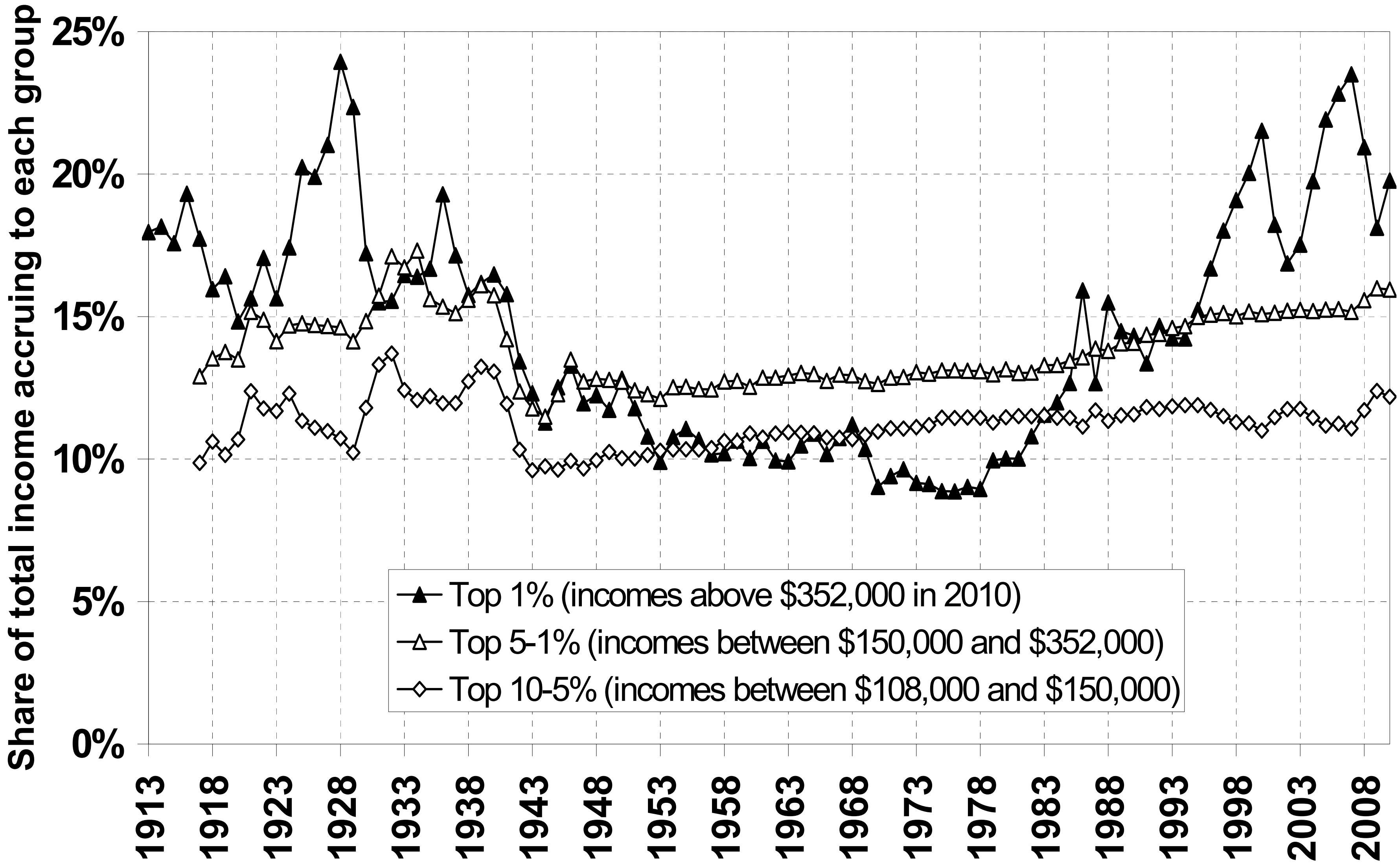
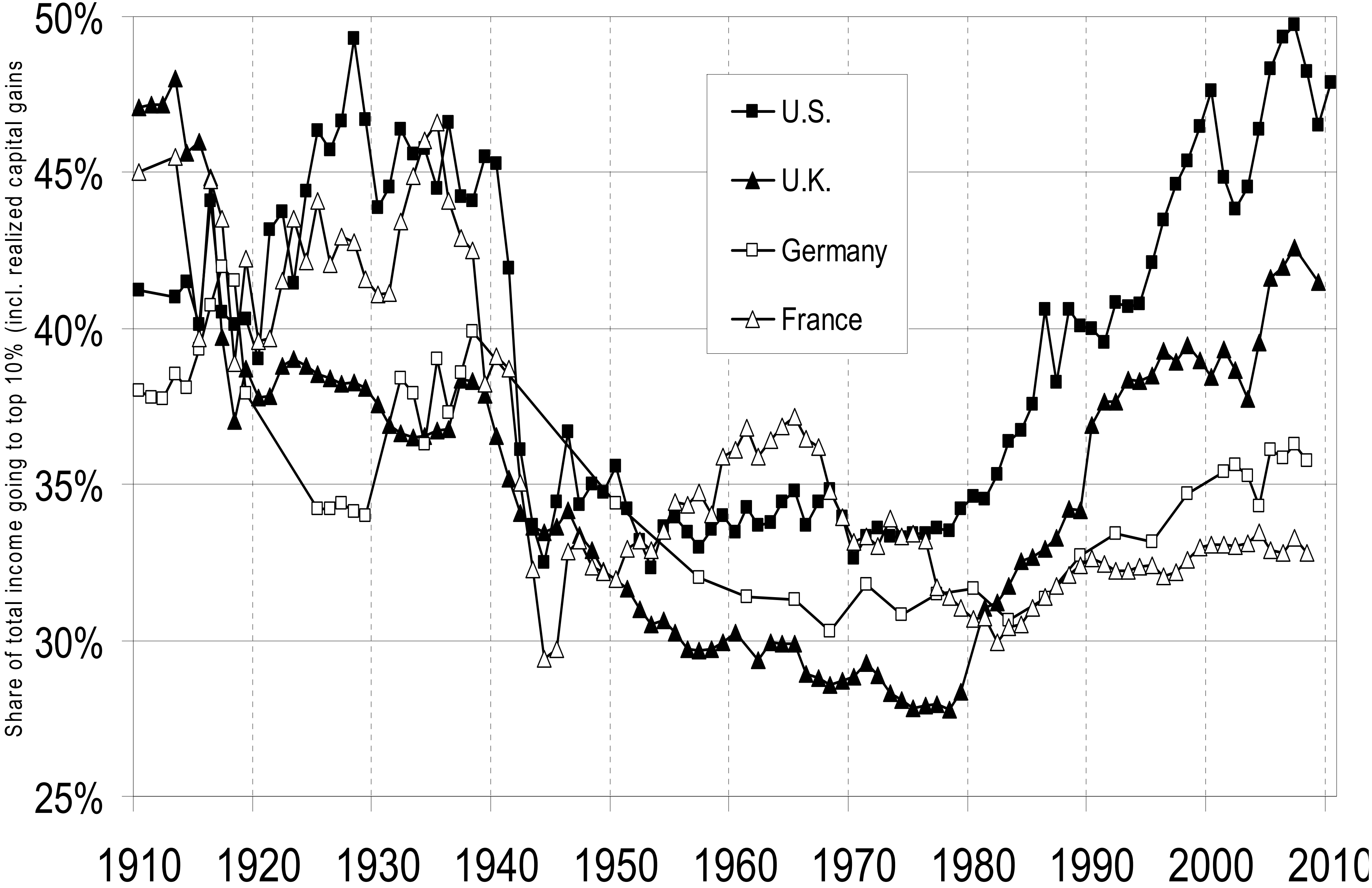


