MAGYAR TUDOMÁNYOS AKADÉMIA
Közgazdaság- és Regionális Tudományi Kutatóközpont

MTA KRTK KTI

Centre for Economic and Regional Studies
HUNGARIAN ACADEMY OF SCIENCES

MŰHELYTANULMÁNYOK DISCUSSION PAPERS

MT-DP – 2016/30

Two different sources of inequalities: profits and rents in advanced market economies

PÉTER MIHÁLYI – IVÁN SZELÉNYI

INSTITUTE OF ECONOMICS, CENTRE FOR ECONOMIC AND REGIONAL STUDIES,
HUNGARIAN ACADEMY OF SCIENCES - BUDAPEST, 2016

Discussion papers
MT-DP – 2016/30

Institute of Economics, Centre for Economic and Regional Studies,
Hungarian Academy of Sciences

Two different sources of inequalities: profits and rents in advanced market economies

Authors:

Péter Mihályi
Chair, Department of Macroeconomics
Corvinus University of Budapest
and External Fellow
Institute of Economics
Centre for Economic and Regional Studies,
Hungarian Academy of Sciences
E-mail: peter@mihalyi.com

Iván Szelényi
William Graham Sumner Emeritus Professor of Sociology and Political Science,
Yale University, USA
E-mail: ivan.szelenyi@yale.edu

August 2016

ISBN 978-615-5594-69-4
ISSN 1785 377X

Two different sources of inequalities: profits and rents in advanced market economies

Péter Mihályi – Iván Szelényi

Abstract

The starting point of our research is Piketty (2014) who follows Marx by asserting that rents are merely one of the forms of profits, therefore they do not require separate conceptual analysis and statistical separation. Speaking of the generation of rents (as a distinctly different mechanism from profit maximising business activity), we use a broader notion of rent than it was customary in the past 50 years. We return to the Ricardian tradition and define the institution of rent as payments for goods, services or for work in employment that exceed the competitive price. Our rent concept includes – *inter alia* - the income of those whose jobs are protected by unions or professional associations, with the same holding for top-managers or celebrities of the entertainment industry. We also show that state-generated oligopolies are not necessarily evil, as they are often justified by other social objectives than equity.

To conclude, three main propositions are presented: (i) rents are not anomalies of the advanced market economies, they are indispensable building blocks of it; (ii) rents are not the privilege of large companies and their owners; (iii) rents, rather than profits are the main driving force of the increase of wealth inequalities since the 1970s.

JEL: B12, D63, E01

Keywords: inequality, capital, capitalism, profits, rents

Az egyenlőtlenségek eredete:
profitok és járadékok a fejlett piacgazdaságokban

Mihályi Péter – Szelényi Iván

Összefoglaló

Kutatásunk kiindulópontja Piketty (2014) világsikerű könyve, amely azt a marxi hagyományt folytatja, miszerint a kapitalista gazdaságban minden járadék forrása végső soron a profit, ezért nincs sem szükség, sem lehetőség a járadékok önálló elemzésére, illetve a rájuk vonatkozó statisztikák összegyűjtésére. Mi viszont a járadékok keletkezését a profit-maximalizálásra épülő üzleti tevékenységtől elkülönítve magyarázzuk. Vagy másképpen fogalmazva: a járadék fogalmát szélesebben értelmezzük, mint ahogyan ezt az elmúlt 50 év szakirodalma tette. Az időben messzebbre nyúlunk vissza és a ricardoi járadékelméletet kíséreljük meg továbbfejleszteni. Ennek megfelelően járadéknak nevezünk minden olyan többletjövedelmet, amely magasabb, mint az az ár, amelyet árukért, szolgáltatásokért vagy alkalmazotti munkáért tökéletes piaci verseny közepette lehetne kapni. Ez a járadék fogalom lefedi – egyebek között – azoknak a többletjövedelmét is, akik szakszervezetek vagy szakmai érdekképviseletek által „védett" munkahelyeken dolgoznak, továbbá a vállalati top menedzserek és a szórakoztató ipar sztárjainak extra magas jövedelmét is. Tanulmányunkban azt is megmutatjuk, hogy sok esetben az állam által generált oligopól helyzetek nem tekinthetők egyértelműen károsnak, mert a verseny korlátozását nyomós társadalmi érdekek igazolják, s ezek felülírhatják az ily módon keletkező, a nagyobb jövedelmi egyenlőtlenségek miatti káros hatásokat.

Cikkünk végén három állítást fogalmazunk meg: (i) a fejlett piacgazdaságokban a járadékok nem tekinthetők valamiféle anomáliának, ezek a rendszer szükséges építőkövei; (ii) nem csak a nagyvállalatok és tulajdonosaik részesülnek járadékban; (iii) a vagyoni egyenlőtlenségek 1970-es évek óta megfigyelhető növekedéséért nem a profitok, hanem a járadékok gyors növekedése felelős.

Tárgyszavak: egyenlőtlenség, tőke, kapitalizmus, profit, járadék

JEL kódok: B12, D63, E01

I. INTRODUCTION

The purpose of this paper – the third within a series of our similar writings[1] - is to "bring rents back in", by and large neglected by mainstream economics. In a way we turn from Smith and Marx to Ricardo in search of a theoretically sound explanation to the phenomenon of "abnormal" or "extra" profits - as they are often labelled in current scholarly discussion.[2] While the question of inequality was a central theme to 19th century economics, in the 20th century the issues of inequality in incomes and wealth tended to be neglected. When it was brought back to the centre of attention, for instance by Simon Kuznets (1955), it was assumed that economic growth would automatically take care of it. During the past few years the topic received increasing attention, especially after the unconventionally voluminous, but nevertheless hugely successful book of Thomas Piketty, *Capital in the Twenty-First Century* (first published in French in August 2013).

According to Piketty, inequalities are not only increasing since the 1970s, but capitalism becomes unequal in a different way: more and more wealth is inherited. The Western-type of capitalism becomes **patrimonial capitalism**. In a sense, capitalism is being re-feudalised in front of our eyes. Piketty is essentially right, but for the wrong reasons. We can accept his assertion in the book and in many other places that inequalities have been growing for half a century, and we share his view that this is a major threat to the legitimacy of the liberal order both at the national and the international level. It is another, though not unimportant matter that the epoch between 1910-1970, when measured inequalities were reduced according to Piketty, was far from ideal. This period was burdened with – *inter alia* – the Great Depression, two world wars and the Iron Curtain.

