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The Importance of Wealth Is Growing

By William R. Emmons and Lowell R. Ricketts

French economist Thomas Piketty predicted in his best-selling book, *Capital in the Twenty-First Century*, that the U.S. and other advanced economies would experience:

- Further increases in national capital-to-income ratios
- Further increases in the share of national income received by owners of capital
- Further concentration of wealth among the richest families¹

Piketty showed that each of these trends had occurred from about 1950 through 2010 in several countries, including the U.S. He presented evidence that these patterns represented, at least in part, a reversal of trends observed between 1914 and 1945.

Data through 2015 largely vindicate Piketty's predictions for the U.S. so far. The capital-to-income ratio, the share of national income flowing to owners of capital and the concentration of wealth all increased between 2010 and 2015. Despite the Great Recession and the global financial crisis, "capital is back," as Piketty predicted.² The importance to families of building financial strength and stability by owning a share of the nation's wealth has never been greater.

The capital-to-income ratio. Conventional economic theory assumes that both the capital-to-income ratio (a measure of an economy's capital intensity, what Piketty labels β) and the capital income-to-national income ratio (what he calls the capital share of income, α) will be roughly constant in the long run in a mature economy like the U.S. Piketty showed that neither ratio is, in fact, constant.

One could argue from Piketty's data that these ratios changed relatively little in France, Britain and the U.S. during the late 19th and early 20th centuries. However, the turbulent period 1914-45—which included two world wars, recessions, depressions, hyperinflation, deflation, and broad social and political upheavals—sharply reduced the capital-to-income ratio in all countries. Large-scale destruction of capital occurred both literally and financially. Thereafter, both capital ratios and wealth concentration increased steadily in most countries.

Figure 1 displays the ratio of net national wealth (a more precise term for capital) to national income for the U.S. Net national wealth consists of privately owned real estate, equipment and software, intellectual property, corporate and noncorporate tangible assets, net international assets, and net government wealth.³ All assets are reported at market values (partly estimated). Debts owed by the private and public sectors are netted against the corresponding claims of creditors, both domestic and foreign.

The U.S. capital-to-income ratio, β , averaged about 444 percent in the first three decades of the 20th century. The corresponding ratios were somewhat higher in Europe and lower in Asia and Africa, according to Piketty's research. The turmoil of 1914-45 reduced β by one-fifth in the U.S., by two-fifths in Asia and by about three-fifths in Europe.

Recovery in β began after 1950 in most countries. By 2007—on the eve of the Great Recession—the U.S. capital-to-income ratio exceeded 500 percent (not shown in the figure). Even in 2010, after the large asset-price declines associated with the recession

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occurred, Piketty estimated β in the U.S. to be about 410 percent, not far below its range in the early 20th century.

Using data from the Federal Reserve's Financial Accounts of the United States and the Bureau of Economic Analysis' National Income and Product Accounts, Figure 1 extends the series for β through late 2015. After a small decline in 2011, the U.S. capital-to-income ratio has increased strongly in recent years as asset prices rebounded. Estimates of about 480 percent during 2014-15 place β above the level in all post-World War II years except those immediately before the recent recession. The long-term trend toward higher capital intensity in the U.S. economy beginning around 1950 remains intact, as Piketty predicted.

Capital income-to-national income ratio.

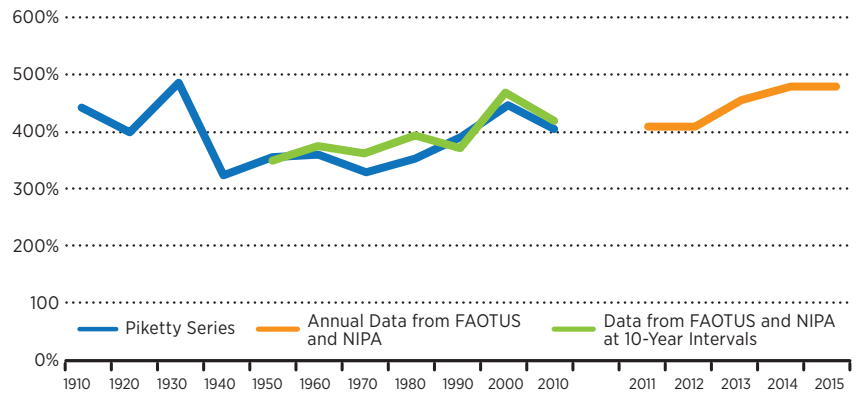
The share of national income that flows to the owners of capital depends on both the relative size of the capital stock (β) as well as the average return on capital, which Piketty denotes r . On one hand, we would expect r to decline somewhat as β increases, because it is natural to assume diminishing marginal returns to additional capital intensity. On the other hand, the productivity and flexibility of new capital (such as computers) are constantly increasing, so the effective cost of installing additional capital might actually fall, enhancing its profitability.

