# Piketty, Inequality, and Noblesse Oblige*

by

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**Abstract**

This paper reexamines the problem of inequality, beginning with a critical commentary on Thomas Piketty's *Capital in the Twenty-First Century*. The paper argues, for a different reason from the Piketty's, that inequality will expand unless some redistribution policy is in place or each generation resets the initial wealth holding. The paper argues against Piketty's redistribution policy via high tax on income and wealth because it will create big government and reduce economic growth. By distinguishing between good and bad inequality, I propose the policies of Noblesse Oblige and No Privilege to correct the bad inequality that arises from inheritance and rent-seeking activities. These policies reduce both bad inequality and big government, and strengthen the foundation of the free and open society.

**Keywords**: Thomas Piketty, inequality, Noblesse Oblige, No Privilege, inheritance, rent-seeking, big government, growth, fairness, justice, human evolution

**JEL Classifications**: D3, H2, J3, Y3

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## 1. Introduction

Thomas Piketty's *Capital in the Twenty-First Century* has become a major focus of popular attention all over the world—a very unusual phenomenon for an academic book of some 700 pages.[1] It has already become one of the Amazon bestseller books in 2014. Ironically perhaps, Mr. Piketty is destined to join the exclusive top one percent club of the income ladder, whom he insists to tax heavily in order to reduce inequality. What has made Piketty's book such a bestseller? The timing of publication and the simple policy message anyone can understand—Tax the rich!—were perfect in stirring up a lot of emotion for both the political Right and the Left.

The common people have experienced a long economic hardship of low wages and unemployment after the 2008 world financial crisis. At the same time, they have seen the CEOs of investment banks, who are supposed to be responsible for the crisis, receiving huge compensations 1000 times larger than the average wage of workers. Piketty's *Capital* came out just when people started to wonder if something might be fundamentally wrong with capitalism. The book confirmed a widespread suspicion that the inequality gap between the rich and the poor was widening in the recent years, and presented a simple solution for inequality: tax the rich. Piketty's message immediately caught on and spread like wildfire.

As soon as such famous Left advocates like Professor Paul Krugman and Joseph Stiglitz have praised Piketty's *Capital*, the Right has started counterattacks. A lot of articles have been written about his book—both pros and cons. Unfortunately, many of them are ideologically motivated. A few seem to go beyond the political Right and Left name calling. The Right (especially the libertarians) has attacked Piketty's *Capital* from all possible directions. For example, they pointed out problems in the data that showed a rising inequality during the last few decades. However, Piketty is neither the first nor the last economist who pointed out the trend of rising inequality since the early 1970s. Many other economists have pointed out the same trend using different data sets.[2] In particular, the US households in the top one percent experienced the greatest increases in household income since the early 1970s.[3] The growth in real income was heavily concentrated at the very tip of the top: the income and wealth shares of the top 1.0 percent (especially, the top 0.1 and 0.01 percent) of households have risen sharply.

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[1] Piketty (2014).

[2] See, for example, Kopczuk, Saez, and Song (2010), Mishel, Bivens, Gould, and Shierholz (2012), Mishel and Sabadish (2012), Stiglitz (2013), and Karabarbounis and Neiman (2014).

[3] See Congressional Budget Office (2011)

Moreover the US and European governments have already implemented many income redistribution programs before and after the 1970s. Therefore, even if inequality had remained flat since 1970, it means that inequality would have been rising without those increasing number of redistribution programs put in place. The trend of rising inequality since the early 1970s is useful information because it tells that an upward trend in inequality has already started in the late 20th century. But it is not the critical part of Piketty's overall thesis. His main claim is not so much about the past, but about the future (which is predicted by his theory of capital and inequality to be explained below) that wealth inequality will expand in the 21st century, without additional government intervention, towards the level only seen before the first war.

Beyond the current polemics in the political world, Piketty's *Capital* deserves to be taken seriously both by the academics and the general public. It is an impressive empirical work. It comprises three main parts: (1) long-term historical analysis of income and wealth growth, (2) forecast of income and wealth inequality in the future, and (3) policy recommendations. I highly value part (1), mostly agree about part (2), but have strong reservations about part (3). This paper discusses some questions I want to raise about Piketty's analysis and conclusion. Before discussing them, I shall provide a concise summary of the book for those who have not read it.

## 2. Piketty' s Main Argument

Piketty's *Capital* is built on more than a decade of research on historical changes in income and wealth since the industrial revolution. In the 18th and 19th centuries European societies were highly unequal under a rigid class structure. Wealth was concentrated in the hands of a limited number of rich families. This system persisted despite the fact that industrialization slowly raised wages for workers. It was not until the first and second world wars and the Great Depression that this highly unequal social structure was forced to change. Capital destruction, high taxes, inflation, bankruptcies during the wars caused wealth to shrink dramatically. The growth of welfare programs in the post-war period also helped both income and wealth distributed in relatively egalitarian fashion. But the shocks of the early 20th century have faded and the logic of capital is now reasserting itself. The level of inequality in modern western economies has started to rise toward the level seen in the 18th and 19th centuries.

