Chapter 13 -- A Social State for the 21st Century

Thomas Piketty, Capital in the 21st Century (Harvard University Press 2014)

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Some Questions

- The 20th century wars wiped out much of the wealth accumulated over the previous centuries, and transformed the structure of inequality.
- 70 years of peace have brought hopes and challenges:
  - 1. the end of poverty
  - 2. the rise of inequalities
- What political institutions could regulate the accumulation of wealth fairly and efficiently?
- New instruments are needed to regain control over the financial system.
- The social state needs perpetual reforms, to reduce its complexity, to increase its efficiency, to face new challenges.

Financial Crises

- Financial crises disrupt the accumulation of capital and harm everyone.
- The crisis of 2008 was less severe than the Great Depression, because governments and central banks acted to keep the financial system from collapsing.
- Central banks are the only public institution capable of acting as lender of last resort and avert a total collapse of the economy.
- But these actions are surely not a durable response to the structural problems that made the crisis possible.
- A progressive global tax on capital would promote the general interest over private interests while preserving the forces of competition.

The State in the 20th Century

- Figure 13.1 shows the historical trajectory of the United States, United Kingdom, France, and Sweden, countries that are fairly representative of rich countries.
- Until 1914, total taxes were below 10% of national income.
- States mostly focused on the 'regalian' functions: police, courts, army, foreign affairs, general administration.
- States also financed some infrastructure, schools, hospitals.
- Between 1920 and 1980, social spending as a share of national income rose by a factor of 3 to 4 or even 5 (in the Nordic countries).
- Between 1980 and 2010, the tax share stabilized everywhere.

The State in the 20th Century

- Taxes stabilized at different shares of national income in different countries:
  - 30% in the United States
  - 40% in the United Kingdom
  - 45% in Germany
  - 50% in France
  - 55% in Sweden
- In all rich countries, the share of taxes in national income rose from below 1/10th to over 1/3, and 1/2 in some countries.

Government Social Spending

- The rise in government spending can be broken down into two roughly equal halves:
  - 1. health and education
  - 2. transfer payments
- Health and education takes a share of 10–15%, amounting to between 1/2 and 3/4 of total cost.
- Health insurance is public and universal in most of Europe. Obamacare is taking the United States in that general direction.
- Primary and secondary education are free or greatly subsidised in most rich countries, but higher education is expensive in the United States.

Government Social Spending

- Social spending accounts for nearly all of the increase in public spending.
- Replacement incomes (pensions and unemployment compensation) and transfers (family allowances, guaranteed income) take a 10–20% share.
- Pensions account for 65-75% of the total.
- Public pensions have eradicated poverty among the elderly. They are highest in Italy and France (13-15% of national income), lower in the United Kingdom and the United States (6-7% of national income).
- Unemployment insurance takes less than 2%.
- Income support takes less than 1%.
- Total social spending takes 25–35% of national income.

Modern Redistribution

- The modern state does not transfer much income from the rich to the poor directly — but it finances public services and replacement incomes available for everyone.
- The growth of the state was made possible by the high rates of post-war economic growth.
- Since the 1980s, with per capita income growth barely above 1%, there is little support for tax increases.
- The organization of a large state raises efficiency issues.

Education and Social Mobility

- One of the main objectives of public spending in education is to promote social mobility.
- Despite a large rise in the average level of education over the 20th century, earned income inequality has increased. Qualification levels have simply shifted upward.
- The intergenerational correlation of education and earned incomes, which measures the reproduction of the skill hierarchy over time, shows no trend toward greater mobility over the long run.
- Mobility is highest in the Nordic countries, lowest in the US, and intermediate in France, Germany, and the UK.

Education and Social Mobility

- Belief in high social mobility in the United States is a myth.
- The top US universities charge very high tuition fees. These fees have risen sharply since 1990.
- The proportion of college degrees earned by children whose parents belong to the bottom two quartiles of the income hierarchy stagnated at 10–20% in 1970–2010, but rose from 40% to 80% for children with parents in the top quartile.
- Parents' income is an almost perfect predictor of university access.
- The average income of the parents of Harvard students is currently about $450,000 — the average income of the top 2% of the US income hierarchy!

The Future of Education

- In Nordic countries, Germany, France, Italy, and Spain, tuition fees are usually low (less than €500). Most people believe that access to higher education should be free or nearly free, just as primary and secondary education are.
- There is no easy way to achieve real equality of opportunity in higher education. Parents' incomes are still the best predictor of their child's future income.
- High tuition fees create inequality of opportunities, but they foster the independence and prosperity that make American universities dominate world rankings.

The Future of Retirement

- In pay-as-you-go (PAYGO) pension systems, contributions are deducted from the wages of active workers and paid out as benefits to retirees.
- In capitalized pension plans, contributions are invested and the returns used to finance benefit payments.
- Most public pension systems are PAYGO.
- In PAYGO, the rate of return is by definition equal to the growth rate of the economy: contributions rise at the same rate as average wages.