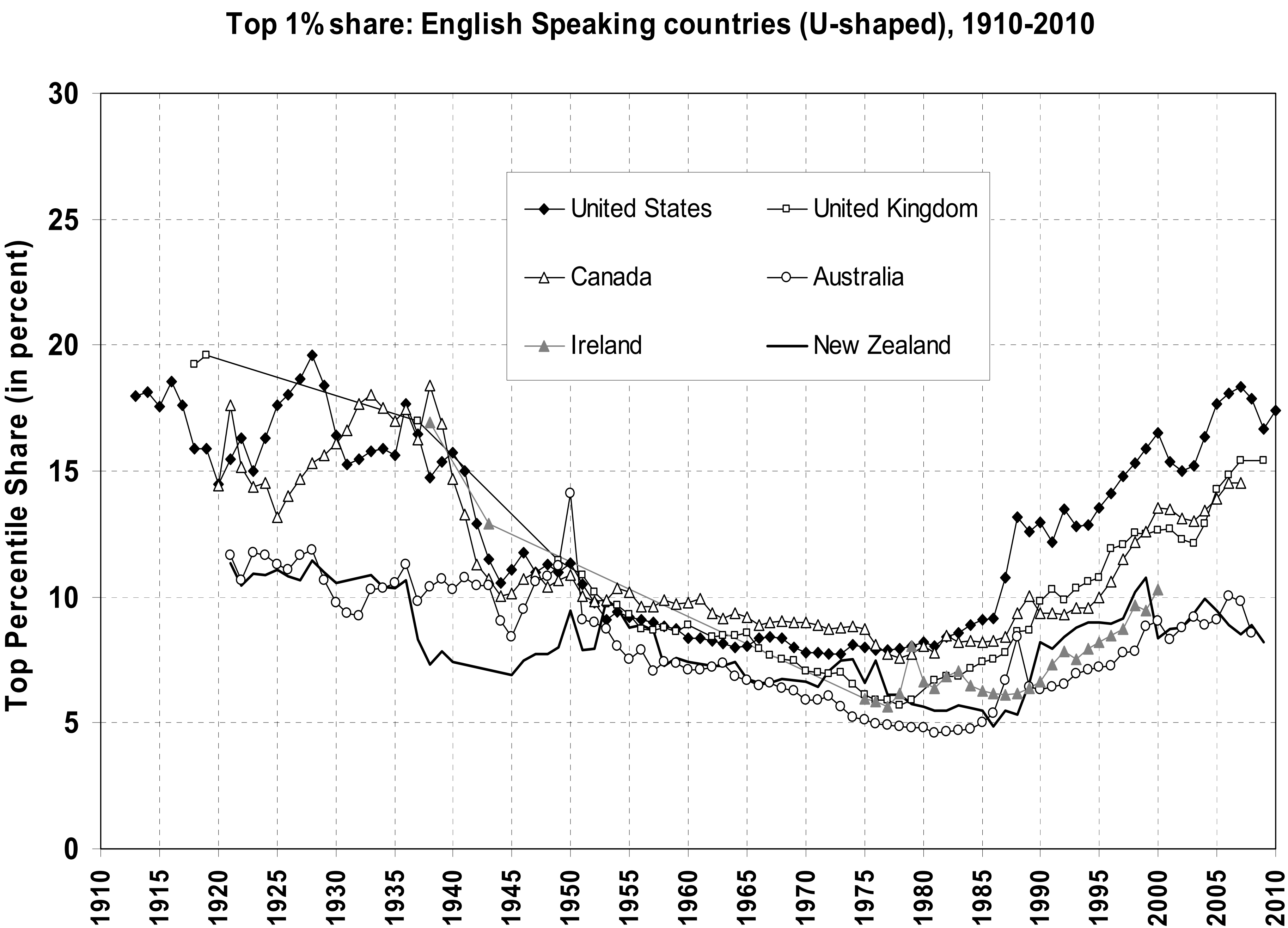
FIGURE 2

Decomposing the Top Decile US Income Share into 3 Groups, 1913-2010

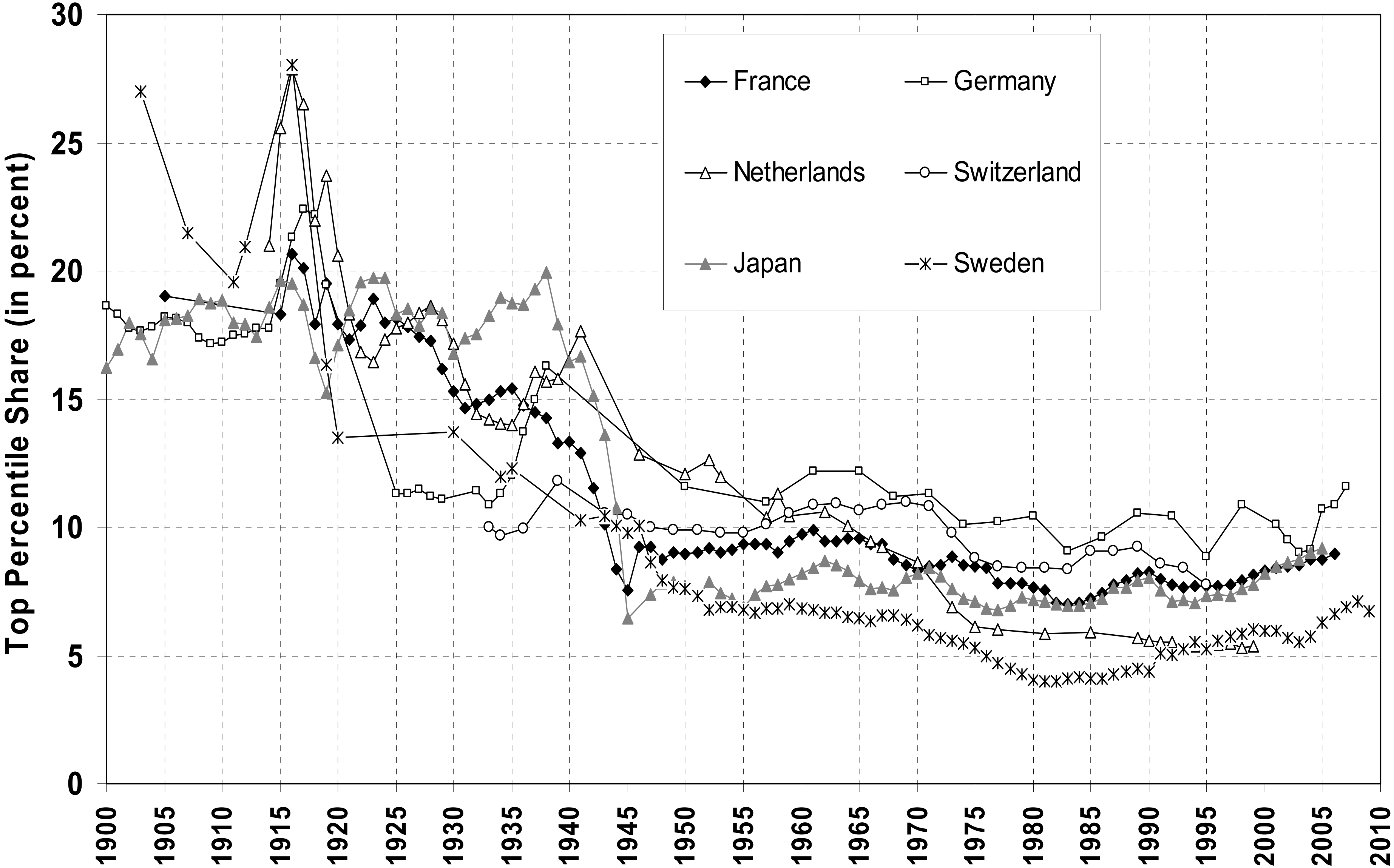
Top Decile Income Shares 1910-2010



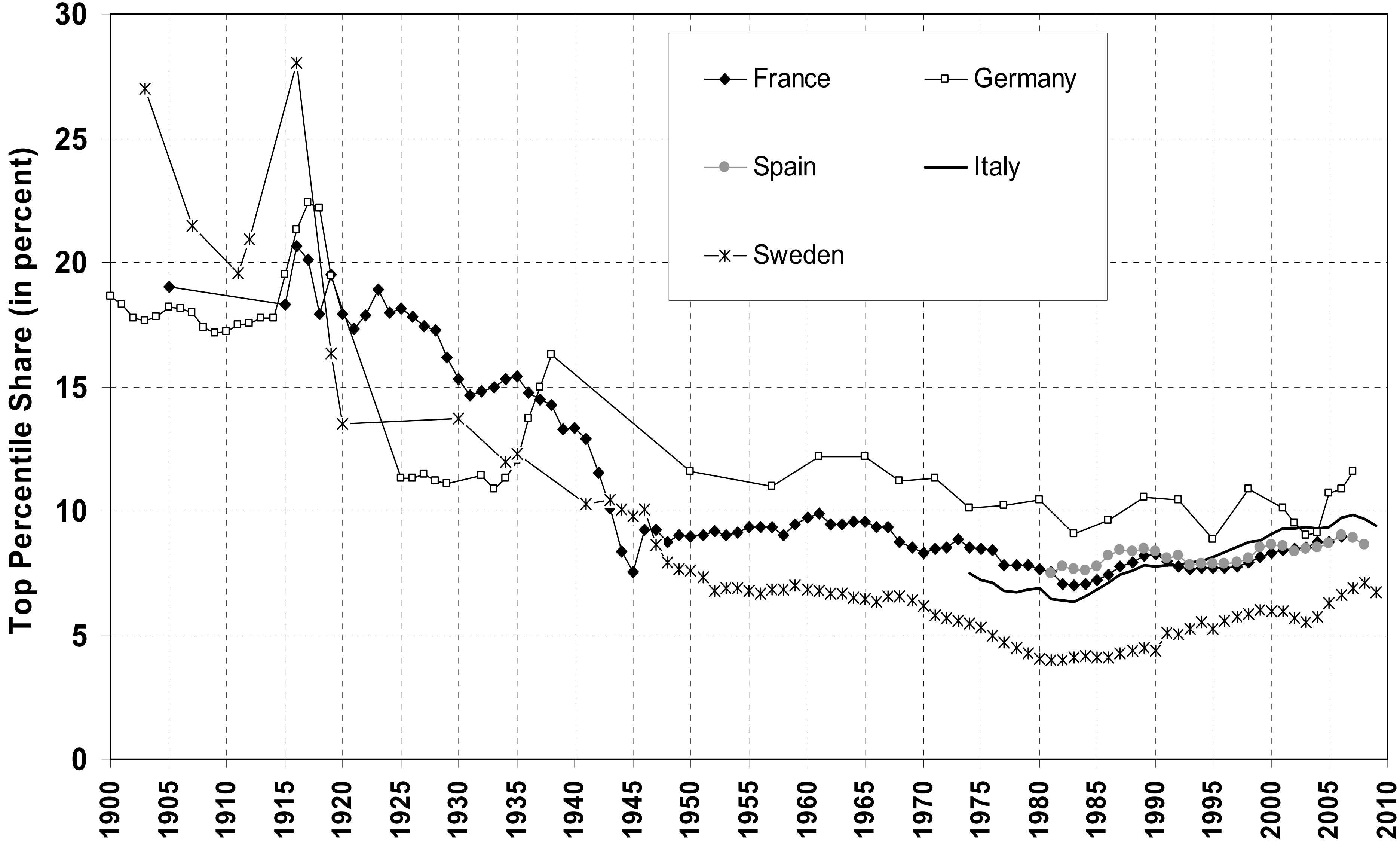
Source: World Top Incomes Database, 2012. Missing values interpolated using top 5% and top 1% series.

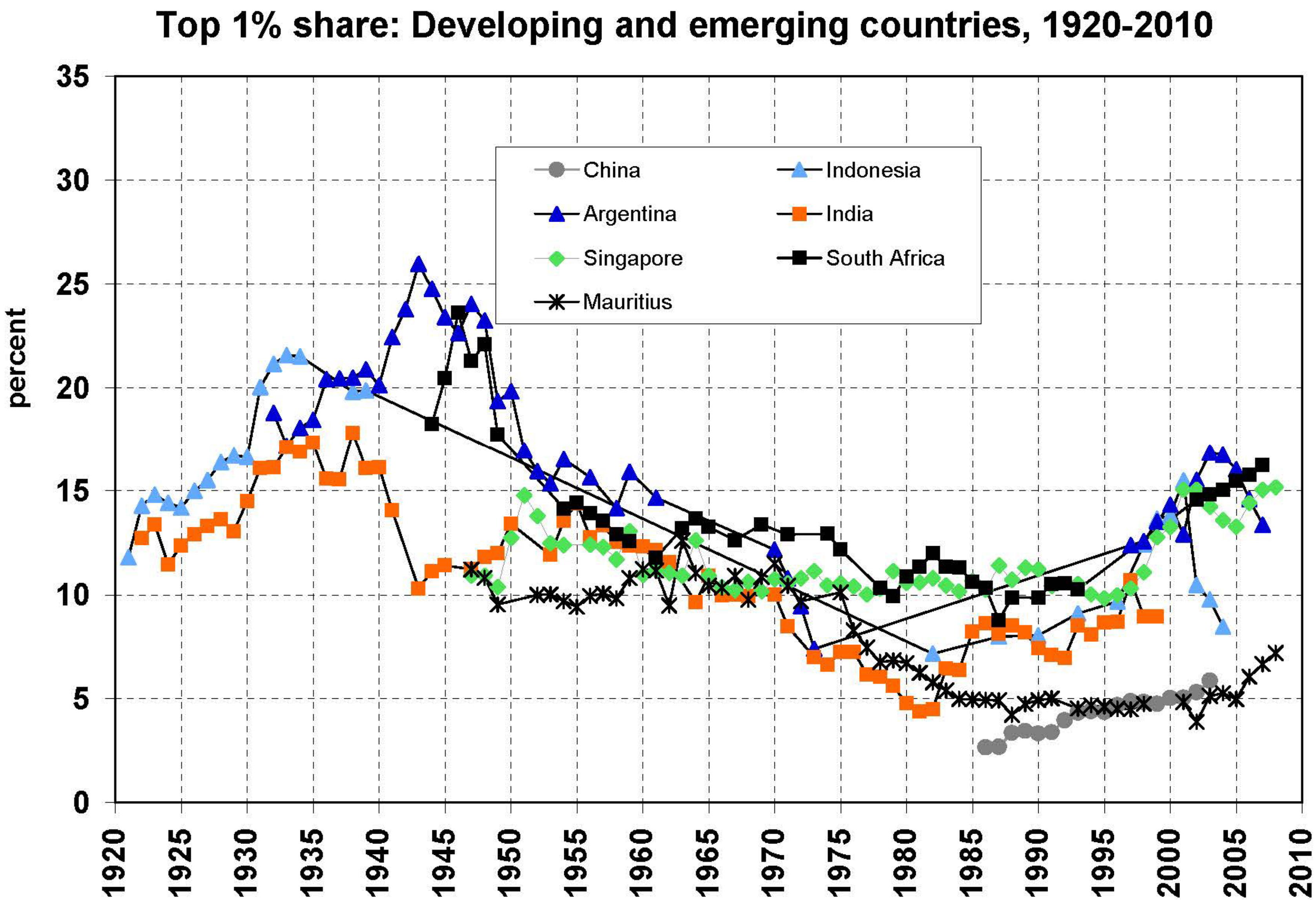

Top 1% share: English Speaking countries (U-shaped), 1910-2010
Top Percentile Share (in percent)
0
5
10
15
20
25
30
1910
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
United States
United Kingdom
Canada
Australia
Ireland
New Zealand