At the same time, we are deeply sceptical about his central explanation, namely that excessive growth of profits[3] is the fundamental reason for the inequalities which, in turn, slow growth and generate popular dissatisfaction in the long run. Another controversial tendency in Piketty's work, as Acemoglu and Robinson (2014) and Atkinson (2015) point it out, is that it overemphasises the privileges of the top 0.1 – 1.0 per cent and their negative impact. This is problematic for two reasons: (i) the places in these elite groups are not long-lasting and not automatically hereditary[4]; (ii) the top 0.1 percent can influence the political process through voluntary donations disproportionately more than others, so it is important to assess

[1] See also Mihalyi – Szelényi (2016a,b)
[2] E.g. Summers (2016).
[3] In Mihalyi – Szelényi (2016a) we deal with the interpretation of the adjective „excessive" at full length. Piketty's entire argumentation is based on his alleged discovery of $\boldsymbol{r} > \boldsymbol{g}$, where $\boldsymbol{r}$ is average growth of profits and $\boldsymbol{g}$ represents the average growth of GDP/head. We show that the $\boldsymbol{r} > \boldsymbol{g}$ model is a statistical artifact, arising from the intermingling of the concept of profit and rent on the one hand, and capital and wealth on the other.
[4] See e.g. Stanley and Danko (1998).

with scrutiny what happens to their life-long accumulated wealth at the end: whether it serves good or bad social objectives, to more or less social inequalities.[5]

* * * * *

The rest of the paper is structured as follows. In Section II, we present something which is so obvious that people tend to overlook it, namely that much of our present inequalities are inherited from the pre-capitalist past and therefore cannot be explained by the general logic of capitalism. In Section III, we revisit Ricardo's theoretical legacy and make the distinction between two sources of inequality: one stemming from profit, the other from rent. In Section IV, we show that the Marxian concept of exploitation was based on the labour theory of value and Piketty was right, when he discarded this concept entirely. On the other hand, we show the way human and social capital play a greater role in the intergenerational transfer of wealth as compared to the inheritance of profit-generating physical capital. In the fourth section we focus on the economic and social implication of rent-seeking behaviour and contrast it with profit-seeking. Finally in Section 5, we conclude by stating that that rents are not anomalies in advanced market economies. They are among the indispensable building blocks which need to be taken into account both in model building and policy making decisions.

II. ALTERNATIVE EXPLANATIONS OF ECONOMIC INEQUALITIES

Before we dwell upon our interpretation of the sources of the *rising* economic inequalities of our times, we make five clarifications pertaining to the past and current *levels* of inequality which we consider essential, but for the economy of space we cannot adequately discuss in this paper.

(i) Pre-capitalist societies were brutally unequal, but they functioned in ways different from the textbook ownership models of 19th and 20th century "classical" capitalism. Inequity, suppression and discrimination were based almost exclusively on social rank/estate or racial, ethnic, caste, tribal or clan divisions. All of these positions tended to be hereditary, or to put it differently based on ascription, rather than achievement. These were the structures that mattered most in the social realm for thousands of years. Nevertheless, one can still find

[5] Think about *The Giving Pledge* initiative of Bill Gates and Warren Buffet, the well-known American billionaires. Their commitment is to dedicate the majority of their wealth to philanthropy, rather than transferring it to the next family generation. For an impressive list of signatories, see http://givingpledge.org/ .

unelected, hereditary rulers on the very top of the social ladder, such as the sheiks of the Gulf States, the kings and the tribal leaders of many African countries owning the most valuable modern capital assets of their own countries. As far as agricultural land is concerned, more than two-thirds of Africa's land is still under customary tenure, with right to land rooted in communities and typically neither written down nor legally recognised. In 31 of Africa's 54 countries, less than 5% of rural land is privately owned.[6] Hence, unlike Piketty, we do not believe that the largest part of present day inequalities can be derived from the "fundamental laws" of capitalism.

We are deeply convinced that ethno-racial, religious discriminations are still *the* major drivers of relative poverty in large parts of the world. Consider the situation of African-Americans or Native-Americans in the US, the fate of aborigines in Australia, the misery of indigenous people in some Latin American countries, the suppression of Muslims by Hindus, Shiites by Sunnites (or *vice versa*) etc. In China, farmers still cannot freely trade the land they use or the houses they own; the *hukou* system still limits the right of hundreds of millions of people to join the urban middle-class. In East European countries, especially in Bulgaria, Hungary, Macedonia, Romania, Serbia and Slovakia, the Roma (gypsy) population is discriminated. Other types of pre-capitalist social categorisations also remain highly consequential, like in Kazakhstan, where the entire population is "ranked" in three clans or *jüz* in Kazakh language. Within-family inequalities need to be mentioned as well, such as the fate of "missing women" in many parts of Asia.[7] Furthermore, as Piketty (2014) himself acknowledges, the principle of primogeniture still exists in many parts of the world: the eldest son inherits all of the family property (or a disproportionally large share).[8]

In the post-communist context we do not yet have the data to test Piketty's assertion, but we can accept his point as a valid research question. We can only speculate about how much of the freshly accumulated post-socialist wealth is going to be transferred to the next generation. It is particularly unclear, whether the children of the present oligarchs in Russia and China will have the possibility to pass the entire set of property rights to their children – including the right to sell these assets to foreigners or move the family's financial wealth to foreign countries.

(ii) In many rich countries, a significant part of the poor are first or second generation of immigrants.[9] This is – partly – the consequence of the Rodrik (2013) paradox: the bottom 10% of the richest countries earn three times more than the top 10% of the poorest countries. It is disputed what is the total effect of migration on global inequalities. The remittances are

[6] *The Economist*, July 16, 2016.
[7] See the seminal study of Sen (1992).
[8] *op. cit.* p. 362.
[9] In 2013, the foreign born population accounted for 13.2% of the total population in the US and 9.9% of the European Union. OECD (2015b) p. 17.

of great and increasing significance for many poor countries and contribute to the decreasing of cross-country inequalities. They are not negligible even in post-communist countries, for instance in Poland and in Hungary with moderate, but increasing outward migration.[10]

(iii) Low incomes arise from low minimum wages to a great extent. But minimum-wages, as a percentage of the median-wage vary significantly among the developed countries. In 2013, the legislated minimum wage amounted to 63 percent of the average wages of full-time workers in France, but only 39 percent and 37 percent in the United Kingdom and the US, respectively.[11] In cross-country comparisons, there is a trade-off between higher wage inequality and the level of underemployment among low-skill persons. The problem is even more severe for those not in the regular workforce. In the grey or black economy, people can earn incomes from all kinds of *ad hoc* activities, and those incomes never appear in the statistics.

(iv) All specialists of the subject know that there are intrinsic difficulties in measuring *statistical inequality* in a precise way. In a medium-size and small countries survey methods are simply not suitable to obtain reliable information of the top 1% or the top 0.1% of the population. For methodological reasons it is difficult to assess the changes in inequality in the short-run, say during the 3-4 years of tenure of a given government. It is very common that the widely used indicators move into opposite directions in such a short time (e.g. the Gini-coefficient and the percentage share of people living at a pre-defined poverty level). Although conceptually it is easy to make a distinction between pre-tax and after-tax incomes, in real life, it is difficult to know whether the system of taxation is not sufficiently progressive[12] or the crux of the problem is merely tax-evasion (cheating).

(v) While inequalities are obviously reflected in health outcomes at the society level, ill-health in itself is an independent source of injustice even in the most advanced countries. As a result of genetic heritage, a fatal accident or infection (e.g. AIDS) many people lose partly or fully their wage earning capabilities for a prolonged period of time, or forever. This and the uncompensated, above-average health expenditures are likely prohibit these people to accumulate wealth in line with their social peers. This does not have much to do with the political economy of capitalism, either.

[10] Mihalyi (2014).
[11] https://stats.oecd.org/Index.aspx?DataSetCode=MIN2AVE, accessed on 7 June, 2015.
[12] Few supporters of the progressive income tax system know that this idea was first coined by Marx and Engels in the Communist Manifesto.

