Well being and inequality in post industrial society

Ralf Dahrendorf Memorial Lecture

St. Anthony's College, Oxford

Adair Turner

30 April 2010

It is a great honour to have been asked to give this first Ralf Dahrendorf memorial lecture. I got to know Ralf some fifteen years ago and like many people I soon realized that I had gained not only a friend but also a remarkably perceptive adviser. Ralf read in detail, commented on, and provided a sparkling introduction to my book "Just Capital". He also provided detailed responses to many other lectures or essays which I sent him pre or post publication. Since we agreed on many issues his comments were on the whole supportive, but also perceptive and valuable in their specific criticisms or suggestions.

But on one occasion, he wrote that while appreciating some of my arguments, he was instinctively unsympathetic to the balance of my conclusions. My article was entitled "Capitalism and the end of history", and in it I argued that while Fukuyama's "end of history", with its convergence of all countries to a sort of mixed economy Switzerland of perpetual peace, was certainly not inevitable, no other societal endpoint was likely to be stable.[1] [2] Ralf however, would have nothing of this

[1] Adair Turner, *Capitalism and the End of History*, World Economics, Volume 5, 2003.
[2] Francis Fukuyama, *The End of History*, The National Interest, Summer 1989.

attempted compromise with Fukayama. He was, he wrote, "instinctively suspicious of all 'endisms'".

Indeed he was. The suspicion of "endisms", of any idea that society can ever achieve some stasis beyond which there is no change and no social conflict, was indeed one of Ralf's enduring themes, and stated clearly in one of his first and most famous books "Class and class conflict in industrial society". In the final paragraph of that book Ralf argued that "Totalitarian monism is founded on the idea that conflict can and should be eliminated". And that in contrast "The pluralism of free societies… is based on recognition and acceptance of social conflict. For freedom in society means above all that we recognize the justice and creativity of diversity, difference and conflict".[3]

Half a century has passed since Ralf wrote those words. Since then the conditions of material prosperity and the structure of economies, which even for a non-Marxist must play some role in determining the nature of social relations and the intensity of social conflict, have changed greatly. Even in Germany, less than 20% of the workforce now earns its living from industrial manufacturing, little more than 10% in Britain, so that we live in what can somewhat usefully be described as "post-industrial societies". And in both Germany and Britain, two of the key countries in Ralf's life, the average standard of living is dramatically higher than in 1957 when Ralf's book was first published. The average citizen of 1957 Germany and Britain, would look on today's average citizen as really quite rich. The poorest of 1957 would see today's poorest as far better off than they were.

[3] Ralf Dahrendorf, *Class and Class Conflict in Industrial Society*, Routledge and Kegan Paul, 1959

But issues of social conflict and social competition remain: one of the major parties in Britain's general election next week asserts indeed that British society is "broken". And while some measures of class differentiation have become less immediately obvious, at least since the Britain of the 1950's, inequalities of income and wealth have grown significantly, and become the subject of increasing debate among economists, sociologists and politicians.

My aim in this lecture is therefore to explore how growing economic prosperity and inequality relate to perceived well being, and how that relationship has changed as our societies have on average become richer and as the structure of economic activity has changed. So while Ralf wrote of "Class and class conflict in industrial society", my title for this evening is "Well being and inequality in post-industrial society".

The attainment of a superior growth rate and thus increasing material prosperity was central to political debate in most developed countries in the second half of the 20th century. Other issues – culture, morals, religion, national identity - were not of course entirely absent, but the issue of which political party would best deliver material prosperity was often a key electoral battleground, in a way which was not true in 19th century or early twentieth century politics. Harold Macmillan's claim for votes in 1959 crucially depended on the assertion that "we've never had it so good". Harold Wilson's Labour government was determined to boost the rate of growth to that being achieved in continental Europe; and Thatcher's promise was essentially that, after some tough medicine, prosperity would grow faster than under Labour.

The shared assumption across the political spectrum was that economic growth – growth in GDP and per capita GDP – would feed directly through to rising well being, welfare, happiness, contentment, or whatever word we use and, therefore, to political success for the party best able to deliver it. The debate was essentially about what policies would achieve that end, and above all about how free a role markets should play in delivering prosperity and what level of inequality was required to ensure economic success and acceptable as a by product.

The conservative narrative, asserted with increasing confidence towards the end of the century, was that free markets were the best way to deliver prosperity and that significant inequality was acceptable and indeed required because it provided the incentives to entrepreneurs, to executives and to ordinary workers, which would ensure innovation, competitive success in global markets, high productivity growth and thus rising prosperity. Unlike in the 19th century, therefore, when conservatives defended inequality and property rights as elements of a natural order, conservative parties now tend to advance an instrumental justification of both markets and inequality – a flexible labour market and low taxes on the rich are good for you because they will make you, the average citizen, richer. Parties of the right, to different degrees in different countries, have therefore tended to be defined less by the classic parameters of conservatism – nation, social order, religion, received morals and culture – becoming instead parties of liberal economic ideology.

