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Capital in the 21st Century: Are the Thomas Piketty's Ideas a Way to Welfare and Prosperity or Enslavement?*

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Abstract: In his seminal work *Capital in the 21st century* Thomas Piketty analyses income and wealth disparities in developed economies observed over last two centuries. He claims that increasing disparities may result in social tensions and even revolutions in the near future and proposes fiscal mechanisms as a remedy to such threats. The aim of the paper is to assess the Piketty's proposals of tax changes aimed at levelling the existing income disparities. First of all, the paper proves that Piketty's tax proposals are contrary to the empirically tested Laffer curve. Secondly, it discusses whether social stratification is or should be a worry for economists and politicians or whether it is a required and unavoidable situation in a well developing market economy.

Keywords: income disparities, capital disparities, Laffer curve, fiscalism, capital tax.

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1. Introduction

Capital in the 21st century by Thomas Piketty is nowadays one of the most widely read books in the field of economics. Moreover, numerous prominent representatives of this scientific discipline indicated him as one of candidates for the Nobel Prize in 2016. Therefore, it seems to be reasonable to discuss this seminal work before its ideas become the part of our lives. First of all, it should be highlighted that Piketty made a great effort to collect and analyse statistical data on incomes and wealth of citizens of many developed nations in last two centuries, which *per se* is interesting and valuable. His statistical analyses show that the beginning of the second decade of the 21st century is characterised by the increase in income and wealth disparities within these societies. In his opinion, such a situation may result in radical social tensions and even revolutions in the near future. In order to mitigate such risks, Piketty proposes some solutions, mainly in the fiscal domain, which could reverse negative tendencies and ensure more equitable share of wealth and incomes. It is impossible in such a short review to analyse thoroughly all the aspects of the book of the length of 730 pages. Therefore, the paper will present the main conclusions from the Piketty's work and focus the attention on his recommendations to level unwanted trends. The key finding from the analysis of income and wealth disparities is the observed tendency of approaching to the stratification level observed at the turn of the 19th and 20th centuries.

The aim of the paper is to assess the Piketty's proposals of tax changes aimed at levelling the existing income disparities. The aim of the paper will be achieved by the validation of the thesis that Piketty's proposals are unrealistic and doomed to failure. First of all, the paper proves that Piketty's tax proposals are contrary to the empirically tested Laffer curve, which means that they do not provide a solution to an identified problem. Secondly, the paper discusses whether social stratification, so often criticized, is or should be a worry for economists and politicians or whether it is a required and unavoidable situation in a well developing market economy.

2. Income and wealth disparities in the 21st century

The study of private and public capitals in the United States and Europe between 1870 and 2010 shows that the fluctuation in the national capital in the long-term corresponds mostly to the fluctuations of private capital (both in the U.S. and in Europe). For the whole period under the study, the (net) public capital calculated in relation to (as percentage of) national income has remained on a relatively stable level varying from -50% (minimum value in Europe) in the 1940s to 68% (maximum value in the U.S.) in the 1970s. As regards private capital, it counted for 5 to 7 times as much as national income in the end of the 19th century, decreased as a consequence of the world wars and the great economic crisis of the 1930s but then increased up to the level of circa 400–500% of national income in 2010. The changes of private capital are illustrated by u-shaped curves. Similar shapes have the curves illustrating the changes of income for the highest decile, which for some countries achieved the level higher than in the beginning of the 20th century. According to Thomas Piketty, such a situation and the aforementioned tendencies generate high risks for social stability in the near future.

Similar changes are observed by Piketty in regard to wealth within the top decile and centile. Although the maximum values noticed in the early days of the 20th century have not been achieved yet, the top decile is in the possession of 60–70% of global wealth, while the top centile owns 25–35% of it. The mentioned disparities are even more visible while analysing the data in Table 1.

