The Philippine Review of Economics

Rethinking the taxation of compensation income in the Philippines
Stella Quimbo and Xylee Javier

Time-varying conditional Johnson S\(\_\) density in Value-at-Risk methodology
Peter Julian A. Cayton and Dennis S. Mapa

Impact assessment of national and regional policies using the Philippine Regional General Equilibrium Model
Roehlano M. Briones

Does judicial quality matter for firm performance?
Josemaria Gabriel V. Agregado, Jose Maria L. Marella, and Toby C. Monsod

A note on the effects of remittances and overseas migration on some Philippine statistics
Sarah Lynne S. Daway and Geoffrey M. Ducanes

International migration and occupational licensing: an empirical exploration
Marina Fe B. Durano

BOOK REVIEW
Piketty’s Capital in the twenty-first century
Rosa Maria Alonso i Terme

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Book Review

Rosa Maria Alonso i Terme


“All theory is gray, my friend. But forever green is the tree of life.”
– Johann Wolfgang von Goethe, *Faust*

It is no wonder Thomas Piketty’s *Capital in the twenty-first century* (henceforth *Capital*) has received so much of both praise and scrutiny. The book, translated by Arthur Goldhammer from the original French, has five ingredients that make it an instant classic: a particularly relevant but relatively neglected subject matter; an excellent and particularly useful historical data set; a simple and intriguing theory on a disturbing trend; a beautiful and readable style; and a set of provocative policy recommendations to address the critical problems that it raises.

One of the first questions I asked myself as I began to read *Capital* was: why was this book not written before? *Capital* contains most of the answers to my question. The evolution of the distribution of wealth and income—especially wealth—is a critically important issue that has nevertheless been largely ignored in economics. The data gathering and economic history of the kind Piketty so brilliantly and painstakingly deals with have been undervalued and have thus received scant attention by academic economists. The economics profession has been so taken up with the complex economic modelling and questions it could supposedly “prove” through econometrics and randomized control trials that some of the most important economic questions that cannot be adequately addressed with these methodologies have received insufficient attention.

Mainstream economics has largely and increasingly avoided group- and class-analysis and favored politically non-threatening though often rather unenlightening “representative agent models”. The kind of good economic literature in the tradition of historical political economy in which Piketty engages—in the best tradition of Smith, Ricardo, Marx, and Keynes—has almost faded into oblivion in the economics profession. And, last but not least, it was politically convenient to go on pretending that capitalism was self-regulating and inequality good, roughly stable, or both.
Since the onset of the *Indignados* and the Occupy Wall Street movements, the old era of complacency in the sufficiency of the invisible hand and self-regulating markets has come to a crashing end, and revisionist waves are reaching even academic economics. *Capital* may be a first great book of a new era in economics.

The rest of this review is divided into six sections. The first discusses what *Capital* tells us a market economy is not like. The second outlines what the book argues a market economy is like. The third presents and critiques the principles according to which *Capital* argues a market economy ought to be run. The fourth is devoted to the specific policy and institutional recommendations presented by *Capital*, based on the economic history it presents and the normative principles it proposes. The fifth outlines some implications of *Capital* for developing countries. The article concludes with a summary of central considerations.

### 1. What the world is not like

One of the most interesting parts of *Capital* is the part that is devoted to challenging some economic theories that have been presented as standard in textbooks and have gone largely unchallenged in the economics profession for decades. All these theories support a benign if not outright triumphalist view of a market economy: that it is self-regulating; tends towards equilibrium; works on a meritocratic basis; and does a good job of stabilizing income distribution. The corollary is that there is little need for government to intervene in either stabilization or redistribution.

The most important theories challenged by Piketty are the Kuznets Curve, the neo-classical convergence theory, the Cobb-Douglas production function, Pareto’s theory of the stability of inequality, and Modigliani’s life-cycle theory of wealth. Let us address each in turn.

The Kuznets curve, which was for a long time accepted by most economists and simply repeated in textbooks, argued that inequality increased at early stages of development, subsequently declined, and finally stabilized in developed countries. This stable distribution in the relative shares of labor and capital in national income was two-thirds for labor and one-third for capital. As Piketty shows, this is not at all the case. On the contrary, there is no structural process of inequality compression that operates over the long run. Rather, as Piketty (page 274) eloquently shows, “In France and elsewhere, the history of inequality has always been chaotic and political, influenced by convulsive social changes and driven not only by economic factors but by countless social, political, military, and cultural phenomena as well.” There is thus no room for complacency.