Parties of the left in turn had to decide how much of this narrative they accepted and how much was compatible with their egalitarian instincts. Reactions differed by country and between those parties with strong Marxists traditions and those more willing to accept the amelioration of working class conditions within capitalism as an acceptable end objective, rather than either a stepping stone or an impediment to revolutionary change. But the direction of change everywhere was towards at least a partial acceptance and in some countries a thorough growing embrace of the liberal economic ideology. The role of social democratic parties was to ameliorate the rough distributional edges of the market economy, but the assumption that markets helped create growth in GDP, that growth in GDP meant social well being and individual welfare, and that significant inequality was acceptable because and to the extent that it helped deliver enterprise, competitive success, productivity growth and rising GDP per capita – those assumptions were largely and increasingly shared across the political spectrum.

Political debate, particularly in Britain, often included reference to the UK's position in rankings of global growth of competitiveness – the 1997 election in particular dominated by alternative claims to competence in the drive for national economic success. Debates about our planning rules often referred to the need to drive national productivity growth by, for instance, allowing less restricted out of town supermarket development. And debate on the appropriate capital gains tax rate for entrepreneurs and private equity investors focussed on the potential impact on incentives , innovation and growth.

But even as that increasing consensus has grown, economic and social developments have occurred which tend to undermine the assumptions on which it is based, and it is on these developments and their consequences for the political narrative, which justifies the market economy and resulting inequality in instrumental terms, that I want to focus this evening.

But before doing so, let me be clear about some things I will not talk about this evening but which are also important and in some cases more important issues. Two in particular:

- First, achieving growth and rising prosperity in the still poor parts of the world, which is arguably far more important than the issues of the social dynamics of the already rich on which I will focus

- And second, whether growth in absolute national GDP matters, not because increased GDP per capita will increase individual well being, but because richer countries are more powerful countries, and economic and indeed military power may still matter in a world which has not yet achieved and may never achieve the "end-ism" of Kantian perpetual peace.[4]

Economic and social developments

Six factors create, I believe, an economic and social context in which the past narrative has lost and is bound to lose power.

1. <u>Growth and happiness</u>. The first is that at the levels of income already attained by rich developed countries – by the US, western Europe, Japan – there does not appear to be a strong link, or indeed any link at all between average GDP per capita and people's average "happiness". Of course there are considerable theoretical and empirical problems in defining and measuring well being or happiness – and indeed in deciding

[4] See Robert Kagan, *Paradise and Power*, Atlantic Books 2003, for the argument that Europe in particular is deluding itself if it believes that absolute economic and military power no longer matters

whether average happiness should be the overriding aim in society. Suppose that the average citizens of a dictatorial country were happier when some numerically very small minorities were oppressed – we face all the complex issues of adding up happiness which the 19th century utilitarians raised but never entirely satisfactorily resolved.

But while these problems certainly make me wary of the idea that we can define and then pursue measures of Gross National Happiness, it is still important that a wealth of data suggests that people in rich developed countries do not feel on average any more content now than 30 years ago, and that, as this chart from Richard Layard's book on "Happiness" shows, self-reported measures of happiness in different countries suggest that people's sense of well being increases as average income per capita rises from very low levels to about £15,000 per annum, but then caps out.[5]

That empirical evidence, moreover, accords with what common sense would tell us.

- That freeing people from hunger, ill-health or continuous back-breaking work in either the workplace or the domestic environment is likely to make a big difference to people's self-reported happiness.

[5] Richard Layard , *Happiness*, Allen Lane 2005

- That getting people out of crowded slums into pleasant, moderately spacious houses will probably make people more content.

- That an economy in which everybody can enjoy several weeks holiday per year – which was achieved between the 1920s and the 1970s – is likely to increase self-perceived well being.

- And that good health and freedom from the fear that ill-health will bring with it financial penury can be hugely important.

- But that once you have an adequate car, the new car with new styling and better acceleration does not transform your long-term happiness even if it gives you a short-term buzz. And that once you have pleasant clothes, designed with at least some sense of style, changing them continually to keep up with the latest fashion is going to make less of a difference.

Taking the bottom billion, about whom Paul Collier has written, from extreme poverty to the standard of living achieved in Western Europe in 1980 would clearly be transformative: taking China's 1.4bn from $3,000 per annum today to, say, $20,000 per annum, will probably deliver significant increases in something we can reasonably label as human well being. But it is simply unclear that further increases in the average measured GDP of already rich societies will make much of a difference to how well-off, or happy, or content, the average citizen will feel.

