Talking Cents

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Talking Cents is an ecumenical group charged by the Anglican Diocesan Council to promote an alternative to current economic and political thought, and to encourage debate within the Church. Ministry Units are encouraged to distribute these articles. This issue is contributed by David Hall a member of the Auckland Anglican Social Justice Working Group.

The End of Neoliberalism?

Economics and best seller books do not usually go hand in hand. Also it is not usual to find economists quoting Jane Austin and Honoré de Balzache – 19th century romantic novelists. But Thomas Piketty's book ***Capital in the 21st century***[1] does both.

Thomas Piketty is a young (43) French economist, a professor at *École des hautes études en sciences sociales* (School for Advanced Studies in Social Sciences) in Paris. ***Capital*** was first published in French in 2013 and since it's publication in English last year has become a best seller in the English-speaking world. It is a large book (669 pages) and is full of tables and graphs. Piketty manages to write in a style that the non-economist can not only understand but comprehend.

Piketty analyses the relationship between "capital" and "income" initially in Britain and France in the 18th century and then in the wider world through the 19th and 20th centuries as data became available. He then extends the analysis to forecast what could probably happen in the rest of the 21st century.

Capital is defined as any asset that confers the right to collect a flow of income that is not dependent on human effort – rents, dividends, interest etc. Conversely, income is money that comes from human effort – wages, salaries, bonuses etc. Capital can be transferred from one person to another through inheritance or gift. Piketty shows that, except for a relatively brief period in the 20th century, the rate of return from capital is greater than the growth rate in the economy (Gross Domestic Product). This means that the amount of capital increases faster than the growth in incomes and leads to a concentration of capital in fewer and fewer hands.

Piketty found that capital or wealth grew to 700% of Gross Domestic Product (GDP) in Britain in the years leading up to the start of the First World War then dropped dramatically to around 300% for the next 40 years corresponding to the two World Wars, the Great Depression of the 1930s and the establishment of the welfare state in the late 1940s through to the mid-1970s. The Neoliberal Revolution of the 1980s has seen the ratio steadily increase to around 600% and increasing year by year. Very similar changes in the Capital/GDP ratio are seen in all other developed countries, including New Zealand.

Although the data is less comprehensive for France and Britain in the 18th and early 19th centuries, France in particular did not see a major drop in the Capital/Income ratio resulting from the French Revolution although there would have been significant transfer of wealth from the land owning aristocracy to the middle classes.

Why does the Capital/GDP ratio increase and why is it important? Basically it is because not all the income (rents, dividend etc) that the owners of capital receive is used for day to day living costs; rather a significant portion goes back into capital. Conversely, the income of the less wealthy is only sufficient to cover living expenses and very little is available for saving or investment. Thus the rich – those who own capital - get richer than the poor. Some economists, and politicians, argue that this is good as the rich have more money to invest in new ventures that result in jobs and income for those without capital, even when that "investment" is in large yachts or great mansions. This is, of course, the so called Trickle Down effect that has been shown, in practice, not to happen.

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[1] English version published by Belknap Books of Harvard University Press 2014

From my perspective the most interesting revelation of the Piketty analysis is the 1914 to 1975 period. The enormous loss of lives from both World Wars is something we rightly acknowledge and deplore but we forget that there was an enormous loss of capital/wealth. How much this loss of wealth particularly from World War One, contributed to the Great Depression, is a question that economic historians have yet to agree on. After World War Two it seems policy makers, and those who elected them, had learnt the lesson and were prepared to manage the economy more carefully and to reduce the income inequality in most of the developed world. This was reversed in the late 1970s with the advance of neoliberal ideology, particularly in the English-speaking countries. This initiated the steady increase in the Capital/GDP ratio to the point it is reaching similar heights to those at the beginning of the last century.

Piketty also looks in detail at the distribution of wealth and income in the larger developed economies. Whereas much of the analysis of inequality has focused on the top 10% of income compared to the 90%, Piketty looks at both income and wealth and not just the top 10% but the top 1%, top 0.1% and even the top 0.01%. One interesting graph shows that % of total wealth owned by the top 0.1% in the Anglo Saxon countries which started at around 10% in 1910 dropped to around 2% in the 1960s. It has steady increased to around 7% today and is still increasing. Interestingly the same analysis for France, Germany, Sweden and Japan show a similar result until the 1980s when the ratio remains around the 2-3% of the previous 20 years. This seems to indicate that inequality is more of a problem for the English Speaking developed countries, a conclusion the Wilkinson and Pickett came to in ***The Spirit Level***.[2]

Piketty looks at the reasons for the every widening wealth gap. In addition to the rate of return being greater than the growth in GDP, Piketty also argues that intergenerational transfer of wealth through inheritance is another significant factor even when inheritance taxes exist. Piketty also comments on the changes in income tax over the last thirty years resulting in much less progressive regimes. However, unlike Wilkinson and Picket in ***The Spirit Level,*** he does not explore the undesirability of gross inequality. But he does make some suggestions about how the wealth gap could be controlled. His primary suggestion is a form of wealth tax that would need to be applied globally. He also argues for a return to a more progressive income tax system.

The application of ***Capital*** to the New Zealand situation can be difficult to assess. A small book "***The Piketty Phenomenon New Zealand Perspectives*** [3] is helpful, and illuminating. Publisher Tom Rennie has brought together 15 NZ economists, historians and social scientists to comment on ***Capital,*** its methodology and conclusions. Inevitably the economists who subscribe to the Chicago School are highly critical and do raise some issues. However, for me, the most insightful comment comes from Associate Prof Susan St John of Auckland University who writes

"Thomas Piketty's book has shown that there is a fundamental flaw in capitalism. Intuitively many of us may have long suspected that an unsustainable compounding of wealth and advantage is an inevitable outcome of the aggressive adoption of a market based economic model. But now we are confronted with theoretical and empirical evidence that requires us to take action. The parallels to climate change are unmistakeable."

It is the policies followed by many of the developed countries after World War Two that Piketty clearly shows produced a significant closing of the wealth gap by a combination of progressive taxation regimes and taxes on wealth transfers through Death Duties etc. One can only hope and pray that the leaders of nations and their policy advisers have the common sense to learn from this period without the need for two world wars, revolutions and a great depression. But it is not just the leaders that have to understand the folly of ever increasing inequality but also the voters who put them there.

Jesus compared the difficulty of a rich man getting into heaven to a camel getting through the eye of a needle. He also criticised the Pharisees for their love of money and the power and social position that went with riches. But Jesus also praised those who gave to the poor and those in need. In the Parable of the Good Samaritan he praise the Samaritan not just for stopping to help the traveller on his way to Jericho but for providing for his ongoing care.

As followers of Jesus are we prepared to continue to advocate for a fairer, more just and equal society? If so we may we will see the end of Neoliberalism and the gross inequality it has produced..

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[2] The Spirit Level. Wilkinson and Pickett. Bloomsbury Press New York, 2010

[3] The Piketty Phenomenon published by BWB Texts Wellington 2104