*Capital* also challenges the neoclassical theory of convergence across economies, showing instead that there is a process of divergence between the world economy’s leaders and its laggards. Convergence theory has already been challenged by both conditional convergence and endogenous growth theories, both of which contradict the necessity of automatic convergence. Piketty’s main
contribution here consists in highlighting that an important long-term development threatens the convergence of Africa’s gross national income per capita with that of developed countries: the large gap between Africa’s GDP and its gross national income due to the large share of the continent’s assets being owned by outsiders.

Similarly, the stability of the Cobb-Douglas production function, a staple of microeconomic theory, is shown to be an inaccurate historical representation of the evolution of production techniques. Specifically, as Piketty argues (page 218), the stability of the capital-labor split in the Cobb-Douglas production function is alluring because it gives “a fairly peaceful and harmonious view of the social order”. However, the stability of the ratio is simply not historically accurate over long periods of time, nor does it guarantee harmony, since the ratio might be stable but with a very high share for capital. Piketty does not point out, moreover, that production functions are not exogenous and given simply by the state of technology and market prices, but they are also the result of government taxation. It would have been useful for Capital to inquire, for instance, whether there is evidence that the capital-labor split is influenced by the heavy taxation of labor through payroll taxes in Organisation for Economic Co-operation and Development (OECD) countries versus heavy subsidies for capital investment and, possibly, by social and political events.

Capital also highlights the lack of empirical evidence for Pareto’s theory of the stability of income inequality. Gini coefficients can and have changed quite dramatically over the years and even more so the shares of various income deciles and centiles in national income. As Piketty astutely points out, the theory was politically useful and understandably attractive to the Fascist governments under whose aegis it initially gained prominence. Perhaps what is most shocking, given the currency gained by the theory of the stability of income inequality, is that, as the book points out, Pareto actually had no evidence to support his theory.

Piketty also disproves Modigliani’s life-cycle theory of wealth. As he points out (page 384), the theory is politically attractive because it offers a “tranquil, one-dimensional view of social inequality: inequalities of wealth are nothing more than a translation in time of inequalities with respect to work.” Namely, people accumulate income in their middle years and consume it by their death. This is not at all what Piketty finds. So what does Piketty find?

2. What the world is like

What all the theories disproved—or, at the very, least successfully challenged—by Piketty have in common is that they portray a tranquil world of apolitical and rather automatic stability in income inequality in market economies. The data Piketty collects and analyzes presents a thoroughly different world and a very different dynamic.

Let’s begin with Modigliani’s life-cycle theory of wealth. It does not hold: the predicted massive dissaving by the elderly does not take place, no matter
how much life expectancy increases. Very high levels of wealth concentration—with the top decile owning 50-60 percent of all wealth, even within each age cohort—are the crucial missing link explaining why there is instead so much inherited wealth.

Historical data from countries ranging from the United States, France, and the United Kingdom to Japan, Argentina, and Colombia show that there is no “natural” tendency towards income or asset equality or even towards a stability in their levels. On the contrary, the reduction in inequality that took place between 1910 and 1950 was, above all, a reduction in incomes from capital as a result of the two world wars as well as government policy. Similarly, the resurgence of inequality since the onset of the Reagan-Thatcher era has been “man-made” and is the result of government policies, in particular with regards to tax policy and finance.

Piketty (page 24) shows that the dramatic increases in income inequality that we have witnessed since the 1980s have been mostly due to “an unprecedented explosion of very elevated incomes from labor, a veritable separation of the top managers of large firms from the rest of the population”. In addition to this explosion in inequality in labor income, there has also been a rapid increase in inherited wealth, asset inequality, and hence inequality in capital income. Two-thirds of the increase in income inequality is due to rising inequality in labor income, and one-third is due to rising inequality in capital income. The result is a progressive return of a rentier class and the growing precariously of what Piketty calls the post-World War II “patrimonial middle class”. In fact, inequality has reached such high levels—rivaling the peak levels of the belle époque—that they challenge what Capital considers to be the social justice necessary for democratic capitalism.