Piketty concluded that, on average throughout the Industrial Revolution, increasing capital productivity and flexibility have been sufficient to offset greater capital intensity. The result is that r has fallen proportionately less than β increased, mitigating downward pressure on the share of national income flowing to owners of capital (α) since World War II, even as capital intensity (β) increased steadily.

Figure 2 displays the history of α in the U.S. since 1930 (when detailed National Income and Product Accounts data became available) and the average of capital shares in the U.K. and France beginning in 1900. The correspondence between the time path of β (Figure 1) and α (Figure 2) for the U.S. is striking. After hitting lows in the middle part of the 20th century, both ratios trended upward through 2010, despite the Great Recession.

FIGURE 1

β : U.S. Net National Wealth (Capital) as Percent of National Income



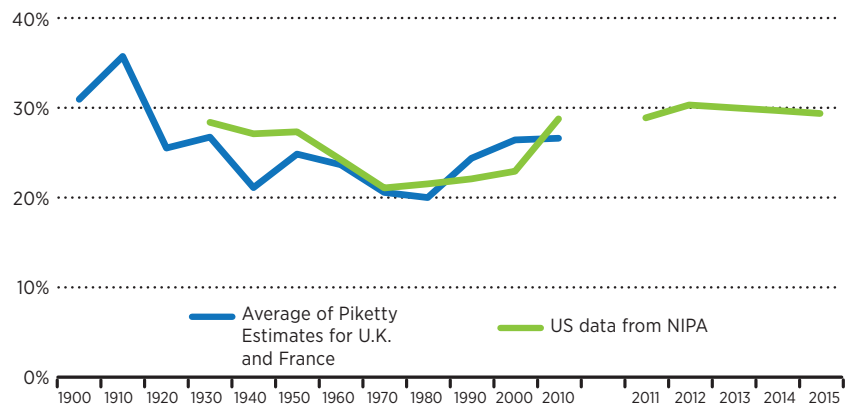
SOURCES: Thomas Piketty, *Capital in the Twenty-First Century*; Federal Reserve Board, *Financial Accounts of the United States*; Bureau of Economic Analysis, *National Income and Product Accounts*.

NOTE: Value for 2015 is the average of four quarters ending in the third quarter of 2015.

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FIGURE 2

α : Capital Income as Percent of National Income



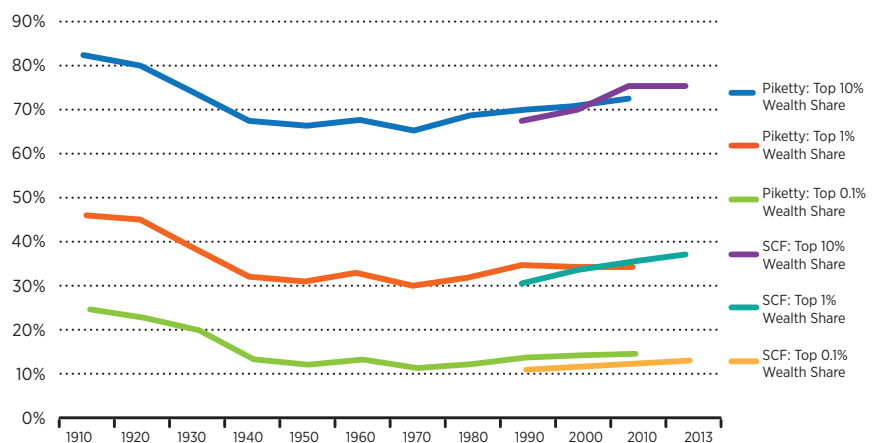
SOURCES: Thomas Piketty, *Capital in the Twenty-First Century*; Bureau of Economic Analysis, *National Income and Product Accounts*.