From those historical discoveries, Piketty builds a new theory of capital and inequality. Its fundamental axiom is the empirical discovery that the rate of return on capital (r) is greater than the rate of economic growth (g): that is, $r > g$. It implies a continuous expansion of wealth inequality. Other things being equal, faster economic growth will decelerate the rate of increase in the wealth/income ratio in a society, whereas slower growth will accelerate it. But there are no natural economic forces that prevent the upward trend of the wealth/income ratio and the steady concentration of wealth. Only a burst of rapid growth (from technological progress or rising population) or government intervention can keep economies from returning to the "patrimonial capitalism" in the 18th and 19th centuries. To prevent soaring inequality contributing to political instability and the destruction of democracy, Piketty recommends government to implement a highly progressive income tax and a global wealth tax.

What I find most interesting among Piketty's discoveries is an ironical fact that the world wars in the 20th century worked as the greatest equalizer of income and wealth distribution among people. The wars reduced inequality in two ways: First, they forced governments to raise income tax rates to finance their war efforts. The top income tax rate rose from less than 10% before the first war to above 90% in the US, UK, and Germany (see Figure 14.1 in Piketty (2014)[4]). Second, they destroyed a substantial part of productive capital so that both capitalists and workers were in a sense brought back to the same starting line in the post-war period. Thus the world wars left us the modern legacy of big government and an egalitarian society.

According to Piketty, however, the equality in the mid-20th century has turned out to be an outliner in the long-term economic history (Figure I.1 and I.2). The post-war period has been characterized by gradual falls in top income tax rates and a rapid accumulation of capital in the hands of the top one percent of the population. This post-war trend reversal from the high to lower income tax rates has resulted in an increasing inequality in income and wealth. This new trend has become clearly visible since the 1980s (Figure I.1 and I.2). Piketty predicts that this trend will continue into the 21st century. To stop the trend of expanding inequality, Piketty advocates for government intervention in the form of a highly progressive income and wealth tax.

The basic structure of Piketty's arguments is the following: Income and wealth inequality will grow without (1) a major destruction of capital (such as a world war) or (2) a very high economic growth empowered by population growth and technological innovation or (3) a high income and wealth tax. Because (1) and (2) cannot be expected in the 21st century, Piketty recommends (3) as the only solution to the increasing inequality problem.

[4] All the figures and tables in Piketty (2014) are publicly available, and can be downloaded from the following address：
http://piketty.pse.ens.fr/files/capital21c/en/Piketty2014FiguresTablesLinks.pdf,

## 3. Critical Questions about Piketty's *Capital*

There exist several ways Piketty's analysis and conclusion may be questioned: First, the empirical gap ($r - g > 0$), which plays a critical role in Piketty's argument, may disappear in the long run. Economic theory implies that the rate of return on capital diminishes over time unless continuous innovations can prevent it. Also the long run in many growth models is characterized by a steady state, in which the gap between the two rates may disappear. The economic theorist must ask Piketty how to reconcile the theoretical implication of the long run steady state equilibrium with Piketty's empirical gap. The problem is that Piketty does not present a formal economic model that can explain the gap. It may well be the case that the Piketty gap is a temporary phenomenon and is bound to disappear in the long run. If one wants to convince the scientist (and thus the policy maker) that the sun will rise again tomorrow, it is not enough to point out that it has risen many times in the past. One has to convince the scientist with the theory of planetary movements (Newton's law). The same applies to the Piketty gap.

Second, actually, the Piketty gap ($r - g > 0$) is not a necessary condition for wealth inequality to expand over time. Wealth inequality will expand so long as the rate of return is randomly distributed among different investments. It is easy to show mathematically that wealth inequality takes a form of a highly skewed distribution over time: for example, if the rates of return on capital follow a normal distribution, the cumulative wealth distribution will take the form of a highly skewed log-normal distribution. The greater the variance of the rate of return on capital is, the greater the resulting inequality. In short, expanding wealth inequality is a very robust theoretical implication of the random rate of return on capital unless some redistribution policy is in place or each generation resets the initial wealth holding. In other words, the Piketty gap is not a necessary condition for expanding wealth inequality. A simple random growth rate model implies it even if $r = g$ holds. This actually strengthens Piketty's claim that inequality will expand in the future, even without the Piketty gap.

