real-world economics review, issue no. 69
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Piketty's policy proposals: how to effectively redistribute income

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There has been growing wealth and income inequality in the US, and people don't like it. The economics profession has provided little guidance in explaining why this is occurring, and what can be done about it; income distribution is presented as being determined by abstract "marginal productivity" market forces that are largely beyond the control of government policy.

In a recent "Economics of Attitude" column (Colander, 2014) I suggested that an important reason for the success of Piketty's *Capital* (2014) was that it provided an entré into wealth and income inequality questions that people believe should be discussed. Unfortunately, Piketty's book is not a good entré into them. It is neither revolutionary nor path breaking; it is primarily an empirical contribution to the income distribution literature combined with some rough notes on how the data relate to economic theory and policy.[1] My argument in my previous piece was that presenting Piketty's book as an entré into the income inequality debate does a disservice to readers who want a serious consideration of how to advance a pro-equality income distribution agenda. In this article I present an alternative approach.

The reason Piketty's policy discussion is not a good entré into income distribution questions is that it is neither novel nor deep. Variations of his proposed policies -- an increase in progressivity to the income tax, and a worldwide, or at least region wide, progressive wealth tax have long been on the modern liberal agenda. Politically, as Piketty recognizes, they have been difficult (essentially impossible) to implement. Piketty does not seriously explore why that modern liberal agenda has not achieved the desired ends, or how a pro-equality distribution agenda can be made workable in the future. So, after finishing the book, the reader is left with a sense that preventing the movement toward more inequality is almost hopeless. Politically, in the US at least, Piketty's policies are nonstarters, and his policy discussion will most likely polarize views, not promote a useful dialog.

Ricardo's and Mill's theories of income distribution

The problem with Piketty's discussion is that it is based in a Ricardian, not a Millian framework in thinking about the income distribution problem. Let me explain. David Ricardo framed the income distribution question as a technical production issue. In Ricardo's model technology determines marginal products and marginal products determine income distribution.

Technology => marginal productivities =>Pretax Income distribution =>Post tax Income distribution

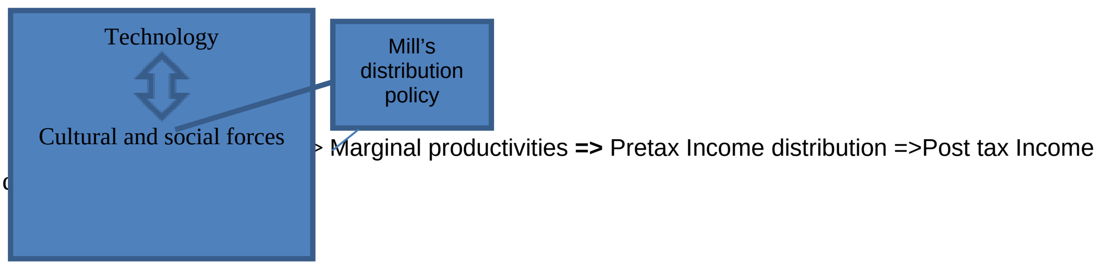
[1] The over hyping of the book is not due to Piketty; he presents his work with appropriate modesty; the problem is with the reviewers who present the book as something that it is not.

This means the policy to affect income distribution is a redistribution policy; it accepts marginal productivities, but is designed to modify the resulting pre-tax income distribution through some type of equality preferring tax policy such as a progressive income or wealth tax. Most liberal economists' discussions about income distribution have followed Ricardo, and that is the way Piketty presents the issue. The pro-equality policy agenda is seen as a *re*distributive tax policy, and conceived of as operating after marginal productivities have been determined as in the schematic above.

Because of its title, *Capital*, many commentators and reviewers have seen Piketty book as developing a Marxian approach. But that is wrong; Piketty is no Marxist, and his analysis and policy suggestions are not Marxian. Specifically, while Marx used Ricardo's analysis, he did not see a liberal policy agenda of progressive taxation as a viable one. He argued that liberal attempts to provide for a more equal income distribution with tax policy would fail because of an inherent contradiction. That contradiction was that the power structure that would be relied upon to change the distribution of wealth and income is the same power structure that reflects the existing income and wealth distribution. In Ricardo's analysis, what technology has created is almost impossible to change. Marx argued that the only solution to this contradiction was a revolution that changed the power structure.

