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KEYNOTE

What Is Wrong with the West's Economies?

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What is wrong with the economies of the West—and with economics? It depends on whether we are talking about the good or the just.

Many of us in Western Europe and America feel that our economies are far from just, though our views on justice differ somewhat. One band of economists, led for decades by the British economist Anthony Atkinson, sees the West as being in another Gilded Age of inequality in income and wealth.[1] Adopting Jeremy Bentham's utilitarian view, they would redistribute income from those in high brackets to those farther down—until we reach the highest "sum of utilities." It is a question, though, whether this doctrine captures intuitive views of what is just.

Philosophers over these same decades have been more interested in the work by the American philosopher John Rawls. His book *A Theory of Justice* argues for a fundamental shift away from Bentham: economic justice is about the distribution of "utilities," for him a word usually denoting the satisfactions of consumption and leisure, not the sum of those utilities.[2] It is about the terms on which each participant contributes to the fruit of the society's economy. For Rawls, justice requires the state to use taxes and subsidies to pull up people with the lowest wages to the highest level possible. That way, the least advantaged get the largest possible portion of the gain from people's cooperation in the economy.

[1] An early work of Atkinson's is *Economics of Inequality* (Oxford University Press, 1975); for a review of his most recent book, *Inequality*: *What Can Be Done?* (Harvard University Press, 2015), see Thomas Piketty, *The New York Review*, June 25, 2015. I was struck by a presentation by Atkinson, "The Social Marginal Valuation of Income," at the conference celebrating the seventieth birthday of Sir James Mirrlees, Clare College, Cambridge, July 28, 2006.

[2] Rawls (1971). The book sees a society's economy as central to the people, arguing that they are drawn together by their desire for mutual gains from collaborating in its economy.

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A struggle persists between these views. The Benthamite view has morphed into the corporatist idea that a nation's government ought to provide benefits, whether in the form of money or tax advantages, or free services, to interest groups—whether corporations, or unions, or consumers—that voice a need until more benefits would be deemed to cost too much. Meeting these claims of many different interests has left little in the public purse for low-wage workers.

The Rawlsian view has found little support among legislators, it is true. In the US, the Earned Income Tax Credit was passed in 1975. But it mainly supplements the income of low-wage mothers of young children. It does nothing for low-end workers as a whole and, to some extent, it actually reduces paychecks for low-paid work of childless women and single men. In Europe, a few countries spend much more than the US on job subsidies but statistical analyses have not found large effects on wages or unemployment.

With little or no effective policy initiative giving a lift to the less advantaged, the jarring market forces of the past four decades—mainly the slowdowns in productivity that have spread over the West and, of course, globalization, which has moved much low-wage manufacturing to Asia—have proceeded, unopposed, to drag down both employment and wage rates at the low end. The setback has cost the less advantaged not only a loss of income but also a loss of what economists call *inclusion*—access to jobs offering work and pay that provide self-respect. And inclusion was already lacking to begin with. In America, black urban teenagers have long been lacking in inclusion. In France there is a comparable lack of inclusion among North Africans. In much of Europe there has been little attempt to include the Roma.

This failing in the West's economies is also a failing of economics. The classical idea of political economy has been to let wage rates sink to whatever level the market takes them, and then provide everyone with the "safety net" of a "negative income tax," unemployment insurance, and free food, shelter, clothing, and medical care. This policy, even when humanely carried out, and it often is not, misses the point that, even if we confine our attention to the West since the Renaissance, many people have long felt the desire to do something with their lives besides consuming goods and having leisure. They desire to participate in a community in which they can interact and develop.