Furthermore, it is well known that the distributions of the rate of return on wealth are characterized by a fat tail, which explains the existence of a super-wealthy class. Warren Buffet, for example, stands at the right-hand fat tail end of the skewed wealth distribution. A fat tail is a property of distributions exhibiting extremely large kurtosis, particularly relative to the ubiquitous normal distribution. The fat tail refers to the tendency of many financial asset price and return distributions to have more observations in the tails and to be thinner in the mid-range than a normal distribution. Assets that prone to frequent jumps in price tend to exhibit fat-tailed distributions. This property of fat tails common among the rate of return on a wide range of assets can explain an extremely large share of wealth owned by the top one percent of households. For example, in the United States, the top one percent held a fifth of the national income in 2007. Wealth was even more unequally distributed than income. The wealthiest one percent owned more than a third of the nation's wealth.[5]

Third, even if the Piketty gap is permanent, one can argue that it simply reflects a risk premium (Figure 10.9). This actually gives a good theoretical justification for the permanence of the Piketty gap, although it leads to a very different policy implication. If the gap represents a risk premium, the higher rate of return on capital over the rate of income growth will be justified as a necessary reward for risk-taking by capitalists. Indeed it is the risk-taking by capitalists that stimulates innovation and drives the economy to grow. Risk-taking is essential for entrepreneurship that is the main engine of economic growth. According to this argument, to give the right incentive to entrepreneurs, it becomes necessary to maintain the Piketty gap. Indeed, if the gap represents a risk premium, Piketty's tax policy will discourage the risk-taking activities of entrepreneurs and therefore reduce economic growth. The risk premium represents a justifiable reward for making riskier investments and starting new businesses. Therefore it should not be reduced by the tax on income and wealth (as proposed by Piketty) if we want economic growth to continue in the future.

Fourth, Piketty underestimates the negative effects of his tax policy on economic growth. He argues that higher economic growth helps the rate of increase in inequality to slow down, which he claims characterized the mid-20th century. Piketty predicts that slow growth will lead to higher inequality through wealth inheritance in the 21st century. To prevent the emergence of such "patrimonial capitalism," he recommends that government should impose a high tax on income and wealth. Piketty, however, does not pay much attention to the possibility of another important causality: that is, a higher tax may reduce economic growth. Without disproving the seriousness of the negative effects of the higher taxes on economic growth, Piketty cannot really justify his tax policy. His tax policy could kill the goose that laid the golden eggs. As a matter of fact, his data indicate that the higher economic growth in 1950-2012 is correlated with the lower top income tax rates (Figure 2.5 and 14.1). The reductions in income tax might have contributed to higher growth in the post-war period

Fifth, Piketty apparently believes in big government. He seems to believe that government behaves benevolently for the best interest of people. It is a naiveté shared by those who regard government as the best solution to all social problems. They either blindly trust government or hide their real motive that covets the power of government.

[5] See Kennickell (2009), Wolff (2010), and Stiglitz (2013).

The former underestimate the risk that government will become a more serious problem than the inequality problem it is assigned to solve. The latter covet top government positions which give them privilege, wealth, and power. As Piketty seems to be a man of good intention, I assume he belongs to the former group. Nevertheless his tax policy implies more tax revenue, which implies greater power for government. Throughout the human history, government is known to abuse power and taxpayer's money for the benefit of politicians, bureaucrats, corporations, and their cronies. Piketty's tax policy will inevitably lead to big government, which develops into crony capitalism, socialism or communism. All of them, as history shows, eventually end up with a stagnant economy.

Sixth, Piketty sidesteps the most fundamental question: Why is inequality undesirable in the first place? He takes it almost as self-evident that inequality is bad and needs to be corrected by government. Piketty argues only that inequality leads to political instability in many democracies. However, one could argue, as many libertarians do, that inequality is a natural outcome of individuals getting incomes according to their marginal products (productivities). That is, people are receiving what they deserve. Higher income is the result of higher economic contribution to society. If so, complaints about inequality are simply expressions of envy: you should grow up and stop comparing yourself with others. In this case there exists no justification for government to take away income from someone and give it to someone else: that is, redistribution is just another word for stealing. Government should not engage in the business of stealing. In short, if incomes correspond to marginal products, it is very difficult to justify any kind of redistribution by government. This is indeed the argument often used by libertarians.

## 4. What Is Wrong with Inequality?

I used to think the same way as many libertarians do until recently: that is, redistribution by government cannot be justified by any rational reasoning. It is essentially the stealing by government of the money individuals have worked hard to earn. So long as the poor are getting more income with economic growth and thus better off, inequality is not a problem even if the gap between the poor and the rich is widening. So long as everyone is getting a wage that corresponds to his/her marginal product, the resulting income distribution is fair and just (even though it is not equal) because it correctly reflects the differential economic contribution of each individual to society.[6] Inequality is not a social problem even though it may be a personal problem as it affects a personal feeling of self-esteem. If so, inequality is a problem that belongs

[6] Mankiw (2013) makes a similar argument.

to social psychology and psychoanalysis, not to economics.