III. PROFITS VERSUS RENTS

In the descriptive analysis of our times, Piketty works with a *five-class statistical* model. The bottom 50 percent is the lower class, the next 40 percent is the middle class, the top 10 percent of wealth-owners constitute the upper class[13], and this upper class is further divided to the top 1 and the top 0.1 percent. In his explanatory model, by contrast, Piketty relies on the Marxian *two-class political economy model* and takes no full account of the special situation of the self-employed who generate their income both from their own work and the assets they own.[14]

As it is well-known, Karl Marx focused on profit-wage differentials in Volume I of *Capital*. In an attempt to elucidate exploitation, he proposed a model with owners of capital as an ever shrinking minority and growing number of wage labourers who only receive the costs of reproduction of their labour power. Piketty accepts Marx's conclusion according to which there is an overarching, secular tendency for an infinite accumulation of capital, so it is concentrated in fewer and fewer hands. Marx wanted to show that property is not "theft" (Proudhon, 1840). He insisted that in all market exchanges equivalents are exchanged. It is not the personal greed of the capitalists that drives the institutions of exploitation and the extended capitalist reproduction process. The capitalists do pay the full price of the labour power of the workers (hence the costs of reproduction of labour power) to those whom they employ, but they keep workers working beyond the hours necessary to cover these costs and they appropriate the surplus created during the extra hours of work.

In a closed economy, under perfect competition, the individual capitalist has no choice. He has to keep wages at the level of reproduction of the labour power and he needs the surplus (profit) to reinvest in order to remain competitive with other capitalists. Hence the low wages of the working class and the profit of the capitalists fit into an equilibrium model. Under these circumstances the expanded reproduction process is a **positive-sum game**, and Marx also thought in that way, although he obviously didn't use this metaphor. If all profit has to be reinvested, more profit may mean more jobs (or what Marx in mid-19th century did *not* consider) higher wages for workers (to generate sufficient demand for capitalist production). John Roemer, arguably the most distinguished "rational choice neo-Marxist" correctly noted: "The neo-classical model of the competitive economy is not a bad place for Marxists to start their study of idealised capitalism".[15] While Piketty expressively

---

[13] See e.g. in Tables 7.1. – 7.3.

[14] This is not a small omission. In 2013, the share of self-employed in the working population was 16.5% in the EU27 and 6.6% in the US. https://data.oecd.org/emp/self-employment-rate.htm, accessed on 9 July, 2015. For the possible complications arising from this, see Guerriero (2012) paper.

[15] Roemer (1982) p. 196. Using another metaphor, this idealised capitalism is a win-win situation both for workers and capitalists alike.

rejects the Marxian *labour theory of value* and the *theory of exploitation* following from it, he tends to concur with Marx's followers in the 20th century and assumes that – apart from exceptional periods, when governments intervene into the economy with redistributive policies or when wars destroy the accumulated private wealth - wages remain relatively low all the time, while capital keeps increasing. But why does the infinite tendency towards capital accumulation and increasing inequality matter, if the capitalists keep reinvesting the profit in the production process hence creating more jobs? If expanded reproduction is a positive-sum game for the economy as a whole, what's wrong with it? Marx offered an original answer to this question, which, however, has proved to be wrong, the theory of declining rate of profit.

Once we step out from Marx's model based on the labour theory of value, we cannot question that cheap technology like computers can have massive productivity gains, and hence rise in national income. This is the explanation why profits in the real world did not decline, the revolution did not happen and instead the real incomes of workers have increased enormously since Marx's time. One qualification, however, is justified. Profit maximising behaviour *can* reduce wealth at the national level. A classic example is outsourcing (especially in case of off-shore investments of capital gains), which can cut wages, create unemployment at home, though it still creates wealth globally and tends to reduce global inequality.

David Ricardo ([1817], 2004), who lived two generations before Marx, was convinced that the concept of rent was indispensable to explain inequalities he observed. As it is well-known, he defined rent as **scarcity rent**[16]: an income derived from monopolistic ownership of agricultural land (and mines). In his framework, rent seeking was interpreted as a **negative-sum game**. Rents create no new wealth; rather they reduce economic growth and reallocate incomes from the bottom to the top.[17] The importance to contrast profits and rents is not trivial whatsoever. Already Ricardo noted the absence of clarity in this distinction: (Rent) "is often … confounded with the interest and profit of capital".[18]

While Piketty is challenging the ethical bases of the observable income and wealth inequalities, he preserves the framework of the mainstream, neoclassical theory of income distribution originally developed by J.B. Clark (1899).[19] Thus, wages and profits reflect respectively the marginal product of labour and of capital. A person's income is determined by his contribution to production, or more precisely, by the marginal productivity of the

[16] In economic text books this is often called „economic rent".
[17] As Ricardo put it "The rise of rent is always the effect of the increasing wealth of the country, and of the difficulty of providing food for its augmented population. *It is a symptom, but it is never the cause of wealth*" (our emphasis). (*op. cit.* p. 40)
[18] Ricardo (1817), 2004, p. 34.
[19] Perhaps this was one of the reasons why his book was so well received in many mainstream macroeconomic departments.

"factor of production" to which he contributes. It is a truly **zero-sum game**, with important consequences: (i) there is no "room" left for rents in the model, or (ii) it has to be assumed that rents are paid from profits at the end. Piketty accepts both explanations, but without saying so.[20] According to him, the neoclassical model is fundamentally right. When wage earners and capitalists fully share the annual national income between them, there is no injustice or exploitation: both classes get what they deserve. There is only one exception in Piketty's line of argumentation: the compensation of the highest paid executives of multi-billion dollar corporations. He does note that these "super managers" receive more than they deserve, owing to their influence and power in the firm, where they are employed. But for Piketty this is merely an undesirable, unnecessary small distortion of the market economy.

A. CHANGING AND NEW FORMS OF RENTS

Ricardo believed that agricultural land was despairingly scarce. Hence its supply is inelastic, while demand for food steadily grows. Under these circumstances the owners of land receive scarcity rent without producing more or better food – i.e. without producing new value. Such rents channel resources away from productive investments and cuts in real incomes of wage and salary earners. In part, Ricardo proved to be wrong, too. First, he did not consider how much the fertility of land can be increased. Secondly, and more importantly, the price/value of agricultural land declined after the inclusion of the Americas and Australia into the emerging capitalist world economy. In fact, even in the 21st century there is an abundant supply of uncultivated agricultural land around the globe.[21]

As we have already suggested in Section II, the early high levels of inequalities were driven by two other forces, and not the ones Marx and Piketty pinpointed. (i) In European countries (especially in England) the privileged estate was able to covert its feudal privileges into privileged positions on the market; (ii) Since appropriate mechanisms of market regulations were not in place, it was possible to create monopoly situations (this is what Marx deliberately excluded from his basic model in Volume of *The Capital*). In some well-noted cases, this type of monopoly or oligopoly was the source of the extraordinary wealth. John Rockefeller is a prime example who by 1900 controlled the production of crude oil, its refineries, transportation and retail sale. To reverse this state of affairs, it required Theodore Roosevelt's anti-trust regulations, which effectively put an end to his national monopoly

[20] Another way of saying what we think is that Piketty (2014) conflates profits and rents and - as Weil (2014), Stiglitz (2015) and Atkinson (2015) pointed out critically among others - he deliberately disregards the differences between capital and wealth. By contrast, Hodgson (2014) argues that the extended definition of capital which includes cash, bonds, collateralisable assets such as buildings, as well as intellectual property has analytical advantages as well.
[21] Under the FAO's definition, agricultural land covers only 33% of the world's land area.

through the "criminalisation" of these kinds of institutional arrangements to foster competition.

