

## Do we want inequality? or Me & Piketty

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*Inequality is not necessarily bad in itself: The key question is to decide whether it is justified.*

Thomas **Piketty**

To begin with, this is a tale of two books. The first, which you almost certainly have heard of and may have read or at least started to read—it is 685 pages long—is Thomas Piketty’s *Capital in the 21st Century*, published in English in 2014. I think it’s a terrific book, even though I disagree with almost all its policy conclusions. The second book, which you probably have not heard of, is my own *The Inequality Trap: Fighting Capitalism Instead of Poverty*, published so far only in English, in 2015. It did get a brief mention in the *New York Times* in a review of several books on inequality ([‘All Things Being Unequal,’](#) 15 December 2015). The reviewer said that although the ideas were familiar the presentation was “lively and able,” which is how in our family we think of my 91-year old mother: lively and able. Never mind. The reviewer spelt everything right.

The latest figures I have seen are that in its various editions and translations, Piketty’s book has sold more than 1.5 million copies. Mine, as of this writing (in September 2015) has sold 1,486, not 1 per cent of Piketty’s, to cite the world’s most popular percentage these days, but just less than one-tenth of that 1 per cent. The question I have been asked to discuss is “Do we want inequality?” My answer is “Yes, but perhaps not quite so much.”

More seriously, my answer is that we don’t necessarily want or not want inequality. What we want is fairness. As Margaret Thatcher put it, “Equity is a very much better principle than equality.” To the extent we do want inequality we want it because it is fair. That doesn’t mean it is always fair, though it may be. Even if it isn’t fair, we may still want it because we can’t figure out how to reduce it without being equally or even more unfair doing so. There is also the possibility that inequality may be efficient, in the sense of encouraging the production of goods, services, ideas and so on, but here I want to spend more time on fairness, as that seems the common preoccupation these days.

Consider Thomas Piketty. He has written an interesting, important, impactful book that has sold, as I say, more than 1.5 million copies and presumably made its author a lot of money as a result. I don’t actually know what Piketty’s royalty rate is (though I suspect it’s higher than mine!) I also don’t know what he has done with his royalties. It may be he has given most of them to good causes. What rich people do with their money (which in my view is for them to decide) is often how we judge them. From those to whom much is given, much visible philanthropy seems to be required.

Piketty isn’t entirely responsible for his book, of course. “You didn’t write that,” as President Obama might have told him during the 2012 election campaign. “It takes a village to write a book,” Mrs. Clinton might have added. People trained Piketty and over the years collaborated with him. In large part, his book is the product of the roughly two decades he and several colleagues spent putting together and analyzing

the World Wealth and Income Database, an intellectual asset for which the world should be truly grateful (unless you buy Lee Kwan Yew's argument that too much information creates too great a temptation for governments to engage in policy mischief). Piketty offers a long list of acknowledgements in the book: I count at least 29 individuals named. His press (Harvard) translated, produced and marketed the book—and did so very well, judging by its sales. Yet, without Piketty the book would not exist. If anyone deserves the royalties, surely Piketty does. Steve Jobs didn't build the iPhone all on his own. But without Steve Jobs would there be an iPhone?

The story of my book is much the same, though on a drastically smaller scale. I wrote it myself; lots of people have influenced me over the years; my press (Toronto) did a great job transforming the manuscript into published form. True, they didn't get me onto the cover of *Bloomberg Businessweek*, which Piketty graced in June 2014. Still, they were very good. My acknowledgements were directed at 14 people. Doubtless I should be more inclusive. But I hereby attest that I am indeed my book's author.

In the question I was charged with for today's discussion: Do we *want* the evident inequality between Piketty's book and mine? Well, "we" might but I certainly don't. I wish my book were doing more nearly as well as his. I wish at the Cannes Film Festival this year it had been announced that *The Inequality Trap* was being turned into a documentary film directed by a famous documentary director, as it was of his. But can I really complain about the unfairness of Piketty doing so spectacularly well and my doing, let's say, not quite so well? There is a market for books and ideas. Piketty and I both compete in it and he is doing much better than I am (for now, at least, though where is life, is hope). If I wanted to match Piketty, I should have written a better book. In sum, I may not *want* the existing degree of inequality between me and Piketty but it would be hard to argue it is unfair.