Our prevailing political economy is blind to the very concept of inclusion; it does not map out any remedy for the deficiency. A monograph of mine and a conference volume I edited are among the few book-length studies of ways to remedy failure to include people generally in an economy in which they will have satisfying work.[3]

Commentators are talking now about injustice of another sort. Workers in decent jobs view the economy as unjust if they or their children have virtually no chance of climbing to a higher rung in the socioeconomic ladder. And moving up appears harder now. Even in the Gilded Age, many of the moguls came up from the bottom. (The rungs were far apart, yet the ladder was climbed.) The feeling of injustice

[3] *Rewarding Work: How to Restore Participation and Self-Support to Free Enterprise* (Harvard University Press, 1997) and *Designing Inclusion: How to Raise Low-End Pay and Employment in Private Enterprise* (Cambridge University Press, 2003).

comes from a sense of unfair advantages: that those above are using their connections to stay there—or to ensure that their children can follow them. The bar to upward mobility is always the same: barriers to competition put up by the wealthy, the connected, corporations, professional associations, unions, and guilds.

But the truth is that no degree of Rawlsian action to pull up low-end wages and employment—or remove unfair advantages—could have spared the less advantaged from a major loss of inclusion since Rawls's time. The forces of productivity slowdown and globalization have been too strong. Moreover, though the injustices in the West's economies are egregious, they ought not to be seen as a major cause of the productivity slowdowns and globalization. (For one thing, a slowdown of productivity started in the US in the mid-1960s and the sharp loss of manufacturing jobs to poorer countries occurred much later—from the late 1970s to the early 1990s.) Deeper causes must be at work.

While people need a just economy for their self-respect and national pride—Rawls regarded justice as the first virtue of a society—justice is not everything that people need from their economy. They need an economy that is good as well as just. And for some decades, the Western economies have fallen short of any conception of a "good economy"—an economy offering a "good life," or a life of "richness," as some humanists call it.

The good life as it is popularly conceived typically involves acquiring mastery in one's work, thus gaining for oneself better terms—or means to rewards, whether material, like wealth, or nonmaterial—an experience we may call "prospering." As humanists and philosophers have conceived it, the good life involves using one's imagination, exercising one's creativity, taking fascinating journeys into the unknown, and acting on the world—an experience I call "flourishing." These gains are gains in experience, not in material reward, though material gains may be a means to the nonmaterial ends. As the writer Kabir Sehgal put it, "Money is like blood. You need it to live but it isn't the point of life."[4]

How might such a good life prevail in a society? Historically, as my book *Mass Flourishing* argues,[5] prospering and flourishing became prevalent in the nineteenth century when, in Europe and America, economies emerged with the dynamism to generate their own innovation. Responding to the challenges and opportunities of an ever-evolving economy, the more entrepreneurial participants were immersed in the experience of solving the new problems and overcoming the new hurdles posed in the process of innovation: these people were "prospering." Sparked by the new spirit of dynamism, the more innovative participants were constantly trying to think of new ways to produce things or new things to produce: these people were "flourishing."

What were the origins of this dynamism? It sprang from the development of a favorable culture. In nineteenth-century Britain and America, and later Germany and France, a culture of exploration, experimentation, and ultimately innovation grew out of the individualism of the Renaissance, the vitalism of the Baroque era,

[4] Sehgal (2015).

[5] *Mass Flourishing: How Grassroots Innovation Created Jobs, Challenge, and Change* (Princeton University Press, 2013).

and the expressionism of the Romantic period. In view of the explosion in poetry, music, and art in the "creative" sector of the economy, it should not surprise us that imagination exploded in the rest of the economy too. In these years George Stephenson conceived the steam railway, John Deere the cast-steel plow that "broke the plains"; Isaac Singer developed and marketed a commercial sewing machine, Thomas Edison the phonograph, the Lumière brothers the cinema, and Florence Nightingale effected a reorganization of hospitals. Innovation was rampant—and very apparently in America, as observers testified. Abraham Lincoln, touring America in 1858, exclaimed that the country had "a great passion—a perfect rage—for the 'new.'"[6]

What made innovating so powerful in these economies was that it was not limited to elites. It permeated society from the less advantaged parts of the population on up. People of ordinary background might be involved in innovations, large and small. Stephenson was illiterate, Deere a blacksmith, Singer a machinist, Edison of humble origins. People of ordinary ability could also have innovative ideas. As I wrote in *Mass Flourishing*, "Even people with few and modest talents…were given the experience of using their minds: to seize an opportunity, to solve a problem, and think of a new way or a new thing."