While socialist countries were believed to be highly egalitarian (that was certainly their legitimating ideology) and indeed inequalities measured in incomes were modest, but those with higher rank (high cadres) tended to be over-compensated by various fringe benefits. Hence inequalities under socialism in their logic resembled those of pre-capitalist societies. [22] Interestingly, the transition from socialism to market economy was partly driven by the same type of forces. Former communist cadres turned themselves into capitalists in the absence of appropriate regulations of the markets. In the early years, distorted domestic prices and austere limitations on consumer goods imports helped many of them to earn their "first one million dollars". This was more so the case in Russia, Ukraine and other post-Soviet successor states[23] than in Eastern Europe. In Russia today, the high concentration of privately owned wealth is based on the extremely high mark-ups applied in the natural resource sector (e.g. oil and gas). In other nations, the wealth of local oligarchs comes from similar types of rents even today. E.g., in Vietnam, capital control rules prevent foreign companies or individuals to own more than 49 percent of shares in any domestic corporation.

But let's return to Ricardo's theory of scarcity rent. Pareto ([1916] 1935)[24] and the American sociologist, Aage Sorensen (2000) already broadened Ricardo's notion of rent further to include all sorts of real estate and all kinds of monopolies. Stiglitz (2012) also points out that while the scarcity rent does not really apply to agricultural land anymore; it certainly applies to residential property and other real estate. In some urban areas around the world from London to Moscow, Shanghai and Singapore tremendous wealth was generated merely from the scarcity of highly desirable locations and not from productive labour or productive investment of capital. Today, the demand for housing no longer comes from just those people who live in these cities all the time, but from the global wealthy who want to have houses in the above mentioned globally attractive cities. This private, consumption-oriented wealth becomes the property of a new urban "aristocracy", which passes this wealth down from generation to generation. Such wealth, reminiscent to the wealth of land ownership of privileged estates under feudalism is concentrated. Indeed its concentration is especially high on the top 1 percent or even 0.1 percent of the social hierarchy. But, we hasten to add, there is a relatively large patrimonial upper-middle class,

---

[22] Szelényi (1978).

[23] In early 1990, the regulated wholesale price of one ton of crude oil was 30 roubles in Russia, which also happened to be the free retail market price of one package of Marlboro cigarettes. At the same time, the world market price for one ton of crude oil exceeded $100 – a historically unprecedented arbitrage opportunity. Åslund (1995) p. 42.

[24] Pareto in his *The Mind and Society* made an interesting distinction between "speculators" (foxes) and "rentiers" (lions), hence between those who seek profits and those who seek rents. A balanced market economy needs both foxes and lions, dynamism and innovation has to be counterbalanced by stability.

say the top 10-20 percent, which also benefits from all this, if they happened to inherit property in the above mentioned cities. Moreover, it is worth noting that here a self-reinforcing mechanism works. As the example of London shows in the light of the Panama Papers, the influx of foreigners drive up the property prices which in turn increases the return of such investments significantly already in the short-run.

But is it only land or real estate from which such rent can stem? When we speak of rent-seeking behaviour (as distinct from profit maximising business investments), we use a broader notion of rent than it was customary in the past 50 years of the literature.[25] **Max Weber's concept of closure** can be a useful way to conceptualise rent in such a broader way. He distinguished "open social relations", where participation is not denied to anyone who wishes to join from "closed relationships" where participation of certain persons are excluded, limited, or subjected to conditions. According to Weber closed groups manage to monopolise advantages to their party by occupying scarce and desirable positions, or by making desirable goods and services scarce through clientelistic practices, by creation of cartels or monopolies.[26] Today, scarcity rent is one of the explanations of the very high compensation packages offered to the best specialists. Firms, as well as universities, hospitals, sport clubs, etc. compete with their peers for stars. They don't want to lose a legendary CEO[27], a professor or an athlete to their rivals. It would hurt their prestige and profits. So they pay more and more, especially in those countries where excessively progressive income taxes do not counter-weight such incentives. Closure in itself is not a guarantee for success neither at the firm level, nor for an individual manager – but it is a great advantage vis-à-vis those who are exluded from the competition.

One of our contributions to the debate on rents is that we believe that it is justified to make a distinction between scarcity rent and **solidarity rent**.[28] E.g., membership in a trade union reduces wage differentials. While nation-wide unions tend to fight for the highest level of employment, branch based unions fight for the highest possible wages for workers in their branch (and union). Especially, branch unions can push wages in their branch above market wages, hence secure rent to "members". Through the highly sophisticated institution of collective bargaining, unions prevent the use of wage incentives to pay more to the best workers, teachers or doctors at the advantage of those who underperform. Arguably the income of those whose jobs are protected by unions or professional associations is composed by two factors: wages/salaries and rents. In developed democratic societies, one of the main functions of such institutions was to create conditions for rents. When the power of trade

[25] See e.g. Tullock (1967), Krueger (1974), Buchanan *et al.* (1980) and Bhagwati (1982).
[26] See Weber (1920) (1978), pp. 43-44.
[27] Solow (2014) calls this rent of supermanagers a „sort of adjunct to capital".
[28] In Stiglitz (2015) these two concepts are treated under a single – in our view misleading – heading: *exploitation rent*.

unions was on the rise, solidarity rent helped to reduce inequalities. However, in the context of the globalised world economy their weight declined[29], and this in turn was likely to have contributed to the stagnation of real wages for low-skilled manual workers in the manufacturing sectors of many advanced economies, and the US in particular.

Those who collect pension in a pay-as-you-go system also receive solidarity rent, people who are on social welfare, whose health insurance is paid by tax-payers contributions do the same (as distinct from those who are in a funded private pension scheme, or whose health care benefits are paid from private insurance policies). Ideally, fiscal transfers always work as mechanisms of solidarity rent – a transfer from the rich to the poor. But even more is true: given the logic of demand side economics rents can be economically beneficial since they can maintain or even boost consumption. This a strong argument for unemployment benefits, but even conspicuous consumption can increase demand, create higher profits and wages, and hence indirectly contribute to wealth generation.

Interestingly, even under socialism workers collected a rent on top of their wages: they had almost absolute job security. It was very difficult to lay off workers, even those who chronically underperformed, even if they showed up at work drunk. Hence their income was only partially remuneration for their work, some of the income they collected almost as "owners" of the collective firm.

Aage Sorensen (2000), whom we have already referred to, offered such a broad interpretation of rent: "Rents are payments to assets that exceed the competitive price or the price sufficient to cover costs and therefore exceeding what is sufficient to bring about the employment of the asset. (…) The existence of rent depends on the ability of the owner of the asset to control the supply".[30] Sorensen also pointed out that the association of rents with land is not required: "Rent will emerge on all productive assets that are in fixed supply and that actors need to maximise their wealth."[31] If we accept this framework, it follows that ownership of potentially rent producing assets, such as licenses, credentials, access to loans to start new businesses or be self-employed is not restricted to capitalists. Those who do not own profit-generating capital still have the possibility to accumulate wealth in other forms, such as pensions.[32]

---

[29] Between 1980 and 2013, average trade union density fell in the OECD countries from 33% to 17%. This decline is uniform across all member countries, with the notable exception of the Scandinavian countries and Iceland. https://stats.oecd.org/Index.aspx?DataSetCode=UN_DEN# accessed on July 10, 2015.

[30] *op. cit.* p. 1536.

[31] *op. cit.* p. 1537.

[32] It is noteworthy that in The World Top Income Database, the database underlying Piketty's book, consumer durables and unfunded defined benefit pensions are not taken into account.