I wonder if Piketty himself would take the same view of the inequality between us. His book says many things about inequality but two that are germane here are the quote I've put at the top of this paper—"Inequality is not necessarily bad in itself. The key question is to decide whether it is justified," which I think is very true—and the following from his discussion of the income from capital: "[T]he central fact is that the return on capital often inextricably combines elements of true entrepreneurial labor (an absolutely indispensable force for economic development), pure luck (one happens at the right moment to buy a promising asset at a good price), and outright theft" (Piketty 2014: 446). That it is hard to tell just how much of each is embodied in any particular income leads him to generalized agnosticism about whether either the existing or emerging degree of inequality in society is fair or not. As agnosticism will be part of my story, too, I'm at least somewhat sympathetic. What we don't know or can't be sure of certainly should limit our policy ambition. But are we really as ignorant in these matters as Piketty suggests?

Applying his tripartite taxonomy to his own royalty income, I very much doubt outright theft has had anything to do with his book's success. He acknowledges his intellectual debts in his front matter and his footnotes. No one has come forward to claim they gave him his whole story when warming up audiences for his public lectures, say, as sometimes happens in the world of rock music. Pure luck probably did play a role in his success. Luck affects all of us. As mentioned, he has been working on questions of income inequality for a long time. That the world would fixate on unequalness after the Crash of 2008, thus increasing the market value of the intellectual investment he had made over the years, doubtless qualifies as luck—though exactly how much is hard to say: Perhaps he anticipated the trouble that was coming so that what looks like luck is in fact at least partly a return to foresight. If you do read the book, however, you understand not far into it that its success, unmistakably, overwhelmingly, is due to both an extraordinary amount of true scholarly labour and an ability to write clearly and engagingly.

In sum, Piketty-and-me seems a case in which (however sad for me to say) inequality is perfectly fair. He is the author (literally) of his good fortune and I of my not-so-good fortune. It would be a strange understanding of fairness that would require him, simply because his book has been so successful and mine has not, to share his good fortune with me. It's his money. He earned it the old-fashioned way. It should be his to keep, subject to the usual rules of taxation, which in my view should not be altered simply because he has done so well and the rest of us have not. In sum, in cases like Piketty's, we want inequality because it is so obviously fair.

Do we nevertheless have reasonable grounds for reducing the inequality that has arisen between Piketty and me, albeit not because we are concerned with inequality *per se*? One can think of several theories that might permit us to do so. As an economist, I'm trained in the post-World War II, Samuelsonian tradition of utilitarian public finance, itself descended from Bentham and Ramsey, in which we take from those with low, and give to those with high marginal utility of income or wealth, assuming the cost of effecting this transfer does not fully offset the social benefit it produces. Piketty, with his large income from his big bestseller presumably has driven his various marginal utilities down to enviably low levels. Mine are probably a little higher. Even so, I lead the comfortable life of a tenured academic. There clearly are other people in society with much, much higher marginal utilities of income/wealth. If there is a social consensus that people's marginal utilities, like their blood pressure, should be kept from extreme levels, redistribution seems a reasonable recourse. In this view, however, our motivation for taxing Piketty is not abhorrence for any supposed immorality of the inequality his success has created, nor harm from it, but simply the belief that taxes should be raised with the least sacrifice in utility, which means taxing richer and therefore presumably lower-marginal-utility-per-dollar people more than the rest of us (an idea that suffers from difficulties that have been well understood since at least *The Uneasy Case for Progressive Taxation* (Blum and Kalven, Jr., 1952)).

What is the cost of effecting this transfer? What would be most convenient is if Piketty's income from *Capital in the 21st Century* were pure rent, that is, a payment not necessary to induce the creativity that produced it. Did Piketty need the royalties, or the reasonable prospect of them, in order to write his book? We obviously don't know. I wrote my book without expecting to sell movie rights, as he may end up doing. Assuming he makes at least 66 cents a book—Harvard asks \$39.95 for the hardcover—was the million or more dollars he has earned from it necessary to get him to write it? How much *did* he need to earn in order to write it? It seems a crass question but academics invited to write textbooks, even English or sociology professors, have to ponder exactly that. If Piketty did make more money than he needed in order to write the book, can we reasonably take the entire excess from him on the grounds that doing so will not change his behaviour?

It's at least possible Piketty didn't need any money at all to write the book.<sup>1</sup> He may have done it because writing books is what academics are supposed to do. Maybe his academic salary, or part of it, is not a rent, because without it he wouldn't be an academic or write books. Why would he do it if not for money? For fame, maybe. As mentioned, he has been on the cover of *Bloomberg Businessweek*. Or for influence. His ideas are much talked about in policy circles and likely have helped enable top-end tax increases in several countries. Or, finally, for the esteem of his peers. Adam Smith tells us in the *Theory of Moral Sentiments* this is humans' main motivation. If Piketty really did write his book for these other reasons, we could tax the

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<sup>1</sup> In fact, I may be a better example of this case than Piketty. I wrote my book with absolutely no expectation of substantial monetary return and am having that non-expectation perfectly realized.

income it has given him at the high marginal rates he himself recommends and not worry that he would write fewer books as a result. If large incomes *can* be reduced without altering the behaviour that “earned” them—a much loaded term, it begins to appear—then utilitarian tax theory says we should do so, assuming we really can redirect the money to people whose utility it will increase more than it will increase Piketty’s or, for that matter, mine.

