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After Piketty?[1]

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Abstract

In this paper, I take *Capital in the Twenty-First Century* by Thomas Piketty as the starting point for a set of twelve policy proposals that could bring about a genuine shift in the distribution of income towards less inequality. In designing the set of proposals, I draw on the experience of reducing inequality in postwar Europe and on an analysis as to how the economic circumstances are now different in the twenty-first century, highlighting the role of technical change and the rise in capital emphasized by Piketty. The proposed measures span many fields of policy, and are not confined to fiscal redistribution, encompassing science policy, competition policy, public employment, a guaranteed return on small savings, a capital endowment, as well as more progressive taxation of income and wealth transfers, and a participation income. Inequality is embedded in our social structure, and the search for a significant reduction requires us to examine all aspects of our society. I focus on inequality within countries, and what can be achieved by national governments, with the UK specifically in mind. The primary audience is those concerned with policy-making in national governments, but implementation should not be seen purely in these terms. There are different levels of government, and certain proposals, particularly those concerned with taxation, may only be feasible if pursued by a group of countries in collaboration. The last of the twelve proposals – for a basic income for children – is specifically directed at the European Union. Finally, actions by individuals as consumers, as workers, or as employers, can all contribute to reducing inequality.

Keywords: Inequality; poverty; wealth; employment; technical change; taxation

1. What next?

The media storm surrounding the publication of Thomas Piketty's remarkable *Capital in the Twenty-First Century* (2014) has ensured that inequality is now in the forefront of public debate. But what next? For those of us concerned about current levels of inequality, the pressing question is: what is to be done (to

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recall Lenin rather than Marx)? How can heightened public awareness be translated into policies that actually reduce inequality?

In this paper, I take *Capital in the Twenty-First Century* (or *Capital*, for short) as the starting point for a set of twelve policy proposals that could bring about a genuine shift in the distribution of income towards less inequality.[2] I focus on inequality within countries, and what can be achieved by national governments, with the UK specifically in mind. (The important issues of global inequality, and Piketty's proposals for a global tax on capital, have to be left for another occasion.) In putting forward proposals, I am naturally concerned with how they could be brought about. The primary audience is one concerned with policy-making in national governments, but implementation should not be seen purely in these terms. There are different levels of government, and a welcome development has been the engagement of local governments with issues of poverty and inequality. Certain proposals, particularly those concerned with taxation, may only be feasible if pursued by a group of countries in collaboration. The last of the twelve proposals – for a basic income – is specifically directed at the European Union. Finally, a consideration often down-played in economics is that inequality results from decisions taken by individual economic actors. Actions by individuals as consumers, as workers, or as employers, can contribute to reducing inequality.

The twelve proposals range from the modest to the radical, and will doubtless meet different reactions. They span many fields of policy, and are not confined to fiscal redistribution – important though this is. Only half are concerned with 'taxing and spending'. It should be stressed that the reduction of inequality is as much a matter for the Minister responsible for science as for the Minister responsible for social protection; it is as much a matter for competition policy as for labour market reform. Inequality is embedded in our social structure, and the search for a significant reduction requires us to examine all aspects of our society.

2. Clarifying the objectives

First we need to clarify the objectives. Here I am concerned with inequality in economic resources, but this can be interpreted in different ways. Many people think in terms of achieving equality of opportunity. It is however important to distinguish between competitive and non-competitive equality of opportunity. The latter ensures that all have an equal chance to fulfill their – independent – life projects. To draw an athletic analogy, all can have the opportunity to acquire swimming certificates. In contrast, competitive equality of opportunity means only that we all have an equal chance to take place in a race – a swimming competition – where there are unequal prizes. In this, more typical, case, there are ex post unequal rewards, and it is here that inequality of outcome enters the picture. The concern that I want to address in this paper is that, even if there were competitive equality of opportunity, the reward structure is too unequal and that *ex post* inequality needs to be reduced.

Stating the objective in terms of *reducing* inequality is important, since there may be agreement on the desired direction of movement, but not on the ultimate destination. People may well disagree as to how much inequality is ultimately acceptable. As Piketty notes at the outset (2014: 1), quoting the *Declaration of the Rights of Man and the Citizen,* social distinctions may be justifiable on the grounds of common utility. But I take the widespread popular reaction to *Capital* as an index that many people agree that the present level of inequality is intolerable, and not justified by the common good.

Reducing inequality means preventing extreme inequality at the top of the income scale. This is the primary focus of Piketty's book and has received most attention in the ensuing media coverage. But as important is what has happened to the bottom 99 per cent. Why, for instance, have we failed to abolish poverty in rich countries?[3] Here, the European Union has set an ambitious goal in its Europe 2020 Agenda of reducing the number of its citizens living at risk of poverty or social exclusion. But, with the decade nearly half past, little progress has been made. Yet this is a goal on which even the critics of *Capital* are agreed: 'the problem is the persistence of poverty' (Feldstein 2014).

