LECTURE 15: THE FUTURE OF GLOBAL WEALTH INEQUALITY

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The brave new world of….

- Donald Trump…. and the political and econiomic power of inherited wealth.

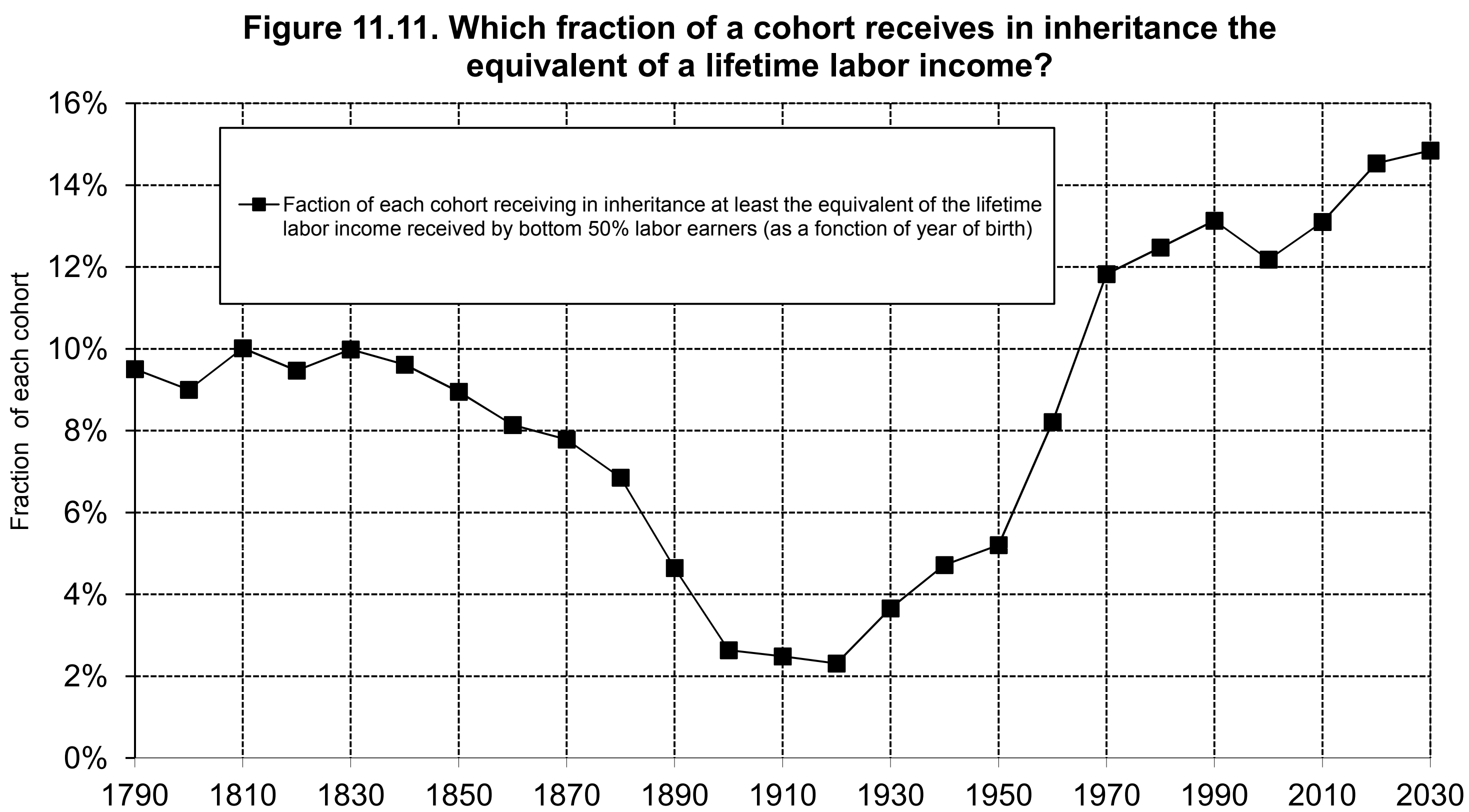
- Is Donald Trump a product of the American Dream?
  - Whereby talent, merit, hard work and intelligence creates success.
  - Or is he a product of inherited wealth/power?

