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Thomas Piketty and the Rate of Time Preference

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Abstract

Using a standard model in which the individual consumption path is computed solving an optimal control problem, we investigate central claims of Piketty (2014). Rather than $r > g$ (confirmed in the data) $r - \rho > g$ - with ρ being the rate of time preference - matters. If this condition holds and the elasticity of substitution in the production function is larger than one, the capital share converges to one in the long run. Nevertheless, this does not have major impact on the distribution of wealth. The latter, however, converges to maximum inequality for heterogeneous time preferences or rates of interest (either persistent or stochastic). For the latter, the presence of finite life times leads to a distribution with finite wealth inequality featuring fat tails.

JEL classification: D31 - E21 - C63

Keywords: wealth inequality, optimal control path, dynamic efficiency, fat tails

1. Introduction

Capital in the 21st century is, without a doubt, the most important economic book of the last years. While it might not be the most-read book - owing to its extensive length - it is definitively the most discussed book. In particular, in the USA (the English translation of) the book perfectly captured the *Zeitgeist* and the political debate about inequality. In the book, Thomas Piketty not only summarises central results of his own work (including important work with co-authors such as Emmanuel Saez, Gabriel Zucman, or Anthony Atkinson), but also presents novel claims. In summary, the book consists of three major parts: (i) a very long-run historical record of empirical evidence regarding inequality, (ii) predictions regarding the future evolution of inequality based upon theoretical ideas, and (iii) policy recommendations in order to combat inequality. While part (i) is widely praised[1], critics mostly focused on the theoretical predictions

[1]Auerbach and Hassett (2015) argue that the indicated trends tend to disappear once higher frequency data is considered rather than the data that averages in time.

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