Moreover, it is not only the vertical dimension of inequality – between rich and poor – that should concern us. There are important issues of horizontal inequality, notably the unequal distribution between men and women, and inequality between generations. Gender is missing from the analysis in *Capital,* which charts the share of the top 1 per cent in France, the USA and other countries, but does not ask how many of them are women? In fact, in the UK, women account for only around 1 in 6, or far short of parity (Atkinson, Casarico and Voitchovsky 2014). Inequality within generations may be exacerbated by between generation inequality. One of Piketty's messages is that the overall growth rate of per capita output in the twenty-first century is likely to be below that experienced in the second half of the twentieth century (see *Capital*, Figure 2.4). In this respect, it is a pity that he did not amplify his – excellent – exposition of national accounts to treat the relationship between national income and household income. There are a number of reasons why the disposable income of households may be expected to grow less than national output. Increasing fractions of output have to be allocated to meeting the challenges of climate change and to funding infrastructure, so that a smaller proportion will be available for households themselves to spend. It was indeed already the case that over the pre-crisis period 1999 to 2008 household disposable income in the UK rose less than Gross Domestic Product (Atkinson 2013: Figure 1). The issue of inter-generational justice cannot therefore be dismissed simply on the grounds that future generations are going to be better off, and this should be one of the yardsticks by which we judge the current distribution of income.

3. Learning from the past

One of the principal messages of *Capital* is that the recent rise in inequality has to be seen in historical context. The book makes use of the World Top Incomes Database (WTID), which contains evidence about top income shares going back to the nineteenth century. In the *Chartbook of Economic Inequality* that I have prepared together with Salvatore Morelli (Atkinson and Morelli 2014), we draw equally on the top income shares from WTID, but also present evidence about overall inequality (the Gini coefficient) and about the proportion living in poverty.

Looking at the historical evidence is a valuable antidote against undue pessimism. From the evidence on overall inequality, going back to 1945 or earlier, we can see that there have been distinct periods when there has been a salient reduction in income inequality. Not all of these periods are informative. Inequality fell in Portugal after the Carnation Revolution. Inequality fell in India in the decade after independence. But there have been significant episodes of falling inequality and poverty from which I believe one can learn, notably the decline in overall inequality that took place from 1945 to 1979 in many European countries. In the postwar period, the Gini coefficient fell by 4 percentage points or more in Denmark, France, Germany, Italy, Netherlands, Norway, Sweden and the UK. This decline in inequality in postwar Europe was not dissimilar to (and in some cases larger than) the rise in the Gini coefficient in the USA in the 1980s and 1990s that generated so much attention.

What caused this decline in inequality in postwar Europe? It was, of course, a period of rapid growth (*Capital* 2014: Figure 2.3), but growth in itself does not necessarily imply falling inequality. What were the underlying mechanisms? First of all, this was a period of expanding welfare state, financed by progressive income taxation. The regular official studies in the UK of the impact of taxes and benefits (for example, ONS 2011) demonstrate the contribution of cash benefits to reducing the inequality of disposable income. The first answer is therefore redistribution, particularly social protection. As it is put by Marx, Nolan and Olivera,

> no advanced economy achieved a low level of inequality and/or relative income poverty with a low level of social spending, regardless of how well that country performed on other dimensions that matter for poverty, notably employment. (2014: p. 18 of discussion paper version)

The postwar reduction in inequality was not, however, only achieved by redistribution. The second contribution was made by capital incomes becoming less unequally shared. There were, as explained in *Capital,* two components: the share of capital in national income was falling and the distribution of capital income among persons was becoming less unequal. In recent decades, the factor shares in national income have been discussed in terms of a fall in the labour share, but we should not lose sight of the fact that in the immediate postwar decades, the share of labour was rising. In his 1969 study, Heidensohn found that over the period 1948 to 1963 there had been a 'rising trend of labour's relative share in a large number of countries' (1969: 304). The share of profits (and rent) was falling in the postwar period, and these incomes were themselves becoming less unequally distributed. Roine and Waldenström (2014) have assembled long-run series on the personal distribution of wealth, and these show large reductions in top shares. Between 1945 and the late 1970s, the share of the top 1 per cent in total personal wealth fell from 39 per cent to 26 per cent in Denmark, from 33 per cent to 22 per cent in France, from 38 per cent to 17 per cent in Sweden, and by some 20 percentage points in the UK. In the UK, one major explanation for the declining top share was the rise in 'popular wealth', notably in the form of owner-occupied houses (Atkinson and Harrison 1978: Chapter 9), but this was not the only factor operating.