Table 1. Capital disparities due to time and geographical location (for calculations the average wealth is assumed at the level of 200,000 Euro per an adult person)

The percentage share of social classes in total capital (average value of capital)	Low disparity (never observed)	Medium disparity (Nordic nations 1970–1980)	Medium/ high disparity (Western Europe 2010)	High disparity (USA 2010)	Very high disparity (Europe 1910)
10% of the rich (upper class)	30% (600,000 Euro)	50% (1,000,000 Euro)	60% (1,200,000 Euro)	70% (1,400,000 Euro)	90% (1,800,000 Euro)
1% of the richest (dominant class)	10% (2,000,000 Euro)	20% (4,000,000 Euro)	25% (5,000,000 Euro)	35% (7,000,000 Euro)	50% (10,000,000 Euro)

Table 1. continued

The percentage share of social classes in total capital (average value of capital)	**Low disparity (never observed)**	**Medium disparity (Nordic nations 1970–1980)**	**Medium/ high disparity (Western Europe 2010)**	**High disparity (USA 2010)**	**Very high disparity (Europe 1910)**
remaining 9% (well-to-do class)	20% (444,444 Euro)	30% (666,667 Euro)	35% (777,778 Euro)	35% (777,778 Euro)	40% (888,889 Euro)
40% (middle class)	45% (225,000 Euro)	40% (200,000 Euro)	35% (175,000 Euro)	25% (125,000 Euro)	5% (25,000 Euro)
50% of the poor (lower class)	25% (100,000 Euro)	10% (40,000 Euro)	5% (20,000 Euro)	5% (20,000 Euro)	5% (20,000 Euro)

Source: Own study based on Piketty (2015).

In order to complete the picture of disparities, the tendencies related to work incomes and capital incomes are presented in Table 2 and 3.

Table 2. Income disparities due to time and geographical location (work incomes – adult people)

The percentage share of social classes in total incomes (average value of yearly incomes)	**Low disparity (Nordic nations 1970–1980)**	**Medium disparity (Western Europe 2010)**	**High disparity (USA 2010)**
10% of the rich (upper class)	20% (48,000 Euro)	25% (60,000 Euro)	35% (84,000 Euro)
1% of the richest (dominant class)	5% (120,000 Euro)	7% (168,000 Euro)	12% (288,000 Euro)
remaining 9% (well-to-do class)	15% (40,000 Euro)	18% (48,000 Euro)	23% (61,333 Euro)
40% (middle class)	45% (27,000 Euro)	45% (27,000 Euro)	40% (24,000 Euro)
50% of the poor (lower class)	35% (16,800 Euro)	30% (14,400 Euro)	25% (12,000 Euro)

Source: Own study based on Piketty (2015).

Table 3. Income disparities due to time and geographical location (work and capital incomes – adult people)

The percentage share of social classes in total incomes (average value of yearly incomes)	Low disparity (Nordic nations 1970–1980)	Medium disparity (Western Europe 2010)	High disparity (USA 2010, Europe 1910)
10% of the rich (upper class)	25% (75,000 Euro)	35% (105,000 Euro)	50% (150,000 Euro)
1% of the richest (dominant class)	7% (210,000 Euro)	10% (300,000 Euro)	20% (600,000 Euro)
remaining 9% (well-to-do class)	18% (60,000 Euro)	25% (83,333 Euro)	30% (100,000 Euro)
40% (middle class)	45% (33,750 Euro)	40% (30,000 Euro)	30% (22,500 Euro)
50% of the poor (lower class)	30% (18,000 Euro)	25% (15,000 Euro)	20% (12,000 Euro)

Source: Own study based on Piketty (2015).

Besides to high capital and income disparities, it is worth noticing that in the 20th century, the middle class emerged, which in fact did not exist in the end of the 19th century. Another important aspect to mention is the fact that the purchasing power of all social classes increased 10 times. In consequence, nowadays, even the lower class lives in totally different conditions than it was 100 years ago. However, if wealth distribution trends are not reversed, the higher wealth concentration will be achieved, which will be possible to reach the level dated as of 1910, when 10% of the society were in the possession of 90% of wealth. Even today, there are people whose wealth exceed the wealth of some nations. In such a situation, it is a question whether the aforementioned disparities will not result in financial crises or wars, even in the global scale (Piketty, 2015, p. 581).

3. R > G disparity

The disparity between average rate of return (r) and average economic growth rate (g) (r > g) is considered by Piketty to be the main reason for growing concentration of wealth and increasing social inequality. However, what is labelled by Piketty as an economic rule, seems to

be a common tautology. Moreover, Piketty neglects the fact that his assumptions are true only in some conditions. First of all, the rate of return (r) is to be higher than the economic growth rate in real values (without any tax burden) and the real value of capital cannot decrease in the given period (e.g. due to inflation, decrease in the value of shares, decrease in the value of real estate or decrease in prices of raw materials). Secondly, it should be assumed that the owners of given wealth have only one heir. Otherwise, the wealth will become fragmented when divided among many heirs. Regardless of the aforementioned assumptions, another important aspects are the value of each wealth and personal preferences of the owners i.e. their spending and level of consumption.