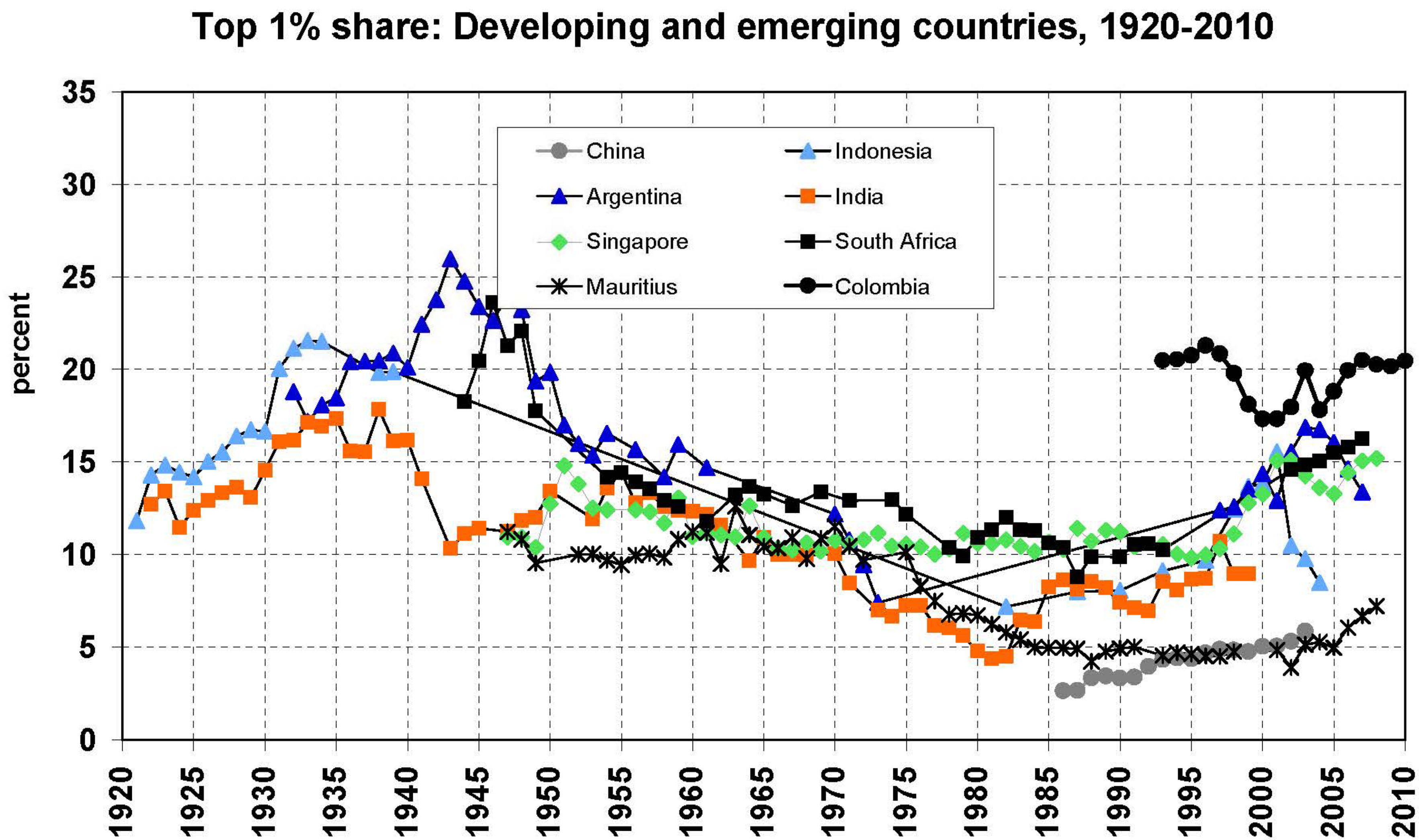
Top 1% share: Continental Europe and Japan (L-shaped), 1900-2010



Top 1% share: Continental Europe, North vs South (L-shaped), 1900-2010




Top 1% share: Developing and emerging countries, 1920-2010
percent
35
30
25
20
15
10
5
0
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
China
Indonesia
Argentina
India
Singapore
South Africa
Mauritius



Top 1% share: Developing and emerging countries, 1920-2010
percent
35
30
25
20
15
10
5
0
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
China
Indonesia
Argentina
India
Singapore
South Africa
Mauritius
Colombia

US 2010 vs Old Europe 1910

- US income inequality in 2010 is as large as UK-France at the eve of World War 1: about 50% of national income goes to top 10% (incl. 20% to top 1%)
- Does this imply that the structure of inequality is the same? Not necessarily.
- In UK-France 1910, inequality was largely based upon inherited wealth: « rentier society »
- In US 2010, inequality is more based upon labor income: « superstar society »
- But this is a matter of degree: concentration of inherited wealth is currently very high in the US, and is rising

Inequality in France 1910-2010

Shares in aggregate labor income or inherited wealth	Labor income 1910-2010	Inherited wealth	
		1910	2010
Top 10% "Upper Class"	**30%**	**90%**	**60%**
incl. Top 1% "Very Rich"	*6%*	*50%*	*25%*
incl. Other 9% "Rich"	*24%*	*40%*	*35%*
Middle 40% "Middle Class"	**40%**	**5%**	**35%**
Bottom 50% "Poor"	**30%**	**5%**	**5%**

Inequality in America 1910-2010

Shares in aggregate labor income or inherited wealth	Labor income		Inherited wealth	
	1910	**2010**	**1910**	**2010**
Top 10% "Upper Class"	**30%**	**45%**	**80%**	**70%**
incl. Top 1% "Very Rich"	*6%*	*15%*	*40%*	*35%*
incl. Other 9% "Rich"	*24%*	*30%*	*40%*	*35%*
Middle 40% "Middle Class"	**40%**	**30%**	**15%**	**25%**
Bottom 50% "Poor"	**30%**	**20%**	**5%**	**5%**

- Main difference btw US and Europe: aggregate wealth-income larger in Europe, bc higher pop growth in US

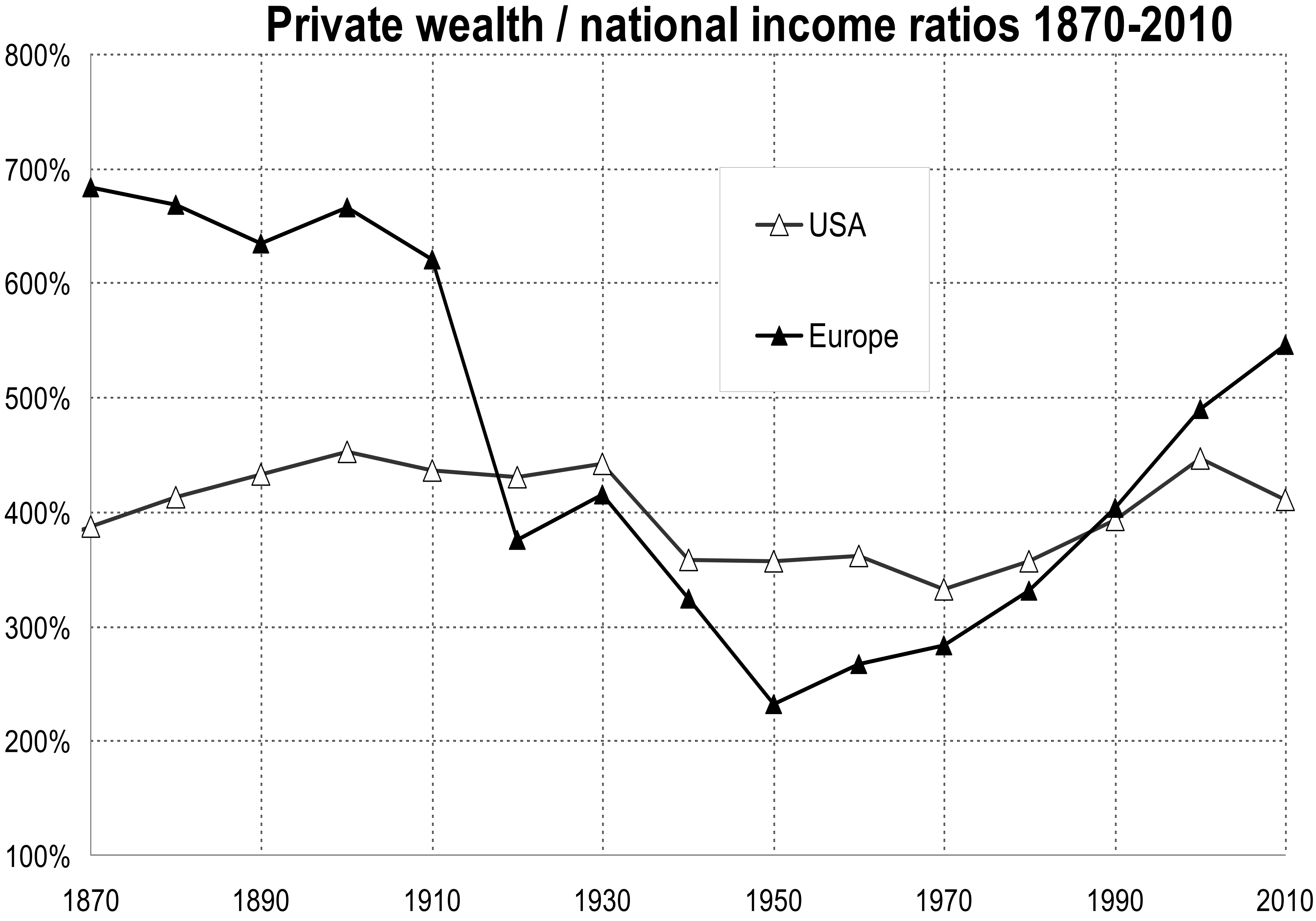
- Key mechanism: wealth-income ratio **β = s/g**