So far I have described the immediate postwar decades in positive terms, and there is indeed a tendency to see the thirty years after 1945 as a Golden Age of growth for all. But it was also a period of rising earnings dispersion. The Chartbook shows that the top decile of earnings rose in the UK from the mid-1950s to the mid-1960s, and in France from 1950s to 1968 (as shown in Figure 8.1 in *Capital).* This extends to the USA, where the rise in top earnings did not start in the 1980s with Reagan, but much earlier (see Atkinson 2008). There was however a period when – in Europe at least – earnings dispersion fell. The experience just described for France and the UK was followed by a period when earnings differentials narrowed. In the UK, the bottom decile rose by a fifth relative to the median between 1968 and 1977; earnings differences were narrowed in France, particularly after the events of May 1968. In the Netherlands, the minimum wage was raised substantially in 1974 and there was a deliberate government policy to narrow differentials (Hartog and Vriend 1989). In each case, an important role was played by intervention in the labour market. This operated in some cases via minimum wage legislation, but also through a now forgotten instrument – incomes policy. In 1975, the pay rise allowed in the UK under incomes policy legislation was a flat £6 per week for everyone. In this period, an important contribution was made to reducing overall inequality by the reduction in earnings and employment differentials by gender. In a number of countries, equal pay legislation took effect during this period.

So, to sum up, inequality was reduced in Europe in the postwar decades, and this was a period that saw redistribution via the welfare state and progressive taxes, a reduced share of capital income/decline in the concentration of wealth, and equalizing labour market policy. From this experience, I believe that we can learn. However, economic conditions are very different from those in 1945–1975 – not least on account of globalization and of stagnation in Europe – and it does not follow that the same measures are desirable, or possible, today. We need therefore to begin with the economic context.

4. Locating inequality in the economics mainstream

A remarkable feature of Piketty's book is the way in which he seeks to locate inequality within the mainstream of economic theory. It is a book about economics as well as about inequality. In building a bridge between macro-economics and personal income distribution, a crucial relationship is that between the rate of return to capital and the volume of capital. If, as Piketty argues, 'capital is back', how does this affect the rate of return and capital's share in total income? His starting point is the aggregate production function, where national output is a function of capital and labour. This is the centre-piece of the Solow growth model. In the case of a perfectly competitive economy, the impact of a rise in the stock of capital on the capital share depends on the elasticity of substitution – see Box I. To the extent that the capital share has been rising in recent decades, Piketty argues that this reflects the elasticity of substitution today being greater than one.

Piketty refers, among other things, to the impact of robotization, and it is interesting to develop this further, along the lines suggested by Summers (2013). Capital can be seen as playing two roles: directly via the first argument of the production function, but also indirectly in so far as it directly supplements human labour. The production function is such that capital is always employed in the first use, but may or may not be used to supplement labour. The condition under which robots, or other forms of automation, are used depends, on the relative costs of labour and capital – see Box I. We can therefore tell a story of macro-economic development where initially the Solow model applies, and growth in the form of a rising capital-labour ratio leads to rising wages and a falling rate of return. Beyond a certain point, however, the wage/rate of return ratio reaches its critical value (A/B in Box I), and robots begin to supplant workers.[4,5] We then see further growth in the economy, as capital per head rises, but the wage/rate of return ratio remains unchanged. There is no longer any gain to wage-earners, since they are increasingly being replaced by robots/automation. What is more, the capital share rises, independently of the elasticity of substitution. The Solow-Summers model encompasses both the phenomenon highlighted by Piketty – a rising capital share – and a second phenomenon giving

Box I. The capital share and robotization

The centre-piece of the Solow growth model is the aggregate production function, $Y = F(K,L)$, where national output, Y, is a function of capital, K, and labour, L. In a perfectly competitive economy, where the rate of return to capital is equal to the marginal productivity of capital, the impact of an increased stock of capital on the capital share depends on the elasticity of substitution. With the textbook assumption that the production function is Cobb-Douglas in form, the elasticity is equal to 1, and the rate of return falls by the same proportion as the stock of capital rises. This leaves the capital share unchanged. Where the elasticity of substitution is greater than (less than) 1, the rate of return falls less (more) than proportionately, and the capital share rises (falls).

In the development of this model suggested by Summers (2013), capital plays two roles: directly via the first argument of the production function, but also indirectly in so far as it directly supplements human labour. Denoting the first use of capital by K_1 and the second by K_2, the aggregate production function becomes $F(K_1, AL + BK_2)$, where A and B depend on the level of technology. The production function is such that capital is always employed in the first use, but may or may not be used to supplement labour. The condition under which robots are used to supplement human labour depends on the relative costs of labour and capital. Where there is perfect competition, K_2 is zero where the ratio of the wage, w, to the rate of return, r, is less than A/B, and where K_2 is positive, then $w/r = A/B$. The ratio of the wage share to the capital share in the latter case is $(A/B)/(K/L)$ and falls with the capital-labour ratio.

rise to widespread concern in the public debate – the failure of growth to benefit wage-earners (the 'squeezed middle').

In this way, the core textbook model can be modified in a simple way to highlight the central distributional dilemma: that the benefits from growth now increasingly accrue through rising profits. This shift in the factor shares matters because capital income is more unequally distributed than labour income (*Capital*: Chapter 7). In seeking to resolve the distributional dilemma, there are at least three ways of addressing inequality in market incomes: to re-balance factor shares towards labour (Section 5), to reduce inequality of wage income (Section 6), and to reduce inequality of capital income (Section 7).