2. Satiation, relative status and positional goods. This lack of correlation in part follows from simple satiation: one winter coat keeps you warm, two winter coats don't keep you warmer. But there are important changes in the nature of economic activity, both in respect to the consumption characteristics of our economy, and its production characteristics, which may also help to explain this phenomenon of declining or even zero marginal benefit.

Obviously one thing that has occurred in rich developed societies is that manufacturing has declined as a percentage of total economic activity. This is not just because many manufactured goods are imported from China: more fundamental factors are that productivity rates are higher in manufacturing than in services, and that as people get richer they choose to spend an increasing percentage of their income on services – factors which would apply even if the world outside the rich developed world did not exist. And that trend is often summed up in the word "post-industrial society", which I've used both as shorthand and because it usefully echoes Ralf's "industrial society". But in fact the changing balance between manufactured goods and services is not fundamental to what occurred. More restaurant bills or more hotel stays are as likely or not to increase personal happiness as more cars, washing machines or ipods. Rather the crucial change on the consumption side is that as we get richer more of our income is devoted to the consumption of goods and services where what matters is our relative income, not our absolute income.

- The richer people are, the more they choose to devote income to buying fashion goods which prove that they are in with the crowd, but the more that other people's incomes have risen as well, the wider the range of goods and services which one <u>needs</u> to buy in order to be in with the crowd – the explosion of family expenditure on children, for instance, being driven by the need to ensure that one's child does not feel deprived of the latest status symbol.

- And the richer people are, the higher the percentage of their income that they tend to devote to competing for the enjoyment of goods and services which are locationally specific, and which, at least in a densely populated country, are in inherently limited supply. To own a house in the attractive location, or to be able to stay in the hotel on the beach rather than a mile away, or the hotel on the skiing piste rather than several hundred metres away, what matters is not your actual income, but your income relative to everyone else's. And to that, an increase in average GDP per capita can make no difference.

3. <u>"Distributive" and "Creative" Activities</u>: Alongside these changes to consumption patterns, important changes in the balance of production activity may be occurring. A key distinction is between activities which are likely to at least increase measured GDP (whether or not that is of real benefit to well being) and activities which are inherently devoted to zero sum distributional competition – in which one person's income increase is at the expense of others.

That distinction between purely distributional economic activities and those which are at least in economic terms value added – between what Roger Bootle in his recent book *The Trouble with Markets* labels "distributive" and "creative" activity - has always been present in market economies (and indeed in all human societies).[6] The salesman who wins an order for his firm at the expense of another firm does not directly create an increase in GDP per capita – he makes his firm richer and another poorer. A clever lawyer whose client wins, redistributes money from the opposing client; the financial trader who bets well makes money at the expense of the one who bets badly. The market economy creates growth not because every person is involved in a directly value generating activity, but because competition between peoples and firms, many of whose activities are in their direct impact purely distributive, will tend to give the advantage to the better idea, the more efficient firm.

So the existence of merely "distributive" activity has always been with us. But it seems highly likely that the relative importance of such distributive activity tends to increase as societies get richer, and it is certainly the case that a disproportionate share of high skilled human resource is devoted to such activities. Financial services – particularly those involved in wholesale trading activities – include a large share of activities which are in their indirect effects purely distributive and which are very highly remunerated: and the share of financial services in our economy has grown. Richer societies tend to different degrees to be more litigious societies; litigation is essentially a zero sum distributive activity, and lawyers are highly paid. And in rich societies consumers are able to

[6] Roger Bootle, *The Trouble with Markets*, Nicholas Brealey, 2009

devote a significant slice of income to buying goods solely because they bear a brand – celebrity A's perfume versus celebrity B's – but brand competition of this sort is essentially distributive rather than value-added – distinct in its economic function from the early development of branding which performed a vitally important function in enabling consistent quality products to dominate over the multiplicity of lower quality and sometimes dangerous products.

How far such distributive activities – in advertising and PR, in much of financial services, in legal services – have increased as a percentage of the total economy, I do not know – it would be an interesting subject for research. But some increase I am fairly certain has occurred. And it is certainly noticeable that many of the highest paid, and therefore presumably highly skilled people, earn their living from activities where the devotion of higher skills must simply increase the intensity of distributional competition rather than deliver value added benefits: if high income attracts cleverer people to become divorce lawyers, society does not gain from the increased intensity of courtroom competition which results. The relationship between high skills and economic value added is becoming more complex, even while the relationship between economic value added and perceived happiness/well being is becoming unhinged.

