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THE MORAL CONSEQUENCES OF ECONOMIC  
GROWTH

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## THE MORAL CONSEQUENCES OF ECONOMIC GROWTH

Economic growth is important for economic and social reasons. The government is committed to economic growth, at least as a goal, as are most of our other political parties. So we can take it that there is a broad public consensus in favour of growth. Yet in some quarters economic growth has not always had a good press in recent decades.

Although few commentators oppose economic growth as such, many argue that the material benefits of growth have to be traded off against its costs. One of these might be that a focus on economic growth could make us greedy and selfish. Some modern sceptics stress that growth is accompanied by, or even causes, systematic inequality and that those at the bottom of the heap can be easily overlooked. Others point to the environmental damage that conventional economic indicators may fail to take into account.

In recent years a new anti-growth argument has emerged: that growing material wealth may not be making us happier. David Cameron, leader of Britain's Conservative Party, has recently called for a focus not just on gross domestic product (GDP) but on GWB – 'general well-being'. "Well-being can't be measured by money or traded in markets", he said. "It's about the beauty of our surroundings, the quality of our culture and, above all, the strength of our relationships."<sup>1</sup> In similar vein, we're hearing more and more about the need to get the 'work-life balance' right – meaning that we should do less work, as if that meant sacrificing economic growth, whereas it is surely an option made possible *by* economic growth.

One advocate of this 'well-being' or 'happiness' agenda is Richard Layard, an emeritus professor of economics at the London School of Economics and an adviser to Britain's Labour government. In his book *Happiness: Lessons from a New Science* (Penguin, 2005), Layard argues that growing wealth increases happiness only up to a point, and a rather low one at that. Beyond that point, more wealth makes the rich happier only because they

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<sup>1</sup> [http://www.conservatives.com/tile.do?def=news.story.page&obj\\_id=129957&speeches=1](http://www.conservatives.com/tile.do?def=news.story.page&obj_id=129957&speeches=1)

come out well from comparing their lot with that of the poor. Meanwhile the poor make the same comparison and end up feeling miserable. Layard believes that the misery of the poor exceeds the happiness of the rich, and so arrives at the startling conclusion that higher taxes on the rich would increase overall happiness.

Layard has also been pressing the British government to employ 10,000 additional counsellors to administer “cognitive behavioural therapy” (CGT) in 250 new “psychological treatment centres” (or “well-being centres”) to cope with an alleged epidemic of mild depression.<sup>2</sup> My inclination to laugh at such ideas is tempered by the knowledge that the Nanny State has no sense of humour. Who knows? Perhaps in a few years the average Pom will be gloomily attending regular well-being sessions, justifying the existence of the thousands of counsellors that the government has thoughtfully provided with the revenues from the new happiness tax on the rich.

With such ideas on the march, it’s a relief to turn to a recent restatement of the case for economic growth which directly contradicts the arguments of Richard Layard and other growth sceptics. Benjamin Friedman, author of *The Moral Consequences of Economic Growth* (Knopf, 2005), is a professor of economics at Harvard University; to my knowledge he’s no relation of his more famous namesake, Milton Friedman. He is an unashamed growth optimist, and, as the title of his book suggests, it is mostly its benign *moral* consequences that he sees as justifying economic growth. He believes that the modern tendency to weigh “material positives against moral negatives” is misconceived. He writes:

The value of a rising standard of living lies not just in the concrete improvements it brings to how individuals live but in how it shapes the social, political, and ultimately the moral character of a people. Economic growth – meaning a rising standard of living for the clear majority of citizens – more often than not fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy. Ever since the Enlightenment, Western thinking has regarded each of these tendencies positively, and in explicitly moral terms (p 4).

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<sup>2</sup> Richard Layard, ‘The case for psychological treatment centres’, 23 February 2006. [http://cep.lse.ac.uk/layard/psych\\_treatment\\_centres.pdf](http://cep.lse.ac.uk/layard/psych_treatment_centres.pdf)

For Friedman, clearly a lot is at stake. The idea that there is some trade-off between economic growth as conventionally measured and a society's quality of life can be dangerous, because it risks undermining a society's moral character. Since there is no such trade-off, Friedman argues, societies can promote economic growth in the knowledge that by so doing they are making progress on all fronts, moral as well as material.

Friedman believes this needs to be said now because he is not confident that the present good economic performance of the United States is securely founded. He looks back to the three decades after the Second World War as a golden age of economic growth and moral improvement. Not only did indefinite economic growth and low unemployment seem assured, but the United States was becoming more open, tolerant and fair. Immigrants were welcomed; the waning of racial discrimination was enshrined in civil rights legislation; opportunity and social mobility had never been so widespread; and each new generation seemed to do appreciably better than the preceding one.