Even if we *can* do it, are we entitled to? Is the fact that Piketty’s income from his book is a rent sufficient for us to take it from him? After all, it’s *his* rent, both in law and perhaps in other ways, too. In a recent [NBER working paper](#), Matthew Weinzierl (2016) describes an online survey in which he asked 2500 American respondents their views concerning a game in which an \$18,000 lottery ticket wins the two people holding it, persons A and B, \$60,000 and \$30,000, respectively. Survey respondents have to decide, as a social planner would, the best way to split the cost between A and B. “Welfarism” would equalize their net earnings, so each gets \$36,000—half the \$72,000 net winnings after the \$18,000 cost is paid. In this distribution, the \$60,000 winner pays the \$18,000 cost of the ticket *and* gives \$6,000 to the \$30,000 winner. Because who gets the \$60,000 and who the \$30,000 is a matter of pure or “brute” luck, and is not “earned” in any way, you might think this 50-50 split of net earnings would be best. Yet fully 75 per cent of Weinzierl’s respondents did not choose that option even when it was offered. Rather, the modal view (with 26 per cent of respondents supporting it) was that the \$60,000 winner should pay the \$18,000 ticket cost but no more. The *average* amount respondents thought the \$60,000 winner should pay was \$16,772: The bigger winner should pay more of the cost—befitting his or her higher “earnings”—but not the entire cost and certainly not more than the entire cost (Weinzierl 2016: 6). If the \$60,000 winner does pay \$16,772, he/she nets \$43,228, compared to the other player’s \$30,000-(\$18,000-\$16,772)=\$28,772. The winning shares are completely arbitrary and the whole process is due to luck yet even so respondents think the best outcome is for net earnings to at least partly reflect gross earnings.<sup>2</sup> Moreover, asked what the “typical American” would say is the best outcome, respondents are even less redistributionist. Their estimate of the average payment by the \$60,000 winner is just \$14,735, with only 14 per cent of respondents believing Americans in general will opt for full welfarist equalization. Weinzierl argues that this evidence “suggests that the two reasons emphasized in conventional optimal tax analyses for allowing inequality in after-tax incomes [that effort should be rewarded and that taxation has substantial efficiency costs] are unsatisfying as explanations for American skepticism toward redistribution” (Weinzierl 2016: 7). In his example, by assumption, differences in gross incomes are purely a result of luck, while taxation has no efficiency costs. Even so, respondents are willing to let winners keep what obviously are rents.

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<sup>2</sup>As the recent memorials to Arnold Palmer reminded us, before their 18-hole playoff for the U.S. Open Championship in 1962, Palmer and Jack Nicklaus faced a somewhat similar problem. As Nicklaus told *Golf Magazine*: “You’ve probably seen that picture of Arnold coming to me on the practice tee before the playoff. Arnold said, ‘Would you like to split the purse?’ Because in those days you could split the purse and the playoff gate. [First prize was \$17,500, and the runner-up got \$10,500.] I thought about it for a second and said, ‘No thanks. We’ll just play for it.’ But it was a nice gesture on his part.” Nicklaus won the playoff by three shots and thus took both the gate and the first-place purse. Of course, golf outcomes likely are not the result of “brute luck.” Nicklaus may have felt his chances of winning were good. Or he and Palmer’s marginal utility of income and degree of risk aversion may have differed. Or perhaps Nicklaus felt dividing the pot in advance was not appropriate, even if a nice gesture by a player who had won 33 professional championships to his zero.

A second problem with taxing rents is practical. How do we identify them? We can agree that rents are the least costly income to tax. But how do we know what's rent? As we have seen, Piketty argues all capital income is part "true entrepreneurial labour," part "pure luck," and part "outright theft." The part owing to labour is not rent, the parts owing to luck and theft are (though theft presumably can be labourious). As to how much of each is embodied in any given income, Piketty essentially throws up his hands: "To be frank," he writes, "I know virtually nothing about exactly how Carlos Slim or Bill Gates became rich, and I am quite incapable of assessing their relative merits" (Piketty 2014: Loc 7749). The policy that emerges from this agnosticism is to tax all large fortunes. What he calls "the fiscal approach" is, he says, "a way to move beyond the futile debate about the moral hierarchy of wealth" (Piketty 2014 : Loc 7731). Tax it all, in effect, whatever the relative importance of labour, luck and theft, whether it's pure rent or essential earnings necessary to elicit effort, investment or inspiration. The fiscal approach is clean and simple. But it hardly seems fair, like locking up everyone found on selected city streets of a steamy summer evening because at that time in that area looting of stores and over-turning of police cars has taken place.