Table 1

Piketty's theory in comparison

	Smith	Ricardo	Marx	Stiglitz	Sorensen	Piketty
Source of inequality	Free competition reduces inequality of feudal privileges.	Scarcity of agrarian land and mines produces rent.	Profit for owners of capital wages for owners of labour power.	Profit for owners of capital and rents for owners of scarce resources.	Control over supply by ownership of scarce assets – leads to rent.	Return on capital (*r*) (profit + rent).
Market competition	Perfect.	Competition for scarce land is limited.	Perfect.	Imperfect information and imperfect competition.	Perfect competition for profits vs. wages, imperfect competition for rent.	Perfect competition, except for inherited capital/wealth.
Labour theory of value	Accepted.			Rejected.		
Marginal productivity theory of income distribution	Not known.			Accepts it as a good approximation, by noting that it has become less and less applicable in the last 30 years.	Rejected.	Accepts it as a general rule, but notes that it is less and less applicable to the top 1 percent (supermanagers).
Social classes	Three non-antagonistic classes based on ownership of factors of production: labour, capital and land.		Two antagonistic classes based on relations of production owners of capital vs. proletariat.	Non antagonistic classes based on distribution of income, upper class, middle class, and lower class.	Antagonistic classes, owners of scarce assets are exploiters, those who do not collect rent are exploited.	Three non-antagonistic classes based on distribution of income, (upper, middle and lower), but antagonism between rent-seekers and the rest of the society.
Future of capitalism	Radiant.	May be destroyed as scarcity rent is increasing.	Declining rate of profit and the revolution of the proletariat will destroy capitalism in the most advanced countries.	Progressive taxes on incomes and taxes of rent generating wealth may save capitalism.	No prediction.	Without a global reform of taxation meritocratic, capitalism will become rent-seeking patrimonial capitalism.

Now, we have arrived to the central definition of our paper. We define rent as the difference between what income would have been in "open relationship" by "closing" such relationships to certain individuals or categories of individuals. In simple algebraic form:

Income from closed relationship – income from open relationship = rent.

It may be difficult to empirically measure all types of rents, but their existence can be demonstrated through counterfactual reasoning. What would have been the income of a closed group, if its members would have been competing in open relationships? At first sight, the Weberian concept of „closed" and „open" relationships looks identical to the proposition in Acemoglu and Robinson (2012), who coined the terms „*exclusive*" and „*inclusive*" societies. But the two are not the same. The American authors – as the title of their book emphasizes – analyse the growth process at the level of nations. Weber speaks of „closed" and „open" relationships within a given economy – and this is the right approach, if we analyse inequalities within a given country. The same can be said about the dual concept of "*open and limited access orders*" presented in North *et al.* (2012). Nevertheless, we strongly agree with their other assertion about the ubiquitous presence of rent in every society, including the most advanced countries.

Within a well-defined historical-political epoch – say lasting 20-30 years in which average people can make personal comparisons - rents can be **temporary** or **enduring**. An entrepreneur who invents new technology may collect rent for a while, but eventually his competitor will invest into the same or a similar technology and this rent will disappear, the incomes of competing entrepreneurs will be set by the supply and demand mechanism. There are many spectacular examples of this: the success of the Windows operating system invented by Microsoft, the rise of the cell-phones which crushed the privileged position of copper-cable based telephone companies, or the shale revolution over the past decade which entirely reshaped the OPEC controlled traditional oil industry. Following Sorensen (and also Marshall (1920)), we can identify two enduring sources of rent. First, some of the *national* monopoly rents enjoyed by entrepreneurs are created naturally, since the costs of entering production within a given country is often prohibitive due to the increasing returns to scale (e.g. network industries).[33] Rents may be created by governments, by issuing concessions to open mines or licenses to run tobacco and liquor shops. Second, there are personal rents on biological endowments, such as genetic predispositions (e.g. special talent in popular sports or in arts) at the level of individuals, and resource endowments at the level of firms and

[33] In the context of globalisation, however, there is a growing number of companies worldwide in every industry, thus competition is actually increasing at the international level.

countries exploiting mineral wealth[34] and other types of geographical advantages such as access to open sea, sunny beaches or snowy mountains, etc.

The rent-based interpretation of the importance of the natural resource sector can be further generalised. As the Hungarian economist, János Kornai (2013) convincingly argued, in other sectors, such as manufacturing or services the most important **markets are oligopolistic** which allow the most efficient firms to harness higher than average profits through arbitrarily large mark-ups, or using our terminology: exploiting a scarcity rent. Usually there are two interrelated factors behind this: pioneering technology[35] and economy of scale arising from the concentration of firms within any given country. While this generalisation may sound idiosyncratic for many economists trained on neoclassical equilibrium models, it is a common place in the management science literature to say that many important industries never have more than three significant competitors.[36] The same trend in the literature also claims that in many markets the shares of the three leading companies reach a ratio of approximately 4:2:1 – i.e. there is a significant market share difference even among the top firms. Data from US Census Bureau also support this claim. E.g. in 2012, the top four US firms' average share of total revenue on a sector-by-sector basis was close to 50% in IT, telecoms and media sector, 40% in retail trade and almost 40% in the finance and insurance sector.[37]

It is very important to underline that state-created monopolies or oligopolies are not necessarily evil, as they are often justified by other social objectives rather than social equity. For example, there are good and widely accepted reasons why intellectual property rights of pharmaceutical companies, individual innovators and artists are defended by "closure" in the Weberian sense through patents and copyrights. It is not surprising that Aghion *et al.* (2015) found positive and significant correlations between innovativeness in the US on the one hand, and top 1 percent income shares on the other. Similarly, it makes a great deal of sense to require state permission for firms to build nuclear power stations, or even simple two-storey houses. It is also in the general interest that physicians have to acquire a special occupational license (e.g. a university diploma) before they can start treating sick people. Other types of regulations (e.g. land use by-laws in urban areas) can be assessed, if at all, on a case-by-case basis only.

---

[34] For many years the World Bank has been regularly publishing country time series under the label *Total natural resources rents (% of GDP)*, whereby rents are defined as the sum of oil rents, natural gas rents, coal rents (hard and soft), mineral rents, and forest rents. See http://data.worldbank.org/indicator/NY.GDP.TOTL.RT.ZS

[35] This is a temporary advantage, as we explained earlier.

[36] This finding was first demonstrated by the founder of the Boston Consulting Group, Bruce Henderson (1976) and then later re-confirmed empirically on a much larger data set by Reeves *et al.* (2012). Since then, successful companies, like General Motors and others live according to this maxim. If they cannot become Number One or Two in an industry, they get out from that market and reinvest their resources somewhere else.

[37] See *The Economist*, 26 March 2016.

B. INSTITUTIONAL CONSEQUENCES OF RENT

If the rise of rents begins to match or even overtake the growth of incomes from profits and wages, this can have major (often unintended and undesired) institutional consequences. We can think of at least two such institutional consequences. Firstly, certain type and some level of rent are necessary for social cohesion and innovation in society. Such rents may be seen as "deserved", but at one level they are still "unearned". The major legitimacy claim of market capitalism is meritocracy. At one point rents generated by any means can be seen as "excessive", if public opinion judges it of too much" for those who "did not work for it". Most people accept some rent to drug manufacturers/innovators, but there may be a ceiling how much is seen as "reasonable" and how much is judged as "exploitive". Same goes for social benefits. In civilized societies most people accept that the poor (or disabled) should have some social support – even if it is "unearned" –, but at one point it may be judged to be "far too much". Even in the US the most sacred social institution like Social Security has be challenged – so far unsuccessfully. Should Social Security be "privatised", hence turned it from "rent collection" to "profit incomes" on deposits made during life time? This is an often discussed alternative to the present arrangement, although given the broad political support for Social Security it is likely to remain the sacred cow of US politics.