That era was abruptly ended by the first OPEC oil crisis, in 1973. The following two decades of relative stagnation were, Friedman believes, accompanied by a coarsening of American society and attempts to roll back the moral gains of the post-war era, manifested, for example, in a new anti-immigrant sentiment. He accepts that the American economy is now growing steadily again but believes that productivity is not growing reliably, that the incomes of many people are stagnant, and – crucially – that younger generations are not doing appreciably better than older ones did.

Although Friedman notes that anti-immigrant and racist sentiment has waned again in the present century, he is nowhere near as upbeat about America's prospects as is, for example, Olaf Gersemann, author of *Cowboy Capitalism: European Myths, American Reality*, a book which I discussed in a speech last year. Friedman believes that the civility, the vitality of its 'civil society', and the faith in its public institutions for which America was once renowned are waning, and that this is a symptom of a loss of confidence which only a return to sustained and substantial economic growth can cure.

Friedman's is a big book and I cannot hope to do more than pick out its essential arguments and logic. Much of it consists of detailed case studies – mostly of the United States, Britain, France, and Germany – from the 19th century to the present, from which Friedman concludes that economic growth makes a society more moral, while economic stagnation does the opposite.

There are exceptions to the rule. The main one – the American response to the Great Depression of the 1930s – was fortunately benign. Most countries responded to the Depression defensively; in Germany the Depression triggered the moral catastrophe of Nazism. While the United States made the downturn in world trade worse by adopting tariff protection, it enacted the New Deal and new welfare policies to assist the unemployed. Economists argue about the wisdom of the New Deal policies, but Friedman believes they signalled a commitment to a fair and humane society that was strong enough to survive the Depression.

But why exactly should economic growth promote moral progress? Friedman explains the link in the following way. Surveys of people's sense of well-being consistently report that people make relative judgments; they compare their situation against moving benchmarks. They typically refer to two such benchmarks: their own situation in the past and the situation of their contemporaries. That is, people evaluate their well-being by judging how they are doing compared with some relevant time in the past, and they also judge how well or badly they are doing in comparison with other people. This seems plausible. To judge their level of well-being, people need some idea of how well-off it's possible to be. Their own past experience and the present experience of other people both provide those standards.

Friedman goes on to argue that normally one of the two benchmarks is dominant in people's judgments of their well-being. This is where economic growth comes in. Friedman says:

By continually giving most people a sense of living better than they or their families have in the not very distant past, sustained economic growth reduces the intensity of their desire to live better than one another. Economic growth

satisfies the form of people's aspiration for 'more' that *is* possible for everyone to fulfill (p 92)

He goes on:

But when an economy stagnates ... the importance people attach to living better than others against whom they naturally compare themselves is more intense. The fact that they cannot do so, or at least on average cannot, then takes on heightened importance in their eyes. The resulting frustration generates intolerance, ungenerosity and resistance to greater openness to individual opportunity. It also erodes people's willingness to trust one another, which in turn is a key prerequisite for a successful democracy (p 92).

This too seems plausible. Without economic growth, one person's gain may well be balanced by someone else's loss, and so social mobility may be resented and resisted. But with economic growth, other people's improved well-being need not be a threat, since we can all get ahead together, and so we are more inclined to be fair and generous to the upwardly mobile rather than to discriminate against them, and less inclined to resent those who are better-off than ourselves.

So far so good. But there is one very important implication of this analysis that Friedman is at pains to stress. This is that the moral benefits of economic growth depend on *indefinite* growth. That is, growth must be a continuous process, not a movement towards some final state of prosperity in which we can give up pursuing material improvements and concentrate on moral and other non-material ends. The reason is that we quickly get used to our changed circumstances and take them for granted. If an economy stops growing, however great the absolute level of prosperity, people lose the sense that they are getting ahead in their own lives, and start to assess their well-being by comparing themselves with one another. And that's when the trouble starts.

As it happens, this is far from a new idea. Friedman himself establishes its pedigree by quoting a version of it in Adam Smith's *Wealth of Nations*, published in 1776:

[I]t is in the progressive state, while the society is advancing to the further acquisition, rather than when it has acquired its full complement of riches, that the condition of the great body of the people, seems to be the happiest and the most comfortable. It is hard in the stationary, and miserable in the declining

state. The progressive state is in reality the cheerful and the hearty state to all the different orders of society. The stationary is dull; the declining melancholy.<sup>3</sup>

This argument identifies a gap in the reasoning of Richard Layard and the 'well-being' school of growth sceptics. As we've seen, Layard claims that, since most people are made miserable when they compare themselves with others, we should tax the rich and turn away from purely economic measures of well-being. Friedman's response would be that, on the contrary, it is insufficient economic growth that is making people doubt that they are making progress in their own lives, which is why they compare themselves with others and so experience feelings of envy and resentment. In respect of happiness, a recent British study supports his view. On the basis of a survey of 177 countries, it found that the top ten countries whose citizens reported the highest levels of happiness were among the richest, Bhutan being the only exception.