4. <u>Growth and Externalities:</u> A fourth factor at work is that measured economic growth produces increased externalities – environmental effects – which themselves can be detrimental to present or future human welfare. Some of these effects have clearly improved in the last 50 years: London no longer has the smogs which it used to suffer: local pollution has declined quite dramatically in most developed countries. But other factors – in particular pure congestion effects have hugely increased in

intensity. Driving a car along a country road in 1950s Britain – for those who could then afford it – was a more pleasant relaxing experience than doing the same today, simply because you were much less likely to be driving bumper-to-bumper behind the car in front. And a large proportion of our car advertisements on television today – apparently shot along roads in rural Scotland or Scandinavia at 4am on a summer morning – are almost bound to produce frustration and road rage since they entice you to buy a product – driving along an open road – that you will almost never actually enjoy. In all sorts of ways, as we get richer, and if we do not carefully manage the process, increasing wealth degrades the very benefits it seems to make more generally available. The more people can afford to enjoy the unspoilt beach or countryside the more spoilt it is. Quite apart from the long term externality of potentially harmful climate change.

In a number of different ways therefore, an increasingly rich economy, is both one in which additional increments of average prosperity are likely to deliver diminishing marginal improvements in well being, and one in which more of both our productive activities and our consumption is devoted to zero sum distributive competition, in which relative skill is crucial to success and relative status crucial to the individual's sense of well being. Given these changes it should not surprise us that our ability to generate an increased sense of well being through growth in measured GDP per capita, which applies in the transition from African standards of living to those of 1970s Britain or Germany, has to a significant extent broken down in rich societies.

5. Growing Inequality: Inherent to Post Industrialisation/Society? My fifth point, however, is that in this environment where relative status

matters quite a lot, and GDP growth has less power to make people happier, that inequality has been increasing in rich developed societies, and in some to quite a startling extent. The scale of the increase has varied by country – more in the Anglo-Saxon countries than in continental Europe, most in the US – but it has been present in all. It has had two dimensions.

- First a tendancy, again most prominent in Anglo-Saxon countries and in particular in the US, for the bottom of the income distribution to fall further behind the median.

- Second a very strong tendency, most extreme in the US but also pronounced in the UK and significant throughout the developed world, for the top to pull away from the middle and the very rich from the moderately somewhat rich. With increases in the income of the top decile over the last 30 years well exceeding those of the median, the top percentile doing better than the rest of the top decile, and the top zero 0.1% of the population pulling far away from the rest of the top 1%.

The first phenomenon – the poorer relative position of the poorest – is probably best explained by a combination of technology and globalisation, with freer movement of traded goods and to a lesser but still important degree labour – i.e. migration – bound in economic theory to reduce the relative income of lower skilled people in richer countries even when it increases the average income level.

The second phenomenon – the richer relative position of the richest – is rooted in an inter-play of factors too complex and multi-faceted to address in detail this evening, but which includes some factors closely related to the other changes I have mentioned – for instance the changing nature of both consumption and of production activities.

- One striking development at the top of the distribution is increasing returns to stardom and celebrity, to high sporting and artistic skill. Stanley Matthews, one of the football greats of 1950s Britain, earned from his football genius an adequate middle class standard of living: David Beckham is in the super rich. CS Lewis made adequate money: JK Rowling is a billionaire. Technology and globalisation are among the factors at work here[7] – the ability of TV and internet to make David Beckham and Harry Potter global brands.. But rising average income level is also important. As people's income rises, they devote more of that rising income to providing their children with the latest branded merchandise, without which relative status is lost, and buying that merchandise puts money in the hands of celebrities. And while the super stars are few, once the minor stars and passing celebrities, the agents and the lawyers and PR firms and the executives of the media channels are included, we have a phenomenon helping to accelerate income growth throughout the top income decile, as well as at the pinnacle of enormous wealth.

- In parallel meanwhile the changing nature of consumption, and its increasing devotion to goods or services which in the hierarchy of human needs are not essential, but nice to have, and driven by fashion or caprice – means that in some areas of economic activity,

[7] Sherwin Rosen, *The Economics of Superstars*, American Economics Review, 1981 explained the process by which mass communications media tended to increase the inequality of distribution of incomes of performance artists. Since then the forces identified by Rosen have intensified.

highly talented individuals can make their companies greatly more successful rapidly and in a highly measurable way. A talented retailer with a flair for store design and ambience, for range selection and for marketing, can make a huge difference to a retail chain's success quite quickly – whereas a talented manufacturing manager can only do so over many years, as research and development investment or manufacturing efficiency improvements slowly reach fruition. And the shorter the time period over which results are achieved and the more easily they seem identifiable with the individual rather than the team, the more they are likely to be reflected in individual remuneration. The higher the percentage of our consumption devoted to goods and services where soft factors like style, ambience and brand matter, the higher is the naturally arising inequality at the top of the distribution.