The experience of working in these dynamic economies was evidently good for most people—far better than the previous economies were, at any rate. Diaries of the period contradict the old familiar tune that the rural life of mercantile times, with its routine and isolation, was preferred to modern life in businesses and cities.[7]

It may be that some other economies lacked (and still lack) the wages for large numbers of ordinary people to afford to pursue careers in which they could prosper or flourish; or they lacked enough jobs for large numbers of people to have those opportunities. High-enough wages, low-enough unemployment, and wide-enough access to engaging work are necessary for a "good-enough" economy—though far from sufficient. The material possibilities of the economy must be adequate for the nonmaterial possibilities to be widespread—the satisfactions of prospering and of flourishing through adventurous, creative, and even imaginative work.

Some economists maintain that nations do not need dynamism to be happy. The French and Italians seem to find it perfectly acceptable that their economies have been almost devoid of indigenous innovation for nearly two decades. They are content with an economy unable to do more than simply let global market forces—including advances in science at home and abroad—pull up the going level of wage rates and prop up the market rates of return on wealth. (In fact, little upward movement of real wages has been occurring of late in the advanced economies.) But from my perspective, such an economy is pitiful next to an economy with significant prospering and flourishing—let alone the economies of heady innovation in the West's past. Oddly, this pitiful sort of economy is very much like the theoretical models of classical economics.

[6] Abraham Lincoln, "Discoveries and Inventions", Young Men's Association, Bloomington, Illinois, April 6, 1858.

[7] See Griffin (2013). Her current work, as yet unpublished, has reached farther into the nineteenth century, where some of the findings are equally or more striking.

In the classical models I have been describing, no one is trying to think up something new (except perhaps new profitable investments) and no one is attempting to create it. There is no conception of human agency, only responses to wages, interest rates, and wealth. The economy is mechanical, robotic. The crops may be growing, but there is no personal growth. In the classical canon, Bentham, with his “sum of utilities,” portrays individuals like machines working to contribute their share to the general welfare. Joseph Schumpeter portrays “innovation” as produced by hard-driving entrepreneurs who make “obvious” applications of discoveries occurring outside the nation’s economy—as if the economy’s central participants possessed no imagination whatever.

Such classical models are basic to today’s standard economics. This economics, despite its sophistication in some respects, makes no room for economies in which people are imagining new products and using their creativity to build them. What is most fundamentally “wrong with economics” is that it takes such an economy to be the norm—to be “as good as it gets.” The cost is that elements of the Western economies are becoming products of this basically classical economics, which has little place for creativity and imagination.

Since around 1970, or earlier in some cases, most of the continental Western European economies have come to resemble more completely the mechanical model of standard economics. Most companies are highly efficient. Households, apart from the very low-paid or unemployed, have gone on saving, each year pushing up their wealth to higher levels, spectacular levels in Italy and France—far higher than in America, leaving aside the super-rich. And with the rise of household wealth contracting the supply of labor, workweeks and labor force participation have been shrinking.

One could argue that the continental economies are marching—D.H. Lawrence’s “everlasting slog” comes to mind—along a path of ever-increasing wealth like that derived mathematically by Frank Ramsey long ago. That study inspired John Maynard Keynes’s influential essay in which he praised the decline of work as liberating the human spirit.[8] Keynes seemed to think that ordinary people are incapable of prospering or flourishing. Even now, many Europeans seem not to have grasped that, while comparatively rich in wealth and spare time, they are poor in the conditions for the good life: an economy conducive to flourishing and prospering. The causes of this decline are clear.