If saving rate s=10% & growth rate g=3%, then $\beta \approx 300\%$

But if s=10% & g=1.5%, then $\beta \approx 600\%$

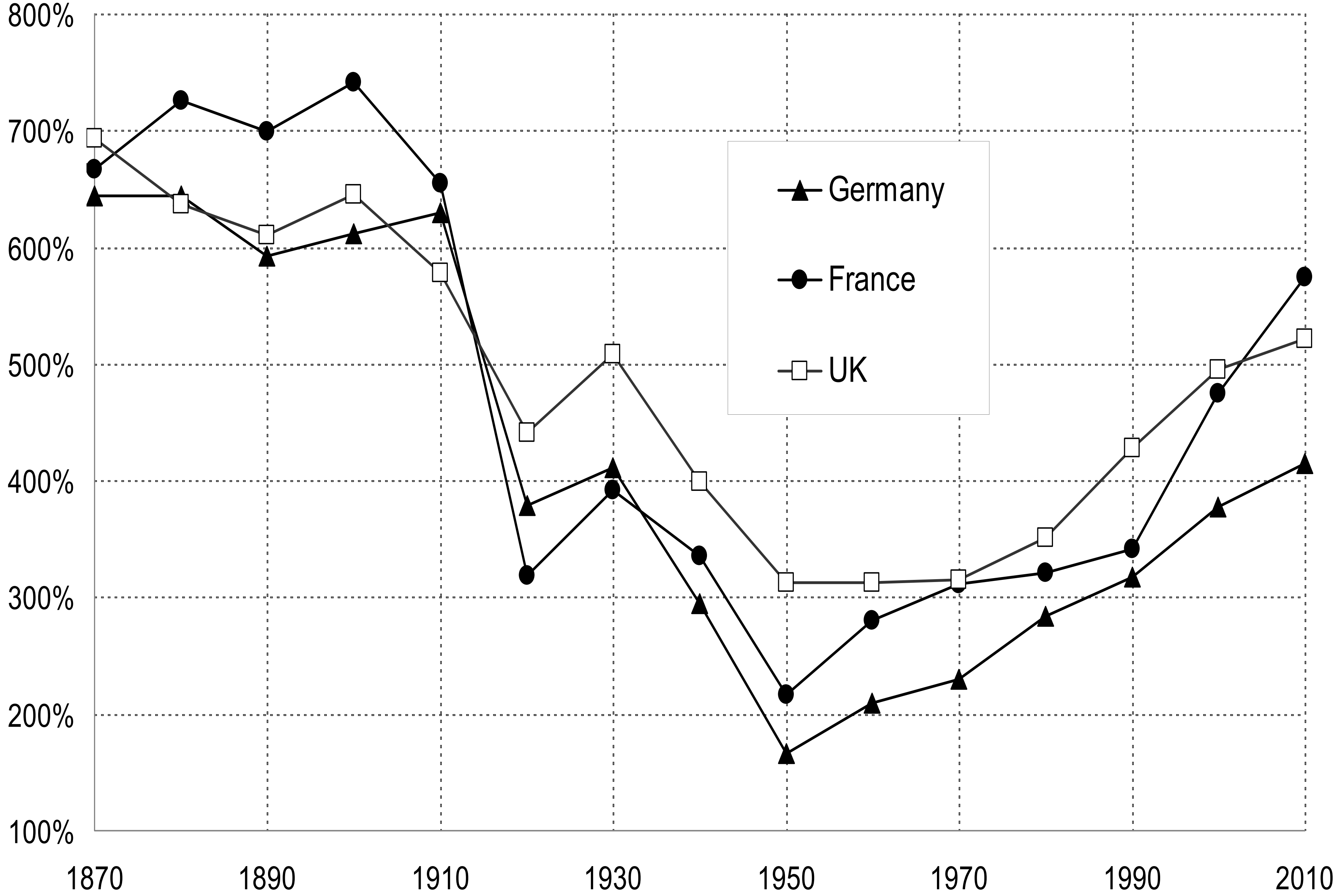
- Back in 1800, the US was already a country where wealth mattered much less than in Europe: abundant land is worth less, so that new world had more land in volume, but less land in value

(more precisely: wealth mattered less in the US if we neglect slavery system; complex legacy for US inequality)

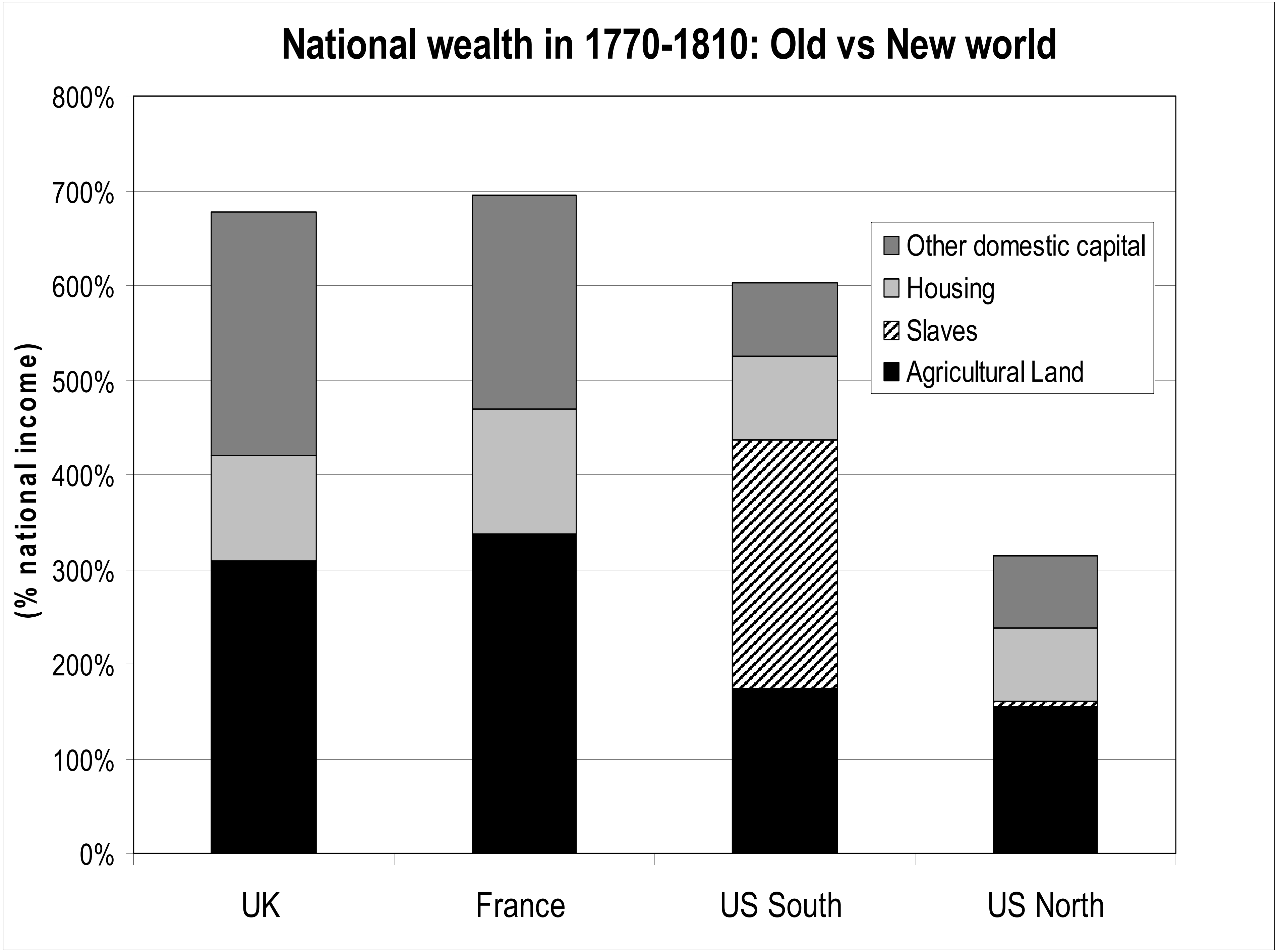


Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)

Private wealth / national income ratios in Europe, 1870-2010



Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)


National wealth in 1770-1810: Old vs New world
800%
700%
600%
500%
400%
300%
200%
100%
0%
(% national income)
Other domestic capital
Housing
Slaves
Agricultural Land
UK
France
US South
US North

Why did US top labor incomes rise so much?

- It is hard to account for observed cross-country variations with a purely technological, marginal-product story: technical change also occurred in Europe & Japan, so why inequality ↑ in US only?

- One popular view among some economists:

  US today = working rich get their marginal product (globalization, superstars)

  Europe today (& US 1970s) = market prices for high skills are distorted downwards (social norms, etc.)

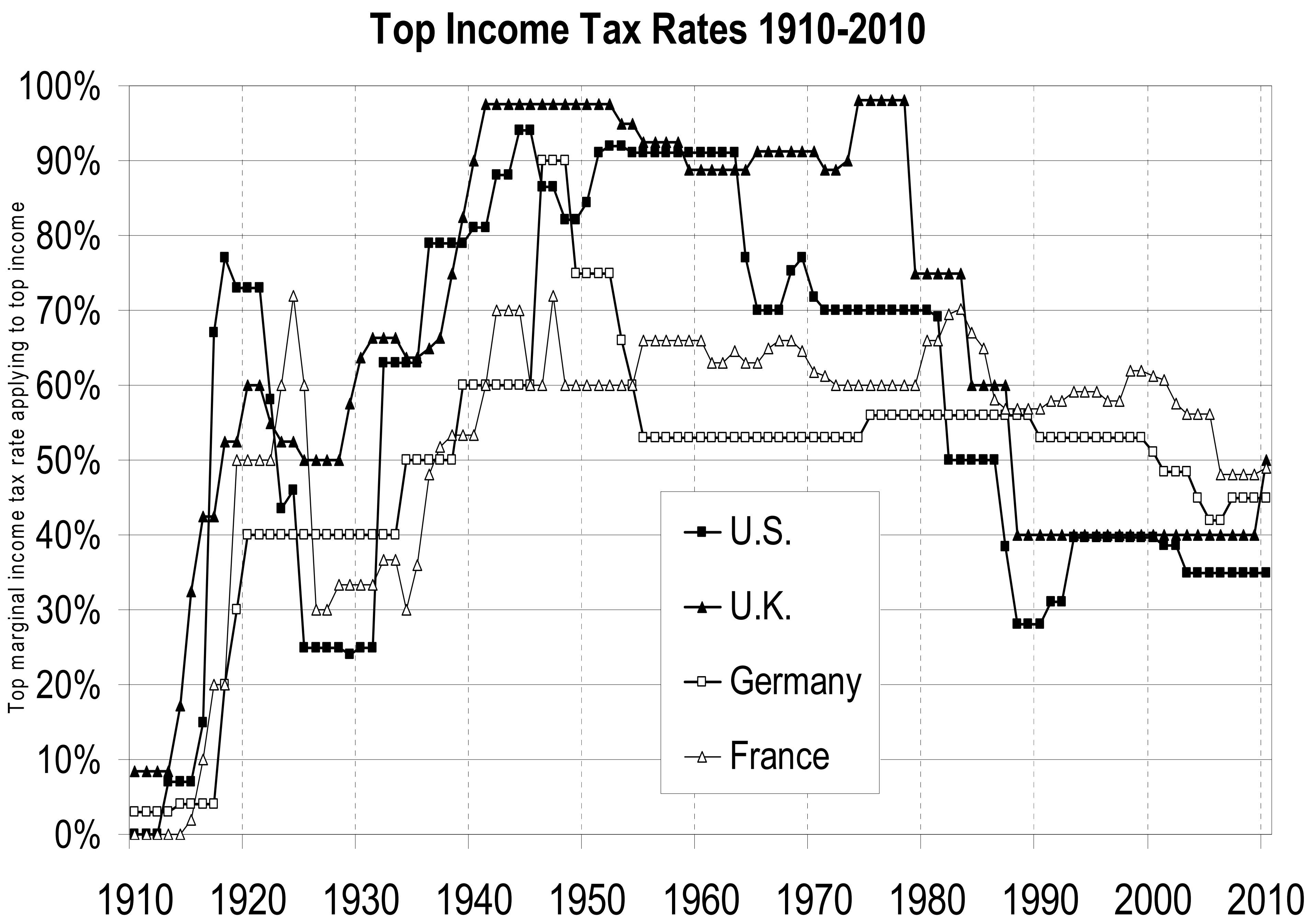
→ very naïve view of the top end labor market…