Secondly, if the wealth of individuals comes increasingly from rent rather than wages or profits, there is little institutional incentive that rent will be reinvested in the most efficient way. The *nouveau riche* or the inheritors are tempted to waste the rent they collected: Easy come, easy go. Profit maximising entrepreneurs tend to invest their profits in optimal ways so fight off competitors. Rent collectors don't face competition, rent can be spent as "conspicuous consumption". The *nouveau riche* entrepreneur tends to use a chauffeur driven Mercedes, or private plane well before they can afford it. The second and especially third generation "inheritors" may spend their inheritance in good case on charity, in bad case on conspicuous consumption. Absence of the institutional mechanism of owners of wealth to use it the most efficient way can have devastating social and economic consequences. It can lead to state failure and economic stagnation or even collapse.

C. CLASS REPRODUCTION THROUGH THE ACCUMULATION OF HUMAN AND SOCIAL CAPITAL

The **educational system** is an important terrain of closures, as defined by Max Weber. Given the high costs of education, especially of elite education, access to the most highly valued education may not be open to all, but it is closed to youth whose parents can afford the often prohibitive costs.

This is particularly prevalent in the US. At Ivy League universities youth from white upper-middle and upper class is overrepresented in spite of all efforts to support the children of less privileged families. One obvious mechanism is strictly achievement based entrance exams, where the children coming from more affluent families simply outperform those who arrive from average families. It is less obvious that the recent trend for US colleges to admit students not just on the basis of intelligence, but on the basis of being "well-rounded" (i.e. having taken ballet classes, performed in plays, founded clubs, volunteered time helping handicapped children, etc.) works in the same direction. Whereas there is some randomness in the distribution of intelligence, all these extra-curriculum activities are things that only very upper middle class, private school children can do.[38] In sum, inheritance is another market based institution which creates rent for the inheritors. This can be inheritance of wealth (even just valued real estate) or social status linked to education in elite universities.

The experience of the United States, in many ways the pace-setter of the capitalist economic system shows that family formation through **assortative mating** further strengthens these tendencies.[39] Since educated men tend to marry educated women more often than two generations ago, this inevitably leads to a concentration of income and wealth, which in turn helps these "privileged" parents to invest time and money in the future of their children literarily from the day of their birth. Children born in families, where both parents (and perhaps even grandparents) hold a university degree, are outcompeting their less fortunate peers throughout the education ladder and later on the job market. This is the main institutional channel through which social inequalities are regenerated and hence patrimonial capitalism is taking more and more ground – not so much for the top 1 percent, as Piketty suggests[40], but for the entire upper-middle class. Three successive cohort studies of 70 thousand children born in the UK in 1946, 1958 and 1970 showed that childhood circumstances determined by the social status of parents profoundly influence lifetime

[38] The authors are grateful to Daniel Treisman for this observation.
[39] Greenwood *et al.* (2014).
[40] *op. cit.* 485-486.

inequalities in spite of all the welfare measures introduced by successive British governments.[41]

There is an additional mechanism of closure in the educational system and that is **credentialing**. Education is often conceptualised in terms of human capital investment. It is usually assumed that human capital invested into education will lead to productivity gains and higher incomes for the better educated results from such productivity gain. But especially powerful professional associations (such as American Medical Association, or American Law Boards) requiring bar examinations play a role to control the supply of occupations under their jurisdiction, hence they may drive up incomes for those occupations by adding a rent to their income from work.

The emphasis on credentialing (rather just on education or training) may have consequences on what kind of knowledge will be required from candidates seeking valued credentials. Not all knowledge required to pass critical exams will have productivity gains, it may be just knowledge which is useful to screen candidates for such credentials. This is what Bourdieu ((1970) 1977) called "**cultural capital**" as distinct from "human capital". Cultural capital serves more the purposes of the reproduction of the "patrimonial middle class", or "patrimonial upper class" rather than increasing the productivity of the graduate. For parents it may costs as much as $300,000-$400,000 just to get their children an Ivy League BA or BSc – but the descendants' Ivy League degree will pass on to them the status of "nobility". Employers will seek Ivy League graduate not necessarily since their technical skills are better, but because hiring such people will add to the prestige of their institution.

* * * * *

There is no need to list examples to show that the term rent is used with different meaning not only in common parlance, but also in the scholarly literature. In this section we tried to delineate the various types of rents and their characteristics. In the spirit of Ricardo, Weber and Sorensen, we consider all incomes as rents, if they stem from ownership of *any* assets, where access to such assets is closed for other economic actors. Our list at present comprises of 9 forms of rents, but it is not exhaustive. Depending on the institutional setup of different countries, additional categories could be included.

[41] Pearson (2016)

Table 2

Rents extracted in advanced market economies by firms and individuals

		Time horizon		Favorably mostly for	
		Temporary	**Enduring**	**Owners of for-profit firms**	**Ordinary individu-als**
	… without direct state involvement				
1	Innovative technology	x		x	
2	Positional goods and services (e.g. agricultural land*, real estate, honoraria of art and sport celebrities)		x	x	x
3	Natural monopolies based on economy of scale and scope (e.g. network industries, shopping malls)		x	x	
4	Limits to market entry by professional organizations (e.g. lawyers, doctors)**		x		x
5	Cartel agreements	x		x	
	… with direct state involvement				
6	Copyrights and other sorts of protection of intellectual properties (e.g. pharmaceutical industry)	x		x	x
7	Solidarity rent (e.g. collective bargaining, welfare payments)		x		x
8	Limits to market entry through licensing (e.g. medical profession)		x		x
9	State capture (e.g. discriminative law-making, tainted public procurements)	x		x	

Notes: * First analysed by D. Ricardo. ** First analysed by A. Smith.

IV. CONSEQUENCES OF INEQUALITIES

Before we move further, let us put the institution of rent in brackets for a moment, as if it didn't exist, because we do not want to underestimate the importance of relative dynamics in the movements of profits and wages. As long as wages are on the rise, this is a positive-sum game, as we argued above. Neoclassical equilibrium models are all based on this assumption, which was perhaps not very far from reality until recently. Globalisation, however, has brutally changed the outcome of the game.[42] While profits have been rising in

[42] See Solow (2015) which bluntly acknowledges this.

many sectors of the US, Germany and other big economies, real wages in the same sectors were stagnating as a consequence of – *inter alia* - outsourcing and the growing share of financial sector. Hence, we agree with Piketty that today the wage-profit relationship in the advanced Western countries could become a negative-sum game for low-skilled workers and employees, which in turn fuels populist sentiments against globalisation, migration and the highly educated, highly paid business executives.

Having said this, we assert that the profit - wage inequality is only loosely related to economic growth or social stability. In some societies – in the United States for instance – high inequalities are accepted and the US produces relatively fast growth and social stability with GINI over 0.40. Some other societies (in Scandinavia for instance) do not tolerate inequality well, but they can still produce good growth rates and great social stability. In contrast to Piketty's main line of argumentation, we contend that voters and political activists are chiefly concerned about *personal inequalities* of income around them, and much less about the concentration of economic wealth and power in the form of publicly traded shares or family-owned companies – i.e. the apposite wealth of capitalists in a class-based model. While it is true, that sensational formulations, such as "48 percent of the world wealth is owned by 1 percent of world's population"[43], can easily catch the attention of the media and through the media these numbers stuck in the memory of social scientists – including Piketty, who often quotes such data -, these "facts" are not mobilising ordinary people. In other words, most people are agitated not because of the gap between business people and wage-earners, but rather because of the large variation of employee-wages. Typical cases are when the salaries of doctors, teachers or policemen are compared to the salaries of bank managers or widely-known celebrities in the area of sport or music, or minimum wages are compared to the minimal cost-of-living. This is one type of scarcity rents, as we explained above. Thus, we cannot leave out rents from the argumentation.

