Bad Government and Central Bank Policy Are the Main Cause of Runaway Inequality

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Theme: Global Economy

Thomas Piketty: "Rock Star Economist" Pushes Inequality to the Forefront of Economic Discussion

French economist Thomas Piketty's book on inequality – Capital in the Twenty-First Century – has gonecompletely viral.

Mainstream economists like Paul Krugman and Joseph Stiglitz endorse it.   So does *Economist* magazine. The Financial Times and New York magazine both call him a "rock star economist".

Slate notes:

> While recently passing through D.C., he took a little time to meet with Treasury Secretary Jack Lew, the Council of Economic Advisers, and the IMF. Even Morning Joe, never exactly on the leading edge of ideas journalism, ran a segment about CapitalTuesday morning.

Is Piketty right or wrong about inequality, its causes and the prescription for addressing inequality?

Piketty Is *Right* about Inequality

We noted in 2010 that extreme inequality helped cause the Great Depression … and the 2008 financial crisis. We noted in 2011 that inequality helped cause the fall of the Roman Empire.

In a few short years, mainstream economists have gone from assuming that inequality doesn't matter, to realizing that runaway inequality cripples the economy.

Pikettey correctly notes that inequality is now the worst in *world history* … and will only get worse.

Asset Prices Rise Faster than Wages

Piketty argues that the main cause for inequality is that the rate of return on capital – land, natural resources, stocks, bonds and other assets – is far higher than the growth rate of the economy:

Because the growth rate is much slower than the rate of profit from holding capital assets, the asset-holders' wealth increases much faster than the wealth of workers. In other words, working stiffs can't keep up with those who make their money from investing in (and seeking rent from) land, stocks, bonds and other assets.

Piketty – a rigorous data researcher – is probably right that this is one of the main causes of inequality.

Bad Government and Central Bank Policy Is the Man Cause of Runaway Inequality

But Piketty underplays the fact that bad government and central bank policy have *greatly* widened the gap between growth rate. After all, Fed chairman Bernanke, Treasury Secretary Geithner and chief economist Summer's *entire strategy* was to artificially prop up asset prices – including the stock market– and see this, this, this and this.

At the same time, government policy has harmed the general economy, caused unemployment and hurt the average American.

Indeed, real wages have actually plummeted since 1969, and most of the new jobs that have been created are part times jobs with no benefit.

In other words, bad government and central bank policy have made the rate of return on capital much higher … but lowered wages. As such, bad policy is the core cause of the recent increase in inequality.

Nobel economist Joseph Stiglitz said in 2009 that the government's toxic asset plan – a scheme to inflate the value of assets held by banks – "amounts to *robbery* of the American people".

Bailouts Feather the Nests of the Fatcats, While Doing Nothing for the Average American

The American government's *top official* in charge of the bank bailouts writes:

> Americans should lose faith in their government. They should deplore the captured politicians and regulators who distributed tax dollars to the banks without insisting that they be accountable. The American people should be revolted by a financial system that rewards failure and protects those who drove it to the point of collapse and will undoubtedly do so again.
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> Only with this appropriate and justified rage can we hope for the type of reform that will one day break our system free from the corrupting grasp of the megabanks.

What's he talking about?

Well, the Fed threw money at "several billionaires and tens of multi-millionaires", including billionaire businessman H. Wayne Huizenga, billionaire Michael Dell of Dell computer, billionaire hedge fund manager John Paulson, billionaire private equity honcho J. Christopher Flowers, and the wife of Morgan Stanley CEO John Mack

And the bank bailouts weren't a one-time thing in 2008. The government has been –

continuously and massively – been bailout out the big banks for the last 6 years.

Indeed, virtually *all* of the banks profits comes from government bailouts. A top banking analyst estimates that subsidies to the giant banks exceeds $780 billion dollars each year.

A study of 124 banking crises by the International Monetary Fund found that bailing out banks which are only pretending to be solvent – like most of the big American banks – *harms* the economy. So growth is slowed, while the richest fatcat bankers rake in the dough.

Indeed, the bailout money is just going to line the pockets of the wealthy, instead of helping to stabilize the economy or even the companies receiving the bailouts:

- Bailout money is being used to subsidize companies run by horrible business men, allowing the bankers to receive fat bonuses, to redecorate their offices, and to buy gold toilets and prostitutes

- A lot of the bailout money is going to the failing companies' shareholders

- Indeed, a leading progressive economist says that the true purpose of the bank rescue plans is "a massive redistribution of wealth to the bank shareholders and their top executives"

(Top economists, financial experts and bankers say that the big banks are too large … and their very size is threatening the economy. They say we need to break up the big banks to stabilize the economy.