& very ideological: we have zero evidence on the marginal product of top executives; it could well be that prices are distorted upwards

- A more realistic view: grabbing hand model =
  - marginal products are unobservable
  - top executives have an obvious incentive to convince shareholders & subordinates that they are worth a lot
  - no market convergence because constantly changing corporate & job structure (+ costs of experimentation → **competition failure**)

→ when pay setters set their own pay, there’s no limit to rent extraction... **unless confiscatory tax rates at the very top**

(memo: US top tax rate (1m$+) 1932-1980 = 82%)

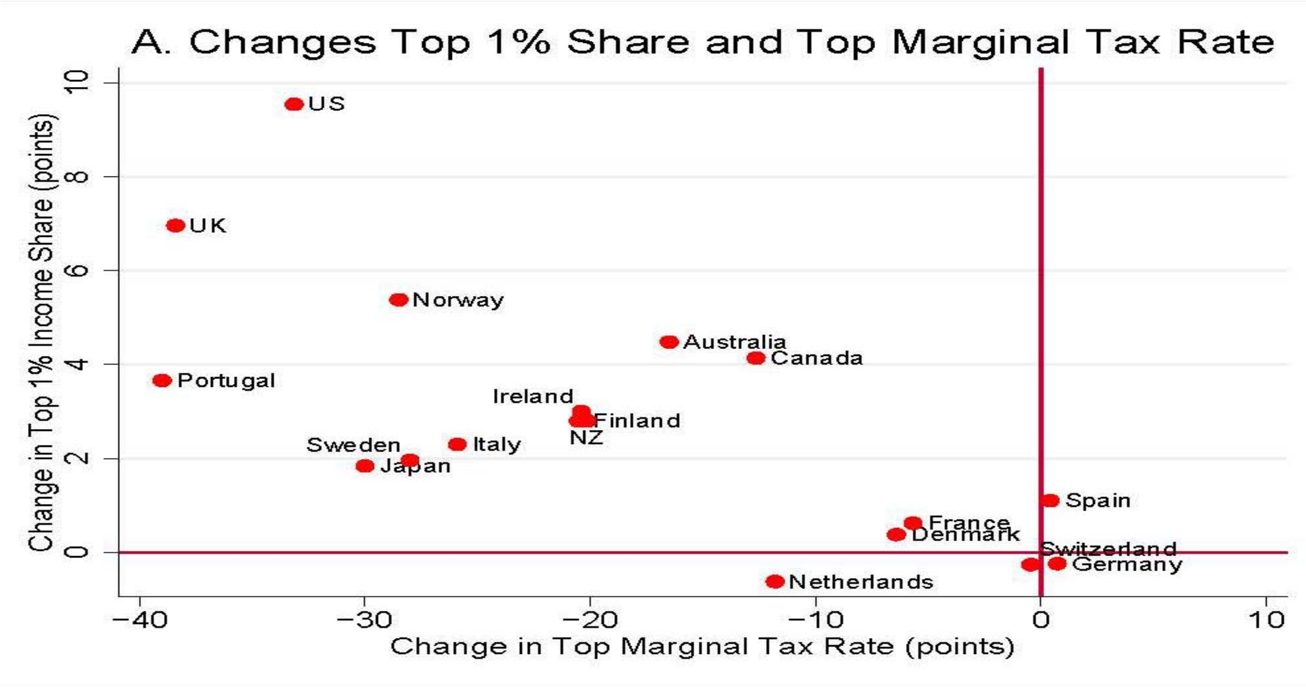


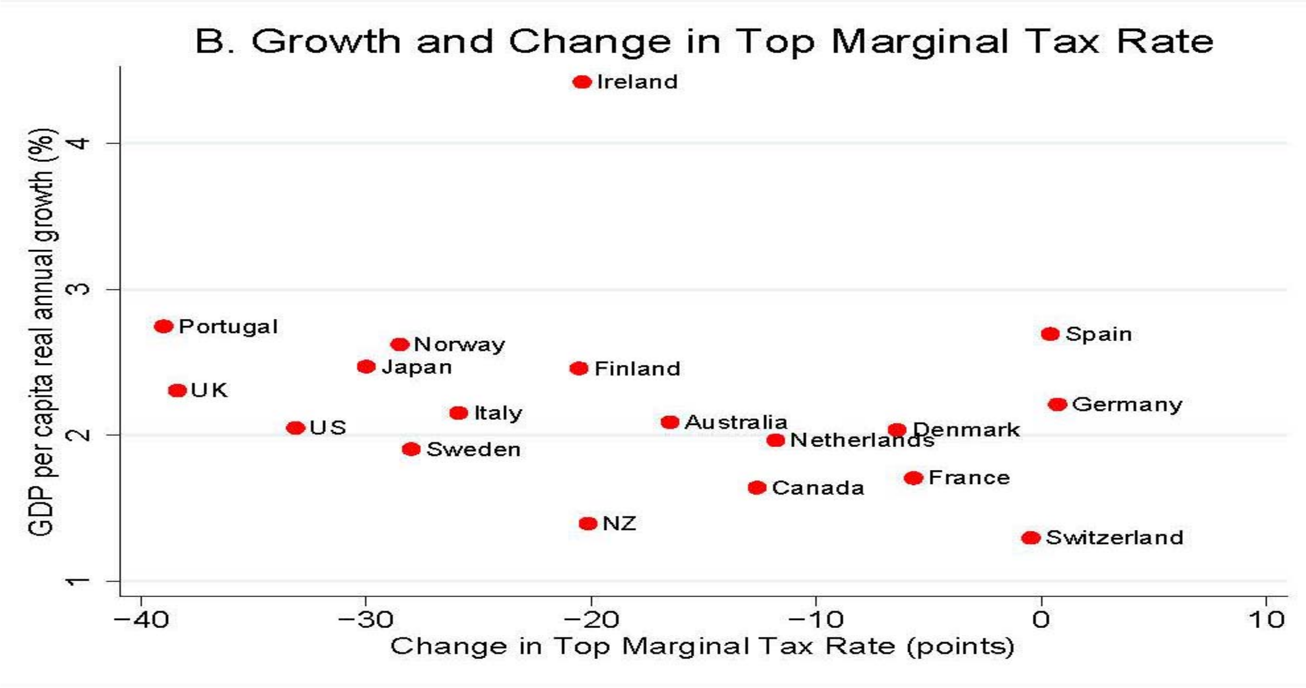
Source: World Top Incomes Database, 2012.

- Explaining long run changes in inequality requires looking at political and cultural change
- As a country, the US has been « playing yo-yo » with the rich over the 20th century:

  - In the 1920s-1970s, the US invented steeply progressive income and estate taxation. One objective was to avoid the excessive wealth concentration associated to Europe.
  - In the 1970s-2010s, the US dismantled progressive taxation. One objective was to renew with govt-free 19^c US. « America is back ». Catch-up by Europe/Japan.

- Pb: US growth 1980-2010 is not better than US growth 1950-1980 or Europe growth 1980-2010
- Extreme concentration of labor rewards does not seem to be the best way to organize 21^c skill based economy


A. Changes Top 1% Share and Top Marginal Tax Rate
Change in Top 1% Income Share (points)
Change in Top Marginal Tax Rate (points)
0
2
4
6
8
10
−40
−30
−20
−10
0
10
US
UK
Norway
Australia
Canada
Portugal
Ireland
Finland
NZ
Sweden
Italy
Japan
Spain
France
Denmark
Switzerland
Germany
Netherlands

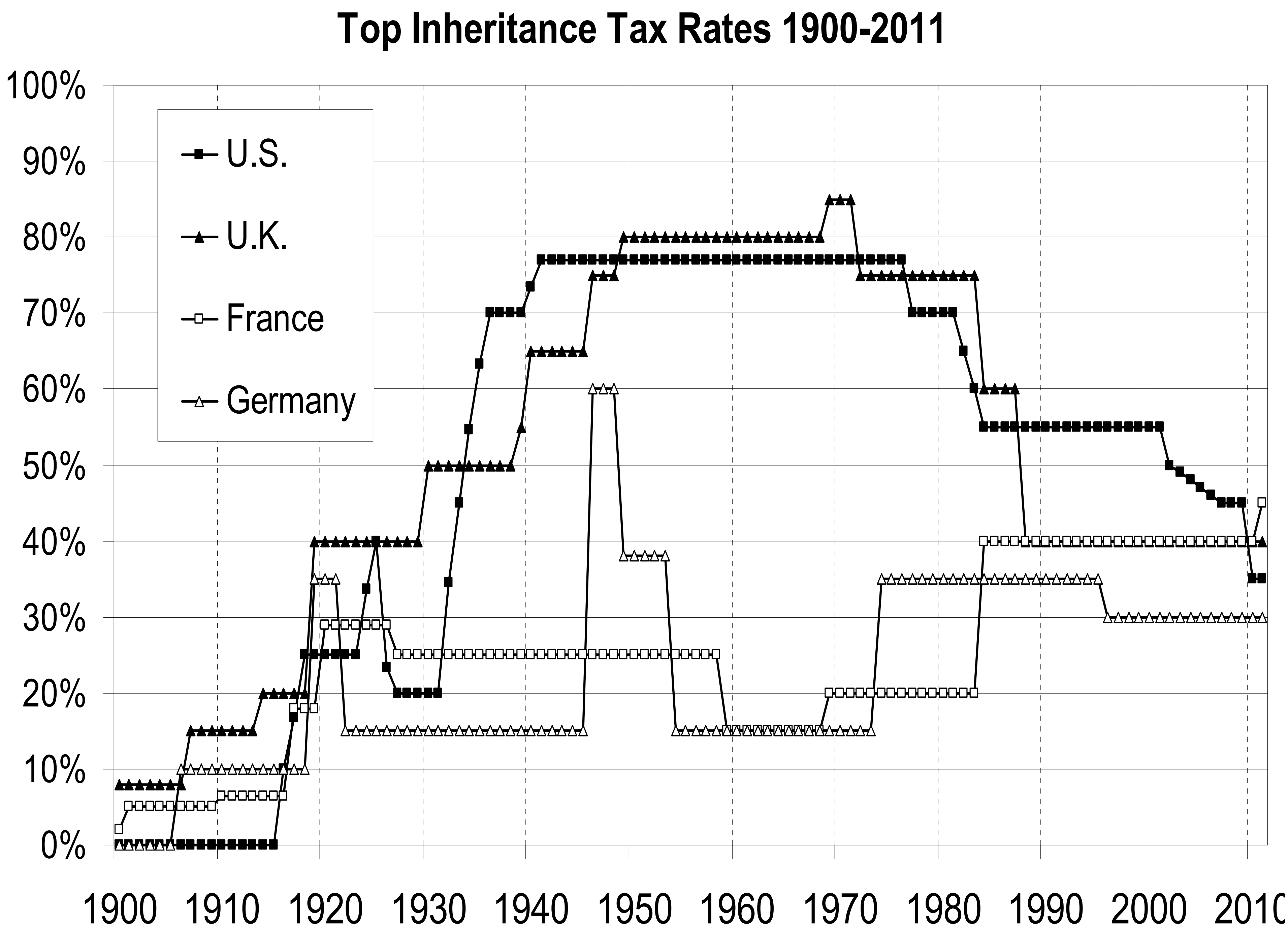

B. Growth and Change in Top Marginal Tax Rate
GDP per capita real annual growth (%)
Change in Top Marginal Tax Rate (points)
1
2
3
4
−40
−30
−20
−10
0
10
Ireland
Portugal
Norway
Japan
Finland
Spain
UK
Germany
Italy
Australia
US
Netherlands
Denmark
Sweden
France
Canada
NZ
Switzerland

