Piketty, Inequality and Housing

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For the past 40 years, there has been growing income inequality in the western world, starting in the USA, then in other Anglophone countries, before affecting traditionally more egalitarian societies in continental Europe and Scandinavia. A variety of explanations have been put forward in an attempt to explain these trends. These include the impacts of globalisation as trade barriers have come down, opening up western economies to competition from developing countries and, combined with technological advances, weakening the bargaining position of the skilled and semi-skilled working class. Labour markets have polarised as the rates of return at the higher end of the value chain have rewarded workers with the requisite skills. The process may have been exacerbated by the weakening or abandonment of collective wage negotiating agreements which tended to suppress wage differentials, and the cultural acceptance of growing economic rents among senior managers.

The popular policy prescription in the 1990s – exemplified by the OECD (1994) Jobs Study - was for governments to accept what Paul Krugman called a “devil’s bargain” whereby growing income inequality was the price that had to be paid for maintaining (or restoring) high levels of employment. The logic of “tax wedges” and “unemployment traps” pointed towards weakening social insurance systems, and shifting towards more residual models of social security. Even before the Global Financial Crisis, a softening of this approach to emphasise the importance of education and training to improve employability and earnings potential had become more widely accepted by institutions such as the European Commission, without rejecting the underlying logic of the approach (Stiglbauer, 2006). The “Hartz” labour market and social security reforms in Germany represent an example of this approach. On a global scale, the rise of the “BRIC” economies has been associated with rising absolute incomes within them, but in the case of China soaring income inequality.

Thomas Piketty’s (2014) monumental work Capital in the Twenty-First Century seeks to resurrect political economy as the framework for understanding the development of capitalism, and in particular the growth in inequality. It is an attempt to escape the “marginalism” of the Jobs Study approach whereby “so far as markets are free,
owners of capital and sellers of labour are paid exactly in line with their (marginal) productivity, then the freest of markets will yield the fairest of incomes and the most productive combination of labour and capital (Kunkel, 2014)".

The distinctive aspect of Piketty’s contribution is to shift the focus away from labour market incomes and towards the role played by capital (or wealth) in driving distribution. His central contention is that empirically the rate of return on capital (r) exceeds the rate of economic growth (g): \( r > g \). This being the case total income will be increasingly become dominated by capital income, whilst returns to labour diminish. This “fundamental logical contradiction” underpins “an endless inegalitarian spiral.”

The central weakness in the thesis, as observed by Kunkel (2014) and others, is that it is largely empirical. Piketty argues that the falling inequality experienced between the end of the First World War and the mid-1970s was an exception to his “law” caused by the destruction of capital by the two world wars, and policies that were for several decades more favourable to labour. However, even if his contention is justified empirically, it lacks, as Kunkel observes, an explanatory value. He does not explain why \( r > g \) should be the “natural” state of affairs.

This is where the paper by Maclennan and Miao makes an important contribution through its focus on housing. Piketty’s book has been subject to some criticism in its broad definition of “capital” which includes both productive capital and non-productive assets including residential housing. Matthew Rognlie, for example, has argued that, “Recent trends in both capital wealth and income are driven almost entirely by housing, with underlying mechanisms quite different from those emphasized in Capital (Rognlie, 2014).” Maclennan and Miao provide some explanatory underpinning as to why housing wealth should have this effect. Noting that “[t]he demand for housing… is income inelastic (it will grow faster than incomes) and price inelastic (…for many, demands will not fall as prices rise)” they further posit that the supply of capital and labour to spatially-concentrated growth areas have become more elastic whilst housing supply is inelastic forcing land values up more quickly than the growth rate. (World cities such as London are exemplars of this process.) So, it would seem that, \( rh > g \) (where \( rh \) = the return on housing). Meanwhile central (or federal) governments are less inclined to support housing policies, with responsibility left with lower tiers of government that are ill-equipped to deal with these challenges.

The consequences of these trends are, they argue, for greater social segregation in cities, and a political economy that reinforces housing scarcity (the “nimby” effect) and rejects redistributive policies (either the taxation of housing capital gains or scarcity rents, or support for renters). It is also possible, although it would need to be investigated thoroughly, that that the returns on housing divert investment away from the productive economy and so diminish economic growth.
The thesis presented by Maclennan and Miao is, nonetheless, built on three “contingent variables”: the assumption of house price growth, whether financialisation prevails, and the role of housing policy.