If we stop bailing out the Wall Street welfare queens, the big banks would focus more on traditional lending and less on speculative casino gambling. Indeed, if we break up the big banks, it will increase the ability of smaller banks to make loans to Main Street, which will level the playing field.

We're all for forcibly breaking them up. But we don't even have to use government power to break up the banks … the big banks would fail *on their own* if the government just stopped bailing them out.)

QE: the Greatest Wealth Transfer in History

It's been known for some time that quantitative easing (QE) increases inequality (and see this and this.) Many economists have said that QE quantitative easing benefits the rich, and hurts the little guy. 3 academic studies – and the architect of Japan's quantitative easing program – all say that QE isn't helping the American economy.

The Federal Reserve official responsible for implementing $1.25 *trillion* of quantitative easing has confirmed that QE is just a massive bailout for the rich:

> I can only say: I'm sorry, America. As a former Federal Reserve official, I was responsible for executing the centerpiece program of the Fed's first plunge into the bond-buying experiment known as quantitative easing. The central bank continues to spin QE as a tool for helping Main Street. But I've come to recognize the program for what it really is: the greatest backdoor Wall Street

> bailout of all time.
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> Trading for the first round of QE ended on March 31, 2010. The final results confirmed that, while there had been only trivial relief for Main Street, the U.S. central bank's bond purchases had been an absolute coup for Wall Street. The banks hadn't just benefited from the lower cost of making loans. They'd also enjoyed huge capital gains on the rising values of their securities holdings and fat commissions from brokering most of the Fed's QE transactions. Wall Street had experienced its most profitable year ever in 2009, and 2010 was starting off in much the same way.
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> You'd think the Fed would have finally stopped to question the wisdom of QE. Think again. Only a few months later—after a 14% drop in the U.S. stock market and renewed weakening in the banking sector—the Fed announced a new round of bond buying: QE2. Germany's finance minister, Wolfgang Schäuble, immediately called the decision "clueless."
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> That was when I realized the Fed had lost any remaining ability to think independently from Wall Street.

Even the president of the Federal Reserve Bank of Dallas said that Fed's Fisher said that "QE was a massive gift intended to boost wealth."

Billionaires have admitted that they are the beneficiaries of QE. For example, billionaire hedge fund manager Stanley Druckenmiller said the following about QE:

> "This is fantastic for every rich person," he said Thursday, a day after the Fed's stunning decision to delay tightening its monetary policy. "This is the biggest redistribution of wealth from the middle class and the poor to the rich ever."
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> "Who owns assets—the rich, the billionaires. You think Warren Buffett hates this stuff? You think I hate this stuff? I had a very good day yesterday."
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> Druckenmiller, whose net worth is estimated at more than $2 billion, said that the implication of the Fed's policy is that the rich will spend their wealth and create jobs—essentially betting on "trickle-down economics."
>
> "I mean, maybe this trickle-down monetary policy that gives money to billionaires and hopefully we go spend it is going to work," he said. "But it hasn't worked for five years."

And Donald Trump said:

> "People like me will benefit from this."

Economics professor Randall Wray writes:

> Thieves … took over the whole economy and the political system lock, stock, and barrel. They didn't just blow up finance, they oversaw the swiftest transfer of wealth to the very top the world has ever seen.

Economics professor Michael Hudson says that the big banks are trying to make us all serfs.

Economics professor Steve Keen says:

> "This is the biggest transfer of wealth in history", as the giant banks have handed their toxic debts from fraudulent activities to the countries and their people.

Lawlessness Is a Core Cause of Inequality

Joe Stiglitz said:

> Inequality is not inevitable. It is not … like the weather, something that just happens to us. It is not the result of the laws of nature or the laws of economics. Rather, it is something that we create, by our policies, by what we do.
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> We created this inequality—chose it, really—with [bad] laws …

Conservative Ron Paul points out that the system is rigged for the rich and against the poor and the middle class:

We asked the top regulator and prosecutor during the S&L crisis, who obtained over 1,000 felony convictions for major white collar fraud – professor of law and economics, Bill Black – what are the core causes of inequality. Professor Black told Washington's Blog:

> The industry that is the largest single driver of surging income inequality is finance. Finance dramatically increases inequality through three primary means. The obvious means is the massive flow of profits out of the productive sector and into finance, particularly compensation for finance elites. We know that a very large amount of that compensation is the product of the "sure thing" of accounting control fraud. They have been able to lead the fraud epidemics with absolute impunity. No Wall Street elite officer who led the frauds that caused the crisis has ever been prosecuted. [Background.] There are virtually no cases of "claw backs" from the C-suite perpetrators' compensation even when it is now inescapable that the "income" they reported to "earn" their bonuses were lies and they were actually creating horrific losses.
>
> The second means is that the three most destructive epidemics of financial fraud in history caused our financial crisis and hyper-inflated the bubble. This too was a "sure thing" because of the fraud "recipe." The household sector's wealth loss was over $11 trillion. Over 10 million Americans lost their jobs. The productivity loss is estimated at over $21 trillion. Each of these actions caused a vast loss of wealth suffered disproportionately by the 99%.
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> Third, finance, even absent fraud, is a major cause of increasing inequality. It is the means of tax evasion, which is (in $ terms) a crime that is all about the 1%, hedge funds, and large corporations. It is also the means, and the excuse, for outsourcing American jobs in the productive sector and extorting domestic tax giveaways by putting U.S. states and cities in competition to induce them to locate in a particular city.

> In the savings and loan debacle we sought to remove all the proceeds of fraud from the guilty elites.

Indeed, the big banks continue to manipulate every market and commit crime after crime and … andprofit handsomely from it, while law-abiding citizens slide further and further behind.

Yet Obama is prosecuting *fewer* financial crimes than Bush, or his father, or Ronald Reagan. Indeed, the government has actively covered up for – and encouraged – criminal fraud.

Indeed, there are two systems of justice in America … one for the big banks and other fatcats, and one for everyone else.

Holding the little guy to the letter of the law – while letting the fatcats run around immune to the law – is making inequality much worse.

Black points out that we should claw back ill-gotten gains from criminals under well-established fraud principles. Specifically, the government could use existing laws to force ill-gotten gains to be disgorged(see this and this) and fraudulent transfers to be voided.

Economist Michael Hudson also criticizes Piketty for failing to address crime and fraud as core causes of inequality:

> The other thing that is left out of the income tax statistics is of course how fortunes are really made, and that's crime and fraud. The good thing about Piketty is he points out, why is it that French novelists and English novelists tell you much more about wealth than economics? And he points out that in the 19th century novels by Jane Austen and Balzac, the way to make a fortune is to marry into it. That's true, but what Balzac also said is that behind every fortune is a great theft.

War Makes Us Poor … But it Makes Fatcats Richer Quicker

War makes the bankers and executives in defense companies rich.

But it makes the rest of us poor.