On the one hand, Piketty finds no evidence of either the equality before the law ushered in by the French Revolution or universal suffrage automatically leading to reduced income inequality. Instead, the reduction witnessed in the 20th century, he convincingly argues, was the result of the progressive taxation of income and inheritance and asset decimation by the two world wars. On the other hand, he does find evidence of a dynamic that is at the core of even “perfectly competitive” market economies: $r > g$. Namely, throughout history, the returns to capital have tended to be greater than the growth rate of the economy, with the gap between the two being larger the lower the average growth rate.

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1 Ray [2014] makes the valuable point, however, that $r > g$ does not strictly suffice to generate a rising share of capital and hence income inequality. Additional factors must be considered, particularly, the differences in the rates of saving between the rich and the poor and the vehicles—e.g., financial wealth or human capital—chosen by the rich to accumulate wealth and to make bequests. The additional factors considered by Ray, however, do hold in reality. Therefore, Piketty’s argument remains empirically valid.
As a result, Piketty argues, the share of capital income in the economy has grown over time and, because capital ownership tends to be highly concentrated, asset and income inequality has increased. Even a relatively small advantage of $r$ over $g$ can, over time, lead to dramatically high increases in asset and income inequality. In this world, inherited wealth dominates over earned wealth or savings, and the entrepreneur turns into a rentier. That is what *Capital* shows happened before World War I and resumed after the neoliberal reforms of the 1980s. The equalizing period of 1910-1950 and the relative stability of 1950-1980 were the war and policy-driven exceptions. Piketty (page 222) concludes that “No self-corrective mechanism exists to prevent a steady increase of the capital/income ratio, $\beta$, together with a steady rise in capital’s share of national income, $\alpha$.”

Capital shows that, at the beginning of the 21st century, Europe is at the forefront of a new “patrimonial capitalism”, with the highest capital share of income, owing to lower economic and especially demographic growth than the United States. As regards income inequality, however, the United States is the “avant-garde”. Since 1980, the share of the top decile in national income exploded from 30-35 percent to 45-50 percent in the 2000s, a dramatic increase by historical standards. Two-thirds of the increase is due to labor incomes, particularly the super-salaries of top managers in large firms, and one-third is due to growing capital income, particularly among the wealthiest 0.1 percent. At the other end of the spectrum, the purchasing power of the minimum wage reached its highest level almost half a century ago in 1969. In the face of this dramatic divergence, Piketty raises an important question which he does not answer, but which others should: whether, or to what extent, politics in the United States has already been hijacked by the top 1 percent.

At the bottom of the income distribution, Piketty argues that rewards are also, to a large extent, the result of social norms, political events, policies, and regulations and not just the result of education and market forces, as “institutions-less” neoclassical economics would have it. He shows, for instance, how the purchasing power of the minimum wage in France increased by 130 percent between 1968 and 1983, while the mean wage increased by only 50 percent. Here, however, many could rightly question whether that increase was sustainable. Piketty does not address this question. More convincingly, he shows how the increase in super-salaries at the top of the income distribution—which was so much higher in the United States than in continental Europe—was utterly uncorrelated with education, marginal productivity or, in any way, “merit”. As he does so, he convincingly questions the link between wages and the value of their marginal product.

Since wealth distribution changes more slowly than income distribution, we are still much ahead of olden times. In France, for example, wealth deconcentration has reduced the top centile’s share in private wealth from 60 percent in 1910-1920
to just over 20 percent now. The result is the emergence in the developed world of what Piketty calls the “patrimonial middle class”. At the global level, however, the distribution of wealth today still appears hugely concentrated and stands at the level of Europe in 1900. The top thousandth apparently owns almost 20 percent of total global wealth, the top centile about 50 percent and the top decile 80-90 percent, while the bottom 50 percent owns less than 5 percent.

Another point made by Piketty (page 462) about the lack of meritocracy in global inequalities is that “petroleum rents might well enable the oil states to buy the rest of the planet (or much of it) and to live on the rents of their accumulated capital”. Even western democracies are not the meritocratic societies many make them out to be. As expected, the highest inter-generational mobility among OECD countries appears in the Nordics and the lowest in the United States, with France, Germany, and the United Kingdom occupying the middle ground. In the United States, extremely high university fees and donations by wealthy parents to top universities, Piketty argues, may help explain why parental income has become an almost perfect predictor of university access. Although recruitment is five times broader at France’s public elite universities than at Harvard, access also benefits the well-to-do because of socio-cultural and other educational advantages.