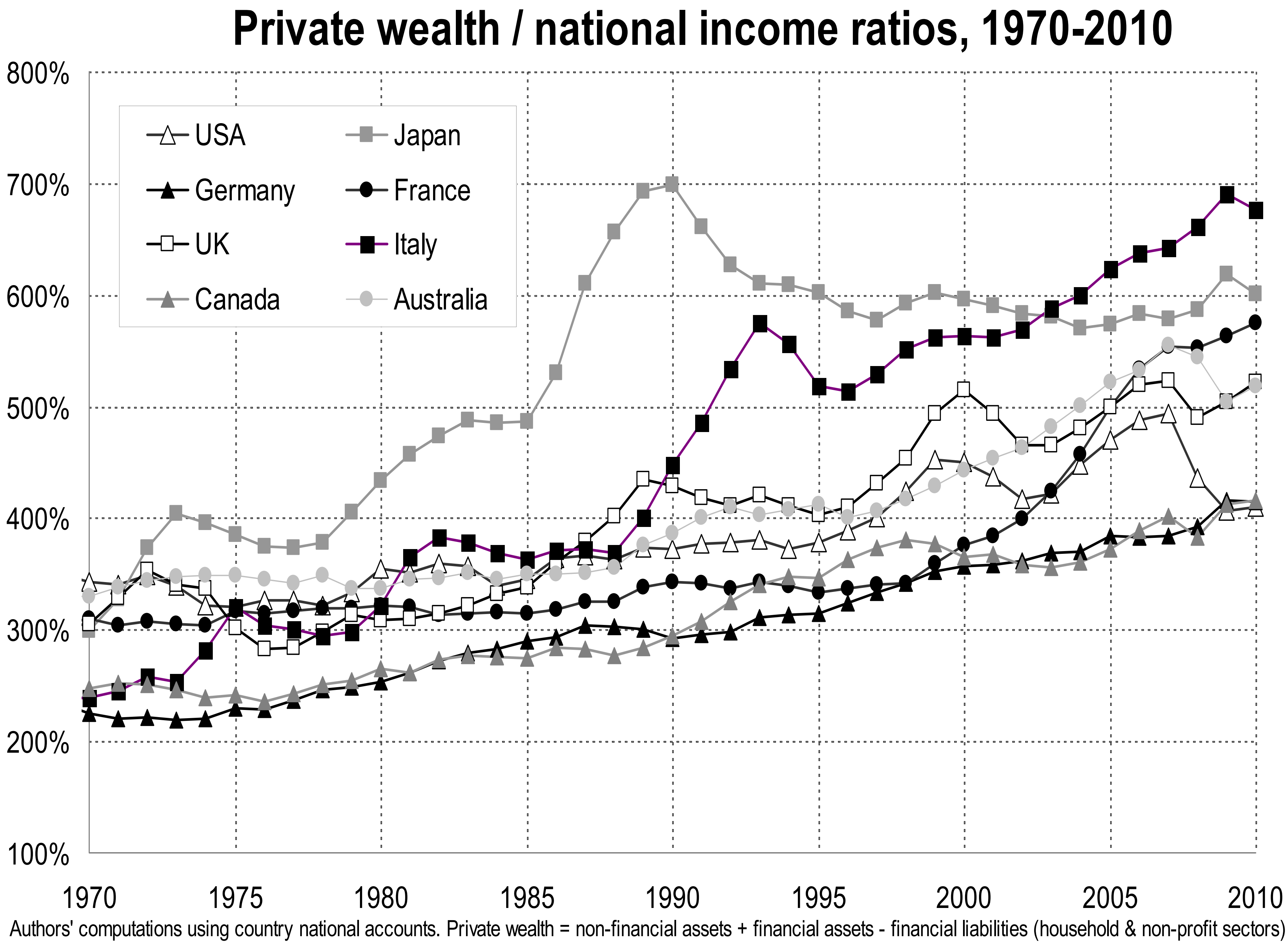
Summing up

- American inequality will keep its distinctive character as long as the US remains the New world, i.e. as long as population growth is much larger than Europe

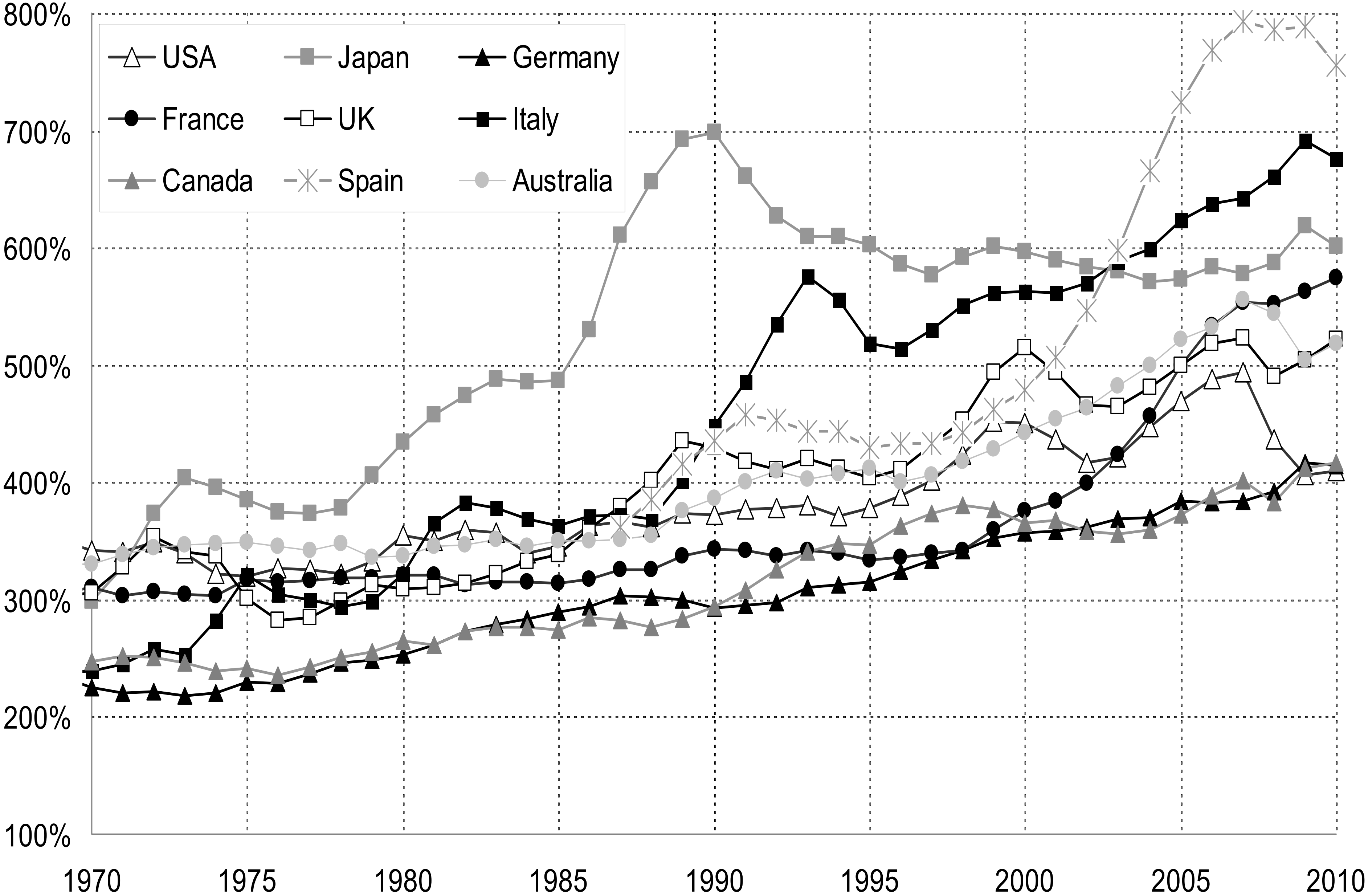
- … and if the US renews with its equal-opportunity tradition and institutions: massive investment in skills, progressive taxation to prevent excessive concentration of wealth and economic power

- Otherwise the US inequality model can become the worst of all worlds: large concentration of wealth + large concentration of labor income + extremist meritocratic discourse putting pressure on loosers

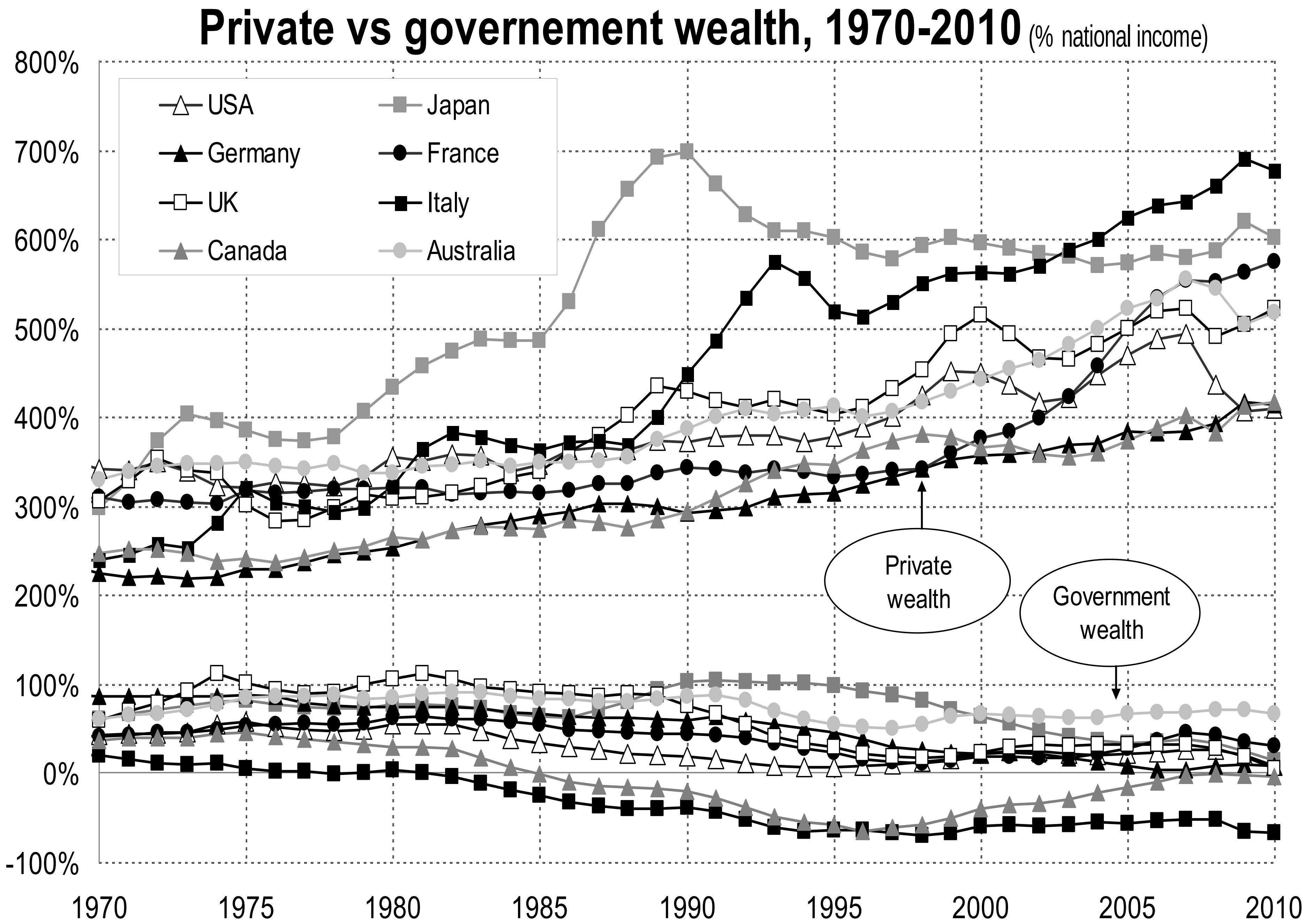

Top Inheritance Tax Rates 1900-2011
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010
U.S.
U.K.
France
Germany