5. What we can do: harnessing technological progress and income shares

The earlier analysis of the economic context suggests one immediate policy conclusion. The capital share depends on the state of technology (the ratio A/B in Box I) and technology cannot be taken as given. Not only the extent of technological progress, but also its direction, is endogenously determined. In the Solow-Summers model described above, the issue of bias in technological progress arises particularly acutely. The invention of robot technology may be seen as raising B, and hence lowering A/B, to a point where the employment of robots becomes feasible. But this did not come about by chance. The rise in B reflected conscious decisions to make such an investment. Resources could have been invested instead in seeking to raise the productivity of workers (A). This brings us to a crucial issue of positional power and control over economic decision-making. Where the choice between raising B and raising A is made purely on the basis of the interests of capital, then there are good reasons to expect that choice to favour the replacement of labour to reduce the possibility of future industrial conflict.

The government does not however have simply to stand on the sidelines. While firms may seek to reduce their employment of humans, the government has a wider set of concerns, where employment and wages enter positively. Employment in the public sector has an important role to play, and here productivity is a function of the demand price, which depends in turn on the desired level of public provision. If value is placed on personal service, with the attendant human contact, then A is higher and there is less scope for automation. Delivery of meals on wheels to the housebound by drone would not provide the human contact that for many old people is an essential part of the service. Put in more immediate terms, if the effect of austerity programmes cutting public budgets is to downplay these elements of service, then they are contributing to switching income from workers to capital. It is however not just public employment. When consumers buy products in the market, they are typically purchasing a joint product: the physical object and the service. The latter may simply be the smile that accompanies the purchase, or it may be the reassurance that the product meets the consumer needs, or may be vital information as to how to use the product. Where the two elements cannot be unbundled, there is no reason to suppose that market forces will produce the right mix.

The endogeneity of technological change means that public policy can play a significant role in influencing the future direction of market incomes. As has been stressed by Mazzucato (2011), the public sector has played an important role in supporting the fundamental research that was subsequently commercialized by the private sector. This leads to the first of the recommendations as to how the rise in inequality could be reversed:

- The direction of technological change should be an explicit concern of policy-makers, encouraging innovation that increases the employability of workers, notably by emphasizing the human dimension of service provision.

Put simply, it is not enough to say that rising inequality is due to technological forces outside our control.

Decisions about the direction of technological change can be influenced in other ways than via science policy. This brings us to the role of monopoly power, which was ruled out in the earlier analysis by the assumption of perfect competition. Indeed monopoly does not feature much in *Capital*. The book was not called *Monopoly Capital in the Twenty-First Century,* and there is no reference to Baran and Sweezy (1966), nor to countervailing power (Galbraith 1952). The changing relative bargaining power of capital and labour is surely one of the explanations of the fall in the capital share in the postwar period and of its rise in recent decades (see, for example, Kristal 2010).[6] In this regard, integration of the analysis of personal income distribution into the economics mainstream needs to look beyond macro-economics to other fields such as industrial organization, where it is recognized that firms have market power in their sales of output, and labour economics that treats bargaining between employers and workers. The capital share can be scaled-back by reducing mark-ups to consumers and by increasing the countervailing power of workers.[7]

- Public policy should aim to reduce market power in consumer markets, and to re-balance bargaining power between employers and workers.

In this respect, there is complementarity between the proposals made here to reduce inequality, and policies that are already central to the EU, notably the promotion of competition and the development of the role of the social partners. Here, in the EU and more widely, a key role is played by the legal system. According to US lawyer S-L Hsu, 'Piketty, his supporters, and his critics are all missing a *huge* piece of the puzzle: the role of law in distributing wealth' (2014: 4). He argues that there is a 'capital-friendly bias that inheres in legal rules and institutions' (2014: 1).

6. What we can do: earnings and employment

I turn now to the distribution *within* the share of labour, where there has been – to differing degrees in different countries – an 'explosion' (2014*:* 304) of wage inequality at the top of the distribution in recent decades. As noted above, there had been an earlier period in the 1950s when top earnings rose, but at that time the distributional impact of rising top earnings was muted by progressive income taxation. *Capital* (2014: Figure 14.1) documents how top income tax rates have since then been substantially reduced, and the first evident approach to reducing inequality is, as Piketty argues, to return to a more progressive rate structure. The UK Government has in fact moved in the opposite direction, cutting the top rates, arguing that the revenue-maximizing top tax rate is 40 per cent (HMRC 2012). However, as explained in Atkinson (2014), there is much that is missing from their analysis and there are broader social objectives. Marginal tax rates are not just a matter of incentives: they are also a matter of fairness. The 'poverty trap' faced by many people in the lower part of the distribution is regarded as unfair because people keep so little of their extra earnings, and this is why the present UK government is introducing the Universal Credit with a maximum withdrawal rate of 65 per cent. This suggests a quite different criterion for the top income tax rate: that the marginal tax rate for the rich should be the same as that for those on low incomes.