- This phenomenon of highly measurable and immediately measurable economic impact moreover, is particularly present in some of those activities which are most clearly – in Roger Bootle's terms – "distributive" rather than "creative". The successful divorce lawyer redistributes income in favour of his or her client and away from the other lawyer's client, and his or her success in doing so is immediately apparent, in a way which is not true of the research scientist working alongside many others on a new drug which will reach patients many years hence. Top lawyers are therefore paid more than top scientists, and the more litigious the society, in either personal or commercial cases, the larger the number of high paid lawyers. The reason why financial traders are paid so much is that their distributive economic impact – the extent to which they have made their firm richer at the expense of others – appears to be immediately measurable. Sometimes of course that is because success this year is at the expense of a trail of toxic liabilities for the future, and financial regulators are trying to fix that problem by demanding bonus deferral and claw back arrangements. But even when we have done that, I still suspect that we will see financial traders paid highly for what at least in their direct effects are distributive rather than creative activities. Which means that the larger the share of financial services within the economy, the wider will tend to be income disparities between the top few percentiles and the median of the distribution.

- Finally in this still only partial list of the drivers of inequality, the factors already mentioned help change cultural attitudes to very high income among high earners and that in itself unleashes further change. If the world of celebrity and fashion and media generates very high pay, and if there are more highly paid corporate lawyers and investment bankers than in the past, and if there are some businesses, such as fashion retailing, where the star CEO can make a big difference and get highly rewarded, then the sense among the generality of the income elite of what is normal and justifiable shifts.[8] In addition the income which they need in order to afford houses in the best part of town increases because the price of those houses is set by the average income of the rest of the income elite. Then add the impact of a partly global market in executive talent, and the role of remuneration consultants with their comparisons

[8] See Polly Toynbee and David Walker, *"Unjust Rewards"*, Granta 2008, for a description of how many of the highest paid gain reassurance from the belief that they deserve their high rewards, rather than seeing them simply as the rewards which the market happens to allocate today because of today's specific circumstances of supply and demand for different skills and today's specific institutional structure.

> between this CEO and that, and the central role which relative status competition plays in the motivations of high talent people, and you have the ingredients for the relentless rise in the relative income of the best off which we have seen over the last 30 years.

A rise which in the dominant narrative of the last 30 years could be justified because it has made the economy more efficient and competitive. But actually there is no clear proof that it has had such effect – the capitalist but somewhat less unequal economies of the 1950s and 60s producing just as rapid rates of economic growth.

6. Inequality, Status Anxiety, and Well Being: But conversely there is some evidence that the scale of the increase in inequality may have undermined average well being. Richard Wilkinson and Kate Pickett in their recent book, *The Spirit Level*, for instance, provide evidence to suggest that a society where the bottom of the income distribution has drifted away from the median will be one in which a wide range of commonsense indicators of well being are worse – with worse health and higher crime – and that extreme inequality and an awareness of inequality, has a direct impact on the well being of the less successful, precisely because they feel they have lost out badly in a competition for relative status.[9] A crucial issue is whether all that matters in this respect is the relationship between the bottom and the median or whether the relationships between the median and the top is also important. A classic liberal argument has been that the latter does not matter, both because the numbers of those at the very top are so small that any attempt to redistribute their income via progressive taxation would only trivially

[9] Richard Wilkinson and Kate Pickett, *The Spirit Level, Why More Equal Societies Almost Always Do Better*, Allen Lane, 2009

benefit the average or poorer citizen ; and because the lifestyle of the celebrity rich is so detached from ordinary people, that people can gain from Hello magazine the thrill of vicarious interest without actually being made less happy through unachievable status competition. People often seem intensely concerned about their position relative to those quite close to them in the income distribution, and less concerned about larger differences between them and people whom they will likely never meet. But arguably that indifference to the much richer changes if in addition to a thin scattering of billionaires, it is the whole of the top decile which pulls away, enjoying a highly visible and reasonably widespread standard of living to which a broad mass of people aspire but which only a minority can ever achieve, given that the standard is defined by relative income not by absolute.

Of course how we should respond to anxieties produced by status competition can be debated– some would dismiss relative status anxiety as another term for envy and envy as an unattractive trait. But if we focus for now not on what should be, but simply on what is, it is I think quite possible that the sharply rising relative income of the top of the income distribution – the top percentile and the top decile – has tended to intensify the competition for relative status: and this may be another reason why rising average income no longer delivers a rising sense of well being.

Let me sum up my argument so far. I described a classic political narrative – embraced enthusiastically by the right and with reservations by the left – in which the market economy and significant inequality were required and justified because they delivered economic growth which delivers well being. But I have then noted six facts.