In most of Western Europe, economic dynamism is now at lows not seen, I would judge, since the advent of dynamism in the nineteenth century. Imagining and creating new products has almost disappeared from the continent—a continent that had been a major wellspring of new industries and new ways of living. Growth there has stopped, and econometric estimates of the rate of homegrown innovation are generally small. The near disappearance of imaginative and creative activity has reduced indigenous innovation, contracted investment activity, and depressed the demand for labor.

The bleak levels of both unemployment and job satisfaction in Europe are testimony to its dreary economies. Polls can produce simplistic responses to

[8] See Ramsey (1928), and Keynes (1930).

questions about complex feelings; but it should not be puzzling that a recent survey of household attitudes found that, in "happiness," the median scores in Spain (54), France (51), Italy (48), and Greece (37) are all *below* those in the upper half of the nations labeled "emerging"—Mexico (79), Venezuela (74), Brazil (73), Argentina (66), Vietnam (64), Colombia (64), China (59), Indonesia (58), Chile (58), and Malaysia (56).[9] As I wrote in a commentary on western continental Europe, "the economy is failing society."[10]

The US economy is not much better. Two economists, Stanley Fischer and Assar Lindbeck, wrote of a "Great Productivity Slowdown," which they saw as beginning in the late 1960s.[11] The slowdown in the growth of capital and labor combined—what is called "total factor productivity"—is stark and, with the exception of the years of the Internet boom, between 1996 and 2004, it has not let up; it has only gotten slower since the 1960s. In my analysis, the slowdown is the source of the deep decline in wage growth, labor force participation, and, on some evidence, in job satisfaction. Markedly fewer lead the good life. (As in continental Europe, the slowing of productivity growth caused wage growth to slow, and many households kept adding to their wealth through savings, all of which has been dragging participation down. Yet America's productivity slowdown started earlier, so the cumulative damage to participation has been greater than Europe's to date).

What is the mechanism of the slowdown in productivity? Many commentators and laymen suppose that the dramatic rise of innovation in Silicon Valley has displaced labor and slowed the rise of wages at the low end and the middle. We have all observed the disappearance of bookstores, record stores, and many other kinds of stores, as well as newsprint. But if innovation in the aggregate were up, it would be hard to explain why growth of aggregate total factor productivity is so unmistakably down. As Alvin Hansen said many decades ago, it is the "cessation of growth," or, as he implied, the slowdown of aggregate innovation, "which is disastrous."[12]

The plausible explanation of the syndrome in America—the productivity slowdown and the decline of job satisfaction, among other things—is a critical loss of indigenous innovation in the established industries like traditional manufacturing and services that was not nearly offset by the innovation that flowered in a few new industries—digital, media, and financial. In the vast heartland of America, the loss of dynamism is almost palpable—and not just in the oft-cited education and health care industries. Companies like Google and Facebook may offer jobs allowing or requiring imagination and creativity, but the whole of Silicon Valley accounts for only 3 percent of national income and a smaller percentage of national employment. Once European economies ran out of American innovations they could copy, the syndrome of low productivity growth hit them too—France and Italy in the late 1990s, Germany and Britain by 2005 or so. That most European

[9] "People in Emerging Markets Catch Up to Advanced Economies in Life Satisfaction," Pew Research Center, October 2014. (Performing better were the UK at 58, Germany at 60, and the US at 65.)

[10] "Europe Is a Continent That Has Run Out of Ideas," *Financial Times*, March 3, 2015.

[11] See Lindbeck (1983), and Fischer (1988). Lindbeck begins, "The growth slowdown that began in the late 1960s or early 1970s is the most significant macroeconomic development of the last two decades."

[12] Hansen (1939).

economies appear to be in worse condition than the American in labor force participation and job satisfaction can be laid to America's noticeable edge in innovation. That has kept America a step ahead.