Housing price growth in excess of the growth rate is not a universal experience. In Europe house price inflation has been notably absent in Germany over several decades, despite the country’s integration into the world economy and being subject to the free movement of capital within the EU. The causes of this – and the rough equality between renting and ownership – are various, but seem to be connected with a particular form of capitalism rooted in ordo-liberalism (Ulrike and Dullien, 2012), and a set of housing policy institutions that reflected this approach established in the 1950s (Kemeny, 1995).

Moreover, the whole analysis would be destroyed should the experience of Japan after 1990 be repeated in the USA, Europe or elsewhere in Asia. Following a housing and asset bubble in the 1980s, Japan has been subjected to a quarter of a century of something akin to “debt deflation” which has caused house prices to fall (by 40 per cent in real terms between 1990 and 2010, Monnery, 2011). Should currently inflated property markets in Europe crash, then the fiscal and especially monetary policy levers available to stabilise them will not exist, as they have already been stretched to their limits. In Asia there are concerns about potential price bubbles in Hong Kong and Singapore, and a building bubble in China (Standard Chartered, 2015).

Inflation has been a feature of western housing markets only since financial markets began to deregulate in the 1970s. These have facilitated price rises and have given rise to a “financialised” form of home-ownership not only in the Anglophone countries but in Spain, the Netherlands and Scandinavia. In this context, financialisation represents not only the increasing tendency for home-ownership to be dependent on mortgage finance, but also for the finance system to make housing assets more “liquid” through equity withdrawal and release – so strengthening the link between asset value and current income. Schwartz and Seabrooke (2008), amongst others, have suggested that this approach was favoured by governments aware that borrowing against the value of homes could alleviate the weakening labour market position of middle and lower earners. In turn, they have created both an economy and political economy dependent on maintaining high asset values, which helps to explain the aggressively loose monetary policies, involving both ultra-low interest rates and quantitative easing, pursued by the Federal Reserve, European Central Bank (ECB) and other central banks including the Bank of England and the (Swedish) Riksbank.

The purchase of government bonds by the ECB was, opposed by the Bundesbank, reflecting its historic antipathy to inflation as well as the relatively unfinancialised nature of its housing market. Lack of financialisation also applies across the post-socialist “transition” countries and most of southern Europe (Stephens, et al, 2015).
The role of culture seems to be important, as suggested by the deeply rooted resistance to mortgaged home-ownership (known as kabala – “debt bondage”) that prevails in Russia (Zavisca, 2012) where mortgage debt represents only 2% of GDP (Stephens, et al, 2015). Lack of financialisation suggests much weaker relationships between housing and inequality.

Nor should housing policy be dismissed. Perhaps paradoxically most studies of what is variously called “housing income” or “imputed rent” indicate that housing reduces inequality. For example, Stephens and van Steen (2011) found that housing income (as measured by the value of home-owners’ net imputed rent, the value of below market rents to tenants, and housing allowances) reduced the poverty rate by 30 percent in England and 28 per cent the Netherlands. This effect was caused by net housing income being highly unequally distributed in favour of low income households. Even when home-owners’ anticipated annual capital gains were added to their housing income, the poverty rate still fell, although not by as much. Housing institutions can therefore perform a valuable role in mitigating income inequality. The question is whether the political economy of housing will shift in their favour as the numbers of younger households find it increasingly difficult to access affordable housing – both in largely deregulated sectors such as the English private rented sector, or in much more regulated systems such as Sweden (Christophers, 2013).

Indeed, whilst traditional housing interventions might be in retreat in the west, in several of the BRIC countries subsidised housing programmes are taking place. The 36 million unit housing programme in China, for example, is the largest that has ever taken place – outstripping even Khrushchev’s programme in the Soviet Union. It is difficult to see how the Chinese government’s ambitions further to urbanise the country (from 54% in 2010 to 70% by 2030, Standard Chartered, 2015) and rebalance its economy towards the domestic sector can take place without such interventions.

But in many of the “old world” western countries the key question is: will the “endless inequalitarian spiral” end as increasing concentrations of housing wealth mean that it consumes its own support base?

If it does end, a further question is whether governments will make informed interventions based on a deep understanding of land markets, development gains arising from the planning system, the appropriate use of fiscal levers and the state’s role in infrastructure provision, or whether simplistic deregulatory approaches that merely facilitate development gains will prevail.
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