There is nothing to stop economies growing continuously. Among other things, growth will not come to an end unless science does. Moreover, most people have aspirations and seek better lives for themselves or their children.<sup>4</sup> To embrace economic growth, however, we must shed this fashionable belief that it comes at some unavoidable moral cost. Friedman has explained why economic growth promotes fairness, openness and trust. But what about the claims that it promotes inequality and damages the environment? Friedman devotes a chapter to each of these topics. These chapters cover a wide range of information and argument and arrive at balanced conclusions.

On inequality, Friedman concludes that the established theory that with economic growth, inequality initially increases and later diminishes is broadly correct. However, new technologies typically cause inequalities to

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<sup>3</sup> Book I, chapter 8.

<sup>4</sup> As Adam Smith put it:

The natural effort of every individual to better his own condition, when suffered to exert himself with freedom and security, is so powerful a principle, that it is alone and without any assistance, not only capable of carrying on the society to wealth and prosperity but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations; though the effect of these obstructions is always more or less to encroach upon its freedom, or to diminish its security.

*Ibid*, Book IV, chapter 5.

widen temporarily as certain groups gain most of the initial benefits from them. Some countries that have only recently started growing fast are bearing out the theory; for example, inequality is increasing in China and India. But in those countries poverty is rapidly decreasing, which is surely the paramount goal. That is, economic growth brings widespread improvements in health, nutrition, and other basic indicators of well-being. (This may seem obvious, but in these matters it's the obvious that most needs restating.)

Turning to globalisation as a source of growth, Friedman observes that it may widen inequality *within* globalising countries but reduce inequality *between* globalising countries. For example, a company in a rich Western country may shift some of its operations to a poorer one, attracted by the lower labour costs. Both countries benefit from the gains from trade. But while the wages the company pays in the poor country are high by local standards and increase the gap between its own employees and other workers there, the wage gap between the two countries is thereby reduced. Again, Friedman finds that globalisation is a strong force for poverty reduction. He writes:

The evidence shows that on balance the effect of international trade in lifting families out of poverty, and thereby enabling them to leave their children in school, is more powerful. Countries that trade more tend to have less child labor. What matters is not any direct effect of trade activity *per se*, however, but the resulting alleviation of poverty in general (p 367).

He concludes that “The contribution of globalization to inequality, such as it was, came as those countries that did not participate fell behind those that did” (p 368). In other words, countries like many of those in Africa need more globalisation, not less.

In his chapter on growth and the environment, Friedman observes that the worst environmental problems are found in poorer rather than richer countries. Many such problems can be solved by economic growth. For example, poor people who damage their health by having to cook with smoky fuels like wood or peat can switch to cleaner fuels as their incomes rise. Many will be surprised to learn that in the United States the area covered by forest is increasing again: “America’s forests contain nearly 40

percent more wood than they did fifty years ago” (p 383). True, some environmental problems are initially worsened by economic growth, most obviously carbon emissions, but further growth will make it easier to solve those problems.

Friedman comes to two main conclusions. First, it doesn't matter if a particular resource is exhausted today so long as we bequeath to future generations the wealth and technology to perform the same functions using other resources. Second, market forces will continue to do much of the job of improving the environment – for example, energy companies have every incentive to invest in new technology that economises on fossil fuel and promotes alternatives to it. Nevertheless, public policy will always have a role to play where environmental problems take the form of externalities that market forces cannot deal with unaided. Overall, environmental problems provide no plausible grounds for growth scepticism.

In view of the great benefits, moral as well as material, that economic growth confers, and Friedman's concerns for the moral health of the United States, it is not surprising that he wants to increase its rate of growth. He rejects a purely laissez-faire approach. He argues instead that the moral benefits of growth are 'externalities' that the unaided market cannot produce in sufficient amounts, and that governments therefore have an obligation to pursue a more active agenda – though only with policies that are consistent with an open and democratic society.