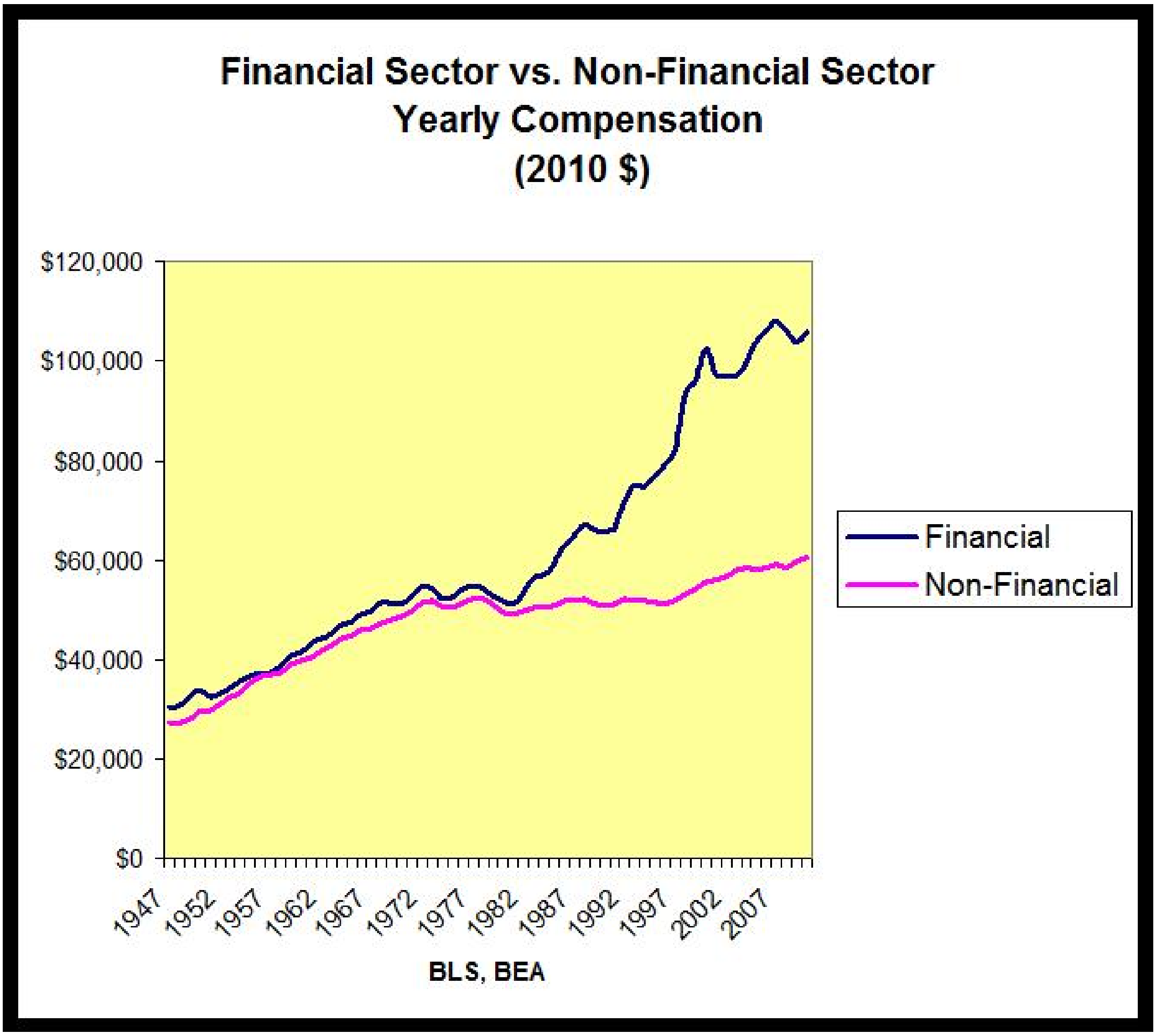
As such, war is a major cause of inequality.

Over-Financialization

When a country's finance sector becomes too large finance, inequality rises. As Wikipedia notes:

> [Economics professor] Jamie Galbraith argues that countries with larger financial sectors have greater inequality, and the link is not an accident.

Government policy has been encouraging the growth of the financial sector for decades:



And see this.

Economist Steve Keen has also shown that "a sustainable level of bank profits appears to be about 1% of GDP", and that higher bank profits leads to a ponzi economy and a depression.

The government is largely responsible for this over-financialization. For example, MIT economics professor and former IMF chief economist Simon Johnson points out that the government *created* the giant banks, and they were not the product of free market competition.

Money Being Sucked Out of the U.S. Economy … But Big Bucks Are Being Made Abroad

Part of the widening gap is due to the fact that most American companies' profits are driven by foreign sales and foreign workers. As AP noted in 2010:

> Corporate profits are up. Stock prices are up. So why isn't anyone hiring?
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> Actually, many American companies are — just maybe not in your town. They're hiring overseas, where sales are surging and the pipeline of orders is fat.
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> The trend helps explain why unemployment remains high in the United States,

> edging up to 9.8% last month, even though companies are performing well: All but 4% of the top 500 U.S. corporations reported profits this year, and the stock market is close to its highest point since the 2008 financial meltdown.
>
> But the jobs are going elsewhere. The Economic Policy Institute, a Washington think tank, says American companies have created 1.4 million jobs overseas this year, compared with less than 1 million in the U.S. The additional 1.4 million jobs would have lowered the U.S. unemployment rate to 8.9%, says Robert Scott, the institute's senior international economist.
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> "There's a huge difference between what is good for American companies versus what is good for the American economy," says Scott.
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> Many of the products being made overseas aren't coming back to the United States. Demand has grown dramatically this year in emerging markets like India, China and Brazil.

Government policy has accelerated the growing inequality. It has encouraged American companies to move their facilities, resources and paychecks abroad. And some of the biggest companies in America have a negative tax rate … that is, not only do they pay no taxes, but they actually get tax refunds.

(And a large percentage of the bailouts actually went to *foreign* banks (and see this). And so did a huge portion of the money from quantitative easing. More here and here.)

Conclusion: Piketty's a Little Rickety On Government Stupidity

The bottom line is that Piketty has done a great job of documenting the extent of inequality, and some of its causes. But he misses the degree to which *bad government and central bank policy* is responsible.

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