Acceptable *Versus* Unacceptable Wealth Creation

BY BERNARD CONNOLLY

How to escape today's populist dilemma.

The *gilets jaunes* protests in France and French President Emmanuel Macron's response to them before caving in unsurprisingly brought forth comparisons with Marie Antoinette. The French president is laughably described in much political commentary as a centrist—as if Left *vs.* Right were the key political struggle.

For now, it is not, although it could quickly re-emerge out of the titanic battle between hyper-extremist advocates, such as Macron, of global "governance"—a global dictatorship of the *nomenklatura*—and ordinary people which must be fought. The elites really are behaving like the Bourbons and the Romanovs. But they seem to have learned one lesson: their rule is less vulnerable to revolution if it is global in coverage. National sovereignty is essential for democracy, and that is why the *nomenklatura,* or at least its European chapters, is so determined to extinguish it.

How can one try to ensure that the conflict between the *nomenklatura* and the *hoi polloi* is not exploited by the extreme Left? First, and most obviously, the *hoi polloi* must be supported against the *nomenklatura* by genuine liberals. That is happening in Britain, where the true liberals are the Brexiteers. But the risk is that the incompetence and malevolence of Remainers in Britain have the end result of putting the Labour Party, the natural home of elitism, in power—and with a leadership fiercely opposed to political or economic liberalism.

In the wider world, a major part of the problem has been that the globalist *nomenklatura* is indelibly associated with the massive distortions of wealth apparent over the past twenty years or so. And that is a problem that has now come home to

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A French gilets jaunes *protester, January, 2019.*

roost for that extremist champion of the *nomenklatura:* Emmanuel Macron.

Macron has reportedly been under pressure from his advisers to try to placate *les gilets jaunes* by restoring wealth taxes which had been removed in the hope of attracting wealthier members of the *nomenklatura,* bankers in particular, to set up shop in France. He has so far resisted that pressure. But in France as elsewhere, there is a very widespread belief that the distribution of wealth has become so unequal that it is now unacceptable.

Yet the accumulation of wealth has traditionally and correctly been seen as the wellspring of capitalism, and thus of progress and of rising living standards for the masses as well as for the wealth creators. Wealth taxes which watered down the incentive to create wealth would, as Macron accepted in a rare moment of realism, lead to stagnation and ultimately to regression, harming everyone. Does this mean that there is an inescapable dilemma, one which apparently is a new phenomenon, in which either the distribution of wealth becomes ever more blatantly unacceptable—creating the risk of a reaction far more extreme than a Piketty-style wealth tax—or a slowing or even reversal of economic progress must be accepted instead?

To escape such a dilemma, one must first draw a distinction between the morality of wealth accumulation and its political acceptability. The morality of wealth accumulation depends on two aspects of wealth: how it is obtained; and what is done with it. But it is the first aspect that is most relevant to its political acceptability, since that is the aspect which determines whether the drivers of wealth accumulation are ones which increase consumption possibilities for society as a whole.

With that distinction in mind, one can offer a definition of (politically-) acceptable and unacceptable wealth. One can think of acceptable wealth as wealth arising from saving out of the fruits of effort, initiative, enterprise, creativity, commercial risk-taking, and beneficial speculation (such as stock-picking, currency speculation, and speculation on the future course of interest rates rather than just "risk-on versus risk-off" speculation). True, the eventual spending of such wealth by its owners means that, given the production possibilities of the economy, there is less consumption available to everyone else. But by construction of the definition, the activities which via saving have given rise to such wealth have increased the production possibilities of the economy, such that the consumption possibilities available to "everyone else" are greater than otherwise.

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Unacceptable wealth, in contrast, is wealth whose eventual spending by its owners must decrease the consumption possibilities, now or in the future, of everyone else relative to a situation in which such wealth had not accrued.

Wealth gained by extractive, rent-seeking behavior is one element of unacceptable wealth. And of course it is such a source of wealth which unites economic liberals and Marxists in disapprobation. Liberals and Marxists have very divergent ideas about how to tackle such sources of unacceptable wealth. Marxists call for the abolition of private capital or at least for much greater state control of economic activity. Liberals call for freer markets, for deregulation, greater competition—and in particular, greater contestability, however unwelcome to existing dominant firms and their political clients and patrons, notably the European Union—major reforms of education systems,

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greater geographical mobility of labor within a country, a simplified taxation system, and a lower burden of tax on the incentives to and fruits of effort, enterprise, initiative, creativity, and commercial risk-taking.

But because such a program of liberalization and increased competition would take time to have its desired effect, undertaking it would be politically difficult as long as popular anger about the distribution of wealth remained so fierce and the illusion that such inequality was an inevitable feature of capitalism remained so widespread. Something needs to be done immediately to redistribute unacceptable wealth. What and how?

Wealth gained by extractive behavior is not the only element of unacceptable wealth. Another element is seen in the wealth that has resulted for some people from the creation of asset-price bubbles unsupported by realistic expectations of future productivity. Such wealth is real for those who hold it but illusory for the economy as a whole. It represents "spreading the wealth," in Obama's rather chilling phrase, in the wrong direction, rather than spreading wealth. Eventual spending out of such wealth must, given that its accumulation has not been the result of an expansion of productive potential, mean that there are fewer resources available for consumption by everyone else than would otherwise have been the case. This is painfully obvious, for instance, to young people trying to get a foot on the housing ladder.

Such wealth is widely perceived, with some substantial justification, as being unfair. An immediate redistribution of the consumption possibilities attaching to such wealth would be a very visible indication that a liberal free-market program would, while increasing consumption possibilities in the economy as a whole, also be intended to reduce unfairness. It would transform the context for the political acceptability of a liberal program and indeed for the acceptability of capitalism—and thus of democracy.

A redistribution of this kind could be effected by taxing, at substantial rates, unrealized capital gains (above a certain threshold) resulting from the bubbles deliberately blown by policy over the past two decades or so. Such gains can be identified; and they can be taxed without adversely affecting incentives to the accumulation of wealth generated by thrift, effort, enterprise, creativity, and commercial risk-taking and without penalizing successful firms and those who have invested in them.

The prescription first involves identifying the most recent point of approximate intertemporal equilibrium. That is, it involves identifying the most recent point at which the three key rates in a capitalist society—rates of return on investment, the rate at which households prefer consumption today rather than consumption tomorrow, and real rates of interest—were in roughly appropriate alignment. At such a point, maintaining growth and employment is not dependent on the emergence and swelling of bubbles. For instance, 1995 was such a point in the United States and 1997 was such a point in Britain.

The required policy action would then be to tax unrealized gains (subject to a threshold level) equivalent to the increase in the economy-wide price/earnings ratio (or price/rental ratio in the case of housing) since the most recent point of intertemporal equilibrium. That would mean that the part of any increase in the price/earnings or price/rental ratio for a specific asset which outstripped

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the economy-wide increase would not be taxed. Thus wealth accrued independently of bubbles, at least some of which wealth must have been the fruit of saving out of enterprise, creativity, effort, and commercial risk-taking, would be immune. But there would be no such relief applicable to assets whose price/earnings or price/rental ratio fell short of the average. One can perform such calculations to suggest how much money could be raised and how it could be used for redistributive purposes—both by cutting other taxes and by allocating funds to poorer people. But the central point, it bears repeating, is that preventing or limiting consumption out of illusory wealth prevents an unwarranted reduction in consumption possibilities for those who do not hold such "wealth." And that is the way to escape the dilemma with which Macron, and the capitalist world as a whole, is so uncomfortably faced. ◆