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PHI169 – Critical Reasoning
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Assignment 4: Arguments Back and Forth

1a.) What is the relation between r > g and inequality according to Piketty? Does Piketty believe that r > g explains inequality in the world? If so, what is his argument?

Thomas Piketty focuses on two primary concepts: the relationship between the rate of return of capital and overall economic growth, denoted by **r** and **g**, respectively. Piketty asserts **r** > **g** is a dominant force augmenting inequality because throughout human history, the rate of capital return is typically higher than economic growth, a fact which favors the most affluent members of society. Wealthy individuals reap the most benefits from the r > g inequality because they have the capital to invest and, subsequently, earn a profit from their investments faster than economic growth. Lower and middle citizens, on the other hand, tend to spend most of their money to satisfy basic needs rather than on capital investments.

According to Piketty, as the rate of return increases, wealth inequality also increases. This leads to a higher concentration of wealth owned by the top 10% of income earners which in turn, worsens economic prospects for the middle class. In one example, Piketty argues that, with a return rate of 5%, wealth owners will only need to reinvest one-fifth of their wealth to compensate for economic growth. Thus, the current capitalist system allows wealthy individuals to develop lavish lifestyles at the expense of a suffering middle class. As a function of **r –g**, wealth inequality is projected to sharply increase as **r** becomes larger. On the other hand, Piketty highlights other factors that may contribute to the disparities observed between wealth and income. While the relation between **r** and **g** is important, factors such as family size and education level also play a role in wealth inequality.

1b.) How does Piketty explain the rising income inequality in the United States in the last 40 years? How does r > g factor into that?

Piketty cites several reasons to account for the rise of income inequality in the U.S. including: changes in supply and demand, globalization, unequal access to education and skills, the race between education and technology, and a significant increase in salaries for managers, CEOs, and other prominent corporate positions. Piketty notes that the relation between **r** and **g** is not necessarily interrelated with income inequality; however, rate and economic growth are more connected with wealth inequality as opposed to income inequality. The wealthiest Americans in the U.S. are able to accumulate capital significantly faster than their lower and middle class counterparts due to easy access to higher education, skills, and a reduction in tax rates, which have decreased substantially since the early 1980s.

1c.) What criticism(s) does the economist Ray level against Piketty? In particular, discuss (i) why the US is an exception and (ii) why r > g does not explain inequality?

NYU economist Debraj Ray criticizes Piketty for oversimplifying the issue of wealth inequality in the United States. First, Ray asserts that the rate of return of capital corresponds to the *level* of capital income as opposed to its growth. Ray expounds on this point on page four of his essay titled, "A Comment on Thomas Piketty's Capital in the 21st Century," where he provides an example of how wealthy individuals accrue income from wealth. "If you have a million dollars in wealth, and the rate of return is 5%, then your capital income is $50,000" (Ray 4). According to Ray, it is level, not growth that is measured by the rate of return. Unlike Piketty who argues that **g** corresponds to economic growth, Ray states that it measures the growth of median income. Therefore, "r > g," Ray contends, does not effectively explain income inequality because the two variables should measure the same quantity. The rate of return is linked to wealth while g is connected to the growth of average income. While it is true that "r > g" accounts for some degree of income inequality at the highest levels, Ray dismisses this notion for lower income brackets. "A poor subsistence farmer with a small plot of land would consume all the income from that capital asset. It may well be that the return on that land asset exceeds the overall rate of growth, but that farmer's capital income would not be growing at all" (Ray 5). The argument Ray poses contradicts Piketty's central argument, namely, that an increasing rate of return is not necessarily related to the growth of capital income. Wealth and capital income are distinct, independent concepts. As a result, Piketty's argument is inconsistent with the parameters that gauge economic variables.

From Ray's perspective, the U.S. is a notable exception since inequality in the U.S. is facilitated by significant returns on "human capital" for the top wage earners. "It is unclear that the story of rising inequality in the United States is one of physical (or financial) capital coming to dominate," says Ray, "rather, inequality in the United States appears to be propelled by incredibly high returns to *human* capital at the top of the wage spectrum" (3). Moreover, rich people tend to save more money on average compared to lower and middle-class Americans. In these scenarios, Ray believes the rate of return exceeds growth; however, this is due to the saving proclivities of the rich, not the "**r** > **g**" inequality Piketty promotes. Furthermore, Ray argues that in the U.S. inequality will not manifest so long as wealth holders use "skill acquisition as the vehicle for their intergenerational transfer" (5).