- First that there does not appear to be a clear relationship between average measured prosperity and average perceived happiness, beyond the sort of income achieved some 30 years ago in the most developed countries.

- Second, that one explanation of this is that as we get richer more of our expenditure is devoted to the consumption of goods – such as fashion goods or positional goods like housing – where what matters is relative income not absolute.

- Third, that much production activity, and probably an increasing proportion of it, is devoted to "distributive" activities rather than to activities which increase even measured GDP, let alone well being, and that it is noticeable that these "distributive" activities are often the highest paid.

- Fourth, that growth generates externalities, which might be expected to reduce perceived well being, and that while some of these – such as local air pollution – we can and to a significant degree have overcome – some, such as congestion effects, are inherent – again increasing the importance of relative income rather than absolute.

- Fifth, that over the last 30 years these changes in economic structure and activity have been accompanied by increasing inequality, both between the bottom and middle of the income distribution, and between the middle and the top.

- Six, that increasing inequality – of both sorts – could directly undermine a sense of well being, because relative status competition is a fact of human nature, whether or not an attractive one.

All of which creates a major challenge to the dominant and increasingly cross-party narrative of late 20th century politics, in which growth delivers well being, growth requires markets, and markets require inequality, and therefore in which you should vote for deregulation and tax cuts for the rich because it will make you, the average citizen, happier. The narrative no longer fits the facts.

What follows from this for policy and for the nature of political discourse? Well let me first repeat the point which I made earlier. That I am more wary than some others – more wary than, for instance, my good friend Richard Layard – of the idea that we should make "increased happiness" the explicit and formal objective of economic and social policy. For two reasons:

- First because I think the problems of aggregating different individual happinesses are truly intractable – no additive quantification of utils of happiness will I suspect ever prove that it is wrong for the majority to maximise their happiness at the expense of a small minority: rather an absolute concept of justice is required as well.

- But second because even at the level of each individual, our measures of happiness or of well being are highly imperfect and will remain so.

We do not have, and I suspect never will have, the ability to construct a Gross National Well Being Index whose maximisation should be pursued instead of GDP per capita. We do not know and cannot know precisely what "success" for a society would be. Rather our knowledge lies in knowing what is not true: but knowledge of untruth is still of value. And we know, I think, with a high degree of probability that the idea that growth in average GDP per capita will necessarily translate into greater human well being, is not true beyond the levels of income already achieved in the rich developed world.

What follows from that more partial knowledge? Some might see it as justifying a sort of radical green socialism – strongly egalitarian to undermine the corrosive impact of aggressive status competition, and opposed in principle to economic growth, since it has no positive value and generates harmful externalities. Is that the right conclusion? Have the arguments in favour of the market economy as the route to innovation and productivity growth, and implying some significant degree of inequality, simply collapsed?

I do not believe so. Indeed I believe that a powerful case still exists for a market economy and as a result for accepting a non-trivial level of inequality, but I believe that the arguments are more complex, less instrumental and in some sense more fundamental than those which the recently dominant narrative have advanced.

Five considerations are I think important:

- First, some level of economic growth does still matter, even in already rich countries, because even in rich countries there are some at the bottom of the income distribution for whom additional income – in an absolute or relative sense – still has the potential to deliver increased well being, and it is very difficult to improve their position through redistribution alone without growth, because redistribution without growth will be very strongly resisted. People may not gain permanently greater well being from additional income, but they may deeply resent having to sacrifice their existing already attained income levels. In technical economist terms, the shape of their utility functions is not an absolute given, but itself a function of the income already attained. In behavioural terms, people habituate to existing standards of living or wealth, and they have deeply ingrained senses of accrued rights. Growth in classic measured GDP form is required to lubricate any desirable redistribution.

- Second and more fundamentally, however, growth should be seen not as the desirable objective which justifies the existence of economic freedom, but rather as the acceptable but not particularly important by-product of economic freedom which is valuable in and of itself. The reason why people should be free to start a business; to innovate new products; to propose new retail formats or clothes designs; or to make existing production processes more efficient, is not that this economic change is good because it will make people permanently happier, but that the human desire to innovate, to change, to experiment, is naturally arising and that freedom to express this desire in itself conducive to well being. The Soviet Union, in its final stagnation period, scored low on human happiness – as measurable in some absolute indicators such as the propensity to alcoholism or to suicide – not only, and perhaps not primarily, because its production system failed to deliver the consumption goods available in the West, but because the organisation of production trapped people in stultifying routines, refusing them the right to develop new ideas, new ways of doing things, either within existing companies or through the creation of new ones. Freedom to innovate and change is an end in itself, not an instrumental means to higher GDP. But if we have that freedom to change and innovate, that will tend to generate productivity growth, and productivity growth means economic growth unless unemployment rises. And one thing we know for sure is that involuntary unemployment makes people unhappy. Rising GDP per capita is the unavoidable and acceptable concomitant of two desirable ends – economic freedom and full employment – rather than the end in itself.