The above assumptions may be presented in the form of mathematical formula used to calculate the level of wealth necessary for recapitalization:

(1) $(r > g \rightarrow \text{wealth concentration}) \leftrightarrow r_{re} = (r - inf - tax) > g$; r_{re} – real rate of return, inf – inflation, tax – tax;

(2) $(r > g \rightarrow \text{wealth concentration}) \leftrightarrow M * (r_{re} - g) > K$; M – value of wealth, K – level of spending,

i.e. inequality exists: $M > K / (r_{re} - g)$, assuming that the owner of capital does not have any other incomes (only capital incomes).

The following example illustrates the aforementioned discussion.

Assumptions:
Average yearly work income – 24,000 Euro;
Rate of economic growth – 1.5%;
Inflation – 1.0%;
Rate of return (financial assets) – 2,0%;
Tax – 19%.
For such assumptions:
r_{re} *= 2% - 1% - 0,38% = 0,62%, i.e.* $r_{re} < g$*, which means that the full recapitalisation will not be achieved.*

Making an assumption that inflation rate is 0.1%, and K = 5 * average work income, it means that M is to be higher than:

M > 120,000 Euro / 0.0012 = 100,000,000 Euro.

In consequence, in the given example wealth is to have value of more than 100 million Euro in order to ensure the assumed lifestyle level and wealth recapitalization. What is more, this assumption is true

when inflation is close the zero level. Otherwise, when the inflation rate exceeds 0.22%, wealth always becomes decapitalised.

Following the Piketty' assumptions that the average rate of return on capital balances between 4% and 5% and that capital capital is invested in real estate in order to eliminate the impact of the inflation rate (as the value of real estate increases such as inflation does), it is possible to calculate the value of invested financial assets to ensure the wealth recapitalization.

Assumptions:
Average yearly work income – 24,000 Euro;
Rate of economic growth – 1.5%;
Rate of return on capital (real estate) – 4.0%;
Tax – 19%.
For the above assumptions:
$r_{re} = 4\% - 0{,}76\% = 3{,}24\%$, *i.e.* $r_{re} > g$
$M > 120{,}000$ *Euro* $/ (3.24\% - 1.5\%) = 6{,}896{,}552$ *Euro.*

It means that in the given example, the minimum value of capital invested in real estate is to be at the level of 6.9 million Euro in order to ensure the assumed lifestyle level and wealth recapitalization.

Both the examples presented above play an important role for further discussions on Piketty's fiscal recommendations leading to changes in wealth disparities in contemporary societies.

4. Ideology and semantics

Piketty claims that a social and fiscal state is the greatest achievement of democracy in the 20th century, which *per se* is debatable. He admits that in some European countries, impositions for the benefits of the public budget have exceeded 50% and it is not too much. It means he believes in politicians who change taxes into welfare and prosperity!!! Maybe it is true in France. However, the studies by Hoppe (2014; 2015) indicate it is the other way and politicians and public officials are driven by their own benefits instead of the well-being of others. What is more, Piketty uses such terms as social justice or morality (sic!). Nevertheless, such justice is not defined and the use of the term of morality in such a context seems to be erroneous. Even the classification of disparities is set

in an arbitrary way. Morality has different meanings for different people which excludes this category from objective scientific discussion, as it results in ambiguity and misunderstandings. A social state considered as a success of democracy means common and free of charge access to medical services and education, social transfers and repartition pension systems. It is worth mentioning that in real life health care is not free of charge, because a lot of services are not accessible or access to them is postponed in time (long waiting lists) that they cannot be received when needed or these services are of low quality. As regards pension systems, they resemble financial pyramids which, taking into account the demographic situation in developed nations, are heading towards bankruptcy.

5. Are additional taxes a panacea for disparities?

Thomas Piketty recommends the implementation of the set of taxes as a remedy for income and wealth disparities. He propagates increasing fiscalism and extended roles played by the state. For him, capitalism is not able to regulate numerous social injustices and only state interventionism may fill this gap. Therefore, Piketty (2015, p. 725) proposes the following taxes:

(1) confiscatory income tax of 82% for work incomes higher than 1 million Euro per year;
(2) high rate of inheritance tax (from a half to two thirds of the value of inherited possessions);
(3) progressive capital[1] tax collected on the yearly basis in the following rates:
- 0,1% – 0,5% for capitals up to 1 million Euro,
- 1% – for capitals from 1 to 5 million Euro,
- 2% – for capitals from 5 to 10 million Euro,
- 5% – 10% - for capitals exceeding 10 million Euro.

