

## “Institutions Matter”

This week witnessed the launch of the Arabic translation of economist Thomas Piketty’s successful book “Capital in the 21<sup>st</sup> Century”. Piketty was kind enough to deliver a 30-minute talk outlining the key themes of his book and how they scale to a Middle Eastern context. We were privileged to attend and wished to share the key highlights with you.

The presentation addressed three key themes:

- 1) The long run dynamics of income inequality
- 2) The return of a wealth based society
- 3) Inequality in developing countries in the post-colonial world

The book generally fails at capturing income trends in the Middle East. Piketty attributed this to the absence of income & tax data. In later discussions with the attendees when questioned on the validity and accuracy of income and tax data in a country with such a big informal sector he conceded that income tax data might not be fully representative. Yet he urged the audience to not give up on data transparency and enhanced data reporting on account of the data limitations.

Despite that, Piketty attempted to share some insights regarding the MENA region. His analysis, in the absence of income & inheritance tax data, was predominantly based on official household surveys which greatly underestimate inequality. Piketty also uses a mix of proxy indicators to capture the extent of the inequality across the region. He poses that the Middle East is the most unequal region in the world; whereby the top 10% of the population enjoys 60% of the wealth. This compares to 35% in Europe, 50% in the USA and around 58% in South Africa or Brazil. Furthermore, when looked at as a region, the majority of wealth in the Middle East is concentrated in small territories with limited population yet rich in oil resources.

Part of the challenge is that the Middle East countries need greater transparency in reporting on income & wealth. Piketty promotes progressive taxation as a means to produce information, fight corruption and limit concentration of property.

Piketty goes on to tackle income inequality in the more global context; he uses historical data to draw some inferences in the state of inequality in the world. Some of the most prominent take-outs are the following:

- © Institutions & policies do matter (education labour, tax, etc...)
- © Major shocks such as wars, depressions and revolutions played a major role in the reduction of inequality and forced the elite to accept new social & fiscal institutions and measures that they would have refused prior to the shocks
- © "Political determinants of inequality are more important than pure economic determinants".

In recent decades, there has been a reversal of the income inequality reduction trend.

The rise in US inequality in recent decades is mostly due to rising inequality of labour income (this can be attributed to changes in the supply & demand for skills, the race between education & technology, globalization, rising tuition, insufficient public investment in education, and falling minimum wages). This claim is used to evidence his notion that "institutions and policies matter".

Meanwhile, the rise of inequality in Europe is slower and lower than the rise of inequality in the USA.

Wealth-income ratios seem to be returning to very high levels in rich countries. In a slow growth society, wealth accumulated in the past can become very important. Furthermore, the capital structure itself is evolving, as capital is shifting away from agricultural lands and more towards housing and other forms of capital. Hence the growing value of wealth globally is partially driven by phenomena such as the housing bubble.

Yet this shift/metamorphosis of capital calls for new regulations of property relations including activities such as institutionalizing patent laws. We live in a world where private capital far outweighs public capital, yet we should always be wary and raise

a red flag when public capital is negative. This means that if the government sold all its assets it still would not be able to repay the public debt.

He concludes with the following:

“The ideal solution involves a broad combination of inclusive institutions; this includes progressive taxation of income & wealth, education, social & labour laws, financial transparency, economic & political democracy and participatory governance.

Inequality regimes need to be put into a broad historical and comparative perspective, so as to invent new solutions.”

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The Acumen Consulting team would like to thank the management of the Faculty of Economics & Political Science for their kind invitation to the talk.

For those of you interested in buying the book, you can find it here:

[http://www.amazon.com/Capital-Twenty-First-Century-Thomas-Piketty/dp/8937834693?ie=UTF8&\\*Version\\*=1&\\*entries\\*=0](http://www.amazon.com/Capital-Twenty-First-Century-Thomas-Piketty/dp/8937834693?ie=UTF8&*Version*=1&*entries*=0)

Or you can now purchase the Arabic translation availed by Dar El Tanweer.