1d.) Do you think these are good criticisms? If yes, explain why. If not, how would you respond? Please also discuss Piketty's response to the criticism that r > g does not explain inequality.

In general, I am inclined to agree with Ray's assessment of Piketty's argument. It is certainly true that the rate of return of capital has been consistently higher than overall growth. However, the inequality Piketty cites is largely insufficient for determining the underlying causes of the wide, income disparities exhibited in highly developed, capitalist societies. As stated previously by Ray, the variables **r** and **g** are incomparable and therefore this claim should not be considered as the primary, driving force behind wealth inequality.

Although I am compelled to agree with Ray, I disagree with the notion that acute concentrations of wealth at the highest income levels does not contribute to economic inequalities. For instance, Ray claims that in the U.S. inequality is caused predominantly by the large returns on "*human*" capital for the top income earners. However, one may argue affluent individuals are not inclined to donate portions of their wealth nor their income to assist in alleviating inequalities in poverty-stricken areas. In fact, Ray stated that the rich tend to save their money more frequently than those who are not as fortunate. Rather than investing capital in prominent corporations and financial institutions, the rich should endeavor to fund social programs, like those geared towards making high-quality education more accessible. Consequently, people will attain the skills necessary to succeed in the competitive job market, resulting in more profitable salaries and a better standard of living. Ultimately, Ray concisely refutes Piketty's central points and offers other explanations for the causes of income inequality that ails our society, like globalization and advances in industrial and informational sectors of the economy. While Piketty included these as potential factors contributing to economic inequality, his primary focus is on **r** > **g**.

Piketty openly admits that r > g doesn't fully explain income inequalities. "The rise of top income shares in the US over the 1980-2010 period is due for the most part to…a mixture of two groups of factors: rising inequality in access to skills and higher education…and exploding top managerial compensation. Piketty attributes the lack of access to skills and education due to higher tuition costs incurred and insufficient public funds. The strident absence of public funds reverberates a point made in the preceding paragraph, specifically that the rich should be more receptive to transferring more wealth to social programs to facilitate the acquisition of knowledge and the skills people need to succeed. Piketty also cites tax cuts skewed to favor upper middle and rich individuals, allowing them to retain a larger portion of their wealth compared to middle-class citizens. In his essay titled, "About Capital in the 21st Century," Piketty reiterates his stance on how **r** > **g** may have a profound impact on wealth inequality.

"Specifically, a higher **r – g** gap has little impact on labor earnings inequality, but it will tend to greatly amplify the steady-state inequality of wealth distribution that arises out of a given mixture of shocks (Piketty 4). With a combination of shocks, like family size and investments, wealth inequality is manageable and approaches a finite number. However, the severity of the r-g gap has the potential to exacerbate wealth inequality. During World War I, for example, numerous shocks like destruction, nationalization, inflation, and reconstruction helped bolster economic fortune. The future Piketty posits is characterized mainly by significant inequalities in wealth, as the population growth rate dwindles and global competition continues to soar. Therefore, **r > g** does not account for inequalities in the broadest sense, yet it can be detrimental if left unchecked.

1e.) What criticisms does the Financial Times level against Piketty's data? How does Piketty respond?

Chris Giles of The Financial Times discusses two criticisms against Piketty's data, one of which scrutinizes his statistics and portrays them as overly exaggerated, while the second addresses claims regarding wealth inequalities. First, Giles contests data from Piketty showing the top ten percent of British citizens holding 71% of the total national wealth. On the contrary, data from The Office for National Statistics shows the top ten percent of income earners with 44%, considerably less than the 71% Piketty asserted. Giles goes on to question the accuracy and credibility of Piketty's findings when he states that estimates of wealth inequality and other numbers "appear simply to be constructed out of thin air" (1). Overall, Giles questions the veracity of Piketty's arguments that wealth inequality is worsening, especially when the numbers Piketty appear to be unreliable. Piketty is also criticized for displaying a lack of consistency in terms of selecting data sources. "Sometimes, as in the U.S., he appears to favour cross-sectional surveys of living households rather than estate tax records. For the UK, he tends to avoid cross-sectional surveys of living people" (Giles 5). Interestingly, Piketty has different methodologies when it comes to choosing specific types of research data. To some extent, I believe this is disingenuous; if the data truly supports Piketty's position, he should be more consistent in how he presents his findings. Giles notes: "there is one important caveat. None of the source data at the basis of Piketty's work is completely reliable. So while this post is clear about what is wrong with Piketty's charts, it is much less certain about truth" (1). Subsequently, Giles partitions his argument into two main parts. Part A addresses Piketty's argument that wealth inequality rose after 1980. Part B undermines the notion that wealth inequality is greater in the U.S. than in Europe.