Private wealth / national income ratios, 1970-2010
800%
700%
600%
500%
400%
300%
200%
100%
1970
1975
1980
1985
1990
1995
2000
2005
2010
USA
Japan
Germany
France
UK
Italy
Canada
Australia
Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)

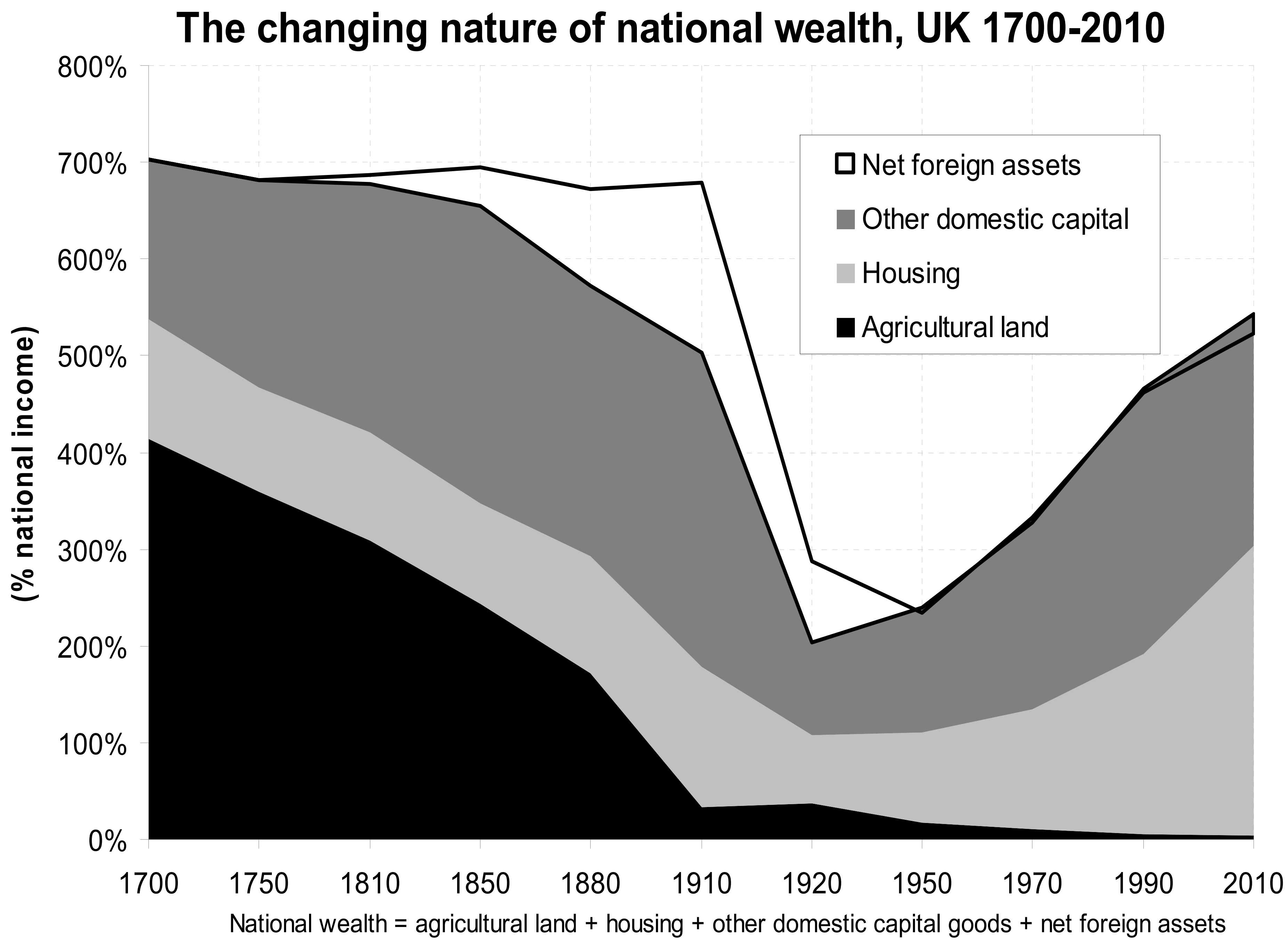
Private wealth / national income ratios, 1970-2010 (incl. Spain)