The Future of Retirement

- When PAYGO systems were introduced in the 1950s, growth rates were high — both demographic growth and productivity growth were high.
- Today, the rate of wage growth is lower, but it is also more predictable, while the return on capital is very volatile.
- A transition from a capitalized system to PAYGO would be problematic.
- A difficulty of PAYGO is that different rules apply to different professions. Governments need to establish a unified retirement scheme based on individual accounts with equal rights for everyone.
- What kind of fiscal and social state will emerge in the developing world?
- China is developing a social state similar to Europe and America, financed by a broad-based income tax.
- India has maintained low levels of taxes and a small social state.

Tax revenues in rich countries

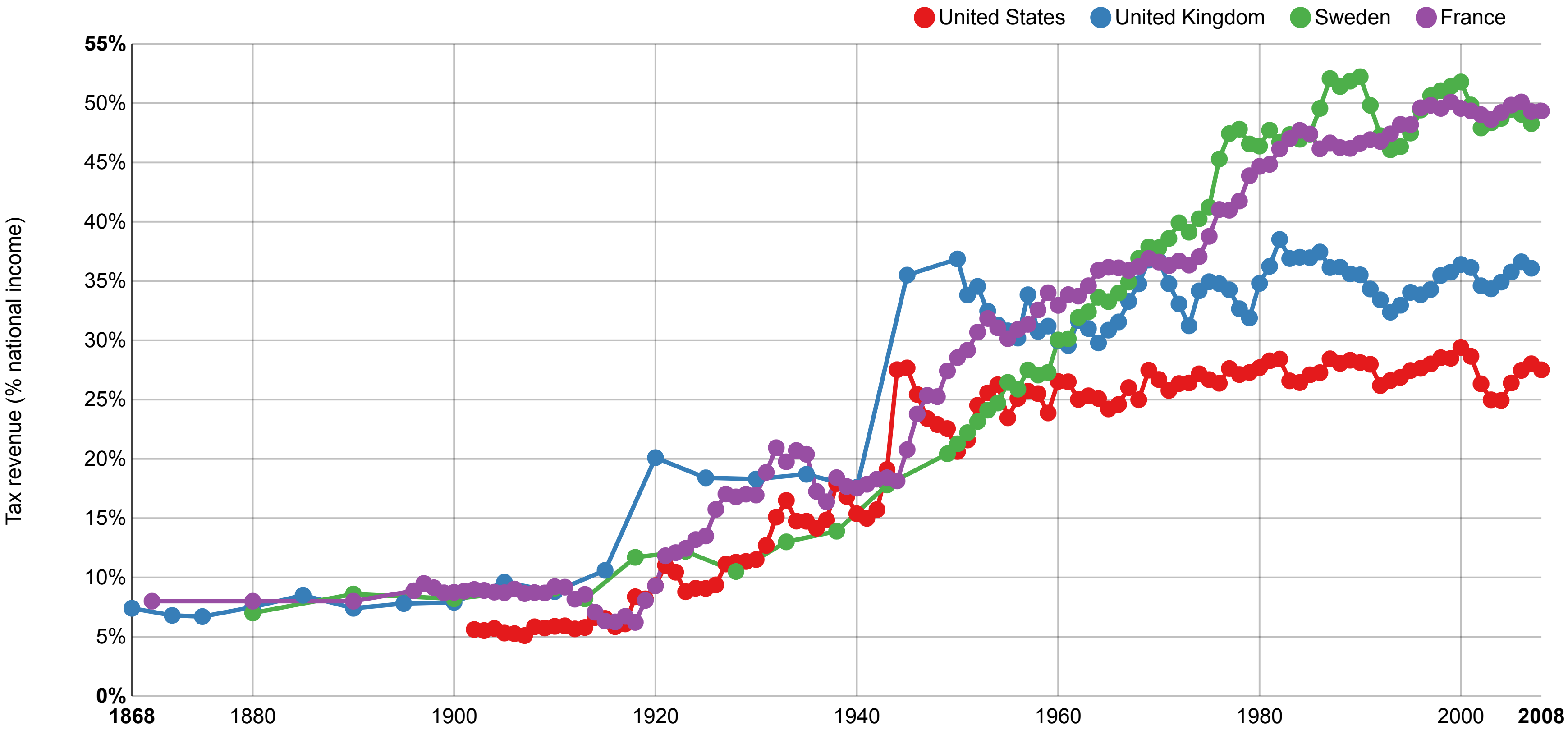

Figure 13.1. Total tax revenues were less than 10 percent of national income in rich countries until 1900-1910; they represent between 30% and 55% of national income in 2000-2010.

Concept and data: Thomas Piketty. Chart created with `rCharts` (author: Ramnath Vaidyanathan)