Wealth Inequality and Power Imbalances: Shedding Some Heterodox Light on a Neglected Topic[1]

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Abstract

This paper argues that the cumulative causation processes between wealth and power risk leading to an escalation of wealth inequality. We confirm with new survey data for the Eurozone Piketty's conclusions that wealth is highly concentrated and that this inequality is perpetuated through dynastic wealth. This leads to an ever-concentrating ability to shape economic and political institutions. While neoclassical economics has a blind spot where power is concerned, we discuss how heterodox approaches have attempted to conceptualize this structural power which influences the framework of economic activity. Finally, we discuss three concrete channels through which the unequal distribution of private assets may affect power relations and economic activity.

JEL classification: D31, E12, P16

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Introduction

Thomas Piketty's work has placed the debate on distribution center stage both in mainstream neoclassical economics and in the public. Previously, the focus on distribution in the economics profession was largely a unique selling point of some heterodox schools of thinking, most notably (post-) Keynesianism and Marxism. Piketty has blazed a trail for research on distribution by showing that key premises of neoclassical economic theory regarding inequality do not hold up to empirical scrutiny.[1]

Piketty has also pushed economic research further by expanding the dominating focus of distribution analysis from income to wealth. Important progress in stock-flow consistent modelling within the post-Keynesian school notwithstanding, a focus on flows rather than stocks remains prevalent both in mainstream and in heterodox theoretical approaches. It is likely that the lack of reliable empirical data has played a key role in directing research towards income, and away from wealth.

1 His theoretical framework remains firmly rooted in neoclassical economics, and is thus open to criticism from heterodox economics (see for example Taylor 2014).

The Household Finance and Consumption Survey (HFCS) is a new data set published by the European Central Bank that provides a basis for the analysis of wealth in 17 European countries for the first time. This has widened the scope for research on wealth in Europe significantly. In particular the detailed socioeconomic information available makes it possible to paint a richer picture of the wealth distribution than Piketty's data allows him to do.

From a progressive point of view, it is imperative that research on inequality is not confined to income differentials based on the (functional and personal) income distribution. The question of power, largely neglected in neoclassical mainstream economics, cannot be broached satisfactorily in economics without an understanding of the distribution of the command over resources, that is, in a first and simplifying approximation, wealth. The ownership of wealth affects power relations and economic activity by conferring disproportionate influence on the democratic process to a very small group of actors. The political sphere, in turn, has an impact on the design of the market framework within which economic actions occur, leading to a process of cumulative causation. Piketty shares this point of view; his scientific analysis is borne by the concern for democracy.

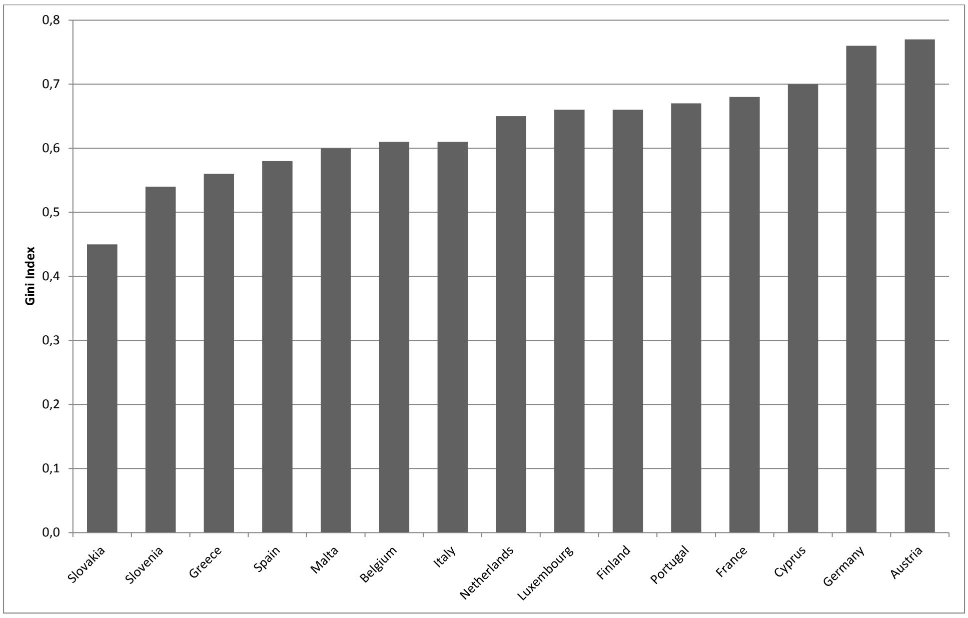
Wealth concentration in Europe

The HFCS data is categorized into household balance sheets. Assets include tangible assets, which comprise for instance the main residence, other real estate property, vehicles and shares in self-employment businesses, as well as financial assets, which contain deposits, shares, bonds and mutual funds, as well as money owed by others to the household. Liabilities consist of collateralized and non-collateralized debt.