What is wrong with inequality? Many economists want to sidestep this fundamental question and start from the assumption that inequality is something undesirable and thus needs to be corrected. Introductory economics textbooks routinely list income redistribution as one of the roles of government without any serious discussion about why it should be. Even Piketty does not give a satisfactory answer even though inequality is the main topic of his research. He only argues that inequality brings political instability in democracies and therefore needs to be corrected. But why should inequality bring about political instability? What is wrong with inequality if it is the results of individuals receiving their marginal products? Should people regard such inequality as unfair and unjust? Not really because they are receiving exactly what they deserve or what they have contributed to society. Envy cannot be a justifiable reason for government to redistribute income and wealth. The appropriate role of government might be to educate people to grow up and stop comparing themselves with others. If we want government to redistribute income, we have to be able to explain what is really wrong with inequality in the first place?

As long as we accept the standard assumptions of economics, in particular, that of Homo economicus and wages being equal to marginal products, it is difficult to justify income redistribution by government. Homo economicus is interested only in self-interest and is not concerned with the interests and possessions of other people. If individuals are all Homo economicus (having no concern with others and therefore no sense of unfairness, injustice, inequality, and envy), wages correspond to marginal products, and the market outcome is Pareto-efficient, then there can be no justification for redistribution by government. Why do you need to redistribute income and wealth if all individuals are only interested in what they have, and they do not care about what other people have? Homo economicus is happy with wages corresponding to marginal products. They are getting what they deserve according to their economic contributions to society.

## 5. Humans Have Evolved To Care about Fairness, Justice, and Equality

However, contrary to the assumption of Homo economicus, humans have evolved to care about fairness, justice, and equality. Inequality emerges as a real social problem that needs to be addressed as soon as we replace the artificial assumption of Homo economicus with real human beings with other-regarding capability. Humans are the products of evolution as all life on earth are. Evolution has given rise to human nature which cares about fairness, justice and equality so that humans can build trust and achieve cooperation among them. Humans have evolved into a cooperative social species because it had helped them to survive in a harsh natural environment. Cooperation has become a great human invention which has made humanity a great success on earth. But cooperation is a very fragile existence that requires extreme care and constant maintenance.

The wealth inequality produced by inheritance and rent-seeking activities stirs a sense of unfairness and injustice. This is because it does not reflect differential marginal products (productivities) and therefore does not represent any real economic contribution to society. Extreme inequality that is not the result of marginal products, together with the sense of unfairness and injustice, is one of the factors that can easily destroy human cooperation. Cooperation based on mutual trust is a necessary condition for human society to function effectively and productively. Without general trust, society can evolve into a non-cooperative and stagnant economy.[7] In short, extreme inequality resulting from inheritance and rent-seeking activities can destroy the very foundation of a cooperative and productive human society.

Society is built on a network of mutual trust and cooperation. Cooperation means interdependence, and interdependence means externality, and externality destroys the fundamental theorems of welfare economics: that is, the equivalence between the outcome of a competitive market and the Pareto efficiency does not hold if cooperation is necessary. In this sense, the market and society are fundamentally different, although society contains the market as a subset. The market is based on the exchange of benefits that are mutually independent. In contrast, society is generally based on the exchange of benefits (from cooperation) that are mutually dependent. Society is a system of interdependent relationships and payoffs. Therefore, Adam Smith's invisible hand may work in the market, but it does not work in society.

It is the sociality of human nature (cooperation) that separates Homo sapiens from other animals. The reason why humanity evolved to possess such social nature is the survival need to resolve the problem of cooperation, to overcome the tragedy of the commons, and to avoid the pit hole of Prisoner's dilemma. Moreover, many games of social life have multiple equilibria, and the criteria of fairness and justice help humans solve an equilibrium selection problem for the betterment of humanity.[8] Humanity has evolved to develop social nature because they needed to survive by the powerful means of mutual help and cooperation. Cooperation has been the critical factor for human

7 Shibuya (2013) shows that society can evolve into a high-trust and high-growth society or a low-trust and low-growth society, depending on the strength of coevolution between general trust and social intelligence.

8 Binmore (2005) argues that fairness and justice have evolved as a social tool for solving coordination problems in human society.

survival, economic growth, and civilization. However, extreme inequality together with a sense of unfairness and injustice can easily destroy mutual trust and human cooperation in group, company, organization, and society. The destruction of trust and cooperation can lead not only to a stagnant economy, but also to an unfriendly and even hostile society. Who wants to live in such a society?

## 6. Good and Bad Inequality

Moreover, from a purely economic point of view, individual wages and salaries often do not correspond to marginal products, contrary to what introductory economics textbooks teach us. Simply put, we cannot calculate a marginal product of a member of organization unless we know the explicit production function that can be differentiated with respect to each member. In most cases, we do not have any explicit production function of an organization. Have you ever seen a differentiable production function of, say, the Apple Company, with respect to each employee? Are they paid according to their respective marginal products? Have you ever seen a differentiable production function stated in the annual report? The difficulty of objectively measuring the marginal product of each worker is the main reason why the performance-based pay system ("merit-pay") does not often succeed.