The classical liberal alternative to Marx

The classical liberal alternative to Marx can be found John Stuart Mill's blending of economic theory with humanitarian insights and values. Mill split from Ricardo and argued that technological forces alone do not determine the distribution of wealth and income; in Mill's theory, income and wealth distribution are co-determined by technology, cultural, and social forces that become entwined with the legal and institutional structure of the economy. In Mill's model of the economy, marginal productivities do not follow from technology. Instead they follow from a much more complex process. For Mill the relationships are:



In Mill's approach marginal productivities do not exist independently of cultural and social forces that create the laws. Thus, a rich person's marginal productivity is determined by the legal and property rights structure combined with technology, not by technology alone. For example, a rich author's marginal productivity is high because of the existing institutional arrangements on copyrights, and social conventions on what is proper compensation, not because he is inherently productive. That same person could have a much lower marginal productivity in an alternative institutional arrangement. Similarly with internet companies.

Mill does not take marginal productivities, and hence income and wealth distribution, as given. They are the result of policy decisions. Different property rights embedded in institutions and culture lead to different income distributions. Mill's theory provides a different approach to achieving a pro-equality income distribution agenda in which policy is designed to create a more equal distribution, thereby requiring far less redistribution to achieve the same pro-equality result. As in the schematic above, policy can be designed to make marginal productivities much more equal, by implementing policy before marginal productivities are determined, thereby avoiding the need for redistributive taxes.

Mill's belief that marginal productivities could be changed played an important role for Mill in rejecting Marx's critique of liberal policy, and his calls for revolution. Mill writes:

> The laws of property have never yet conformed to the principles on which the justification of private property rests. They have made property of things which never ought to be property, and absolute property where only a qualified property ought to exist. They have not held the balance fairly between human beings, but have heaped impediments upon some, to give advantage to others; they have purposely fostered inequalities, and prevented all from starting fair in the race. That all should indeed start on perfectly equal terms is inconsistent with any law of private property: but if as much pains as has been taken to aggravate the inequality of chances arising from the natural working of the principle, had been taken to temper that inequality by every means not subversive of the principle itself; if the tendency of legislation had been to favour the diffusion, instead of the concentration of wealth—to encourage the subdivision of the large masses, instead of striving to keep them together; the principle of individual property would have been found to have no necessary connexion with the physical and social evils which almost all Socialist writers assume to be inseparable from it. (Mill, 1848, p. 209)

Mill's approach to thinking about marginal productivity and distribution theory and policy was followed by Alfred Marshall, who, in his *Principles of Economics* specifically noted that marginal productivity theory is not a complete theory of income distribution; but is simply a part of the story. The problem for Marshall was that developing a full theory was far beyond the analytic technology of the day, so he, like Mill, emphasized that it was necessary to go beyond economic theory in thinking about economic policy and distribution theory. For Mill and Marshall, economic theory only provided half-truths and the connection between theory and policy had to go far beyond any existing models or theory. Mill's policy thinking includes thinking about how policy might influence norms, tastes, and institutional arrangements to achieve the desired policy goals. That Marshallian/Millian approach to the use of economic models in thinking about policy is quite different than Ricardo's and Piketty's.

Economists in the 1930s did not follow the Mill/Marshall "half-truths" path in which economic policy followed not from formal economic models, but from reasoned judgment that used those models but integrated their results with a broader, more expansive world view. Instead, they structured their policy thinking around narrow economic models, and as they did, the Ricardian approach to income distribution became the way income distribution policy was framed. That made taxation the primary policy vehicle they explored to achieve a pro-equality income and wealth distribution goal. It is this approach that Piketty follows in his policy discussion, and it is that approach that has not worked in the past. He correctly argues that anti-equality forces are currently winning. But he does not, as Mill did, address the question of how those policies can avoid the Marxian critique that, given the system, real change is essentially impossible because the power structure to change the income distribution is the power structure than reflects the existing distribution of income.

An alternative policy approach

Following a Millian approach to policy, there is another set of income equality policies that, in my view, offer the best hope of achieving a pro-equality income distribution goal. As opposed to trying to *change the income distribution, given marginal productivities*, in the Millian approach you use policies that change tastes, norms, and institutionally determined marginal productivities. Using this policy one structures the property rights so as to make the marginal productivities of individuals more equal, thereby making the distribution of income more equal without resorting to redistributive taxation. Here are some examples:[2]

- Property rights could have had more limited duration. Patent and copyright laws could have been designed for much shorter periods, so that the benefits of the work are passed to the broader public.
  - Intellectual property rights could have been significantly limited.
  - Institutions favoring open source software and material could have been institutionally encouraged.
  - Instead of perpetuity property rights in land, 100 year leases could have been given, with the land reverting to social wealth, and re-leased, when the lease comes due.