- Return to a more progressive rate structure for the personal income tax, with a top rate of 65 per cent on the top 1 per cent of incomes.

In learning from past experience, however, we should note that reductions in inequality were achieved in the past not only via redistribution but also by addressing inequality in pre-tax earnings. Here the conventional wisdom is that this is best achieved through investment in education and skills, but the determination of earnings is not simply a matter of market forces, and important roles are played by government intervention and by the social norms which influence the behaviour of employers and workers. I referred earlier to the role of incomes policies, which were in some cases statutory and in others agreed between the social partners. Governments should not abdicate their responsibilities, which, in my view, mean a living wage at the bottom, to end in-work poverty, but also a change in norms regarding the acceptability of high pay at the top. It will doubtless be objected that ethical considerations cannot over-ride market forces: insistence on a living wage would speed the replacement of workers by robots. For this reason, I would propose that there should be an under-pinning:

- The government should offer guaranteed employment at the living wage to everyone who seeks it.

Public employment would be an option open to everyone. Clearly it would require a substantial investment in training and imaginative personnel policies. To some readers, such a proposal may seem outlandish and infeasible on fiscal grounds, but for many it may appear no more outlandish or fiscally irresponsible than the policy that financial institutions are too big to fail. Public employment has formed part of active labour market programmes in a number of countries. In the USA , it was authorized under the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1978, which allowed the Federal Government to create a 'reservoir of public employment'. Put another way, policy to reduce poverty – to achieve the Europe 2020 goal – has so far been largely based on raising employment, but 'as many as a quarter to a third of working-age Europeans living in poverty are actually already in work'

(Marx and Verbist 2014: 271). A government employment guarantee would be a direct contributor to the employment objective, and, by ensuing pay at the living wage, would tackle 'in-work' poverty.

Moreover, the market forces objection should not be over-stated. There are many circumstances in which supply and demand considerations only place upper and lower bounds on the rates of pay, and there may be multiple market equilibra with different distributional implications. The fact that there may be a wide range of pay consistent with market forces is reflected in anecdotal evidence, such as the statement of a past CEO of Shell that 'if he had been paid half as much he wouldn't have run the company any worse and if he had been paid twice as much he wouldn't have run it any better' (reported in the *Guardian,* 19 August 2014: 23). In theoretical terms, in the job search model, which underlies much modern macro-economics, once a job match has been achieved, there is a surplus to be divided between employer and worker. What is being proposed is that the division of that surplus should reflect ethical principles.

- Employers should adopt ethical pay policies that share common principles, and the adoption of such a policy should be a pre-condition for eligibility to supply goods or services to public bodies.

The principles of a pay code should govern the spread of pay between top and bottom, but should also be concerned with the horizontal dimensions of inequality. A firm may be an equal opportunity employer, but this may lead to unequal ex post rewards. One has to ask why only 1 in 6 of the top 1 per cent of incomes in the UK goes to a woman. One has to ask why, in the UK, the wage profile has tilted against younger workers. Between 2008 and 2013 in the UK, median earnings of full-time workers rose by 6 per cent less than prices, but the fall was least (2 per cent) for workers aged 60 and over, and became increasingly larger as one moved down the age scale: 8 per cent for those aged 30 to 39 and over 10 per cent for those aged 22 to 29 (Annual Survey of Hours and Earnings 2013).

7. What we can do: wealth taxation

If a rising capital share is leading to increased income inequality, then this can be countered in three ways: (a) the taxation of capital, capital income or wealth transfers, (b) the encouragement, through fiscal or other means, of the accumulation of wealth by small savers (Section 7), and (c) increasing the net worth of the state, so that a larger proportion of the capital share accrues to society as a whole.

These measures are inter-connected in that the increased net worth of the state can only be achieved by fiscal surpluses, and these should be achieved by raising taxation. Given the shift in the distribution of income towards capital, this in turn means that we should look to an increased contribution from taxes on capital – reversing the direction of past travel. Here I have three proposals.

The first proposal is for a return to the system under which capital income is taxed at a higher rate than earned income. Until 1984, the UK had an investment income surcharge. I would however like to go back further in time to the *earned income relief* that used to apply in the UK (before 1973/4):

- Increased taxation of investment income via the re-introduction of earned income relief in the personal income tax, so that earnings are taxed at a lower rate over an initial range.

This differs from an investment income surcharge in that it maintains the same top rate (65 per cent) for earned and investment income (which may not be easily distinguished at this level), but allows a lower marginal tax rate on earnings for an initial band. To achieve this effect under the present UK tax system, the basic rate would be raised from 20 to (say) 25 per cent, and the personal allowance reduced by 20 per cent, but earnings up to the end of the basic rate band (also reduced by 20 per cent) would be reduced for tax purposes by 20 per cent. This would leave the basic-rate taxpayer with just earnings (or pension) in an unchanged position, but would increase the tax on investment income for everyone above the (new) tax threshold.

