Thinking Liberal

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Matthew Green - essays on economics

1. Wealth, wellbeing and economic growth

BEGIN WITH THE END IN MIND. This is the first of Steven Covey's *Seven Habits for Highly Effective People*. And very good advice it is too. But too often we simply do what we think people want us to do without considering where it is leading: we "go with the flow" in the cliché.

Economists suffer from this as much as anybody else. Game theory specialists are technically an exception; they make a science of beginning with the end in mind, but alas they do so on such an artificially narrow scope that they are nearly useless. Any economist can explain what the limitations of using income per head as a benchmark are. They have all heard of the concept of saturation, where people have enough of what they want, and do not want any more. But mostly they carry on as if these insights were unimportant. Income is the benchmark of economic performance; more is better; growth is good. Debate on their relevance is confined to the fringe. Will an OECD report for France, say, ever conclude that policymakers shouldn't worry too much about economic growth because its people have enough of what they want; extra income only comes at the cost of lost leisure and more impersonal goods and services, and is mostly just a pointless treadmill of people seeking more status? Don't be daft.

And mostly this works just fine. Income has the huge advantage of being measurable, where happiness and contentment, for example, are not. And somebody is always asking for more. But as our income just goes on rising, we really do need to stand back and ask what it is all for. And as we struggle with the question of how to share Earth's limited resources across all its inhabitants, we certainly need more insight on this if we are to settle on the right policies.

So how to think about this? A good start is to try to think of the world without money. Money is an abstract construct of the human mind, worth almost nothing in its own right; you might be able to use coins for jewellery or notes for wallpaper, but that's about it and mere book entries are absolutely valueless in themselves. A Martian visiting Earth and only able to watch people, without understanding language, might only guess that it exists. So what, then, is wealth without money? For the moment it is simplest to consider the question of wealth, and gloss over the difference between wealth and income.

First and foremost there are the goods and services people consume. The wealthier people are, the more they can consume. When people talk of poverty, the main concern is that people have enough to eat, have access to health and education services, and so on. But there is the weasel word "can"; wealthy people may opt for a frugal lifestyle, consuming less than people we consider to be wealthier. A further concept is security, or the ability to maintain consumption whatever he circumstances. Ask people what the benefit of being wealthier is, and "peace of mind" is sure to come into the picture. People with surplus wealth have accumulated rights to consume in the future without exchanging goods or services of their own. But peace of mind is not what comes to mind when talking to many restless, and often very wealthy people. Ask an entrepreneur why he or she wants to be rich (assuming he or she is that type of entrepreneur) and the answer isn't likely to be to provide a better level of security to life. If security was important, they'd avoid the risk-taking that is an essential part of this type of wealth creation. We are left with something else which we might call power or status. This is the ability to get other people to do what we want them to do, and the freedom to not comply with what other people want us to do. Wealthy people are important; they get recognition. This is partly because people want to influence them to spend their wealth in a particular way; but there is something about wealth being social recognition as well.

So wealth is a combination of consumption, security and status. First observe that wealth defined like this doesn't always equate to wealth as the value of assets, in the conventional way that we describe. People in some jobs may be poorly paid, but have lots of status; people in societies with extensive social security schemes have more security than would be suggested by their income and possessions.

Let's apply this outlook to society at large. First let's consider an archetypal pre-industrial society. Most people, we'll call them peasants, are engaged in agricultural production; there is a small ruling elite; there are also some trade and service roles, but these are a small minority. The elite enjoys much greater wealth, in all three senses, than the peasants. And by and large there is a fixed amount of wealth to distribute across everyone, dictated by the basic productivity of the land. One person's gain is somebody else's loss. Why is this distribution sustainable? One answer is that it is always possible for an elite to rise and secure and advantage, and because it is possible, they do. A more satisfactory answer is that the elite creates benefits for everybody by supplying what economists call "public goods" – services (these goods are almost always services) that cannot be supplied properly through a market system because it is impossible to opt out of them. These include the protection of an army and maintaining a rule of law. These goods are not supplied efficiently through a collective mechanism, so the elite can add value – and pay for itself. So everybody is better off if they stay as they are, even if the peasants seem to get the thin end of the deal. There is jostling within the elite, and between elites of neighbouring territories; every so often an elite is so ineffective that the peasants rise up and replace them. But essentially this is a stable system, so long as it remains a zero-sum game: i.e. that total production remains stable, and there is no way of increasing it. Everybody senses this, and a deep conservatism follows. The elite, the aristocracy, feel they have a right to rule, because everybody would be worse off without them. The peasants accept their place because they can't do better.

