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BOOK REVIEW

Capital in 21st Century

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"Capital in the Twenty-First Century" is a book written by a French economist, Thomas Piketty in 2013. It was initially published in French (as Le Capital au XXIe siècle) in August 2013, later was translated by Arthur Goldhammer in April 2014. This book is based on 15 years of research on the historical dynamics of the income and wealth (1998-2013). Piketty delivers an elegant framework for making sense of a complex reality. His theorizing is bold and simple and hugely important, if correct. In every area of thought, progress comes from simple abstract paradigms that guides lateral thinking, such as Darwin's idea of evolution, Ricardo's notion of comparative advantage or Keynes's conception of aggregate demand, similarly Piketty's idea ultimately proves out to make a major contribution by putting forth a theory of natural economic evolution under capitalism. He has sketched out the evolution of inequality since the beginning of industrial revolution.Mr. Piketty reckons, the importance of wealth in modern economies is approaching levels last seen before the First World War. He has put the major focus on the wealth and income inequality in Europe and the United States during the 18th century. Mr. Piketty has derived a grand theory of capital and inequality. As a general rule, we know that wealth grows faster than economic output. This book is fundamentally based on the theory that when the rate of return on capital (r) is greater than the rate of economic growth (g) over the long term, it results in concentration of wealth that further leads to unequal distribution of wealth. This causes social and economic instability. He introduced this concept in the form of the expression i.e., $r > g$ (where r is the rate of return to wealth and g is the economic growth rate). He aptly used the tax statistics to measure inequality and documented the evolution of income and wealth over the past 300 years (particularly in Europe and America). He shows that the period from about 1914 to the 1970s was an historical outlier in which both income inequality and the stock of wealth relative to annual national income fell dramatically. Since the 1970s both wealth and income gaps have been raising back towards their pre-20th-century norms. The most cited Piketty statistic in the book is that, 60% of the increase in US national income in the 30 years after 1977 went to just the top 1% of earners. The only section of the US population that has done better than the top 1% is the top 10th of that 1%. The top 100th of the 1% have done best of all. It states that faster economic growth will diminish the importance of wealth in a society, whereas slower growth will increase it and demographic change that slows global growth will make capital more dominant, keeping other things equal. But there are no natural forces pushing against the steady concentration of wealth. He suggested only a burst of rapid growth from technological progress or rising population or government intervention can be counted on to keep economies from returning to the "patrimonial capitalism". In his book, the theory of capitalism explains and offers a prediction of where wealth distribution is heading. He emphasizes on the fact that the free-market system has a natural tendency towards increasing the concentration of wealth because the rate of return on property and investments has consistently been higher than the rate of economic growth. In the 18th and 19th centuries western European society was highly unequal. Private wealth dwarfed national income and was concentrated in the hands of the rich families who sat atop a relatively rigid class structure. The chief proposition of the book is that inequality is not an accident but rather a feature of capitalism which can only be reversed through the state's intervention.It is further argued that

capitalism is a threat to the democratic order in an economy if not reformed. Piketty has based his argument on a formula that relates the rate of return on capital (r) to the rate of economic growth (g), where r includes profits, dividends, interest, rents & other income from capital and g is measured in income or output. He discusses that, when the rate of growth is low, wealth tends to accumulate more quickly from the rate of return on capital (r) than from labor and tends to accumulate more among the top decile and centile resulting in increasing inequality. This system persisted even as industrialization slowly contributed to rising wages for workers. Thus the fundamental force for divergence and greater wealth inequality can be summed up in the inequality i.e., r>g. He also examines inheritance from the perspective of the same formula. Its essence is most easily grasped by thinking about population growth; for instance, assume a world where couples have four children. In that case, an accumulated fortune will dissipate, as the third generation of descendants has 64 members and the fourth has 256 members. On the other hand, if couples have only two children, a fortune has to be split only 16 ways even after four generations. So, slow growth is especially contributing to rising levels of wealth inequality, as is a high rate of return on capital that accelerates accumulation of wealth. Piketty argues that as long as the return to wealth exceeds an economy's growth rate, wealth-to-income ratios will tend to rise, leading to increased inequality. According to Piketty, this is the normal state of capitalism. It is also stated in the book that there was a trend towards higher inequality which was reversed between 1930 and 1975 due to some relatively inimitable circumstances that is the two World Wars, the Great Depression and a debt- fueled recession that destroyed much wealth, particularly that was owned by the elite. High taxes, inflation, bankruptcies & the growth of sprawling welfare states caused wealth to shrink dramatically and ushered in a period in which both income & wealth were distributed in relatively democratic manner. But the shocks of the early 20th century have faded and wealth is now reasserting itself. Such events provoked the governments to undertake steps towards redistributing income, productivity and population rises pushed up growth. But without such countervailing factors, he contends, higher returns on capital will concentrate wealth especially when an ageing population means that growth should slow. Piketty's expectation of rising wealth concentration is not bizarre. However, it is a prediction based on inferring from the past and not an inherent model of capitalism. He assumes that the returns to capital will not fall substantially even as the stock of wealth rises. Mr. Piketty closes the book by offering policy proposals that assume the growing concentration of wealth is not only inevitable, but the thing that matters most. Piketty recommends a global system of progressive wealth taxes (where the rate of tax rises with the level of wealth) to help shrink the inequality and avoid the vast accumulation of wealth under the control of a tiny minority which would diminish the risk of economic or political instability down the road. Thomas Piketty in his book also debates that the world today is returning towards patrimonial capitalism, owning 25%-35% of the nation's wealth, implying much of the economy is dominated by inherited wealth. Their power is increasing which would indeed cause oligarchy. He describes the emergence of this class in the middle years of the 20th century as a transformation that "deeply altered the social landscape and the political structure of society and helped redefine the terms of distributive conflict". Piketty cites novels by Honoré de Balzac, Jane Austen and Henry James in his book to explain the rigid class structure based on accumulated capital that existed in England and France in the early 1800s. For example, the annual value of inheritances in France has tripled from less than 5% of GDP in the 1950s to about 15%, not all that far from the 19th-century peak of 25%. Piketty envisages a world of low economic growth and dismisses the idea that bursts of technological advances will bring the growth back to the levels of the 20th century, opposing that we should not base ourselves on the "caprices of technology". He also states that a progressive annual global wealth tax of up to 2% along with a progressive income tax without requiring great social contributions in return. For example, include more vigorous enforcement of antimonopoly laws, reductions in excessive protection for intellectual property in cases where incentive effects are small and monopoly rents are high, greater encouragement of profit-sharing schemes that benefit workers and give them a stake in wealth accumulation, increased

investment of government pension resources in riskier high-return assets, strengthening of collective bargaining arrangements, and improvements in corporate governance. Probably the two most important steps that public policy can take with respect to wealth inequality are the strengthening of financial regulation to more fully eliminate implicit and explicit subsidies to financial activity, and an easing of land-use restrictions that cause the real estate of the rich in major metropolitan areas to keep rising in value. The books that represent the last word on a topic are important but the books that represent one of the first words are even more important. By focusing attention on the issues around the long-run functioning of our market system, "Capital in the Twenty-First Century" has made a overwhelmingly significant contribution.