Due to the ex-ante harmonization of the HFCS survey it is possible to compare the available data across countries. However, looking at absolute wealth levels is not particularly meaningful. This is especially the case for median wealth, but also for the mean. The reason lies in the institutional differences of national welfare systems, which affect the necessity of private households to accumulate wealth (Fessler et al. 2012): Countries with a well-functioning social housing policy or pay-as-you-go public pension scheme tend to have lower private wealth. A more promising approach is thus the cross-country comparison of distributional aspects, for which the data is very well suited.

Figure 1 lists the countries covered by the HFCS according to their Gini coefficient of net wealth. It shows that Austria, Germany, Cyprus and France have the highest inequality. At Gini values of up to 0.77, inequality in wealth is thus much higher than income inequality for all individual countries as well as for the Eurozone as a whole. The wealthiest 10 percent of households in the Eurozone own more than 50 percent of total net worth in the HFCS data. In contrast, regarding income flows the 10 percent of households with the highest income receive roughly 31 percent of total income (ECB 2013b).

The high concentration of wealth found in the HFCS is even likely to be an underestimation of the actual wealth inequality. Both the willingness to participate in voluntary wealth surveys such as the HFCS at all (response rate), and to answer individual questions on wealth levels (item non-response) declines at the two tails of the wealth distribution. However, since the amount of wealth owned collectively at the lower end of the wealth distribution is negligibly small, the main cause of the distortion lies in the very high wealth levels at the top end of the distribution.[2]



Source: Sierminska and Medgyesi (2013), HFCS (ECB 2010)

Fig. 1. Gini index of wealth by country

This discrepancy between survey information and actual wealth is made palpable by a comparison between the HFCS data and the Forbes list of the richest people in each country (Vermeulen 2014). In Germany, the household with the highest wealth in the HFCS survey owns 76 million Euro, while the household with the lowest wealth out of the 52 Germans covered by the Forbes list has 818 million Euro. In Austria, the gap is even more dramatic. It spans from 22 million (HFCS) to 1,560 million Euro (Forbes).

For this reason, Piketty prefers administrative data on wealth, usually gathered through estate or wealth taxation. These capture the entire distribution of wealth much better, despite problems relating to tax avoidance and evasion as well as exceptions in the legal definition of the tax base, which often differs from an economic or accounting-based definition of wealth.

2 Some countries that participated in the HFCS attempted to correct for this underestimation through oversampling; however, this was not possible in all cases. The results suggest that countries that oversample achieve a partial correction of non-response bias and the low probability of very wealthy households to be drawn into the sample.

Piketty's administrative sources also suggest underreporting of large fortunes in the HFCS. According to Piketty's data, the top 1 percent in France owns roughly 24 percent of total wealth (Piketty 2014), whereas the HFCS data yields 18 percent for that value. It is thus very likely that the inequality registered in the HFCS underestimates the actual level of wealth inequality. This should be borne in mind in the interpretation of results found from survey information on wealth, and the HFCS data in particular.

This distortion can be partially corrected for by exploiting the statistical regularity that top wealth levels are distributed according to a Pareto distribution (Vermeulen 2014, Eckerstorfer et al. 2015). However, even these estimates may not fully capture the extent to which wealth inequality is understated by the HFCS data: Even at the upper limit of the range given by Vermeulen's estimates, the share of France's top 1 percent does not reach the 24 percent reported in Piketty's administrative data.

On the whole, the findings from the first wave of the HFCS on wealth inequality clearly support Piketty's conclusion: Wealth is extremely strongly concentrated in European high income countries. The HFCS data allows extending this finding to 15 further countries of the Eurozone.