- Is Donald Trump articulating the concerns of the “losers” of globalization?
  - The *cultural and economic* threat of mobile labour and capital

Introduction

- In liberal democracies, the equal rights of citizens contrasts sharply with the real inequality of living conditions among people.
- The normative justification of this inequality rests upon the assumption of merit. It is assumed that economic inequalities are merit based inequalities.
- Figure 11.11 illustrates why Piketty is concerned about inheritance. In 1893 Durkheim assumed that liberal democracies would abolish inheritance at death.
- Is inheritance compatible with democratic merit?

Inheritance



Within the cohorts born around 1970-1980, 12-14% of individuals receive in inheritance the equivalent of the lifetime labor income received by the bottom 50% less well paid workers. Sources and series : see piketty.pse.ens.fr/capital21c

Inheritance

- The graph shows that for those born around 1970-1980, 12-15 percent of individuals will inherit the equivalent of what the bottom 50 percent of the population earn in a lifetime.

- Inheritance and rent-based incomes are problematic in market-based democracy. Why? Because in a context of R>G inheritance will predominate over savings.
  - The past devours the future

- When Mario Draghi took over as president of the European Central Bank (ECB) his proposal to resolve the Euro crisis was to "fight against rents" in Europe. What he meant by this was the fight against monopolies.

- For economists the term 'rent' is generally used in a pejorative way and it is assumed to equal the lack of competition, particularly in the non-traded sector.

- But historically 'rent' was a term that was used to describe *any income* that was earned from owning a *capital asset*.

Rent seeking

- For Piketty 'rent and inheritance' are not an imperfection in the market. Rather they are the logical consequence of capital accumulation in a slow growth economy.

- He is highlighting that market *and economic rationality* have nothing to do with *democratic rationality*.

- Democracy and social justice require specific institutions of their own, and these institutions cannot be justified or legitimated in terms of market competition.

- When universal suffrage was instituted in the 19th century (and property-based voting abolished) it ended the *legal domination* of politics by the wealthy.

- But it did not abolish the economic forces capable of producing a society of rentiers.

Global inequality

- Let's move on to examine why this matters at a global level.

- Financial globalization and the inequality of R>G leads to a greater concentration of capital ownership. This automatically contributes to a structural divergence in the ownership of capital, particularly at the very top of the distribution.

- One way to observe this (the impact of the R>G inequality among the *top centile*) is to examine global wealth rankings (ranking of billionaires) and global wealth reports.

- Both of these rankings illustrate that the rate of return on the large fortunes has grown faster than average wealth. See the latest Crédit Suisse report in the notes.

Global wealth

- Global inequality of wealth in the early 2017 is comparable in magnitude to that observed in Europe in 1900-1910.

- The top 0.1 percent own 20 percent of global wealth, the top 1 percent own 50 percent of global wealth and the top 10 percent own between 80-90 percent of wealth.

- If the top 0.1 percent (4.5 million people) enjoy a 6 percent return on their wealth, while average global wealth grows at 2 percent a year, then after 30 years their share of global capital is likely to increase to 60 percent.

- Do multi-billionaires run the world?

Global tax

- Piketty suggests that to avoid the perverse consequences of extreme wealth inequality, democracy requires a global wealth tax.
  - Other mechanisms to redistribute include: inflation, expropriation, nationalization.

- The unequal returns to different types of capital assets (which is heavily dependent upon the initial portfolio size) and the fact that the highest fortunes grow faster than average wealth, amplifies the inequality R>G.

- All large fortunes, whether they are inherited or entrepreneurial in origin, grow at extremely high rates.

- Once a fortune is established, the capital tends to grow according to a dynamic of its own. Money reproduces itself (think Marx on accumulation).

- But more importantly, inherited wealth accounts for *more than half* the total amount of the largest fortunes worldwide.

- Hence the entrepreneurial argument does not justify all inequalities of wealth. Fortunes can grow far beyond any rational justification in terms of social utility. This is Piketty's justification for a progressive annual tax on capital-wealth.