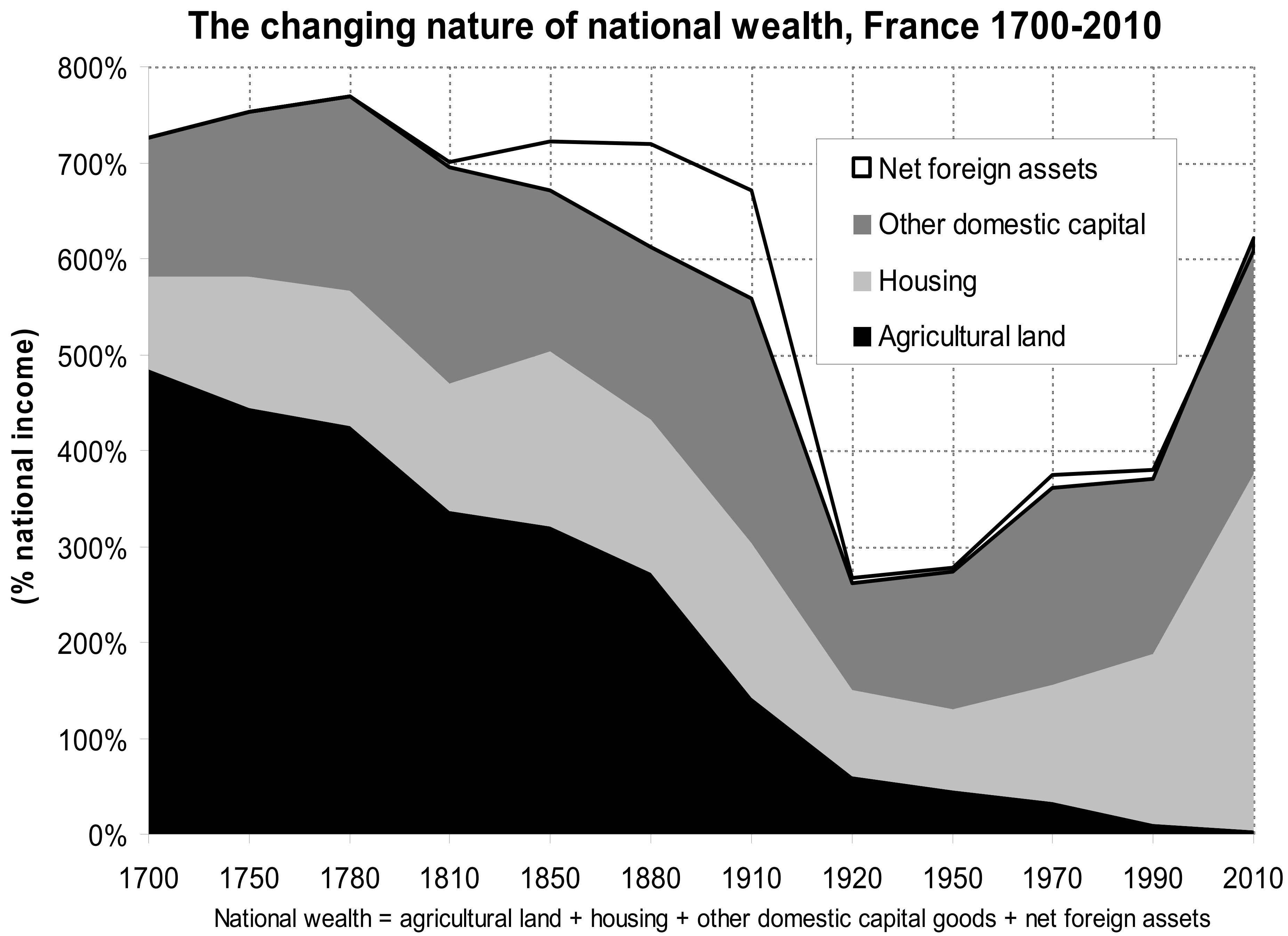


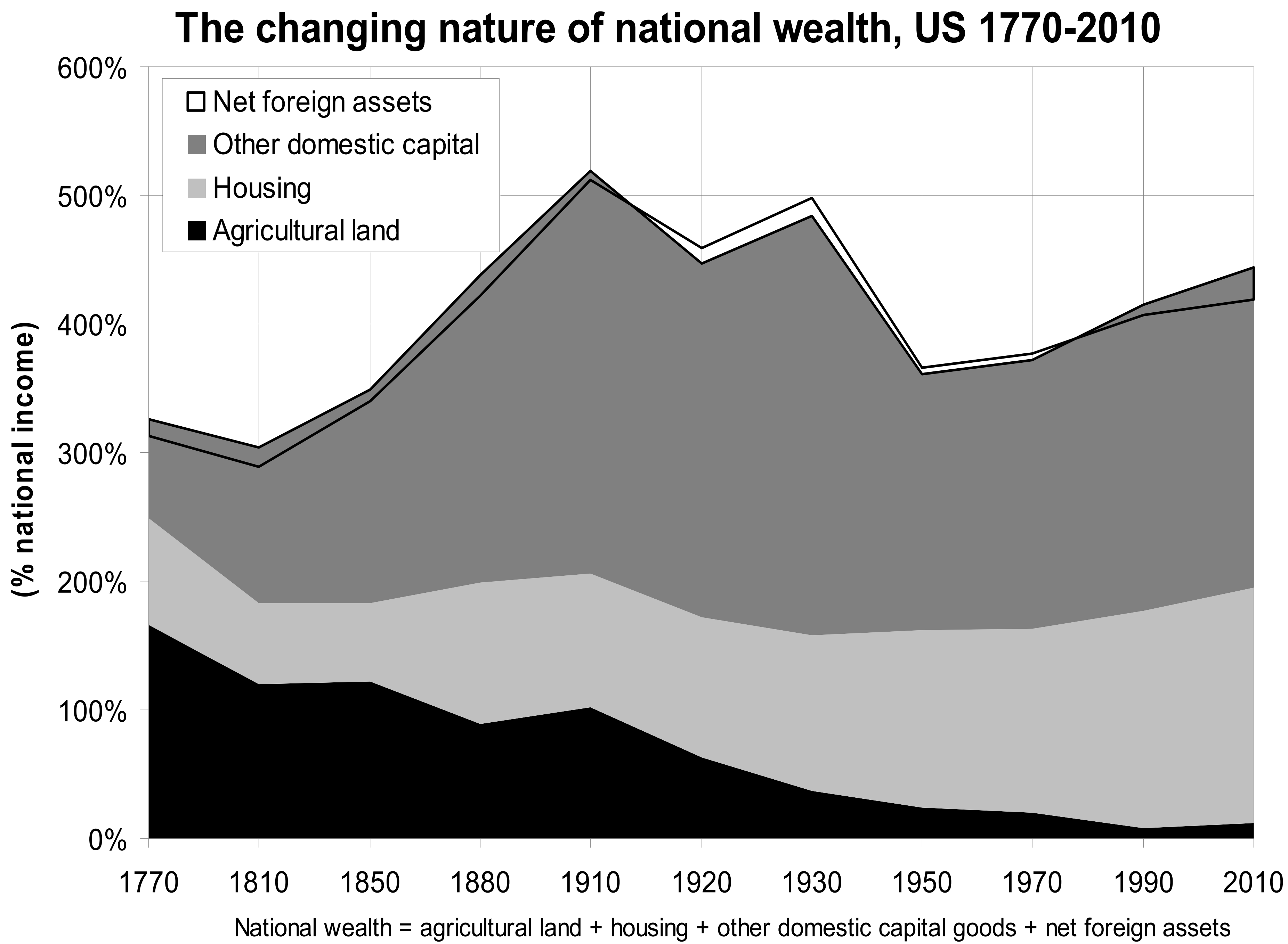
Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)



Authors' computations using country national accounts. Government wealth = non-financial assets + financial assets - financial liabilities (govt sector)

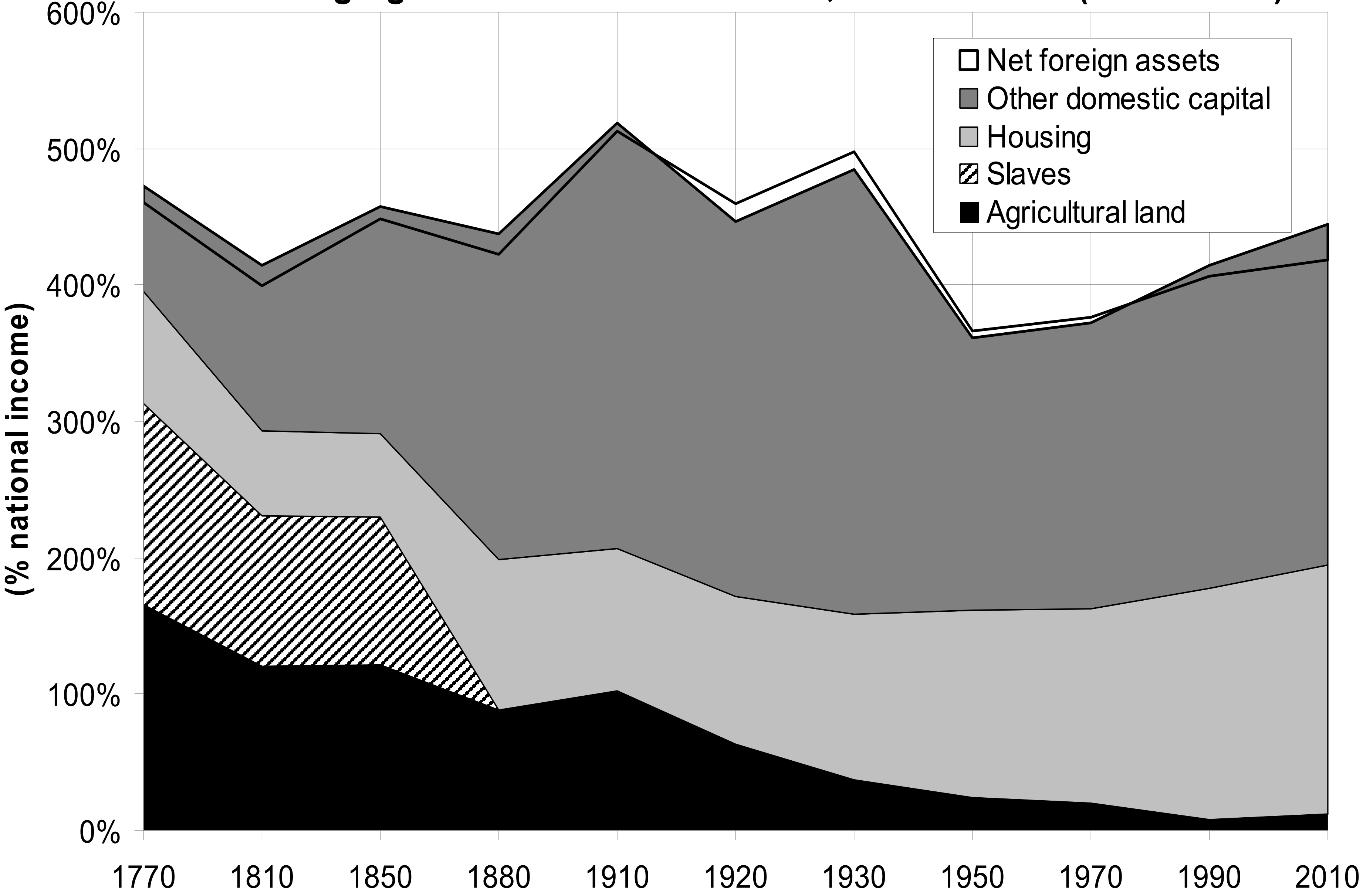

The changing nature of national wealth, UK 1700-2010
800%
700%
600%
500%
400%
300%
200%
100%
0%
(% national income)
Net foreign assets
Other domestic capital
Housing
Agricultural land
1700
1750
1810
1850
1880
1910
1920
1950
1970
1990
2010
National wealth = agricultural land + housing + other domestic capital goods + net foreign assets


The changing nature of national wealth, France 1700-2010
800%
700%
600%
500%
400%
300%
200%
100%
0%
(% national income)
Net foreign assets
Other domestic capital
Housing
Agricultural land
1700
1750
1780
1810
1850
1880
1910
1920
1950
1970
1990
2010
National wealth = agricultural land + housing + other domestic capital goods + net foreign assets

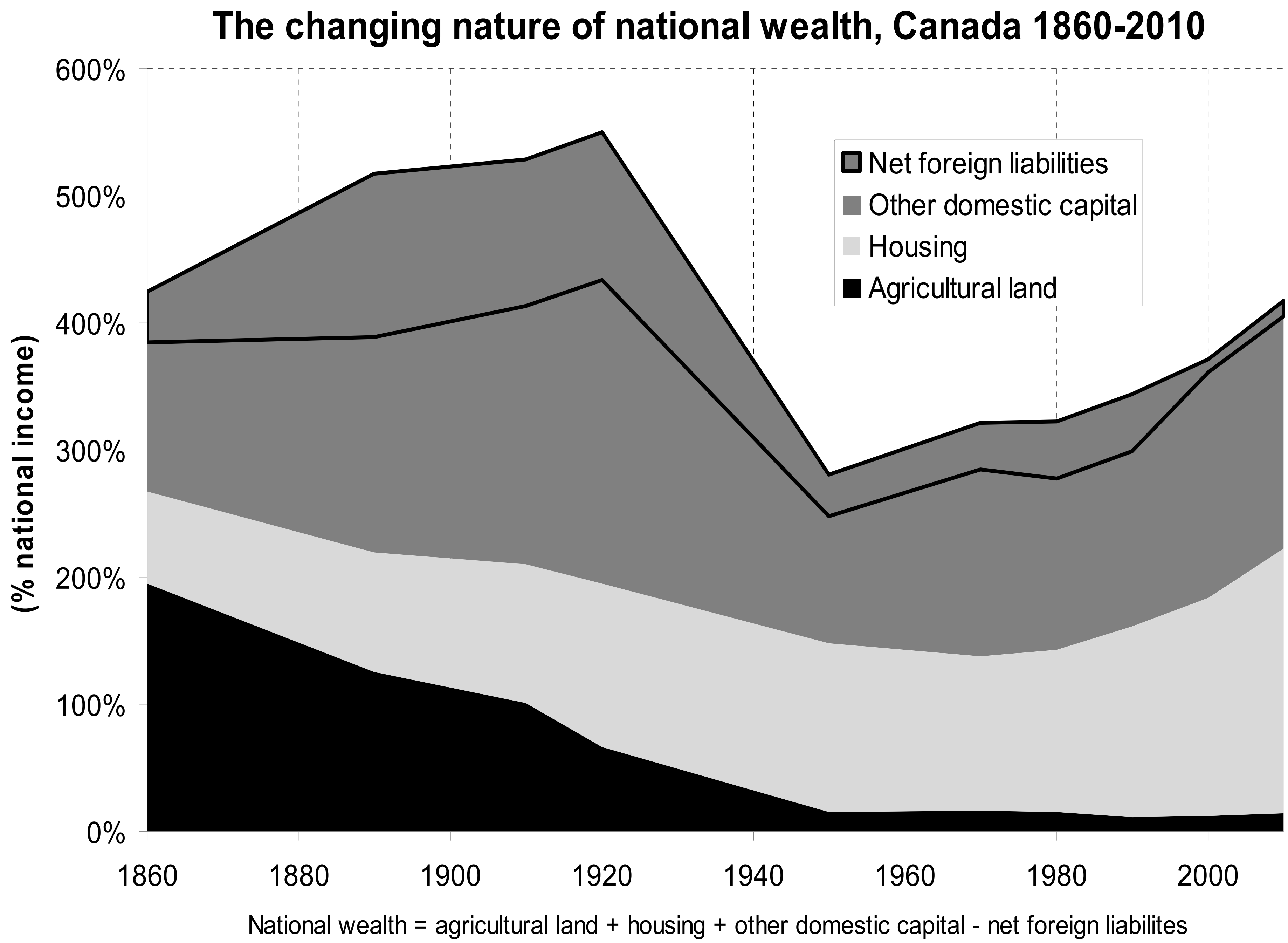


The changing nature of national wealth, US 1770-2010
Net foreign assets
Other domestic capital
Housing
Agricultural land
(% national income)
600%
500%
400%
300%
200%
100%
0%
1770
1810
1850
1880
1910
1920
1930
1950
1970
1990
2010
National wealth = agricultural land + housing + other domestic capital goods + net foreign assets

The changing nature of national wealth, US 1770-2010 (incl. slaves)



National wealth = agricultural land + housing + other domestic capital goods + net foreign assets


The changing nature of national wealth, Canada 1860-2010
600%
500%
400%
300%
200%
100%
0%
(% national income)
1860
1880
1900
1920
1940
1960
1980
2000
Net foreign liabilities
Other domestic capital
Housing
Agricultural land
National wealth = agricultural land + housing + other domestic capital - net foreign liabilites