PART A – In terms of wealth inequality in the U.S. between 1810 and 2010, Giles compiled data from Altern and FT that demonstrates gradual increase in wealth inequality. However, there were notable decreases in inequality in countries like France, for example. In France, wealth inequality for both the top 10 and 1% decreased after 1980. In Sweden, wealth inequality has increased slightly over the last 30 years and in Great Britain, wealth inequality rose between 1990 and 2000; however, the trend went down between 2000 and 2010.

PART B - The second part encapsulates Giles' refutation of Piketty's assertion that wealth inequality is notably higher in the U.S. compared to Europe. Giles juxtaposes Piketty's data with that of other sources, like Wolff and Kennickel, to determine whether the wealth disparities between the U.S. and Europe merit attention. Pages 8-9 depict the original chart published by Piketty in conjunction with charts compiled by Kennickel, et al. On one hand, Piketty assumes there was a moderate increase in wealth inequality between the years of 1870 and 1960 for the top 10% of wealth holders. On the other hand, Kennickel does not corroborate Piketty's findings, as there is no data available between 1870 and 1960. Furthermore, Kennickel shows that wealth inequality in the U.S. was lower than that of Europe between 1810 and 1870, and between 1910 and 1970. Based on Giles' figures, it wasn't until the beginning of the 21th century that the United States started to surpass wealth inequality in Europe. This is contrasted by Piketty's data, which shows the top 10% of wealth holders overtaking Europe in 1960, nearly 50 years earlier than Kennickel. The wealth concentration, Giles says, "has been pretty stable for 50 years in both Europe and the U.S."(9). All in all, Giles seemingly debunks one of Piketty's central arguments by proving that other sources do not show an alarming increase in wealth concentration by the rich. Although Giles says there are no upward trends, this doesn't mean that the concentration in wealth couldn't increase, rather, that it is not anticipated to skyrocket as Piketty claims.

Following numerous substantive criticisms, Piketty issued a direct response to The Financial Times on May 23, 2014. In regards to the data modifications Giles encountered while studying Piketty's charts, Piketty replies: "As I make clear in the book…one needs to make a number of adjustments to the raw data so as to make them more homogenous over time and across countries" (1). However, editing data for the purposes of homogeneity is ironic because changes to raw facts and figures defeats efforts to ensure consistency within the data. Piketty concedes the data can be improved and pledges to do so in the coming years. Two of Piketty's colleagues, Emmanuel Saez and Gabriel Zucman, revised data for the U.S. statistics. Unfortunately, the publication became available after the release of Piketty's book. In addition, Piketty believes that any improvements made to the World Top Incomes Database won't alter projections for an increase in wealth inequality in the coming years. At the same time, Giles cites data from Kennickel showing a steady rise in wealth inequality between the U.S. and Europe, whereas Piketty predicts a sharp increase. Piketty concludes the letter by turning his attention to the integrity of his wealth inequality estimates. "Finally, let me say that my estimates on wealth concentration do not fully take into account offshore wealth, and are likely to err on the low side" (1). Despite Piketty's admission of not trying to paint a dire picture for the future of wealth inequality, however, one may easily derive this impression by looking at the steeply increasing function of r – g. In essence, Piketty argues for taxing wealth and income proportional to the rate at which top wealth is accumulated. "…[I]f top wealth holders are rising at 6-7% per year in real terms…and if one aims to stabilize the level of wealth concentration, then one might need to apply top wealth tax rates as large as 5% per year, and possibly higher" (Piketty 8). Although Piketty doesn't take into account the dissenting opinions of his other colleagues, like NYU economist Ray, his overall thesis that the rate of return of capital has increased steadily over the past few decades, has some merit. The position of taxing wealth and income to compensate for the rise of capital returns, I believe, should reduce the staggering disparities in wealth and income among various social classes.