Secondly, I believe that the UK should re-visit the possibility of an annual wealth tax. This idea was examined in the 1970s but not pursued by the then Labour Government. As has been observed by Weale, there are 'reasons for thinking that the 1970s arguments might have been presented rather differently in the current circumstances' (2010: 834). He refers to the rise in the ratio of personal wealth to national income, which has increased from 3 in the 1970s to over 5 today (Atkinson 2013a). In this rise, owner-occupied housing has played a major role, accounting for around half of the increase, and this asset warrants separate attention, in conjunction with a reform of council tax. But there remains the other half of the rise in the wealth/income ratio, and scope for an annual tax on wealth (excluding owner-occupied housing). At the same time, circumstances have also changed with regard to the globalization of the economy, and one important question is the extent to which national governments can effectively collect such a tax, without collective action at the EU level and stronger agreements on information exchange. Here there are lessons to be learned from the French experience with the Impôt de Solidarité sur la Fortune, regarded by Piketty as a mixed success (2014: 533).

- A fresh examination of the case for an annual wealth tax, and the prerequisites for its successful introduction.

Thirdly, if, as is argued in in *Capital* (2014: Chapter 11), we are seeing a return of inherited wealth, we need to re-consider the contribution that can be made by the taxation of wealth transfers. The revenue from the present Inheritance Tax (IHT) is modest. In 2012–13 it represented some 2 per cent of the amount collected in income tax; fifty years earlier, the figure had been 9 per cent (HMRC tax receipts website, and *Inland Revenue Statistics 1987:* Table 1.1). More effective taxation of wealth transfers in the UK could be achieved either through converting IHT into a lifetime capital receipts tax or by abolishing IHT and taxing inheritances received under the personal income tax.

- All receipts of inheritance and gifts inter vivos to be taxed *either* under a lifetime capital receipts tax *or* under the personal income tax, with appropriate averaging provisions and thresholds.

Under both versions, the tax would include all gifts inter vivos, above an additional modest annual exemption. Both versions would mean that people are taxed on the amount received, rather than the amount left, in contrast to the present UK Inheritance Tax. This switch would provide a direct incentive to spread wealth more widely. In this way, it could contribute to reducing both gender inequality and inequality across generations. The taxation under income tax would mean a top marginal rate of 65 per cent, but it is worth remembering that more than 100 years ago, John Stuart Mill proposed 'a heavy graduated succession duty on all inheritances exceeding [a] minimum amount, which is sufficient to aid but not supersede personal exertion' (quoted in Ekelund and Walker 1996: 578).

8. What we can do: encouraging small savings and a minimum inheritance

The redistribution of wealth is as much about the encouragement of small savings at the bottom as it is about the restriction of excesses at the top. This aspect is largely missing from *Capital*. Indeed many people have responded with puzzlement to the book's emphasis on the rate of return exceeding the rate of growth, when they are themselves receiving negative real rates of return on their savings. As several commentators have explained, we need to distinguish different rates of return. Between the rate of return to capital, the factor price, and the return to individual households stand intermediate institutions, such as pension funds, investment funds, and government. The wedge between the return to capital and the rate paid to investors is the source of income for the financial services industry, which is itself highly unequally distributed, and has contributed markedly to the rise in top income shares.

Measures that reduce the wedge between the rate of return and the rate received by small savers therefore contribute doubly to the reduction of inequality. In part this could be achieved by regulation, as with the imposition of maximum management fees for pension providers, but direct competition by state financial institutions is likely to be more effective.

- The government via National Savings should return to offering a guaranteed positive (and possibly subsidised) real rate of interest on savings, up to a maximum per person.

That there is scope for expanding competition is evidenced by the fact that there are 60 times as many members of credit unions in the USA as there are in the UK. Increased competition is not however enough. There need to be major efforts to increase the 'countervailing power' of savers in a market where the financial institutions are monopolistically competitive and where many institutions have abandoned their mutual roots. Given the greater extent to which individuals are now expected to make investment decisions (as with the increased flexibility for pensions), there is a pressing need for an independent financial service that is available to all and which, since individuals are now taking over a role that used to be played by the state, should be publicly-supported. The aim of such efforts should be to bring the realized return to households closer in line with the rate of return with which Piketty is concerned; and at the same time to ensure that the lending policies are more closely attuned to the public interest, including the provision of loans on reasonable terms to those in need.

- The encouragement of institutions to represent the interests of savers and borrowers, and to provide alternative outlets for savings not driven by shareholder interests, aided by the establishment of a publicly-funded money advice service providing independent guidance free to all savers.

This countervailing power would become even more important if the next proposal were to be adopted.