- Competition could have been more strongly supported by limiting government supported monopolies.
  - Regulatory structures of institutions could have allowed for narrower specialists, so that the rents created are spread more widely and more competition is created.
  - Open certification not requiring specific high-priced formal training programs, but rather "open-to anyone" certification exams.
  - At risk students could be provided with a "bottom up" educational option, in which, they receive the money that would have gone into educating them if they learn the material on their own.

- Individual's social, not materialistic, proclivities are encouraged.
  - The society could advocate and support a stronger tradition of social responsibility of the rich, so that achieving social goals becomes a favored luxury good of the rich. Andrew Carnegie's *Gospel of Wealth* could have been built into the fabric of society.
  - Institutions could have been designed to encourage social benefit, rather than private benefit, entrepreneurship.
  - Materialism embedded in the GDP goals could be countered by replacing GDP with other measures of social success such as Sen's Capabilities Index.

Why Mill's distribution policy agenda will work better than Piketty's redistribution policy agenda

A likely response to these ideas is that they are as "pie-in-the sky" as Piketty's. I agree they are pie-in the sky, but they are much more likely to be effective than Piketty's because they avoid being undermined by the "take away principle." That principle has long been known by parents, but somehow has not made its way into economist's policy precepts. The principle is:

[2] Further examples and expansion of these examples are given in Colander and Kupers (2014).

It is much harder to take something away from someone than not give it in the first place.

There are many expressions of this principle in the popular culture: “Don’t be an Indian giver”; “Possession is 9/10s of the law.” Or, as Mohamed put it: “The person who takes back a gift is like a dog which vomits, then eats what it vomited.” Recently this principle has been given scientific backing by behavior economists’ discovery of loss aversion. [3]

The take away principle has significant implications for any pro-equality distribution agenda. It explains why it is so hard to change the income distribution through progressive taxation, even when, in principle, a majority of the population favors more equality. A progressive taxation redistribution policy undermines the pro-equality sensibility of people because it frames the issue as if you are taking something away from people. People want equality, but they don’t want anything taken away from them to achieve it.

Piketty’s, and almost all of modern economist’s discussions of a pro-equality policy agenda have failed to take this takeaway principle into account. They present that pro-equality distribution agenda as involving tax policy that is designed to *re*distribute income. That frames the policy discussion around the idea that people have earned something and that they possess it. In that frame any government pro-equality policy is designed to take it away. That framing, as Marx recognized, condemns the policy to failure because of the take-away principle. The Millian policy approach that I am advocating does not try to *re*distribute income fairly. Instead it focuses on creating laws, property rights and an opportunity space that distribute income more fairly.

Some final comments

Mill did not develop his pro-equality policy agenda in part because he felt that, with the right policies, inequality of income would not be a serious problem for future society. He believed that an affluent society would not be worried about income inequality; the concern about income and wealth distribution would fade away as society became richer and norms changed to make accumulation of wealth of far less concern.

His vision of future society was one “in which, while no one is poor, no one desires to be richer, nor has any reason to fear being thrust back by the efforts of others to push themselves forward.” (Mill 1848) Given existing norms and culture, this seems a utopian dream, but those norms have been created by existing policies, not because they are inherent in human society.

Such a pro-equality outcome is possible to achieve by policy only if we stop thinking of economic policy narrowly, and start thinking about it in a much broader context. Our society is an affluent materialistic society, where materialistic goals are encouraged by policy. Given existing institutions, tastes, and culture, there is little hope to achieve a pro-equality redistribution agenda. But if we focus policy on a pro-equality distribution policy agenda – a policy that includes a norms policy, a cultural policy, and a pro-equality property rights policy that is designed to achieve as much equality as possible, and to rid ourselves of our society’s

[3] To make this general principle applicable for policy, it needs to be quantified. So here is my quantification, which is based on the ratio of time my children would cry and scream when I took something away from them (t), relative to the time they would cry and scream when I refused to give it to them in the first place (r): t/r=7.5, with a standard deviation of 3. Based on this estimate, it is 7.5 times more difficult to achieve an income equality goal by redistribution policy than it is by distribution policy.

current materialistic fetish, movement toward equality can be achieved in a way that would be supported by a large majority of the population on both the right and the left. It won't be easy to implement, but it will be much easier to implement than the Piketty policy proposals.

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SUGGESTED CITATION:
David Colander, "Piketty's policy proposals: how to effectively ~~re~~distribute income", *real-world economics review*, issue no. 69, 7 Oct 2014, pp.161-166, http://www.paecon.net/PAEReview/issue69/Colander69.pdf