Capital endowments

- Another way to observe the fact that the greater the initial amount of capital, the greater the return, is to examine the capital endowment of ivy league US universities. Table 12.2 reports the findings.
- The average real rate of return was 8.2%. The higher rate of return is the outcome of sophisticated investment strategies.
- Most of these top universities invest in high yield assets such as private equity funds, foreign stocks, derivatives, real estate, natural resources and raw materials.
- They tend not to invest in US government bonds.
- These large returns on capital endowments largely account for the prosperity of the most prestigious US universities.
    - Should the US government tax these institutions higher and redistribute to poorer colleges?

University endowments

Table 12.2. The return on the capital endowments of U.S. universities, 1980-2010	
Average real annual rate of return *(after deduction of inflation and all administrative costs and financial fees)*	Période 1980-2010
All universities (850)	8.2%
incl.: Harvard-Yale-Princeton	10.2%
incl.: Endowments higher than 1 billion $ (60)	8.8%
incl. Endowments between 500 millions and 1 billion $ (66)	7.8%
incl. Endowments between 100 and 500 million $ (226)	7.1%
dont: Endowments less than 100 million $ (498)	6.2%

Between 1980 and 2010, U.S. universities earned an average real return of 8.2% on their capital endowments, and all the more so for higher endowments. All returns reported here are net of inflation (2.4% per year between 1980 and 2010) and of all administrative costs and financial fees.
Sources: see piketty.pse.ens.fr/capital21c.

Sovereign wealth funds

- Now consider the case of sovereign wealth funds and petroleum states. Unlike US universities, we don't know what the investment strategies of these funds are.

- The Norwegian sovereign wealth fund is worth about 700 billion. 60 percent of money earned from Norwegian oil was reinvested into the fund, while 40 percent went to government public services and expenses.

- The financial reports of the next two biggest sovereign wealth funds, *Abu Dhabi Investment Authority* and *Saudi Arabia*, are more opaque.

- Abu Dhabi boasts an average return of 7 percent, whilst Saudi Arabia is approximately 2-3 percent. This is because Saudi Arabia primarily invests in US Treasury bonds. But it is now diversity into Silicon Valley.

- At a global level, sovereign wealth funds hold total investments that equal $5.3 trillion, of which $3.2 trillion belongs to petroleum exporting states. This is the same as the fortune of all the worlds billionaires.

Petro states

- As oil becomes more scare and its price increases, the inequality R>G would imply that the share of global capital going to petro-states could reach 10-20 percent.
- This would not bode well for democracy, as it implies growing economic dependence on oil-producing states.
- The populations of petro states are often tiny, but their global investments are huge.
- Can we imagine a democratic state blocking a sovereign wealth fund from buying up real estate in a country?

China/Asia

- A large portion of the global capital stock is accumulating in Asia, particularly in China.
- In borderless capital-markets, Chinese investment is causing some political tensions. See figure 12.5.
- The big difference between China and the small Arab oil-producing states is that Asian populations are huge.
- Most of the future investment in Asia is likely to be spent on their own domestic populations/infrastructure.
- The total capital stock owned by European households is 70 trillion whereas the sovereign wealth fund in China is less than 3 trillion.
- Rich countries are being taken over by domestic oligarchs not China.

Conclusion

- Wealth in most western democratic countries is private and cannot be mobilized by governments for public purposes.
- For example, the Chinese government recommended to the EU to mobilize private capital to solve the Greek debt crisis.
- But the EU cannot tax or mobilize the capital it generates within it's member-states.
- Small states compete with each other to reduce capital taxation at the very moment when demand for public expenditure is increasing.
- Cautious estimates suggest that unreported financial assets held in tax havens amount to nearly 10 percent of global GDP. Most of this belongs to residents of rich countries.
- To overcome these contradictions Piketty proposes a global tax on capital wealth, particularly within the European Union.

Discussion

- Is Piketty (among many other scholars) right to be concerned that domestic wealthy oligarchs are in a position to distort and pervert democracy?