Just as the great changes in asset inequality of the 20th century in the OECD were brought about by war, the large changes in income inequality were caused by taxation (though *Capital* arguably does not differentiate sufficiently between the two). The progressive taxation of income and inheritance of the post-World War II period—combined with the war-driven demise of the rentier class—created the world of diminished inequality of 1950-1980. These were the 30 Glorious Years when growth was fastest and egalitarianism at its peak: *Les Trente Glorieuses*. Similarly, the Reagan-Thatcher era ushered in an era of globalization characterized by trade- and capital-account liberalization, deregulation, and privatization. These policies catalyzed a race to the bottom in (especially capital) income taxation and a race to the top in taxing the middle classes and the poor through indirect taxation and—something which does not receive sufficient attention in *Capital*—fees on public services.

It is this sharp cutback in top income tax rates which, Piketty argues, caused the dramatic escalation in top salaries. In fact, he finds that the size of the decrease in the top marginal income tax rate between 1980 and the present is closely related to the size of the increase in the top centile’s share of national income over the same period. Moreover, the countries which implemented the largest cuts in top income tax rates are also the countries that experienced the steepest increases in the top earners’ share of national income. Piketty argues that these tax cuts did not lead to any productivity increases that were noticeable at the macro level. Lower tax rates did, however, result in an incentive for top managers to advocate super-salaries for themselves. These individuals, Piketty states, increasingly control politics in their countries, although he provides no evidence to support this argument.
Piketty could have adduced recent analyses of the evolution of the redistributive role of the state to support his case. In particular, he argues that the role of the state in the OECD is not so much redistributive as focused on raising taxes to fund universal access to public services in a way that is “more or less equal for everyone”. This description does not do justice to the very important—though declining—redistributive role of the state in the OECD. As the International Monetary Fund has pointed out, in the OECD, even from the mid-1980s to the mid-1990s, fiscal policy offset 73 percent of the 3-percentage point increase in pre-tax-and-transfer income inequality, while in the next decade this percentage had declined to 53 percent [Coady 2012:12]. The state does thus redistribute, though due to the reduction in the progressivity of tax systems and the curtailment in transfer payments to lower income groups, its redistributive capacity is being increasingly undermined. Capital could also have mentioned encouraging trends, such as those in Latin America where tax systems have become somewhat more redistributive since the 2000s [Mahon 2012:18] and inequality, though still very high, has been declining [Gasparini:2009].

In Piketty’s view, the future looks grim. In a scenario of annual economic growth of 0.5-1 percent and average returns to capital of 5 percent, \( r \) is thus much greater than \( g \), and income and wealth will tend to become increasingly more concentrated. Only policy and institutional change can prevent this perverse economic—and—ultimately—political—dynamic which, if unimpeded, is not only an affront to social justice, but also undermines our democratic system. What Piketty does not argue, but could, is that the weak consumption of the bottom 50 percent in the OECD, driven by the collapse of their market earnings and the increase in their taxation over the past three decades, is behind the structurally weak aggregate demand which has done so much to lengthen the Great Recession begun in 2008.

### 3. What the world should be like—principles

On the face of it, Piketty (page 19) espouses the utilitarian principles of the French Revolution according to which inequality is justified to the extent that it is “socially useful”, Piketty says, “Inequality is not necessarily bad in itself: the key question is to decide whether it is justified, whether there are reasons for it.” His basic argument is that, if higher incomes respond to greater effort and skills and hence higher productivity, then they are justified. This is what he calls the meritocratic argument upon which our modern capitalist democracies are based. He then goes on to show how meritocracy cannot explain the evolution of incomes, especially at the very top. These incomes, he convincingly shows, are due to inheritance and super-salaries: what he rightly calls “luck”.

Two key elements are missing from Piketty’s analysis: one technical and one normative. The largely overlooked technical factor is the fact that returns depend not just on productivity but on the value of marginal product. Hence, the market
price of output is a key determinant of returns to factors which, by definition, is completely outside any “meritocratic” framework: the rising price of oil or the collapsing prices of coffee, cotton, or textiles will necessarily be reflected in returns to both labor and capital involved in their production, regardless of any “merit” on the part of either. So, if income is driven by changes in relative prices, is any resulting inequality acceptable simply because it has a clear market rationale? Piketty does not pose this question.