Now let's introduce technological change. For economists, the term "technology" is a bit of a dustbin concept; it's the explanation for any change in productive capacity that is not explained by the quantity of labour or equipment. We immediately picture more modern, more efficient machines, but really it is much wider than this: a lot of it is about how work and society is organised. With technological improvement it becomes possible for a society to produce more from the same inputs; so they consume more, and they are wealthier. Society changes; the land does not need so many people, so people start making things and providing services instead. Sometimes the ruling elite is able to trap the benefit of change for themselves. They may invest the newly freed up labour in giant projects like the Pyramids (I use this example to create a picture – not because I necessarily know that the Egyptian Pyramids were the result technological advance). This may be viewed as consumption on a massive scale by the elite, although this is tied with status and security (in the afterlife) too. There are plenty of examples

in history of societies becoming rich through technological advance, with the basic social structure retained, eventually to collapse as the change stagnated, or they were unable to beat off an external threat. We may think of the Roman empire or various Chinese dynasties.
But in Europe from the 15th century on (I'm sure there plenty of people who would specify an earlier or later point), an entirely different dynamic developed. A skilled middle class evolved taking most of the benefits for themselves, often based on trade. And this process encouraged innovation and yet more technological change: if people can keep the benefits of innovation for themselves, then more and more people are drawn in. A momentum developed that meant that people expected a steady increase in productivity. The new middle class eventually displaced the old aristocracy from their position of power. A new class of industrial workers also evolved, as agricultural productivity advanced so far that few people were needed on the land. But this is proving a temporary phenomenon as technological changes marginalises this class in the same way as the peasantry have been. Inste4ad a new class of service workers is emerging.

So the modern, developed society is created. Technological change has made it possible for everybody to consume more, and to provide higher levels of security across the population. The search for status remains the zero-sum game it always was. Our average wealth depends on our average production; this only rises if our average productivity rises. So the one thing economists and policy-makers seem to agree on is that increased productivity is a Good Thing.

Let's pause to consider the implications of this. What if we measured wealth on the basis of the number of man-days of other people's work we consume? On average nothing can change: it is always one man-day a day, if you adjust for the time people don't work (childhood, retirement, holidays, etc.). The rich man consumes more than one man-day; the poor man less. We can get more for our man-day by working longer – but one of the benefits of a wealthier society is that you work less, on average (economic figures get deeply confused on this – in modern societies more women are drawn into the workforce, apparently increasing the amount of time we work – but only because they are being released from unrecorded work in the home). The process of making everybody better off comes with this proviso.

And it's here that we start to see a dark cloud. We lose as well gain from this technological advance. It's fine if technological progress cuts out drudgery and dead time, but we all know that it goes much further than this. We may buy more things, but the personal attention applied to each thing we buy is less. Life becomes more and more impersonal. Everywhere we see resistance. We use goods and services with low productivity as status goods: hand-made jewellery, personal trainers, chauffeurs, and so on. People turn to homeopathy and other alternative treatments because they are more personal than the impersonal monster created by modern medicine. We seize on modern technology that improves personal contact: mobile phones, social networking, and so on. Policy makers fret that productivity growth is slowing, and that it has always been weak in services, which occupy an increasing proportion of the economy. It doesn't seem to have dawned on them that one of the reasons for this is consumer preference: that people buy services with low productivity exactly because their productivity is low. And if that is what they want, then a liberal economist must let them.

And this brings into view another problem with eternal growth. Do we always want to consume more? This question is forever complicated by the eternal drive for status. Lots of people want to get richer not to consume more, but to improve their status, which means their position relative to everybody else. This gives an economy a certain momentum, but ultimately it is fruitless; we can't satisfy the demand for status by producing more goods overall. There is also genuine poverty – a proportion in any society where it is clearly worthwhile to consume more or work less. But in advanced societies it is by no means clear that improving average wealth will do much for this group – this is a much deeper challenge, which I will return to in another essay. Perhaps there are things that we will always want more of: health care for example. But increasingly the goods that we will want are the goods that no productivity growth will give us: more personal services, more land to live on, more fame and recognition. And if we can't get these, we will be less inclined to work. We will choose shorter hours, longer holidays and retire early if we can.

Maybe it's easy for a 50-year old to write these words, but is this really what we see? In the UK personal debt is at record levels and economists wonder at the sustained levels of consumption that they see. Surely people want more, more, more? But a lot of the debt relates to a property boom. And if I'm right a lot of other consumption relates to fashion goods (with fast obsolescence – essentially low productivity goods) or leisure. The popularity of cheap flights seems to fit the pattern of forever rising consumption until you remember that they are mainly related to leisure – which means more time off. Anyway, there seems to be something essentially unbalanced about the whole thing. People are saving less for retirement, yet living longer; there's a strong element of madness about the whole property investment boom, seemingly based on impossible expectations of increasing value. One day people may discover that fame and status doesn't need much money: indeed that may be one of the outcomes of the internet revolution. Earn just enough money to get by; inhabit the internet long tail; get lucky: this isn't such a senseless strategy, but involves little economic production or consumption. Technological advance may create more leisure, not more income.

When that day dawns we can expect economic growth to stop dead in its tracks, and yet people will be just as happy as before. But it will take most economists a long time to understand what has happened.

This essay was written in 2008, with only a minimal edit in 2016; the financial crash was gathering speed, but had not yet impinged on most people's consciousness. It was intended as the first of a series, but I ended up writing just one more.

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February 2016