The system of wages and salaries in a company reflects a commonly accepted norm in the company and society. For example, it is well known that a low-rank member generally gets more than his/her marginal product whereas a high-rank member less than his/her marginal product.[9] Utility consideration requires in organizational equilibrium that a low-rank worker be compensated by a high-rank worker who receives a greater utility associated with a high status in the organization. One notable exception is the CEO who can practically decide his/her own compensation unless the board effectively functions as an independent watchdog. When the board members are under the control of the CEO (as is often the case), there is no mechanism for the CEO compensation to match the marginal product. Recall that the marginal products of many CEOs were a huge negative during the 2008 world financial crisis. Have you ever heard a story of an investment bank CEO who received a negative compensation in any year because the CEO's marginal product was a big minus? Apparently the CEO compensations are not determined by marginal products.

Extreme inequality also causes many private and social sufferings. Empirical studies show that inequality is negatively correlated with trust, life expectancy, educational achievement, and positively correlated with mental illness, obesity, teenage pregnancy,

[9] See Frank (1984, 2011), Pfeffer and Blake (1990), and Pfeffer and Konrad (1990).

homicides, and imprisonment.[10] The implication is that extreme inequality is bad not only for the mental and physical health of individuals, but also for society at large. It is a remarkable paradox that many people often find themselves today in the middle of anxiety, depression, and violence at the pinnacle of material and technological achievement. They are worried about the social status and how others see them, and unsure of their friendships. How is it that humans have created a society of mental and emotional sufferings despite the level of material comfort unprecedented in human history? Much of those individual and social sufferings are linked to inequality perhaps because extreme inequality tends to generate hostility. Therefore, to reduce human sufferings, we need to address the problem of inequality.

We have at least four reasons why inequality can be a problem: First, inequality affects the physical and mental health of people. To improve the quality of social environment, we have to address the problem of inequality. Second, individual wages and salaries do not necessarily reflect the marginal products. In particular, the CEOs can practically decide their own compensations. Third, extreme inequality can destroy trust and thus cooperation in group, company, organization, and society. The destruction of trust and cooperation will result in lower economic growth. Finally, wealth often becomes the most powerful means to influence politics and government policy in favor of the rich and the established at the expense of the general public and the newcomers. It will weaken not only the foundation of the market system, but also that of the free and open society

All in all, there is good and bad inequality. Good inequality is the one that results from incomes generated from marginal products (productivities). It results from individuals receiving incomes that correspond to their economic contributions to society. People with higher productivity and thus a greater social contribution get higher wages. The resulting inequality is good inequality in the sense of being efficient, fair, and just. Good inequality provides a right incentive for people to work hard and take risks in entrepreneurial activities. In sharp contrast, bad inequality results from inheritance and rent-seeking activities, and it has little to do with marginal products. Bad inequality tends to protect the acquired positions and vested interests. It prevents others from competing with the establishment by means of privilege, monopoly, politics, subsidies, and regulations. In short, good inequality is associated with entrepreneurship and economic growth, whereas bad inequality is detrimental to trust, cooperation, and economic growth. It follows logically that good policies must aim at reducing bad inequality and promoting good inequality.

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[10] See Wilkinson and Pickett (2009).

## 7. Another Legacy of the Twentieth Century: Big Government

As mentioned earlier, the 20th century was characterized by the world wars, which left the legacy of an egalitarian society and big government. So far we have been talking about the problem of inequality, which Piketty thinks will get worse in the 21st century. He advocates a high tax levied on the wealthy as the solution. However, what about another legacy? What is going to happen to the problem of big government? Is government going to get bigger or smaller in the 21st century? One thing is clear. If Piketty's tax policy is to be implemented, governments all over the world will get bigger because they receive more tax revenue. In my view, this big government is bound to create more serious problems than inequality itself. In fact, I believe that big government is the main reason for the gradually declining growth rates among modern economies (Japan, US, and EU) since the late 20th century.

During a war, the market system is abandoned as many parts of the economy are placed under the direct control of central government. There is a risk that this government control may survive even after the war is over because of the following three reasons: First, people are brainwashed or used to government control or a totalitarian way of thinking and life style. Second, the government has one clear goal after the war toward which it can mobilize all the people and resources: that is, the reconstruction of an economy that was destroyed during the war. It is natural therefore that the reconstruction of the economy after the war leads to big government. The risk is that government stays big even after the reconstruction of the economy has been accomplished. This leads to the next reason for the upkeep of big government. Third, whatever rhetoric they may employ, politicians and bureaucrats love power, and power is never easily surrendered even after the need for big government has disappeared.

Indeed that is exactly what has happened. Two new developments have contributed to maintaining big government after the second world war and the reconstruction of economy. First, Keynesian economics has convinced people all over the world to pursue full employment as a major goal of government. It has required government to keep increasing government expenditure to prevent an economic recession and unemployment. It has ended up with big government and big debt. Second, the idea of the welfare state has gained support from both government and the general public. It has again required government to keep increasing government expenditure to pay for a welfare system with a huge public debt. These developments have helped government play a bigger role in the modern economy. In short, full employment and a welfare state have become the new goals of government and thus provided justifications for maintaining big government after the war in the 20th century.

