Your on the
Street Reporter

Uyless Black

Epilogue XI to *The Nearly Perfect Storm*

Capitalism and Inequality: Part One: Comments on Thomas Piketty's *Capital in the Twenty-First Century*

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Preface

My intent in writing *The Nearly Perfect Storm: An American Financial and Social Failure,* and these epilogues is to spark your ire. I am not one to compose inflammatory compositions. I began my studies of the 2008 financial crisis with a neutral view of the subject, perhaps even skewed toward the financial world (specifically, the investment banking industry), reflecting my former employment at the Federal Reserve.

No longer. The more I learned about the institutions and individuals who were involved in the meltdown, the more disgusted I became. I wish this turn of events had not come about. I wish I had found the Great Recession occurred because of a downturn in a conventional business cycle. It did not.

Do not expect this series to be light-hearted, although I will attempt some gallows humor to lighten the load.

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Epilogue XI for *The Nearly Perfect Storm*
Capitalism and Inequality: Part One: Comments on
Thomas Piketty's *Capital in the Twenty-First Century,*

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Hello from Your on the Street Reporter. These epilogues are written on occasion as a follow up to *The Nearly Perfect Storm: An American Financial and Social Failure*.[1]

The quotes from *The Nearly Perfect Storm* can be found Appendix One and Appendix two in this article.

Epilogue XI introduces *Capital in the Twenty-First Century*, by Thomas Piketty, a professor at the Paris School of Economics. This article has "Part One" in its title. Because of the impact and surrounding controversy of *Capital* (my shorthand notation for his work), this series will present more than one piece about the book.

The thesis of Piketty is that the practice of capitalism, by its very nature, leads to an increasing concentration of wealth held by a *very small* minority of people, leading to economic and social instability.

He proposes a solution: progressive taxes---not on income, the conventional approach---but on capital. If a person makes millions of dollars a year, the person keeps it. Instead, taxes are accessed on the person's assets, such as property, bonds, and stock. I am not certain how this would be done, as income in the form of money becomes capital. But Piketty explains this money is not capital, but capital income.[2] Nonetheless, the idea is unto itself unconventional. Piketty claims:

> The right solution is a progressive annual tax on capital. This will make it possible to avoid an endless [unequal] spiral while preserving competition. …This would contain the unlimited growth of global inequality of wealth, which is currently increasing at a rate that cannot be sustained in the long run, and that ought to worry even the most fervent champions of a self-regulated market. Historical experience shows, moreover, that such immense inequalities of wealth have little to do with the entrepreneurial spirit and are of no use in promoting growth. [3]

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[1] Available as hard copy and ebooks at Amazon (Kindle), Barnes & Noble (Nook), and other book stores.
[2] Thomas Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: Belknap Press of Harvard University Press, 2014), 572. Without delving too much into the details of his economic theory: If the rate of return on capital (r) is greater than the rate of economic growth (g) for a prolonged time, the concentration of wealth will continue to accrue to these lucky few. He is not in favor of taxing income, because he claims it would discourage innovation and entrepreneurship. From my personal experience as a small business owner, I never considered taxes during my plans to form a new company or create a new product. But then, I was not versed in accounting and finances.
[3] Ibid.

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True to the adage, "Where one stand, depends on where one sits," the free-market advocates have taken him and his data to task. As one example**:**

> There's more criticism over Thomas Piketty's best-selling *Capital in the Twenty-First Century*, this time from Daron Acemoglu and James Robinson, two well-known economics professors. …Their claim? Piketty…made similar mistakes to Karl Marx in his search for a grand theory to explain inequality and predict the future.
>
> This approach, they contend, takes a materialist approach to capitalism, in which the ownership of the means of production (in this case, capital) determines how an economy develops. Institutions and society play a scant role.
>
> "Despite his erudition, ambition and creativity, Marx was ultimately led astray because of his disregard for institutions and politics," they write. "The same is true of Piketty."[4]

I have read about 250 to 300 pages of Piketty's 685 page book. I concentrated on the material about America and Sweden, skipping over information dealing with Britain and France. I thought he brought in discussions about institutions and politics, perhaps not as detailed as these two economists might wish.

Regarding their statements about institutions and politics, for this article, and echoing my themes in *The Nearly Perfect Storm*, America's political system has been outfoxed and waylaid by two institutions I broadly identify as Wall Street and Big Business. As written several times in my book, I came to this view reluctantly and with difficulty, because I benefited greatly from America's overall pro-business milieu.