NOTE: Value for 2015 is the average of four quarters ending in the third quarter of 2015.

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FIGURE 3

Share of Total Wealth Owned by the Wealthiest 10 Percent, 1 Percent and 0.1 Percent of U.S. Families



SOURCES: Thomas Piketty, *Capital in the Twenty-First Century*; Federal Reserve Board, *Survey of Consumer Finances*.

NOTES: Survey of Consumer Finance values for 1990 and 2000 are linear interpolations of adjacent survey dates: 1989 and 1992 for the 1990 estimate; 1998 and 2001 for the 2000 estimate. The 2010 and 2013 values are taken directly from the SCF surveys for those dates.

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As was true for β (the capital-to-income ratio), α (the share of national income flowing to owners of capital) has remained recently at levels at or above those of the early 20th century.

Top wealth shares. An increasing share of national income flowing to owners of capital does not necessarily imply increasing concentration of wealth among a few rich families. The capital stock could grow faster than national income—raising β —even while the distribution of wealth across the population becomes more equal. Piketty showed, for example, that the capital share (α) in France has increased since 1950, but the share of wealth owned by the very richest families has not.⁴

Figure 3 displays the share of wealth owned by families that rank in the top 10 percent, top 1 percent and top 0.1 percent of the U.S. wealth distribution in each year (not necessarily the same families over time). Paralleling the post-World War II recovery of β and α in the U.S.—but unlike the situation in France—Piketty showed that the share of total wealth owned by the richest U.S. families increased steadily between 1970 and 2010.

Data from the Federal Reserve’s Survey of Consumer Finances roughly match Piketty’s estimates for 1990, 2000 and 2010 and show that wealth-concentration ratios increased further by 2013, the date of its most recent survey. Indeed, wealth shares of the top 10 percent, top 1 percent and top 0.1 percent of U.S. families

increased faster after 2010 than during the four decades ending in 2010.⁵ Thus, the increasing share of national income flowing to owners of capital in the U.S. has, in fact, coincided with increasing wealth concentration.

Wealth is more important than ever. Despite large asset-price declines associated with the Great Recession and weak investment in its aftermath, capital looms larger in the U.S. economy than it has in a century. The capital-to-income ratio and the share of national income flowing to owners of capital are at levels not seen on an extended basis since the early 20th century. The concentration of wealth ownership is not as high now as it was in the early 1900s, but its upward trend since about 1970 remains intact.

Based on these data, one can safely say that, at least through 2015, Thomas Piketty was right. Capital’s importance in the 21st century U.S. economy is growing. Building wealth has always been an important part of household financial stability. But with the typical family’s wage income growing slowly and capital’s role in the economy growing larger, owning productive assets and minimizing debt has never been more important for families’ financial success. ■

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ENDNOTES

- 1 Piketty, Thomas. *Capital in the Twenty-First Century*. Cambridge, Mass., and London: The Belknap Press of Harvard University Press, 2014.
- 2 For more technical details, see Piketty, Thomas; and Zucman, Gabriel. “Capital Is Back: Wealth-Income Ratios in Rich Countries, 1700-2010.” 2014, *Quarterly Journal of Economics*, pp. 1255-1310.
- 3 The major asset category excluded from this measure is consumer durable goods, which depreciate quickly.
- 4 The capital share (α) in France increased about 3 percentage points between 1950 and 2010, while the share of wealth owned by the richest 10 percent, 1 percent and 0.1 percent of families decreased by 10, 9 and 5 percentage points, respectively. The families that benefited the most from this deconcentration of wealth were those below the top 10 percent but above the median. Piketty called this group the “patrimonial middle class” because many of these families, while not rich, nonetheless were accumulating wealth during their lifetimes that could be passed on to their children.
- 5 The average annual increases in the share of wealth owned by the top 10 percent, top 1 percent and top 0.1 percent of families between 1970 and 2010 were 0.18, 0.14 and 0.08 percentage points per year, respectively. The average annual increases between 2010 and 2013 were 0.20, 0.48 and 0.31 percentage points, respectively.