- The payment of a capital endowment for all, either at adulthood or at a later date;

Inheritance tends to get a bad press in *Capital*, but the return of inheritance is not to be deplored; indeed it is to be welcomed in the light of the distributional dilemma described above. The problem is that inheritance is highly unequal. If everyone inherited the same amount, then many of our concerns would disappear. A step in this direction is to ensure that everyone receives a minimum inheritance. It is far from a new idea. In 1797, Thomas Paine set out in his *Agrarian Justice* a scheme

> To create a national fund, out of which there shall be paid to every person, when arrived at the age of twenty-one years, the sum of fifteen pounds sterling, as a compensation in part, for the loss of his or her natural inheritance, by the introduction of the system of landed property. (Paine 1797)

The proposal by Paine[8] has its modern counterpart in schemes for asset-based egalitarianism, as proposed in the USA by, for example, Ackerman and Alstott (1999). In the UK, such a scheme was introduced in 2005 in the form of child trust funds, which were a vehicle for saving tax free with a contribution paid by the government, although they have been abandoned by the Coalition Government. In my *Unequal Shares* (1972), I had proposed a universal capital payment as part of the state pension, but considerations of inter-generational justice – the fact that we cannot look forward to continuously rising living standards – would now lead me to propose that the minimum inheritance be introduced on scaled basis. This means both that the payment would be phased in, and that the total received over the years would increase with the year of birth.

9. What we can do: social security for all

As we have seen, a major role in reducing inequality in the past was played by the welfare state, and one of the reasons for rising inequality in recent decades has been the scaling back of social protection. To quote the OECD Secretary-General, 'from the mid-1990s to 2005, the reduced redistributive capacity of tax-benefit systems was sometimes the main source of widening household-income gaps' (OECD 2011: 18). It is essential to restore the effectiveness of the welfare state. This does not necessarily mean returning to the same institutional arrangements; the welfare state cannot be fixed in stone but must adapt to changing circumstances. New labour market relationships and new forms of contribution mean that we should think more radically about the basis for our social security system. It is for this reason that I have proposed a variant on the idea of a basic income, a variant that I have christened a 'participation income'. A basic income would pay a fixed minimum income to everyone, replacing the personal tax allowance, and reducing existing state transfers in payment by the same amount. While a basic income is often described as 'unconditional', there has of course to be a qualifying condition. This is usually taken to be citizenship, but citizenship is not the same as the basis for taxation nor is it evidently the right basis in the EU context. An alternative approach therefore is to make the basic income conditional, not on citizenship, but on participation in society. 'Participation' would be defined broadly in terms of social contribution, which for those of working age could be fulfilled by full- or part-time waged employment or self-employment, by education, training or active job search, by home care for infant children or frail elderly people, or by regular voluntary work in a recognized association. The notion of contribution would be broadened, taking account of the range of activities in which a person is engaged.

In the EU, the basic income offers a means to make progress towards the Europe 2020 goal of reducing the number at risk of poverty or social exclusion, and it is in the EU context that the proposal is made here. In proposing a 'participation income', rather than a universal basic income, I am aware that it is open to the twin objections that its conditionality would risk excluding vulnerable people and that it would involve an administrative process. However, a universal income is a chimera. Any actual scheme would involve a condition of eligibility and hence the risk of exclusion. Citizenship would be highly discriminatory, and probably counter to EU law. The current rules for benefit eligibility have proved politically toxic, and there is considerable unease about the rules applied to people living in a country but not being domiciled for tax purposes. All of these point to the need for an explicit agreement about the notion of participating in a particular society. Given such an agreement, the application of the rules would of course require administrative machinery. For example, qualifying non-market activities would require validation. But the existing social insurance system requires such machinery if it is to be brought into the twenty-first century, so that the issue would in any case have to be faced.

Launching an EU initiative for a participation income would be a bold political move. Proposing such an initiative would appear to fly in the face of decades of EU failure to make progress on social security harmonization. There are however two reasons for optimism. The first is that it offers a solution to problems with which national governments are struggling – just as the early European institutions offered a solution to national problems of economic restructuring. The second is that the participation income is a new form of social security. There would be no question of imposing a national model on all Member States. It would not be Bismarckian or Beveridgean social insurance. It would be a twenty-first century route towards a Social Europe. There is, moreover, a straightforward first step for the EU to take: the payment of a universal benefit to families for all children, perhaps varying by age, can be seen as a specific form of basic income.

- An EU initiative for a participation income as a basis for social protection, starting with a universal basic income for children;

The starting point – an EU-wide basic income for children – could be, set, say, at 10 per cent of median equivalized income in each Member State for each child. (Child benefit for the eldest child in the UK is currently around 7 per cent, for younger children it is less than 5 per cent.) It would, under the subsidiarity provisions, be administered and financed by each Member State. Such a programme – refined in its details – would allow the EU to invest in its future and contribute to inter-generational equity. Moreover, where the child basic income is paid in the first instance to the mother, the scheme would contribute to redressing the present gender inequality.