The normative factor is the absence of an articulated ethical argument about inequality. Piketty’s most often-mentioned criterion for the acceptability of inequality is utility. Utility, however, is an attractive but ultimately unconvincing argument for inequality. And, although Piketty spends most of his time debunking the meritocratic myth, he ends up recognizing that, even if it were true, it would not be sufficient to justify high levels of inequality. *Capital* puts forth two main reasons for questioning a high level of inequality, regardless of the reason behind it. The first is that it would end up undermining meritocracy as inherited wealth ultimately dominates “earned” wealth or savings. The second is that inequality would be incompatible with social justice and democracy.

And here is the crux: social justice. Piketty, at various points, mentions the word (social) justice as a normative standard and openly argues that he is trying to contribute to the debate on how best to achieve a “just social order”. At times, when he speaks about justice, it becomes clear that, at heart, his ethics—like those of much of the Left in western countries—are more Christian than utilitarian. The economist in Piketty sees himself as a utilitarian and the Frenchmen as an heir of the French Revolution, but his ethics are actually Christian. Where do we see this? In his condemnation of high levels of inequality regardless of origin or utility; in his questioning of why capital should earn any returns at all—despite its obvious utility; in his outrage at the gall of those who attempt to justify high levels of wage inequality through meritocratic arguments. When all is said and done, Piketty is really arguing—possibly unbeknownst to him—that there is no “merit”: it is all gift and that, as Pope Francis said in *Evangelii Gaudium*, “Inequality is the root of social evil.”

Piketty proves that inequality is high, that it is rising, and that it does not respond to any meritocratic rationale. But he does not prove that this rising inequality is not, in the words of the core of his open argument, “socially useful”. In this sense, Piketty’s argument is less than complete, compared to that of people who would view inequality, by definition, as a social ill per se. Absent an explicit normative guide, Piketty places excessive faith in majority rule: positive justice. To the question of what are the right institutional and policy responses to the rising tide of income inequality he describes, Piketty’s answer is for them to be democratically
debated and decided upon. This is certainly true but, again, his lack of an absolute ethical standard opens his position to other questions: is any “democratic” majority response acceptable in tackling inequality? Are there no fundamental rights that need to be respected, which are beyond “democratic” debate? Where is the limit of the power of the state and the collective over individual (property) rights? Piketty does not address these critical questions; nor can he.

Utility, the rule of law, meritocracy, the market, and even democratic decision-making, are ultimately insufficient, weak criteria with which to judge inequality. There is doubtless no simple answer to the question of what is a “just” level of inequality for a given society at a given time. But, at least, it is important to focus on the right principles to follow in answering the question. One gets the sense Piketty would have done his cause more justice had he based his normative arguments on a more comprehensive (e.g., an unabashedly Christian) set of social ethics. These would also have provided him with the realization that individual rights place some important limits to his redistributive voluntarism and that the individual and the community need to be enlisted to fight inequality alongside the state.

4. What the world should be like—normative proposals

Piketty’s main normative proposal is the implementation of a progressive tax on individual net worth for the wealthiest and on the market value of all financial and non-financial assets net of debt for others. This tax, Piketty proposes, could go from 0 percent for net assets below 1 million euros to 1 percent for net assets between 1 and 5 million and 2 percent above 5 million. He also offers the possibility of a more steeply progressive tax on the largest fortunes at 5 or 10 percent on assets above 1 billion euros. Finally, he argues that there may be advantages to having a minimal rate on modest-to-average wealth of, say, 0.1 percent below 200,000 euros and 0.5 percent between 200,000 and 1 million. Capital also proposes a highly progressive income tax, with a proposed maximum tax rate for developed countries of 80 percent, which the book argues would be optimal while also openly acknowledging it as confiscatory. This tax is presented as a possible complement to the above-described progressive tax on global wealth.