Big government, however, promotes the spirit of collectivism and demotes the spirit of individualism. Specifically it weakens the mindset of freedom, responsibility, independence, self-reliance, individual initiative, the willingness to bear risks, the readiness to back one's own conviction against a majority, the willingness to voluntary cooperation with others, and a healthy suspicion of power and authority, whereas it strengthens the mindset of dependency, obedience, and the follower. Most of all, big government is incompatible with the spirit of individualism that is the backbone of entrepreneurship. If government decides everything, it leaves little opportunity for individuals to learn and exercise free will and moral values. In short, big government strengthens collectivism, and weakens individualism which is the moral foundation of a cooperative and productive society.

I have already argued that Piketty's high tax policy will inevitably lead to big government. It will worsen the problems of big government such as wasteful use of taxpayers' money, unnecessary public projects, endless accumulation of government debt, bureaucratic expansion and embezzlements, political corruption, crowding-out of the private sector activities, government control of private lives and business operations, bureaucratization of society, and lower economic growth. These are the direct and indirect costs of Piketty's tax policy that aims at reducing inequality. In short, Piketty's tax policy suffers from a trade-off between reducing the problems of inequality and enlarging the size and power of government.

Moreover Piketty's tax policy fails to distinguish between good and bad inequality. Therefore it does not satisfy the condition of good policy: that is, to reduce bad inequality and promote good inequality. Piketty's tax on income and wealth indiscriminately reduce both good and bad inequality. At the same time, it distorts entrepreneurial incentives to work hard, take risks, and start new businesses. It is therefore bound to reduce entrepreneurial activities and thus economic growth. What we need is a policy that will reduce bad inequality and promote good inequality. Now let us consider such alternative policies that are superior to Piketty's high tax policy.

## 8. The Policy of No Privilege (against Rent-Seeking)

Two main sources of bad inequality are inheritance and rent-seeking activities.[11] Both inheritance and rent-seeking activities produce an inequality that does not reflect marginal products (productivities) or economic contributions to society. Moreover, as

[11] The term "rent" was originally used to describe the return to land because the owner of land receives rent payments by virtue of his ownership and not by virtue of what he does for society. The meaning of the term "rent" has been extended to include monopoly profits, government subsidies, and benefits from government regulations.

inheritance is one form of favoritism, it will damage trust in the market system (capitalism) and destroy human cooperation because it generates a sense of unfairness and injustice. Furthermore, rent-seeking activities will distort the efficient allocation of economic resources, and therefore detrimental to the efficient working of the market system (capitalism) and economic growth. In short, good policies must aim at reducing rent-seeking activities and inheritance, both of which give rise to bad inequality, that is, inequality that does not reflect economic contributions to society.

First, to correct bad inequality due to rent-seeking activities, I propose a policy of No Privilege or the abolition of all privilege created by government. So long as government is willing to offer privilege to selected groups, it gives rise to irresistible incentives for many others to use their wealth (power) to obtain more privilege that leads to more wealth (power). Typically the wealthy obtain privilege from government by financially supporting politicians (and bureaucrats) who have power to provide privilege. It is an exchange of political favors between the wealthy and the politicians that comprises the real world politics. In return to the financial support, the politicians give privilege to the wealthy in the form of government regulation and subsidy. The problem is that both the wealthy and the politicians benefit at the expense of the general public who bear the cost associated with such exchanges of favors in the political market.

Thus a vicious circle of wealth and privilege will start through a political process: it will generate more bad inequality and big government, which is controlled by the wealthy and special interests. It will be accompanied by an expanding public debt because the ultimate source of privilege is the taxpayer's money whether it takes a form of regulation or direct subsidy. A regulation designed to protect special interests ultimately costs the taxpayers. Therefore such regulation is nothing but an indirect subsidy. The general public will suffer from the mounting future tax burden and the loss due to inefficiencies in the market economy created by the political exchange of privilege and wealth. In short, a vicious circle of inequality in wealth and inequality in privilege will be created by a political process even in modern democracies.

To stop this vicious cycle, we must make government abolish all kinds of privilege, without which the wealthy have no incentive to engage in rent-seeking activities. It is the potential privilege offered by government that attracts the wealthy and special interests to engage in privately rewarding but socially wasteful rent-seeking activities. Privilege is characterized by a divergence between private and social returns. It is this divergence between private rewards and social benefits that attracts rent-seeking activities by special interests and distorts the outcomes in a socially undesirable direction. The best way to stop rent-seeking activities is to abolish all privilege offered by government. Therefore I shall put forward the policy of No Privilege that will reduce the size and power of government as well as bad inequality arising from rent-seeking activities.