The current that can be seen as running counter to Piketty is that increasing levels of inequality do not necessarily lead to political instability. Important counter-examples can be observed both in Western and post-communist democracies and post-communist authoritarian regimes. The disprivileged poor are inclined to abstain from voting in elections. This holds for such divergent countries as the US or Hungary, and the political elites are fully aware of this. In a vote-maximising strategy, pro-poor policies simply don't pay off. In authoritarian China, where elections are largely ceremonial, inequalities skyrocketed, but so far the popular response was mute. Since 1978 economic growth was phenomenal, the boats of hundreds of millions were lifted out of poverty with the rising tides,

[43] Oxfam (2015), the renown charity timed the publication of its fresh research for the opening of the Davos economic summit, and skillfully captured the headlines of many newspapers. Another sensational formulation of the same report was that "85 richest people on the planet have the same wealth as the poorest 50% (3.5 billion people)".

even though at very unequal speed. So people might have accepted more inequalities as long as their prospects for a better life seemed secure. Martin Whyte (2010) found that inequality was not a major concern for the ordinary Chinese. Russia had similar experiences during the first few years of the 21st century.[44]

Furthermore, everyday experience as well as academic research show that ordinary people have little idea about the true (i.e. statistically measured) size of inequalities in their own countries. Gimpelson and Treisman (2015) demonstrated on a variety of large, cross-national surveys that what people think they know is often wrong. In their list of 40 countries, the "least correctly informed" people are the citizens of 8 post-communist countries (Ukraine, Hungary, Croatia, Slovak Republic, Estonia, Poland, Slovenia and the Czech Republic); while on the top of the list we find two rich welfare states (Norway and Denmark).[45] Moreover, they showed that the *perceived level of inequality* – and not the actual level – correlates strongly with the ideologically motivated demand for redistribution and the reported conflicts between the rich and the poor.

What really annoys people – ordinary people and social scientists alike - is the knowledge *or* the presumption that the successful entrepreneurs and specially the most successful ones are greedy, dishonest and corrupt. In the North American media, during the recent financial crisis, "Main Street" represented the interests of everyday people and small business owners, in contrast with "Wall Street" (in the United States) or "Bay Street" (in Canada), symbolising the interests of highly paid managers working for large banks and corporations. In Southern European countries, like Bulgaria, Romania or Greece, where rent seeking, managed by government is especially common, this can be seen as an important reason for political instability and the strikingly low trust in market institutions as such. Under particular historical circumstances, rent-seeking may have devastating consequences to economic performance and brutally negative impact upon the society (e.g. Venezuela, Brazil).

As we have already shown on the example of Ricardo's failure to predict "scientifically" the rise of scarcity rent for agricultural land, it is inherently impossible to predict the future trends of other types of scarcity rents, too. The last 20 years exemplified that rents on oil- and gas extraction can vary enormously and with this the relative income position of the workers as well. The same explanation holds for the case of Norway and the UK, if compared to France of Italy. In Central and Eastern Europe, the "free" money flowing from the European Union has been the chief motivation of rent-seeking practices of those firms,

[44] The Mihalyi – Szelényi (2016b) paper is entirely devoted to the role of rents in the transition process from the pre-1989 socialist to the present day capitalist system.

[45] The list was compiled from a questionnaire, where people were asked to choose the income distribution diagram with the Gini coefficient closest to the correct one for their country in 2009. On the top, 61% of the Norwegian respondents made the right choice concerning the distribution of post-tax-and-transfer incomes, while in Ukraine only 5 (!) per cent of the respondents were right.

individuals, local governments, etc. which feel themselves close to the centre of political power, where the access to EU-funds is controlled.

V. CONCLUSIONS

It is often left out from the narrative that while *intra-country* inequalities have been rising, globalization significantly decreased the *inter-country* inequalities due to the large population weight of China and India, as opposed to the relatively small weight of many very small, but very poor African countries. Rising international competitiveness of these large economies (as well as the successful post-communist member states of the European Union) have a depressing effect on the real wages of the median blue-collar factory workers in the older market economies. The rise of wages in the developing countries is the cause of the wage stagnation in the developed countries – these are the two sides of the same coin.

Our main inference in the present paper is that the crucial question is not the extent of measured inequality (income or wealth). Countries with GINI around 0.20 or 0.40 can equally be economically dynamic and socially cohesive. Beyond the still remaining pre-capitalistic, ethno-racial, religious, gender-based pay gaps, etc. described in Section I, our key political economy question is what mechanism generates inequality in the business sector: profit-seeking or rent-seeking. The statistically measured changes in the distribution of wealth at the society level cannot be explained by the fluctuations of profits, as Piketty contends. Since the 1970s rents play an increasingly important role. Our second assertion is that rents are not anomalies in liberal market economies. They are time and again generated by governments or other collective agencies in the workings of free markets. To a large extent, they are unavoidable and indispensable, while at the same time they are potentially dangerous for the system's stability. Hence, our contribution to the current literature is the re-introduction of the Ricardian concept of rent in a predominantly value-neutral manner.

In other cases rents are destructive. There are two main institutional arrangements along these lines: state capture by private businesses and market capture by political elites. These are obviously harmful phenomena and may threaten the legitimacy of such regimes and/or undermine their economic efficiency. Nevertheless, unlike Ricardo and much of current economics literature, we interpret rent broadly (in the spirit of North, Wallis, Weingast and Sorensen). Rent originates not only from ownership of land, mines, real estate, but from ownership of any asset which is scarce - either "naturally" or made scarce by insufficiently regulated markets or state intervention in favour of clients.

Piketty's book suggests a gradual shift from progressive income tax[46] toward progressive wealth and inheritance taxes. Beyond a certain amount of relative wealth (defined in the context of a given country) our distinction between wealth emanating from profits or rents is not relevant, hence such reforms are sensible for us, too. This may call for lower tax rates on incomes, profits and consumption (VAT) and higher tax rates on inheritance and capital gains. For sure, the fact that current tax rates are extremely low in the OECD countries allows huge manoeuvring room for future change.[47]

Finally, when discussing inequalities, it is a mistake to focus on the wealth of the top 1 percent or 0 .1 percent, as Piketty does, because the positions in these elite groups are not long-lasting and not necessarily hereditary. Through the combined effect of accumulated human and social capital, higher per capita incomes, inherited real estates and assortative mating, the yawning gap between the families of the top 20 percent and the rest of the society is much more upsetting. There is a great deal of irony in the fact, that readers and enthusiastic supporters of Piketty's book who likely belong to the patrimonial upper class, the top 20 percent of their own countries everywhere, are so irritated by the wealth of the top 1 percent. As Robert Solow maliciously noted, there is a relationship between this biased focus of the Piketty book and its phenomenal international success: **envy is a more powerful emotion than compassion**.[48]

[46] Few supporters of the progressive income tax system know that this idea was first coined by Marx and Engels in the Communist Manifesto (1848).

[47] In 2012, the combined revenue from all kind of property and (net) wealth as a percentage of GDP was in the range of 0.3% (Estonia, Mexico) and 3.9% (UK). https://stats.oecd.org/Index.aspx?DataSetCode=REV accessed 9 July, 2015.

[48] Robert Solow in Conversation with Paul Krugman: "Inequality: What Can Be Done?, 1 May, 2015 https://www.youtube.com/watch?v=DGmUtJkTaqc

REFERENCES

Acemoglu, Daron and Robinson, James A. (2012): *Why Nations Fail, The Origins of Power, Prosperity, and Poverty*. Harvard University Press.