- The third point, however, is that this freedom to innovate, to change, to challenge, to do things in new ways, is likely to be important not only for the opportunities it gives on the production side of the economy, but for the consumption possibilities that it delivers. Because even if more and better products and services have decreasing capacity to make people permanently happier, the potential for change, for innovation, may be in itself important to human contentment. If average income doubles in the next 30 years, we have no reason to believe that we will then on average be happier, but the anticipation that the next 30 years will bring new things, new ideas, new fashions and styles, may be in itself important to our contentment. The journey may be important not the destination. Clothes fashions do not in any objective sense get better, they simply change, year by year, sometimes indeed reverting to patterns seen decades before, and there is no reason to believe that in 30 year's time people will feel happier about the fashions they wear then than they do today. But the very fact that each year brings new fashions, with different designers competing to attract customer approval, may be important to some people's contentment, even while it also generates some anxieties. The next generation of electronic gadgetry – whatever lies beyond ipods and iphones and high definition TVs – will not make people permanently more content, but the expectation that the market will create new ideas and products may be important to many people's sense of progress and direction – and the absence of new ideas and products and styles might generate a sense of dullness and stagnation. The experience and the expectation of change can be important to current contentment, even if change will not make us permanently more content.

- Fourth, it is highly likely that the absence of markets and economic freedom will tend to lead, not merely to low growth, but to complete stagnation and indeed regression. That was the case in the Soviet Union in the final stagnation years, with measures of GDP growth actually negative and measures of well being, such as alcoholism or suicide, suggesting an absolute decline. One of the reasons for that was relentlessly growing corruption, as individuals channelled their human propensity to compete for relative status into the corrupt redistribution of the existing economic cake, rather than into open competition between businesses and individuals. A crucial justification of market competition and of significant resulting inequality, is therefore simply that we are not going to change human nature, and that if people are not able to compete for relative status through the market place, they will compete in more harmful ways. That thought is found, like so much other wisdom, in Keynes's *The General Theory* where he noted that not only are there "valuable human activities which require the motive of money making and the environment of private wealth ownership for their full fruition" but that "moreover, dangerous human proclivities can be canalised into comparatively harmless channels by the existence of opportunities for money making and private wealth, which, if they cannot be satisfied in this way, may find their outlet in cruelty, reckless pursuit of personal power and authority, and other forms of self aggrandisement".[10]

- Fifth and finally, attitudes to inequality, even among the less well off, are nuanced and the impact of rising average income on concerns about inequality is ambivalent. On the one hand rising prosperity increases the importance of positional goods and of competition for relative status: on the other many average earners are more likely to be relaxed about inequality simply because they have perfectly adequate incomes. Once you have a car, does it matter so much if someone has a bigger car: the answer is for some people yes and for some people not at all. As a result concerns about inequality often relate to its degree not its existence and are related to concepts of "fairness". Where inequalities are based on factors which people can intuitively understand – artistic or sporting talent, high professional competence, or a wide and obviously onerous span of responsibilities, or where people feel

[10] JM Keynes, *The General Theory of Employment, Interest and Money*, Macmillan 1973 edition, p 374

> that business success and high remuneration derives from the free choices of consumers – "I chose to go to that restaurant and therefore that restaurant owner is successful"– even very significant inequalities produce little concern. Where they are perceived as deriving from activities whose value people do not comprehend or which they doubt – as has become the case with some financial services activity – it is resented.
>
> It is therefore not clear that the only inequality that the average person would accept in advance, if operating behind a Rawlsion veil of ignorance, is that which they know would make they themselves better off. A rational person behind a Rawlsion veil of ignorance, might logically choose to live in a world of significant inequality, since they would know that if they were lucky enough to have the capabilities required for competitive success, they would be frustrated at being unable to exercise those talents, and more frustrated perhaps than by failure in relative status competition, provided that the skew of rewards in that competition is not too extreme.

There is therefore, I believe, a compelling case for economic freedom, for the market economy, and for treating the economic growth and non-trivial inequality which will result, as acceptable and inevitable by-products. But it is a different case from that often advanced in the last 50 years. And as a result it has different implications for optimal policy. For, once we reject the instrumental argument that sees economic growth maximisation as the end-objective, at least four things can follow:

- The first is that if GDP growth is not the objective, we should not treat potentially adverse consequences on growth as key arguments against other desirable objectives. Nick Stern argues that mitigating climate change might only cost one year out of the next 40 years of GDP growth at 2% per annum:[11] but even if the potential loss was much bigger, the downside in human well being of such a sacrifice may well be close to nil. And in debates about physical development – the pros and cons of new roads, out of town shopping or housing developments – the supposed benefit to national economic growth should not be treated as an argument which overrides judgemental assessment of direct quality of life effects.