10. The way forward

If the public interest aroused by the publication of *Capital* leads people to ask 'what could be done?', then I have given my personal answer as far as inequality within rich countries is concerned. It is an answer that is partly directed at excessive concentration of wealth, and as such follows directly from the arguments in *Capital*. But I am also concerned with those who own little and the need to build up small savings. I have emphasized measures to combat poverty in rich countries, not least to make a reality of the Europe 2020 objective of reducing the number at risk of poverty and social exclusion. I have underlined the need to reduce gender inequality and to address inter-generational inequity. These considerations underlie the proposals summarized below (to which should be added measures to address global inequality).

- The direction of technological change should be an explicit concern of policy-makers, encouraging innovation that increases the employability of workers, notably by emphasizing the human dimension of service provision.
- Public policy should aim to reduce market power in consumer markets, and to re-balance bargaining power between employers and workers, contribute to reducing the share of capital.
- Return to a more progressive rate structure for the personal income tax, with a top rate of 65 per cent on the top 1 per cent of incomes.
- The government should offer guaranteed employment at the living wage to everyone who seeks it.
- Employers should adopt ethical pay policies that share common principles, and the adoption of such a policy should be a pre-condition for eligibility to supply goods or services to public bodies.
- Increased taxation of investment income via the re-introduction of earned income relief in the personal income tax, so that earnings are taxed at a lower rate over an initial range.
- A fresh examination of the case for an annual wealth tax, and the prerequisites for its successful introduction.
- All receipts of inheritance and gifts inter vivos to be taxed *either* under a lifetime capital receipts tax *or* under the personal income tax, with appropriate averaging provisions and thresholds.
- The government via National Savings should return to offering a guaranteed positive (and possibly subsidised) real rate of interest on savings, up to a maximum per person.
- The encouragement of institutions to represent the interests of savers and to provide alternative outlets for saving not driven by shareholder interests, aided by the establishment of a publicly-funded money advice service providing independent guidance free to all savers.

- A capital endowment for all, either at adulthood or at a later date.
- An EU initiative for a participation income as a basis for social protection, starting with a universal basic income for children.

The proposals are listed like a menu, but there are important complementarities. In a number of cases there are evident connections, such as those between the living wage, the jobs guarantee and the participation income, or those between the capital endowment and the measures to improve the return to small savers. Inequality may only be reduced if there is a combination of measures. The proposals for additional government spending have to be balanced against the new revenue to be raised. More generally, taken together they are a response to the challenges faced by many different groups in society, seeking to bring to the public debate a coherent set of new (and old) ideas as to how inequality can be reduced.

In the space of this article, I have not attempted to give specific numbers nor to provide detailed costings. I have not considered the possible arguments as to why the measures proposed here may have adverse effects on incentives, competitiveness and growth. These economic arguments are important, and I seek to address them elsewhere (Atkinson, forthcoming). But, as Piketty writes, 'the history of the distribution of wealth has always been deeply political' (2014: 20), and it will be largely politics that decides whether any of these dozen proposals to reduce inequality are adopted in the UK, by the EU, or elsewhere.

(Date accepted: September 2014)

Notes

1. This paper is based on research carried out as part of the EMoD programme supported by INET at the Oxford Martin School, notably the *Chartbook of Economic Inequality* assembled jointly with Salvatore Morelli (Atkinson and Morelli 2014), for which the website has been constructed by Max Roser. The paper draws on material presented in a plenary lecture 'Can we reduce income inequality?' at the annual meeting of the Nationalökonomische Gesellschaft/Austrian Economic Association in Vienna, May 2014. I am most grateful to participants at the meeting, and to François Bourguignon, Andrea Brandolini, David Hendry, John Micklewright, Brian Nolan, Thomas Piketty, Charlotte Proudman, Max Roser, Emmanuel Saez, Salvatore Morelli and Agnar Sandmo for comments on earlier versions.

2. This is not a review of *Capital*. I was asked several times to write a book review, but did not accept these invitations since I felt that I had been too closely involved in joint research with the author. Friends and colleagues will however attest that I have been recommending that they read the book ever since the French edition was published in 2013.

3. As a personal note, I have long been concerned with both wealth and poverty. My first book (Atkinson 1969) was about poverty in Britain, and my second book (Atkinson 1972) was about wealth and inheritance.

4. Brynjolfsson and McAfee (2011 and 2014) refer to a 'point of inflection'. Their formulation is different in that they identify K_2 as 'digital capital' and argue that it will benefit at the expense of 'ordinary capital'. The distributional implications of this alternative model are considered in Atkinson (forthcoming).
5. According to the estimates of Frey and Osborne (2013), 47 per cent of US jobs are susceptible to computerization.
6. Capital shares and union power may indeed be simultaneously determined, with the decline in union bargaining power being caused in part by the bias in technological change (Acemoglu, Aghion and Violante 2001).
7. It is important to note that a rise in the labour share does not necessarily reduce inequality of household disposable incomes. One has to trace through the implications: see, for example, Brandolini 2010.
8. According to the estimates of Lindert and Williamson (1983: Table 2), fifteen pounds would have represented around half of the annual earnings of a farm labourer in England and Wales in 1797.

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