--- (2014), “The Rise and Decline of General Laws of Capitalism Daron”, Manuscript, http,//economics.mit.edu/files/10302, downloaded 17 July, 2015.

Aghion, Philippe, Ufuk Akcigit, Antonin Bergeaud, Richard William Blundell, and David Hemous (2015): "Innovation and Top Income Inequality", *CEPR Discussion Paper* No 10659.

Åslund, Anders (1995): *How Russia Became a Market Economy*, Washington, D.C., The Brookings Institution.

Atkinson, B. Anthony (2015): *Inequality*. Cambridge, Harvard University Press.

Bhagwati, Jagdish N. (1982): “Directly Unproductive Profit-Seeking (DUP) Activities”, *Journal of Political Economy*, 90, 988–1002.

Bourdieu, Pierre and Passeron, Jean-Claude (1970) (1977): *Reproduction in Education, Society and Culture*. London, Sage.

Buchanan, James M., R.D. Tollison and Gordon Tullock (eds.) (1980): *Toward a Theory of Rent Seeking Society*.

Clark, John B. (1899): *The Distribution of Wealth, A Theory of Wages, Interest and Profits*.

Gimpelson, Vladimir and Treisman, Daniel (2015): “Misperceiving Inequality”, *NBER Working Papers* No 21174.

Greenwood, Jeremy, Guner, Nezih, Kocharkov, Georgi and Santos, Cezar (2014): ”Marry Your Like, Assortative Mating and Income Inequality”, *NBER Working Paper*, 19829, January

Guerriero, Marta (2012): „The Labour Share of Income around the World, Evidence from a Panel Dataset”, University of Manchester, Institute for Development Policy and Management, *Working Paper* No. 32.

Henderson, Bruce (1976): „The Rule of Three and Four“, https,//www.bcgperspectives.com/content/Classics/strategy_the_rule_of_three_and_four/

Hodgson, Geoffrey M. (2014): “Piketty has Redefined Capital, after 200 Years of Confusion”, http,//theconversation.com/piketty-has-redefined-capital-after-200-years-of-confusion-25770

Holcombe, Randall G. and Boudreaux, Christopher, J. (2015): “Market Institutions and Income Inequality”, *Journal of Institutional Economics*, published online: 20 July 2015.

Kornai, János (1986): “The Soft Budget Constraint,” *Kyklos*, Volt, 39. No. 1. 3-30.

--- (2013): *Dynamism, Rivalry, and the Surplus Economy. Two Essays on the Nature of Capitalism*, Oxford University Press.

Krueger, Anne O. (1974): “”The Political Economy of Rent Seeking Society”, *American Economic Review*, 64(3), 291-303.

Kuznets, Simon. (1955): “Economic Growth and Income Inequality”. *American Economic Review*, 45(1), 1-28.

Marshall, Alfred (1920) (1949): *Principles of Economics*. London, McMillan.

Marx, Karl (1867) (1954): *Capital. A Critique of Political Economy*. Moscow, Progress Publisher

Marx, Karl and Engels Friedrich (1848): *Manifesto of the Communist Party*, https://www.marxists.org/archive/marx/works/download/pdf/Manifesto.pdf

Mihalyi, Peter (2014): "Post-Socialist Transition in a 25-Year Perspective", *Acta Oeconomica*, Vol. 64. (S1), 1-24.

Mihalyi, Peter and Szelényi, Iván (2016a): "Wealth and capital: a critique of Piketty's conceptualisation of return on capital", *Cambridge Journal of Economics* (forthcoming).

Mihalyi, Peter and Szelényi, Iván (2016b): "The Role of Rents in the Transition from Socialist Redistributive Economies to Market Capitalism", *Comparative Sociology* (forthcoming).

North, Douglass C., Wallis, John Joseph and Weingast, Barry R. (2012): *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History*, Cambridge University Press.

OECD (2015a): *In It Together, Why Less Inequality Benefits All*, OECD Publishing, Paris.

DOI, http,//dx.doi.org/10.1787/9789264235120-en.

OECD (2015b): *Indicators of Immigrant Integration 2015. Settling In*. OECD Publishing, Paris.

Oxfam (2015): *Wealth, Having it all and wanting more*, 19 January. Downloadable from http,//policy-practice.oxfam.org.uk/publications/wealth-having-it-all-and-wanting-more-338125

Pareto, Vilfredo (1916) (1935): *The Mind and Society*. (Trattato Di Sociologia General), New York, Harcourt, Brace.

Pearson, Helen (2016): *The Life Project*, Allen Lane.

Piketty, Thomas (2014): *Capital in the Twenty-first Century*. Cambridge, Harvard University Press.

Proudhon, Pierre Joseph (1840) (1994): *What is Property? An Inquiry into the Principle of Right and Government*. Cambridge, Cambridge University Press.

Reeves, Martin, Deimler, Mike, Stalk, George and Pasini, Filippo L. Scognamiglio (2012): "BCG Classics Revisited, The Rule of Three and Four", https,//www.bcgperspectives.com/content/articles/business_unit_strategy_the_rule_of_three_and_four_bcg_classics_revisited/ .

Ricardo, David (1817) (2004): *Principles of Political Economy and Taxation*. Mineola, N.Y., Dover Publications.

Rodrik, Dani (2013): „The Past, Present, and Future of Economic Convergence", http,//www.sss.ias.edu/files/pdfs/Rodrik/Presentations/Past-Present-and-Future-Economic-Convergence-(October2013).pdf

Roemer, John (1982): *A General Theory of Exploitation and Class*. Cambridge, MA, Harvard University Press.

Sen, Amartya (1992): "Missing Women", *The British Medical Journal*, Vol. 304, 7 March.

Solow, Robert M. (2014): "Thomas Piketty Is Right", *New Republic*, 22 April.

Solow, Robert (2015): "The Future of Work, Why Wages Aren't Keeping up?", *Pacific Standard*, 11 August.

Sorensen, Aage (2000): "Toward a Sounder Basis for Class Analysis', *American Journal of Sociology*, 108(6), 1523-1558.

Stanley, Thomas J. and Danko, William D. (1998): *The Millionaire Next Door, The Surprising Secrets of America's Wealthy*, Simon and Schuster.

Stiglitz, Joseph. (2012): *The Price of Inequality*. How Todays Divided Society Endangers Our Future. New York, W.W. Norton.

--- (2015): "New Theoretical Perspectives on the Distribution of Income and Wealth among Individuals", Parts I-IV, *NBER Working Paper Series*, 21189, 21190, 21191, 21192.

Summers, Larry (2016): "Corporate profits are near record highs. Here's why that's a problem", http,//larrysummers.com/2016/03/30/corporate-profits-are-near-record-highs-heres-why-thats-a-problem/ Downloaded, 30 March, 2016.

Szelenyi, Iván (1978): "Social Inequalities in Socialist Redistributive Economies", *Journal of Comparative Sociology*, 19.1-2, 63-87.

Tullock, Gordon (1967): "The Welfare Costs of Tariffs, Monopolies and Theft", *Western Economic Journal*, 5 (June), 224-32.

Weber, Max (1920) (1978): *Economy and Society*. Berkeley, CA, California University Press.

Weil, David N. (2015): "Capital and Wealth in the Twenty-First Century", *American Economic Review*, Vol. 105 No. 5. 34-37.

Whyte, Martin K. (2010): *Myth of the Social Volcano*. Stanford, Stanford University Press.