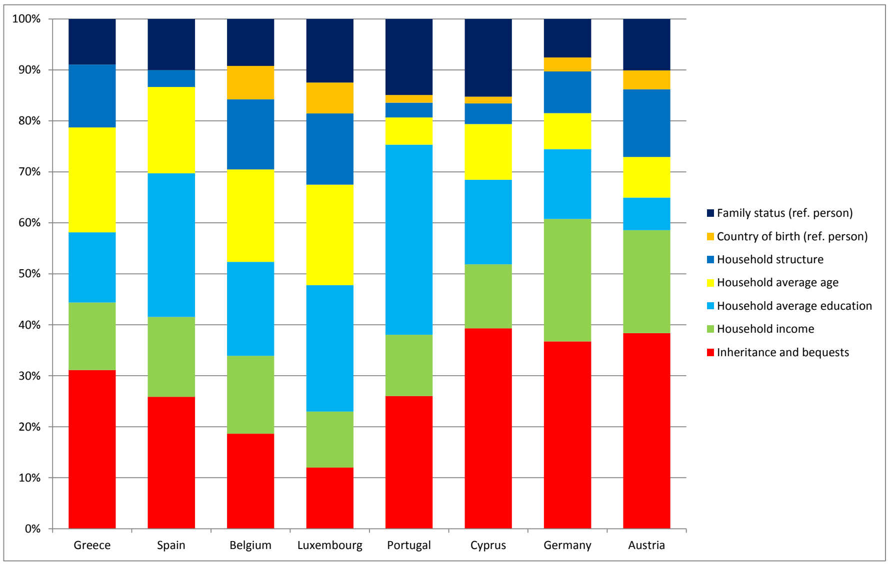
Inheritances

One of Piketty's main concerns is the role of inheritances in the rising concentration of wealth. He argues that at the beginning of the 21st century, large fortunes are much more likely to arise from inheritance than from work. This is comparable to the situation in the 19th century, when substantial inheritances paved the way to a much higher living standard than labor income ever could.

Piketty's conclusions regarding inheritances are based on data gathered painstakingly from French administrative archives on estate taxes and probate records established in the wake of the French revolution. Unfortunately, this also means that the results are not easily replicable for other European countries. Here, again, the HFCS can fill in the picture, albeit at the cost of underestimating inequality since survey information on past events such as inheritances is particularly prone to underreporting.

The HFCS can be used to estimate the effect of different explanatory factors on wealth inequality, as a first approach to disentangling the two possible sources of this inequality – savings out of income versus inheritances. Leitner (2015) applies the Shapley value approach to decomposition for selected HFCS countries. In this analysis, inheritances make up for roughly a third of the predicted inequality of gross wealth, which is by far the largest single factor, on average for all the countries covered (see Figure 3). In contrast, the contribution from differences in gross household income amounts to about 10 percent. While there are some differences between countries in the individual factors, these should not be overstated. With the exception of education in Spain, Portugal and Luxembourg, inheritances are the single most important factor contributing to the inequality in gross wealth in all countries studied.

Thus, as Leitner (2015: 21) concludes, "[w]hether or not a person is born into a wealthy and educated family and thus inherits assets determines to a considerable extent whether he or she will make a fortune". These findings from the HFCS thus confirm Piketty's conclusions from his outstanding data on inheritances: Inheritances are crucial for wealth inequality in Europe. As Piketty stresses, this is linked to questions of equality of opportunity and thus the legitimization of the political and economic system. We turn to this question next.



Source: Leitner (2015), HFCS (ECB 2010)

Note: Countries sorted by Gini coefficient for gross wealth.

Fig. 2. Relative contribution to income inequality (% of predicted Gini coefficient)

Wealth inequality and power relations

Wealth inequality has important implications for many facets of the economy and society, which is strongly linked to the question of power. However, this topic is typically neglected in mainstream economics. References to power are mostly restricted to monopoly power or bargaining power in goods and labor markets which are seen as deviations from perfect competition.

By implication, this could lead to the view that the state of perfect competition is a situation free of power influence (Kalmbach 2008). In fact, general equilibrium theory obviates the consideration of power. A renowned contribution to show the irrelevance of power relations is Böhm-Bawerk's (1914) paper "Power or Economic Law?". The Austrian economist questions the possibility of power relations that prevent economic laws to determine prices and the allocation of goods in a long-term perspective. Böhm-Bawerk was of the opinion that the economic forces of marginal productivity will generally prevail (Berger and Nutzinger 2008). Although the perspective of Böhm-Bawerk's contribution was not focused on power in general, power relations did not play a major role in mainstream economic theory after the so-called marginal revolution (Dürmeier 2008).

There are multitudinous explanations for this blind spot in mainstream economic theory. One reason is the contradiction between neoclassical methodological individualism versus the wider perspective of societal classes, which is required for analyzing power. This broader perspective, taken by classical economics, invariably entailed the consideration of political and economic conflicts and questions of power relations. However, neoclassical economics focused on utility-maximizing, summable individuals, with the effect that the microfoundations of macroeconomics deflate the relevance of unbalanced power relations or unequal power blocs in a society.

Another explanation of the absence of power in mainstream economic theory relates to the self-perception of neoclassical economics as an exact science with a physics-inspired methodology (Mirowski 1989, Rothschild 2002). The empirical realist ontology of mainstream economics limits the consideration of real-word economic issues such as power relations (Palermo 2007). The omission of power in economic theory is thus linked to the fear of loss of precision and the looming contamination of the pure science through less exact topics that are hard to quantify.