My initial response was to recall that not all external benefits are under-supplied by the market, and that government policies to provide them don't always work. High standards of personal hygiene and appearance are positive externalities – we all benefit from other people observing them – but they are reliably supplied by market forces without government intervention. I also feared that Friedman was about to propose those active industry policies that were fashionable during the recession of the early 1990s, inspired by the supposed success of the interventions of Japan's Ministry of International Trade and Industry. But in fact Friedman's policy

prescriptions are mostly about tackling government failure, not market failure.

His growth agenda is designed for the United States and its immediate goal is to restore the levels of investment in material and human capital that the United States achieved in the three decades after the Second World War, to such great material and moral effect, but which have never fully recovered after their sharp fall in the early 1970s. He suggests the main reason for this fall is the drop in national saving, caused mostly by the chronic budget deficits of the US federal government. He notes that the budget surpluses and public spending restraint of the late 1990s were accompanied by a revival in business investment, as more savings became available for the private sector to use. But under President Bush the federal budget has slipped back into deficit, and business investment has correspondingly fallen again to its low trend level.

Friedman criticises Bush's tax cuts since 2001 both for being unfair, in that the benefits disproportionately favoured the rich, and for helping to push the budget into deficit. He treats this effect on the budget as self-evident. In doing so he disregards the evidence that the tax cuts, particularly the second round in 2003 which was more growth-oriented, have had benign supply-side effects in stimulating production and so expanding tax revenues, with the result that the deficit is now trending sharply downwards.

But Friedman places at least as much emphasis on the spending side of the budget, where the Bush administration's record of expanding government has been appalling. If America's domestic savings are to increase substantially, the costs of Social Security (that is, the age pension) and Medicare (highly subsidised medical care for the aged), which are escalating for demographic and other reasons, must be reined in as a matter of urgency. He thinks that part-privatisation of Social Security in the form of individualised saving accounts could in the long run increase the private saving rate. As for Medicare, he believes only competition and choice in medical insurance plans can remove the present incentives to waste money on unnecessary drugs and services.

Competition and choice play a big role also in Friedman's proposals for reforming formal education, the main source of investment in human capital and a major source of productivity. One problem is that even now too few young Americans avail themselves of the benefits of education, which are in fact very great: according to Friedman, "each additional year of schooling increases a person's lifetime earnings by 7 to 8 percent" (p 423). The smallish minority of children who fail to finish high school could be helped by greater use of intensive early-intervention programmes like Project Head Start. Public assistance for the larger minority that do not progress to higher education should be targeted on the poorest ones, who might otherwise be put off by the prospect of paying their way through college. Hardest of all is to improve the performance of America's primary and secondary schools, which has remained mediocre despite more money and smaller classes. This is where Friedman thinks that more choice and competition are essential so that good teachers can be appropriately rewarded and all teachers are subjected to incentives to perform well.

Friedman's growth agenda seems rather brief and I would have some reservations about it. A higher GDP is not the overriding social goal: most economists would propose overall welfare or well-being instead. Thus we might increase GDP by mandating a 60-hour working week and compulsory personal savings, but would that make people in general feel better off? However, the greatest value of his book lies not in the details of his policy prescriptions but in his vigorous restatement of the case for economic growth at a time when growth is widely viewed with scepticism. His claim that economic growth improves us morally as well as materially is hardly outlandish, or even new. If it seems so today, that's because we haven't heard it for a while. But as it's based on evidence from several case studies, it is always open to challenge or confirmation from new evidence.

Two significant sources of such evidence can be singled out. One is Continental Europe, where growth has seriously slowed in the big economies of Germany and France, and all but stopped in Italy. Friedman records evidence of recent moral regression in France and Germany,

where racist and anti-immigrant political parties have gained ground in the last 15 years or so. Friedman believes that these are classic instances of economic stagnation and fear of unemployment leading to growing intolerance and resentment. The potential for things to worsen is great. Tony Blair, Britain's prime minister, recently warned that Europe could return systematically to extremist politics if its leaders don't enact the necessary economic reforms. So far there is little sign that they have the will to do so.

The other place to watch is China, currently undergoing an episode of economic growth whose scale and pace are unprecedented in human history. Friedman has the courage of his convictions and claims boldly that "as long as China continues its recent economic expansion, Chinese citizens will eventually enjoy greater political democracy together with the personal freedoms that democracy brings" (p 11). This claim is especially audacious given that Friedman has based his case almost entirely on evidence from Western countries – the United States, Britain, France and Germany. If he turns out to be correct about China, it will seem that Western values are indeed universal – the ones to which all of humanity eventually aspires (as claimed by commentators like Francis Fukuyama) – with implications for the prospects for modernisation and democratisation in other non-Western countries, including Muslim ones.

The stakes are as high as that. Let's hope Friedman is right.