Income Inequality in the Long Run

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According to Kuznets' influential hypothesis, income inequality should follow an inverse-U shape along the development process, first rising with industrialization and then declining, as more and more workers join the high-productivity sectors of the economy (Kuznets (1955)). Today, the Kuznets curve is widely held to have doubled back on itself, especially in the United States, with the period of falling inequality observed during the first half of the 20th century being succeeded by a very sharp reversal of the trend since the 1970s. This does not imply however that Kuznets' hypothesis is no longer of interest. One could indeed argue that what has been happening since the 1970s is just a remake of the previous inverse-U curve: a new industrial revolution has taken place, thereby leading to increasing inequality, and inequality will decline again at some point, as more and more workers benefit from the new innovations.

This lecture attempts to cast light on this central issue. On the basis of the new evidence gathered by economists since the time of Kuznets, what can be said about the "laws" governing the long run dynamics of income inequality? In particular, we will rely on the new series on income, wage and wealth inequality covering the 1901-1998 period recently constructed for France and the United States (Piketty (2001), Piketty and Saez (2001)).

Our general conclusion is that the "technical change" view of inequality dynamics described above is not the whole story: politics seems to matter much more than what the mechanical theory tends to suggest. In particular, the decline in income inequality that took place during the first half of the 20th century was mostly accidental. In France, and to a very large extent in the U.S. and in other developed countries, wage inequality has actually been extremely stable in the long run, and the secular decline in income inequality is for the most part a capital income phenomenon. Top capital incomes were severely hit by major shocks during the 1914-1945 period, and they were never able to fully recover from these shocks, probably because of the dynamic effects of progressive taxation on capital accumulation and pre-tax income inequality. This suggests that the decline of top income tax rates observed since the 1980s (and the repeal of the estate tax recently enacted in Italy) might well have important consequences for long run inequality dynamics.