- The second is that economic stability is more important than economic growth. Radical financial deregulation was justified on the grounds that it would improve the growth rate, with greater instability risks acceptable to achieve that end. But if increases in average prosperity have at best limited ability to foster perceived well being, while set backs to already achieved income clearly harm it, and unemployment harms it even more so, than the bias of policy should be towards moderating fluctuations in the rate of growth, not maximising it.

- And third, that while there is a case for accepting significant inequality, we cannot avoid a debate about the degree, and the optimal degree cannot be determined by theories as to what level maximises growth. Rather we are in the difficult space where attitudes to acceptable or desirable inequality – and thus to the

[11] *The Stern Review of the Economics of Climate Change*, 2006

degree of progessivity in income or inheritance tax systems are inherently judgemental and political. As I quoted earlier, Keynes believed that there was a case for inequality because there were "valuable human activities" which required it and because "dangerous human proclivities" would otherwise be canalised into harmful activities. But he also believed that "it is not necessary for the stimulation of these activities and the satisfaction of the proclivities that the game be played for such high stakes as at present". I have some sympathy with that conclusion as it relates, for instance, to some of the stakes for which the game has recently been played in the financial sector, but it does leave us without a guiding criteria on which to judge how high the stakes should be.

- Fourth, if measured GDP growth is not the objective, but an acceptable by-product, but if there are particular forms of economic growth which might tend to feed more directly through to human well being, then we cannot avoid the fact that the pattern and mix of economic growth might be as important or more important than the absolute growth rate. If for instance we assume that medical advance is conducive to well being – improving health during life, preventing premature deaths, and increasing longevity – then we might prefer investments which would speed medical advance, even if measured GDP actually increased less, with the consumption of some other goods reducing as a result. And if we believed that beautiful urban space, or excellent arts, were more likely to deliver permanent increases in well being than increasingly ferocious competition to afford branded fashion goods, then that might change our attitude to the balance of public and private expenditure.

All of which, however, carries great dangers. For once you no longer have a defined maxim our social and economic decisions lack useful constraints, and each interest group is able to argue that their specific proposal is best for human welfare, even if in reality its primary purpose is to serve their narrow interest – with architects of beautiful urban spaces and producers of high quality art being no freer of the human proclivity to pursue their own self-interest than any other humans. Faced with that danger, some may wish to stick to an economic growth target as at least "objective", to hold onto the hand of nurse for fear of finding something worse.

But I think we will have to let go nurse's hand because the narrative that growth delivers human well being, and that inequality is instrumentally justified because the market economy delivers more growth, has lost its power. And it has lost its power because of a wonderful achievement, the attainment over the last 200 years – and through the power of the market economy – of an average standard of living in most developed countries sufficiently high that further improvement in the average measured standard of living is no longer a vital objective. And again the thought can be found in Keynes, this time in his 1930 essay on "Economic Possibilities for our Grandchildren". [12] Calculating the long term impact of even quite modest growth of 2% per annum, he foresaw an early 21st century economy which could entirely banish poverty as his society knew it, satisfy most human wants beyond the dreams of most people of his day, and do so while also hugely extending leisure hours.

---

[12] See Robert Skidelsky, *Keynes, The Return of the Master"*, Chapter 6, *Keynes and the Ethics of Capitalism*

Well we did it, but we are still not satisfied.

And perhaps the key conclusion is that we never will be satisfied. That difficult social choices and conflicts do not derive simply from a scarcity of resources which can be banished by any level of economic growth: nor is there some level of prosperity, some end point, beyond which the human proclivity to compete for relative status declines. As Keynes said, we cannot "transmute" human nature, but the essence of politics is an endlessly changing, never resolved debate, as to how best to manage the implications of that nature.[13] That debate should be informed by good social science to which Ralf's professional life was devoted – and good social science sometimes tells us what is not true even when it cannot give complete answers as to what is. It isn't true that economic growth will make people on average happier, or make social conflict go away. And the justification for economic and political liberalism lies not in its ability to generate economic growth which will make conflicts disappear but in the celebration of variety, diversity, and difference as ends in themselves. I think had I been able to send this lecture to Ralf for his comments, this is one conclusion with which he might have agreed.

---

[13] See Oliver Letwin, *The Purpose of Politics*, Social Market Foundation, 1999, for an extended exposition of the argument that there is no permanent solution to the tensions inherent in human civilisation, and that the true purpose of politics is the increasing debate and revision of the arguments which these external conflicts raise.