It seems as Piketty forgot about the empirically validated Laffer curve, which illustrates the changes of budget incomes from taxes in relation to the level of tax rates (Gwiazdowski, 2005). Important

[1] Piketty includes into capital all assets (real estate possessions including those for own use, financial assets, material assets, non-material assets) reduced by the value of liabilities (e.g. loans).

evidence supporting the aforementioned relationship is provided by examples from the economic history of the United States, where income taxes were reduced three times: in 1925, 1981 and 1986. In all three cases, budget incomes from taxes increased. Another example is the increase in the excise tax on alcoholic drinks in Poland in 1999–2001, which resulted in lowering budget incomes from excise duties.

It should be highlighted that the key Piketty's idea is to introduce the capital tax in the global scale in order to prevent from capital migration. The questions are whether the aforementioned fiscal proposals would be effective in levelling wealth and income disparities and whether such an operation is achievable. At the first sight, the first of the aforementionned taxes seems to be a reasonable and required solution. For instance, while during the last economic crisis the governments provided public support to private banks in order to protect them from bankruptcy, some members of their boards earned more than 10 million Euro. In the case of financial institutions, it should be mentioned that the governments rescued banks only for their own benefit because they were afraid of unveiling the weaknesses of fractional reserve financial systems. In consequence, all the taxpayers were charged for the insouciance of governments while the management boards of banks experienced impunity. However, when considered thoroughly, all the recommended taxes are a manifestation of populism which will result in the catastrophe for the middle class and the enslavement of citizens by politicians and public officials. Moreover, those affected by such taxes would most likely immigrate to tax heavens. In consequence, such a solution will have a very harmful effect on local markets loosing capitals of tax payers endangered by increased impositions. What is the reason for such a definite statement? First and foremost because, every human being is driven by the general principle of his/her own benefit. Therefore, only those who have no chances to escape from such an oppressive fiscal system will pay taxes. The following example illustrates what are the consequences of the mentioned fiscal creativity for taxpayers:

Family business AAA – net value of capitals - 12 milion Euro;
Net profits – 500.000 Euro;
Owner – Jan Kowalski – 100 % shares, only dividend incomes;
Capital tax – 600,000–1,200,000 Euro per year.

In the above example, Jan Kowalski receives 500,000 Euro of dividend per year, decreased by the value of tax (in Poland – 19%) which gives 405,000 Euro at his disposal. However, he is submitted to the capital tax of 600,000–1,200,000 Euro. As a result, in order to pay this tax, Jan Kowalski will be forced to divest some shares in his company!!! Is it a manifestation of social justice and morality? Whose morality is it? Fiscal solutions proposed by Piketty would erase the middle class or force its members to immigrate to tax heavens. The idea of social justice would result in equitable poverty. Politicians and public officials having the powers to decide in 70% (of income) about what is right for their citizens would be the only ‘winners’ of analysed solutions.

6. Conclusions

Summing up, it should be highlighted once again that Piketty made a great effort to analyse the changes in income and wealth disparities observed over last two centuries. It is undeniably the work interesting from the statistical point of view and providing readers with deep knowledge related to discussed issues. However, fiscal proposals recommended by Piketty as a panacea in order to reduce social disparities should be assessed critically.

The implementation of Piketty’s fiscal innovations would reduce capital disparities neither among the citizens of a given state nor in the international context. There are no chances to implement such solutions in the global scale. And even if it happened it would be very likely that a new state would be established by the rich, soon. What is more, the announcement of establishing such a state would result in breaking the fiscal policies of other states.

A question should be asked whether income and wealth disparities are a negative and undesirable phenomenon. In the opinion of the author of the paper such reasoning is erroneous and in the real world social disparities are an indispensable aspect of the free market economy. These disparities are often considered as the forces driving progress and encouraging entrepreneurship. They push people to devote to their work in order to achieve more, to keep up with others. It should be also mentioned, that the members of the lower class in well developed economies have never experienced conditions they have nowadays.

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