What then caused this narrowing of innovation? No single explanation is persuasive. Yet two classes of explanations have the ring of truth. One points to suppression of innovation by vested interests. Their power has risen enormously in Western Europe and finally America over the postwar decades. Invoking corporatist notions of economic control and social contract originating in the *corporazioni* of ancient Rome, some professions, such as those in education and medicine, have instituted regulation and licensing to curb experimentation and change, thus dampening innovation.

Invoking the corporatist notion of solidarity, companies hurt by innovators—as GM was hurt by BMW and Toyota—have been able to obtain federal government bailouts to help them regain their positions. As a result, fleeting innovators—BMW and Toyota in my example—often lose money in their attempts. So would-be innovators will think twice before trying again to innovate in America's automobile market.

Invoking the corporatist tenet of social protection, established corporations—their owners and stakeholders—and entire industries, using their lobbyists, have obtained regulations and patents that make it harder for new firms to gain entry into the market and to compete with incumbents. A result is that the outsiders have been stifled—though some entered new industries before those too could put up barriers. And some insiders, now protected from new entrants, feel it is safe to drop whatever defensive innovation they used to do. We can see dramatic examples of how these barriers protect insiders in the pharmaceutical and the medical device industries, where the FDA approvals process has blocked new entry and slowed innovation to a crawl. Insiders feel free to raise their markups, thus increasing profits and wealth inequality.

We can test this theory. Bureau of Labor Statistics data on the US nonfarm business sector show labor's share of income falling from 66 percent at its twin peaks in the mid-1970s to 61 percent in the 1990s and around 58 percent more recently. OECD data on business sectors show a rise in capital's share from 32.5 percent in 1971–1981 to 34.5 percent in 1995–1997 in the US and from 33.3 percent to 38.5 percent in the European Union.[13]

The second explanation points to a new repression of potential innovators by families and schools. As the corporatist values of control, solidarity, and protection are invoked to prohibit innovation, traditional values of conservatism and materialism are often invoked to inhibit a young person from undertaking an innovation. Schools are doing less to expose the young to the great books of adventure and personal development. Parents teach their children from infancy to be careful and stay close to the family. There is discussion now of the overprotected child: the need for a return to "free range" children who are allowed to explore, to try things and take chances.[14] Parents urge their children upon graduating to take a

[13] OECD, *Economic Outlook*, December 1998.

[14] See Hanna Rosin (2014), and Lenore Skenazy (2009).

secure job with high pay, not a job at a startup. Many universities are now teaching courses in "responsible investing" but nothing on venturesome investing.

How might Western nations gain—or regain—widespread prospering and flourishing? Taking concrete actions will not help much without fresh thinking: people must first grasp that standard economics is not a guide to flourishing—it is a tool only for efficiency. Widespread flourishing in a nation requires an economy energized by its own homegrown innovation from the grassroots on up. For such innovation a nation must possess the dynamism to imagine and create the new—economic freedoms are not sufficient. And dynamism needs to be nourished with strong human values.

Of the concrete steps that would help to widen flourishing, a reform of education stands out. The problem here is not a perceived mismatch between skills taught and skills in demand. (Experts have urged greater education in STEM subjects—science, technology, engineering, and mathematics—but when Europe created specialized universities in these subjects, no innovation was observed.) The problem is that young people are not taught to see the economy as a place where participants may imagine new things, where entrepreneurs may want to build them and investors may venture to back some of them. It is essential to educate young people to this image of the economy.

It will also be essential that high schools and colleges expose students to the human values expressed in the masterpieces of Western literature, so that young people will want to seek economies offering imaginative and creative careers. Education systems must put students in touch with the humanities in order to fuel the human desire to conceive the new and perchance to achieve innovations. This reorientation of general education will have to be supported by a similar reorientation of economic education.

We will all have to turn from the classical fixation on wealth accumulation and efficiency to a modern economics that places imagination and creativity at the center of economic life.

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