The rationale for the proposed progressive capital tax is twofold: to rein in inequality; and to foster financial transparency. Ideally, the tax would be implemented globally, but, failing that, it would begin at the European level and progressively expand to the OECD and beyond. International agreements for the automatic sharing of banking data would be aggressively sought out. This increase in financial transparency, Capital rightly argues, would be an important benefit of the tax it advocates. Beyond its economic and transparency advantages, the initiative would also have significant political benefits in the fight against money laundering—arguably implicit in Capital’s transparency argument—and, relatedly, in the global struggle against terrorism.
The importance of avoiding high levels of asset and income inequality cannot be overstated, for utilitarian reasons of protecting competition and private consumption as well as for preserving democracy. Nevertheless, the most important reason for avoiding high levels of inequality—social justice—is something Piketty is somewhat shy to acknowledge, presumably in order to preserve a predominantly utilitarian viewpoint.\(^3\)

For his remedies, Piketty focuses exclusively on government or state-level action. However, his own analysis of the root causes of inequality highlights the need for broader (and deeper), arguably complementary, lines of intervention such as improved values education and social change. Social values, as *Capital* acknowledges, are at the root of the recently rightly decried greed of those arguing for super-salaries and the relatively widespread social belief that earnings are “merited” rather than “gift”. Indeed, social norms are an important—and, in *Capital*, underemphasized—determinant of wages and profits, which help explain what is considered moral and acceptable, at the bottom as well as at the top of the income distribution.

Under a different ethical logic—of “gift” rather than supposed “merit” and of social justice—no one can argue for super-salaries that are coupled with the progressive erosion of the salaries of the middle classes and the working poor or for the implementation of supposedly “efficient” but regressive tax policies. Nor should societies tolerate them. Different individual and communal ethics would also lead to a level of sharing of individual income and wealth that should reduce the role of government in doing so. Without such a change in individual and social perceptions and ethics, the kind of comprehensive and sustained change needed to build a more just society will simply not take place. Having redistribution take place at least partially outside the purview of government has many advantages. It preserves greater degrees of individual and social freedom; and it avoids excessive concentration of power in the hands of government. Hence it allows a better balance between the individual, the community and the state, ultimately fostering improved personal ethics: people would increasingly share voluntarily rather than through state imposition.

Most of Piketty’s proposals affect the top 0.1-10 percent, and he, arguably, does not sufficiently focus on the bottom 90 percent. The book is intentionally devoted to analyzing the growing economic concentration at the very top of the asset and income distribution spectrum and to putting forth proposals to curb it.

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\(^3\) The Bible presents a strong proposal for avoiding high levels of inequality: distributing the land of Israel among the 12 tribes *equally* depending on their relative populations (except for Levites who, as priests, only receive small areas near the cities). To preserve this equality every 50th year, on the jubilee, all land goes back to its original owners, slaves are set free, and debts are forgiven. In other words, physical, human, and financial capital is redistributed to avoid concentration. The New Testament also presents an ethic of austerity, sharing, and redistribution to ensure that no one is needy. Finally, the twin principles of Catholic Social Doctrine are the common good and preference for the poor. This is all aimed at social justice.
Nevertheless, it would have been useful to provide a more integrated picture, including the impact of the trends and policies the book decries on the bottom of the spectrum, as well as on the economy as a whole. As it stands, the focus of Capital is arguably mistaken: it is centered on how to weaken the rich instead of on how to strengthen the poor. The economic argument could also have been broadened at the macro level to show how this economic concentration at the top was worsening the lot of the bottom 40 percent, not just in relative terms, but in absolute terms. Its impact on the public good, through the weakening of aggregate demand, could also have been laid out.

From a policy point of view, Piketty does mention that the nineteenth-century social democrats had already argued that an increase of direct taxation would allow a reduction of the indirect taxation that so heavily falls on workers. He should have gone further. If the lot of the middle and working classes is to improve, much else needs to change. Indirect taxation should certainly fall, especially in Europe. But other measures are equally badly needed. Social security needs to stop being funded from pretty flat taxes on wages, which distort relative prices of capital and labor and discourage employment. Instead, social security needs to begin being funded from progressive taxes on personal and corporate income. Fees on public services should be thoroughly reviewed and, in many cases, slashed or even eliminated. And the value-added tax should be extended to the all-powerful, over-developed, under-regulated, and under-taxed financial sector. Public “bads”, particularly short-term capital flows and pollution, should also be more heavily taxed.

Thus, although Piketty sets social justice and the preservation of capitalism and democracy as key goals of his work, he ends up focusing on a rather narrow—though vitally important—slice of that reality: that of the world’s top income earners. The bottom 90 percent deserve more; although that is concededly another effort.

