Thomas Piketty called it the most important formula in economics: it's R > G , which means that the rate of return on capital (R) is greater than the rate of growth in the economy (G).

That simple equation explains why the wealthy always get richer, why inequality keeps growing, and why governments pretend it’s inevitable when it isn’t.

In this video, I unpack how political choices and not economic laws have made wealth compound and wages stagnate, and what we can do to reverse it.

https://www.youtube.com/watch?v=KKwCTaUQ5gM?si=pyJup91Ya181IcKr

This is the audio version:

https://www.podbean.com/player-v2/?i=95ptz-19b2ad0-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

Why do the wealthy always get richer?

That's the evidence that we can see all around us at present, and the fact is, that is true. Whatever you are told about the fact that hard work supposedly creates prosperity, the evidence is otherwise.

Those who now own wealth are seeing their wealth grow faster than wages are rising. That's the way the world is now, and this is the result of deliberate economic design, and it's not an inevitable truth.

There's a simple formula that explains this. It was created by a man called Thomas Piketty in an extraordinarily fat book called Capital in the Twenty-First Century. Published in French in 2013 and in English in 2014. The whole basis of this tome is to be found in a simple formula, which is R is greater than G ($R > G$), and we need to explain what that means to understand why it is that the wealthy really do always get richer.

In Piketty's work, R is the rate of return on capital. In other words, it's profits, it's rents, it's dividends, and the gains made from speculation in financial markets. They represent the rate of return on capital.

G is the growth of national income, and most of that goes to labour. So it follows that if R, the rate of return on capital, is greater than G, the growth in the national income, much of which comes down to labour, then wealth is growing faster than is the rate of return to labour, otherwise called wages. And so inequality is not a side effect of this system. It is a built-in outcome within it. The rich don't need to work to get richer. They just need to own wealth.

Wealth compounds over time. But what we know is that wages do not. That simple fact creates increasing inequality, and we know that inherited advantage, whether that is wealth or having parents who are able to provide you with opportunities that others are denied, creates situations where opportunity leading to wealth grows more than income does for everyone else, and it does so right across generations.

Access to assets becomes the dividing line in society. And more and more of what we produce flows to those who do actually own wealth now, and power follows the money, including, of course, political power.

But for one rare moment, this was not true. That rare moment, as Piketty showed in all the data that he produced to underpin this book, was from 1945 to 1975.

In the aftermath of the Second World War, we had something which was entirely different from everything that had been seen before or since. We had full employment. We had rising real wages. We had high levels of public ownership. We had strong trade unions to keep the returns to labour high. And we had high taxes on wealth, which cut down rentier power so that those with wealth could not exercise extraordinary influence over the way in which society was operated.

During that period, something that has not been seen before or since happened: the rate of growth in the economy grew faster than the rate of return to capital. In other words, people got a greater share of the return from growth than did the owners of wealth. Society shared the gains of that period of quite extraordinary political change.

But what we now know is that that was a historical anomaly.

Margaret Thatcher in the UK and Ronald Reagan in the USA, basing their ideas on the work of Milton Friedman and Friedrich Hayek, ensured that the march towards inequality resumed, and it did. From the 1980s onwards, governments cut taxes for the wealthy. They liberalised the world's market system so that money could flow into tax havens. And money flowed out of productive investment and into stock markets, and the financiers gained. Finance was deregulated to ensure that asset prices were inflated. And central banks prioritised the interests of asset owners over workers, and we saw the consequence in terms of high mortgage rates and high rents.

The consequence was that the gains in the extraordinary period from 1945 to 1975 were reversed. Once again, R, the rate of return to capital, rose above G, the rate of return to the economy as a whole, and of course, as a consequence, because G reflects, by and large, the return to labour, inequality returned.

Real economic growth in advanced economies is now barely 1% to 2%; sometimes it's less than that. In the UK, we've got used to seeing very little real growth. But at the same time, we're seeing the rate of return to capital grow by 4% or more in many years. What is clear is that in that case, the wealthy must be getting wealthier, and that is the case. Even government bonds now pay rates of interest that guarantee real returns to their owners above the rate of growth.

It's as if everything is structured to make sure that the wealthy get wealthier and everybody else pays the price. The top are taking more every year while public services are collapsing. We have stagnation for the many and acceleration for the few, and all of that is explained by this simple formula: R is greater than G.

But there's not an inevitability to this. It's happened because governments have chosen to privilege wealth over wages. The tax system rewards capital and punishes labour, and we can see that through things like the national insurance system in the UK, which punishes labour hard, but leaves wealth entirely alone. And the obsession with balanced budgets makes sure that private fortunes soar whilst public investment declines. Market power is tolerated even when it starves society of essentials, which is now why so many people are living in intolerable housing conditions and in poverty.

There's nothing inevitable about R - the rate of return to capital being greater than growth, the rate of return to everything else; it is policy that's been engineered, but it is happening. And that means we have to rewrite the rules of the economy because this cannot be maintained. It's like a cancer growing within our society. This wealth is not being productive; it's destructive. It's actually squeezing out everything of value in our economy.

When the private sector talks about 'squeezing out', they pretend that the state is denying the private sector the opportunity to grow. But in fact, the exact opposite is true. The private sector is growing inordinately.

And if we look at the parallels inside human existence, there's only two occasions when we see unlimited unfettered growth of the sort that wealth is now seeing. And one is when cancer cells invade our bodies, and the other is obesity, and we know that both of these are deeply harmful. And that's the case of wealth as well, when it grows in the way that it now is in our society.

The way in which wealth is accumulating, in shares, in speculative land, is all deeply toxic. And a bubble is going to be inevitable, as I have said many times before.

So what do we need? We need, of course, to direct investment into care, into climate and communities, to raise G, the real rate of growth in the economy.

We need to strengthen workers' bargaining power, so wages rise to match the growth in productivity, which they haven't for decades. We don't have a problem with productivity gains in the UK or anywhere much else in the Western world at present. We have a problem with the growth from productivity going to the owners of capital and not to wages.

And so we need trade union powers reinforced and not weakened yet again.

And we need to stop rent extraction in housing, in monopolies and in finance.

We need, in other words, to bring the economy back under democratic control.

This is the challenge. We need to have G greater than R. We need that for a very long time to come to address the imbalance that has been created by 45 years of it being the other way round, with wealth growing faster than wages.

And markets won't fix this. They're designed to cause it. Only political courage can reverse the flow of power and wealth to a few at cost to the many.

We are heading for a new form of feudalism, which will be backed up by the new forms of fascism that we are now seeing, where wealth can buy everything. And what we need instead is a society that serves us, and not the rentier class.

It's possible, we could do this, but we have to understand one simple formula; G, the rate of return to work, has to be greater than R, the rate of return to capital. Then we will have a more equal, fairer, just society where everybody can prosper, including the wealthy, because let's be clear, they'll still be wealthy, but they just won't be growing disproportionately to the rest of us, and that's fundamental to the future well-being of our societies, our countries, and our democracies.

We have to reclaim wealth for the benefit of everyone.

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