### 9. The Policy of Noblesse Oblige (against Inheritance)

Inheritance is not a part of the market mechanism. In fact it does not play any socially productive role in optimally allocating economic resources. In all likelihood, a child of the wealthy is not the best manager of the inherited wealth. Inheritance therefore is not an essential part of the efficient market mechanism: it is at best a man-made custom that may need to be revised and updated. The question is whether inheritance has any positive function to perform in our society. The answer is “no” except for a small family business: in this special case, the family members may share a strong incentive among themselves to succeed together in the market over many generations. In short, except for the case of small family businesses, the inheritance of wealth generally poses an economic problem that needs to be resolved from a viewpoint of economic efficiency and the betterment of society.

Consequently, to correct bad inequality arising from inheritance, I shall propose a policy of Noblesse Oblige or the obligatory private use of wealth for the benefit of humanity. It is a policy that gives wealthy individuals an option of utilizing their wealth for the benefit of humanity instead of building a family dynasty. The idea is that the wealthy can decide the way his/her wealth is put to use for the benefit of the current and future generations of humanity. The point is that it is not the government (politicians, bureaucrats, and their cronies) that decides the usage of wealth but the owner of wealth. This will drastically change the structure of government revenues and expenditures. For example, substantial part of social capital will be supplied by the private wealth owner. At the same time it will effectively limit the size and power of government. The final judgment whether wealth is actually used for the benefit of humanity should belong to an independent agency that is part of the judicial system.

The policy of Noblesse Oblige will be implemented by a combination of a prohibitively high inheritance tax above an exemption and an obligatory use of wealth for the benefit of humanity. We can set the inheritance tax in such a way that rational individuals will clearly prefer making use of their wealth for the benefit of humanity over giving away their wealth to government as an inheritance tax. It is important that the amount of exemption should be set at a high enough level so that the operation of small family businesses will not be disrupted by the inheritance tax. After all, the purpose of our inheritance tax is not to make the wealthy pay a lot of inheritance tax: on the contrary, the purpose is to make them opt out of paying the inheritance tax and choose to utilize their wealth for the benefit of humanity.

As a result, the wealthy will be obligated to make the best use of wealth for the benefit of humanity, instead of building a family dynasty, but they are free to choose when, where, and how they do so. The only condition is that it has to contribute to the benefit of the current and future generations of humanity. The inheritance tax is never intended to be used directly, but only as a "nudge" to activate the better elements of human nature (empathy, reason, morality, trust, and cooperation). It gives a strong incentive for the wealthy to consider seriously how to use their wealth far in advance of their death. It is a perfectly rational thing to do in lifetime that the wealthy make a plan for the best use of wealth for the benefit of humanity. After all, they cannot take wealth with them wherever they are destined to go after death.

The greatest advantage of the policy of Noblesse Oblige is that it puts the decision of how to use wealth in the hands of individual owners instead of government, that is, bureaucrats, politicians, and their cronies. It encourages individuals to exercise their autonomy and individual initiative, putting their freedom of choice into practice. An instructive example may be the Bill & Melinda Gates Foundation (with the endowment of 40 billion dollars), which takes over much of the work and function that government traditionally took for granted (scholarships, schools, libraries, educational reform, health care, vaccine program, HIV research, agricultural development, poverty, and etc.). The wealthy can, of course, build bridges and fix roads, if they want to. The role of government is limited to providing public goods and services that cannot be supplied by the private sector. In particular, government has no direct role in wealth redistribution. It is the responsibility of the owner of wealth to decide the best way it should be utilized for the benefit of humanity.

The policy of Noblesse Oblige provides right incentives to the wealthy for utilizing their wealth for the benefit of humanity rather than building a family dynasty. Unlike government tax, the policy encourages entrepreneurial activities and supports economic growth. People (entrepreneurs) are free to make money and accumulate wealth as much as they want by working hard during their respective lifespans. The policy requires only that they have to decide whether they want to leave their wealth to government as inheritance tax or make use of wealth themselves for the benefit of humanity. The policy of Noblesse Oblige uses a high inheritance tax in such a way that the wealthy will opt out of paying the inheritance tax and make the best use of wealth for the benefit of humanity. It is aimed at shifting the incentive of the wealthy from building a family dynasty to building a better society. At the same time, it gives the right incentive to the children of a wealthy family to work hard independently without relying on the wealth of parents and avoid family feuds over inheritance.

## 10. The Superiority of Noblesse Oblige over Government Tax

A lot of private consulting businesses will emerge that assist the wealthy to decide how to use their wealth for the benefit of humanity—instead of how to avoid taxes. This is a better and productive way to use time, energy, and wealth of people for the betterment of society. The wealthy will compete with each other in the ways they utilize wealth for the benefit of humanity. They may act like a public celebrity such as a movie star, a literary icon, a political activist, and a bestseller novelist who make contributions to the welfare of the general public. The wealthy individuals have resources to make contributions to society by creating social capital. Their names will be honored and attached to their contributions that they make for the benefit of humanity. The general public will be better off thanks to the social capital such as schools, hospitals, universities, research institutions, non-profit organizations, philanthropy, all established under the name of individual contributors. That will give the right incentives to the wealthy for creating a cultural and social environment that is conducive to building a cooperative and productive society.