Nonetheless, America's so-called rugged capitalism---which I call synthetic capitalism---fits the profile of many of Piketty's observations. I have reproduced facts from my book and Episode IV of this series to support my assertion. [5]

Piketty is also taken to task because of these assertions:

> Furthermore, the higher one climbs in the income hierarchy, the more the spectacular the rises [of income inequality]. …and this visibility naturally raises the question of what justifies such high levels of compensation.[6]
>
> The central fact is that in all the wealthy countries, including continental Europe and Japan, the top thousandth [of the population] enjoyed

[4] Piketty, *Capital.* 572.
[5] Ibid., Appendix One, 312, 313, and 205-206, sources and footnotes.
[6] Ibid., 319.

> spectacular increases in purchasing power in 1990-2010, while the average person's purchasing power stagnated.[7]

The free-market proponents claim these disparities come about because of the differences in merit and competency: the muddling masses are not as talented as those in the upper echelons of society. In contrast, the regulated-market proponents say the system is rigged. "Merit" is based on the luck of the DNA draw: which mother a baby comes from and so forth.

It is both. And after doing the research for *The Nearly Perfect Strom*; after living for over seven decades; after observing my brothers and sisters-in-law struggle in their lives to make a living, I side with the modest idea that the baby born to a couple with degrees from Harvard and Radcliffe has a bit of an edge over the baby born to a couple with no degrees from anywhere.

To address Piketty's claims on this subject, I will use Episode IV of this series again. Take a look at the statistics in Appendix Two. What do you think? Were these people paid in accordance with their performance? Were their pay envelopes a bit too bulky? Like that baby born to the couple (make that the single mother, as the dude has gone elsewhere to procreate), are they on the dole?

If I had been a stockholder in these companies, I would be looking for their boards of directors with a rope in my hand…figuratively speaking of course. (Don't call the SWAT teams.)

Say what we will about these specific claims in *Capital*, and the controversial data on which they are based, his thoughts merit consideration. The book is a worthy contribution to this important subject.

[7] Ibid., 320.

Appendix One

Quotes from *The Nearly Perfect Storm* about the issue.

Page 312:
• 1980: The wealthiest one percent of Americans took ten percent of national income.
• 2007: The wealthiest ten percent of Americans took fifty percent of national income.

Page 313:
The average increase in real income for the bottom 99 percent of American families between 1973 and 2006 was 8.5 percent. The richest one percent saw a 190 percent increase in income.

Pages 205-206:

Pay Per Financial Sector Worker as a Percentage of Average U.S. Compensation

Year	Financial Sector Share
1948	103%
1958	100%
1968	101%
1978	100%
1988	123%
1998	143%
2006	178%
2007	181%

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Appendix Two

Here is a table taken from page 157 of *The Nearly Perfect Storm*, with a few of my comments.

Below is a survey of the compensation seven top executives received in relation to the performance of the firms they headed. CEO compensation is shown in millions (M); firm performance is shown in billions (B).[8]

Company	CEO	Compensation	Performance of Firm
AIG (1)	Martin Sullivan	1995-2007: $ 49.5M	2008: Lost $37.6B
Bear Sterns(2)	James Cayne	1998-2007: $290.4M	2007: Leveraged 35.5 to 1
Citigroup	4 previous CEOs	1998-2007: $483.1M	2007: Lost $18.7B
C'trywide (3)	Angelo Mozilo	1998-2007: $246.7M	2007/2008: Lost $3.9B
Lehman (4)	Richard Fuld	1998-2007: $255.9M	2008 (1st half): Lost $2.3B
Merrill Lynch	E. Stanley O'Neal	1999-2007: $157.7M	2007 (2nd half): Lost $35.8B
WaMu(5)	Kerry Killinger	1998-2007: $123.1M	2007 (4th qtr): Lost $8.0B

(1): Now a ward of Uncle Sam.
(2): Now a ward of JPMorgan.
(3): Now a ward of Bank of America.
(4): Now a ward of nobody.
(5): Seized by Uncle Sam; parceled out to JPMorgan and bankruptcy courts.

They were not alone. In 2006 Goldman Sachs set aside $542,000 per employee in a bonus pool, over fifteen times the annual income of an average American. These figures represent past practices. I have not seen data of current practices. If you come across some, please send to me.

[8] Gretchen Morgenson, "Give Me Back My Paycheck," *The New York Times*, February 22, 2009, 7.

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