5. Some implications for the developing world

What are Capital’s implications for the developing world? I will lay out two. Perhaps the most important implication is the fundamental fact that capitalism is not self-regulating and that, barring large shocks or appropriate government policies, it tends towards high levels of asset and income concentration. This should be no news to the developing world. There is no obvious trend toward greater equality, as Kuznets may have thought. On the contrary, consistent with Capital’s central message, there has been an increase in income inequality in most of Asia since the 1980s. Meanwhile, in Latin America, inequality had only begun to modestly decline in the 2000s due to the implementation of more redistributive government policies in favor of the poorest. Most of the fiscal effort, however, has been borne by the middle classes, and there is no evidence of thinning at the top. The developing world is also a privileged witness to Piketty’s arguments that
high levels of income and, even more, asset inequality undermine both economic competition and socio-political democracy. The Philippines is a case in point.

So what should the developing world do? Two main lines of action emerge from Piketty’s analysis. First, systematic data collection and economic historical analysis are urgently needed. The kind of economic history written by Piketty would be of enormous use in any context, perhaps especially in the developing world. The end of secrecy and the beginning of a new era of transparency in the global tax administration and financial sectors is urgently needed. This is so for reasons of transparency, good governance, and an equitable funding of the public goods and services that are critical to fostering inclusive growth and poverty reduction, especially in the developing world. This data would also allow the elaboration of economic histories on the evolution of income and asset inequality in the developing world and would form the databases needed for an effective and equitable tax policy and administration. *Capital* should be an inspiration to focus economic analysis on the big issues that matter most for development and for social justice in the developing world.

Second, the developing world urgently needs to rethink tax policy. Just as the French Revolution and universal suffrage did not automatically bring greater equality to the developed world, democracy *per se* will not make the developing world more equal. Therefore, I would argue that the developing world needs a progressive tax on capital and inheritance even more than the developed world. This is because of the enormously high level of concentration of wealth in the developing world and its economic and political implications. But it is also due to the pressing need to reduce the tax burden on the poor and the middle classes. Many middle-income countries in Latin America and Asia have “come of age” in the era of regressive taxation. This has led to the establishment of regressive tax systems, in which the burden falls heavily on the shoulders of the middle and bottom of the income distribution.4

Recent studies on fiscal mobility (e.g. Lustig [2012]) show that the value-added tax—typically with single and/or high rates and few or no exemptions or 0-ratings for necessities—pushes large numbers of people below the poverty line in Latin America despite the existence of conditional cash transfers, which only protect the poorest. Similarly, education and health fees are strongly regressive and prevent the access of the poor to essential social services and the opportunity for upward mobility. Wages are taxed through payroll taxes, thus increasing informality, distorting production techniques, reducing labor demand and reducing the progressivity of the tax system. At the same time, capital income is taxed at rates which are about half the level of those on labor income, while the rates on top earnings keep falling. Tax exemptions continually proliferate, and

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4 As a measure of this, bishops of Latin America openly stated in their 2007 declaration of Aparecida that tax systems need to be progressive in order to be socially just.
the vast financial sector is exempt from value-added tax. The wealthiest of the wealthy hide their earnings—even illegitimate earnings—in fiscal havens.

If the average citizen is to recover his or her confidence in the state, the public sector needs sufficient and equitable financing, and this requires a thorough tax policy reform in developing as well as developed countries. This tax reform should have as one of its key pillars a progressive global tax on all income sources and could usefully be complemented, as Piketty proposes, with a global tax on capital and inheritance, with rates to be determined on a country-by-country basis. As Capital well says, these new policies will require international agreements on financial transparency.

6. Concluding thoughts

The days of complacent belief in the systemic stability or progressive decline of inequality in our capitalist democracies are over. The question should now be what each country can do, at each point in time, to prevent inequality from getting out of hand by curbing concentration at the top while fostering good incomes and living conditions for the rest. One need not agree with all of Piketty’s proposals, but he has certainly opened our eyes to some disturbing realities and raised critically important questions which we only ignore at our peril.

I will finish by proposing that we should not have waited this long to question the regressive and unjust policies of the post-1970s era. The delay in reaction by academe, policy-makers, and the public at large has been due to a set of factors which we should be wary of. These factors include insufficient data and analysis of inequality trends; the hegemonic “meritocratic” thinking according to which people deserve their market earnings; the misguided belief that inequality is justified if it is “socially useful”; and the positively and normatively wrongheaded willingness to trade off equity for efficiency. If we had not been willing to undertake this unethical trade-off to start with, we would not have had to wait four decades to find out that inequity is not, after all, either merited or efficient.

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References