Power is a notoriously nebulous concept that is hard to pin down. While political and sociological approaches to power have been taken up and extended in heterodox economics, the focus is restricted to intentional behavior in the relations between more and less powerful individuals (relational power). However, in the application to wealth inequality, structural power is important. Dutt (2015) argues that the definition of power can be broadened in the optimization approach by considering purposive action to change the "rules of the game". The concept of structural power entails the possibility to shape the framework in which political institutions, economic subjects, scientists, or the media operate. Structural power also comprises setting the public agenda and influencing the norms of discussion, that is, which topics are "open" to debate and which are off-limits. The aim of structural power is to maintain the prevailing power relations.

We briefly discuss three aspects of how the unequal wealth distribution may affect power relations and economic activity. Since an exhaustive discussion of inequality and power is beyond the scope of this paper, we confine ourselves to, first, wealth inequality and the participation in political decision making processes, second, the concentration of the means of production and corporate power, and third, the discrepancy between private wealth and public debt as a source of power.

Regarding the first aspect, the connection between wealth inequality and political power, there is a distinct dearth of empirical work. This is likely to be due to the lack of wealth data on the one hand, and to the difficulty in quantifying power on the other hand. An important exception is Page et al. (2013) who gathered data on wealthy Americans in order to study the differences between their political preferences and those of the general public. They find a remarkable consistency between the preferences of the wealthy and actual policies. However, most work focuses only on income inequality. Gilens and Page (2014: 564) show that income elites and organized groups representing business interests have substantial impact on policy making in the US, while "mass-based interest groups and average citizens have little or no independent influence". Bonica et al. (2013) analyze the relation between US voter turnout and household income and reveal a distinct positive correlation. Duca and Saving (2014) document the existence of long-run, bi-directional feedback effects between income inequality and political polarization.

Regarding the second aspect, the concentration of certain wealth components like business wealth also implies the concentration of corporate power. While concentration and centralization are systemic characteristics of capitalism, corporate power can have a decisive impact on how society functions and is highly relevant for questions of political economy. Harvey (2014) thus does not limit the consequences of corporate capital concentration and monopolistic tendencies to market pricing effects. He argues that the historical process of commodification is the result of the rent-seeking motive and monopolistic preferences of capital owners (see also Crouch 2004). Commodification is an expression of changing power relations in a society since corporations enforce the private (and in the best case monopolistic) production of hitherto public goods.

The third aspect briefly discussed here is the discrepancy between private and public wealth. While public wealth still played an important role in the post-World War II era, privatizations and deregulation have been eroding it for decades. The mirror image of this decline is the ascension of private wealth since the 1970s (Piketty 2014). This development has been accelerated by the financial and economic crisis since 2007. On the one hand, public means were used to restore private wealth through bailouts of corporations mainly in the financial sector in some European countries. On the other hand, budgets came under further pressure from automatic stabilizers reacting to the recession. While public debt rose dramatically as a consequence, public wealth was not expanded simultaneously. This alters the balance of power in favor of private corporations and wealthy individuals in the context of private-public partnerships and donation-funded public services. The preferences of democratically legitimated institutions thus, at the very least, need to be aligned with those of the wealthy elite.

Conclusion

This paper argued that wealth inequality is a key topic for future research in heterodox economics, because it allows addressing the question of power. In our view, the cumulative causation processes between the command over resources and the ability to structurally shape the economic and social framework is of pivotal importance for a progressive understanding of economics.

Two recent developments give a new impetus to this area of research: Piketty's success has sensitized both mainstream economics and the public to issues of distribution, and new data published by the European Central Bank, the Household Finance and Consumption Survey (HFCS), makes it possible to paint a richer picture of the wealth distribution in the Eurozone.

The cumulative causation processes inherent in wealth accumulation run the risk of leading to an escalation of wealth inequality. On the one hand, as documented convincingly by Piketty, large fortunes reap higher returns, and are perpetuated as dynastic wealth. On the other hand, very large fortunes may exert power by influencing the institutions governing economic and political decision making.

The question of power is inextricably interlinked with wealth inequality, and their interplay offers many interesting open questions for heterodox economics, both in theoretical and in empirical work. For instance, theoretical questions around the macroeconomic effects of wealth inequality beyond debt leverage and consumption out of wealth remain underaddressed, as well as issues regarding the accumulation of wealth at different positions in the wealth and income distribution. Given the manifold open questions, the new data and the renewed interest in questions of distribution by the public and by parts of mainstream economics, we believe that there is an optimistic perspective for future inequality research in Europe.

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