The difficulties of deciding how much of any particular income is rent and how much is not are obvious. The Canadian cartoonist Ralph Hagen once drew a lovely panel called "The New Simplified Tax Return. Step 1: Calculate income from all sources. Step 2: Send it." We need only imagine the forms a person would have to fill out for a tax on pure rent: Step 1: Tell us how much of your income you did not need in order to engage in the economic activity that produced it for you. Step 2: Pay this amount. Only the deeply devout and fastidiously truthful—think Swedish Quakers—would end up paying their rent tax.

On the other hand, people have tried to gauge, at least roughly, how much of an economy's overall income is rent. A recent attempt to do so for Canada concluded that, as in many other rich countries, the biggest increases in incomes in recent years had come in FIRE (that is, finance, insurance and real estate) and natural resources. After reviewing the numbers, the study concluded that "Although some high incomes are surely compensation for hard work, the growth in top incomes over time has been so large that rent extraction must be the major contributing factor" (Lemieux and Riddell 2015: 134). The authors' implications seem to be that such income is therefore available for aggressive redistribution. Many observers, Piketty included, argue more generally that high corporate incomes, in whatever industries, are mainly rents seized from corporate boards by top managers exercising big informational advantages over part-time directors. Such incomes can also be taxed at high rates without fear of inducing economic inefficiency.<sup>3</sup>

On the other hand, the Canadian study cited found that people earning their incomes in FIRE and natural resources together accounted for just one-fifth of the membership of Canada's top 1 per cent. Even if these people's incomes are mainly rent, can we be sure the incomes of the other four-fifths are mainly rent, too? Corporate executives and specialists in finance do make up a sizeable share of the top 1 per cent of US earners, but the list also includes: lawyers; computer, math, engineering and technical workers; real estate agents; professors and scientists (though they were only 1.7 per cent of the 1 per cent in 2005); people in the arts, media and sports; farmers and ranchers; and people who were either not working or deceased; among others (Bakija, Cole and Heim 2012: Table 2a). Many people in these fields may well earn rents. Do they *all* earn rents? Is all their high income completely undeserved and therefore eligible for seizure that won't produce negative economic consequences, as seems to be the working assumption of many social critics in these final days of the Obama era?

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<sup>3</sup> For Canadians, however, there is an interesting question whether a high corporate income paid to prevent an executive from moving (southward) to a jurisdiction in which executives do get to keep their rents is itself still a rent. Without the high payment Canada may well lose the executive.

As I indicated, I'm sympathetic with Piketty's agnosticism about the moral virtue or otherwise of high incomes. Without very detailed information—complete tax records, certainly, but also much more than that—it is very hard to generalize about whether an individual fortune was gained by effort, luck or theft, and even more difficult to generalize regarding all fortunes.<sup>4</sup> On the other hand, Piketty is obviously right that inequality is not bad in and of itself and that what is important is whether it is morally justified. Luckily, we do not have to decide these matters in aggregate or on average. We already have procedures available for doing it on a case-by-case basis. Theft is generally illegal. We can prosecute people who steal. That may be easier said than done: Thieves, including white-collar ones, will resist detection and prosecution. But it can be done. As for rents, many are not *per se* illegal. Sometimes they do come from pure luck. We may choose to stand back and let luck happen. As for those not attributable to luck, we know where lots of them are generated: in our capital cities, by intrepid private interests and their hired lobbyists, whose business is to seek rents. Even Joseph Stiglitz (2012) rails against rent-seeking, though not surprisingly his beliefs about just who in society earns the biggest rents differ from the beliefs of most people operating in the public choice tradition that first brought attention to rent-seeking. We may differ on cases from Stiglitz but it seems to me significant that people on both the Left and Right of the political spectrum (if it still is a spectrum, rather than a canyon) can agree that people legislating or regulating themselves into wealth is, as Adam Smith told us 240 years ago, unfair.

Do we need inequality? Not necessarily. Inequality is an aggregate, macro concept. What we need instead is a micro approach to politics and law that judges the fairness or not of individual actions. Whatever inequality emerges from micro processes that do aggressively punish theft and discourage rent-seeking will be the inequality we need.

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<sup>4</sup> Actually, it's not difficult at all, judging by the number of people willing to do it. What I mean is that it is difficult to do it in any meaningful way.

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