Another advantage of the policy of Noblesse Oblige is that it will never end up with an endless debt accumulation, which besets all governments around the world today. The wealthy will not leave a large debt after using most of their wealth for the benefit of humanity in the form of scholarships, schools, hospitals, museums, parks, philanthropy, and building other social capital. There will be a strong incentive for the wealthy not to leave any debt for their sons and daughters. Moreover, commercial banks will not lend money even to the wealthy more than they can repay. That puts a natural limit on their expenditures. In contrast, government has no such a limit because tax incomes for government are after all someone else's money. Politicians, bureaucrats, and their cronies have little interest and incentive in making sure that the taxpayer's money be used wisely and efficiently.

Consequently, in contrast to Piketty's tax policy, the policy of Noblesse Oblige achieves two goals at the same time: reducing bad inequality and big government. It also promotes a cooperative society which is congenial to economic growth. Therefore, in addition to reducing inequality and big government, it promotes economic growth and helps build a better society. It encourages the initiative and freedom of the wealthy individuals, which then helps spread the culture of entrepreneurship among the general public. It will achieve these improvements by unleashing the better elements of human nature (empathy, reason, moral sense, trust, and cooperation) instead of the undesirable elements of human nature (dominance, ideology, revenge, distrust, and confrontation). The better elements of human nature will orient us from egoism and violence towards altruism and cooperation.[12] Policy and social institutions must be designed to encourage the better elements and discourage the undesirable elements of human nature.

In short, the policy of Noblesse Oblige will achieve the objectives of

(1) reducing bad inequality (and the associated individual and social ills),
(2) reducing the size and power of government,
(3) stimulating individual initiative and freedom,
(4) building a cooperative and altruistic society, and
(5) promoting economic growth.

It is superior to Piketty's tax policy, which may reduce inequality (both good and bad inequality), but will produce big government, restrict individual initiative and freedom, stimulate the undesirable elements of human nature, and reduce economic growth. Piketty's confrontational policy will bring about more conflicts, distrust, and hostility in society, whereas the policy of Noblesse Oblige will achieve the opposite.

## 11. Conclusion

In conclusion, I find Piketty's historical analysis of income and wealth very important, his forecast of their future developments most likely, but his policy recommendations seriously mistaken. Overall Piketty's *Capital* is a very important contribution to humanity because it has brought our serious attention to the question of inequality. It deserves to be examined carefully by everyone interested in the future of human society. I urge everyone, especially libertarians, to rethink deeply about the problem of inequality beyond the level of name calling. This is important because many libertarians think that inequality is not a problem. We must recognize the fact that humans have evolved to care about fairness, justice, and equality so that they can build trust and achieve cooperation. Cooperation has helped humanity to survive natural selection, create civilization, and become a great success on earth. But cooperation is a very fragile existence that can be easily destroyed by an inequality that stirs a sense of unfairness and injustice.

There exist good inequality and bad inequality. The main sources of bad inequality are inheritance and rent-seeking activities. Inequality arising from these two sources is fundamentally different from inequality arising from marginal products: the latter reflects economic contributions to society whereas the former does not. Much confusion

[12] See Pinker (2011).

can be avoided if we make a clear distinction between good and bad inequality. Extreme inequality becomes a real social problem (1) if it causes individual and social ills (distrust, hatred, and crimes) together with a feeling of unfairness and injustice, (2) if it is not the result of wages corresponding to marginal products (such as the CEO's salaries), (3) if the feeling of unfairness and injustice associated with bad inequality destroys mutual trust and human cooperation, and (4) if wealth is used as a means to gain political power, which distorts an efficient market outcome and weakens the foundation of the cooperative and productive society.

Piketty's high tax policy on income and wealth fails to distinguish between good and bad inequality. Moreover, contrary to his intention, it will create a hostile society with big government and reduce economic growth. Instead of Piketty's tax policy, I have put forward two policies to reduce bad inequality without adversely affecting good inequality: First, I have proposed the policy of No Privilege or the abolition of all privilege to prevent bad inequality arising from rent-seeking activities. It will reduce big government and promote economic growth. Second, I have proposed the policy of Noblesse Oblige or the private use of wealth for the benefit of humanity. It will reduce bad inequality arising from inheritance, reduce the size and power of government, stimulate individual initiative and freedom, build a cooperative and altruistic society, and promote economic growth. In short, the policies of Noblesse Oblige and No Privilege will reduce both bad inequality and big government, and strengthen the foundation of the free and open society.

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