On the Future of Economic Growth and Capitalism

International Panel on Social Progress (IPSP)
Chapter 4
Growth, human development and planetary welfare

Prof. Dr. Ottmar Edenhofer, Venice 18th May 2016
Structure

1. What is the International Panel on Social Progress (IPSP)?

2. Three narratives about capitalism
   a) Capitalism as liberation
   b) Capitalism as exploitation/alienation
   c) Third ways

3. How to think about the future
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Why IPSP?

• Societal demand for a vision of a possible better future

• Excessive focus on technical solutions, neglect of the quality of social relations, institutions

• Great advances in social sciences since WWII

• But increased specialization, requiring collective synthesis

• Can social sciences serve society?
Objectives of the IPSP

• Comprehensive coverage of the dimensions of social progress

• Make up-to-date social science more accessible and relevant

• Feed social actors and citizens with ideas about possible futures, influence public debates

• Raise interest in social justice and long-term perspective among scholars
Key principles

• Independent initiative led by global panel of social scientists
• Bottom-up and peer-based collegial project
• Non-binding funding (independent from governments, international organisations, lobbyists…)
• High value given to pluridisciplinary approaches and to stakeholders’ feedback
Another bland report?

• Social context
  • People are anxious about the future
  • People are anxious about inequalities
    (1%, poverty eradication, development)

• Contents
  • Focus not on academic hair-splitting but on one applied question: can society be improved?
  • Be objective but make recommendations
  • Seek consensus but be open about disagreements
  • IPSP can be conditionally prescriptive: “if your objective is this, then the best way is that”
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Capitalism as origin of today’s wealth

• Malthus (1798): endless cycle of small technological improvements and ensuing small increases in population

• Economy in vicious cycle of stagnation until 18th century

• Since then: phenomenal success in creating material wealth

• Exponential growth in production

• What caused this escape from the brink to starvation for the majority of the population?

• Solow (1956), Swan (1956): growth is driven by technological progress
Capitalism as origin of today’s wealth

Gross World Product Per Capita

People living in extreme poverty

- East Asia and Pacific
- Europe and Central Asia
- Latin America and the Caribbean
- Middle East and North Africa
- South Asia
- Sub-Saharan Africa
Growth and technology

• Development of new technology drives economic growth

• Where does technology come from?

• Romer (1990), Grossman and Helpman (1991) and Aghion and Howitt (1992): technology is endogenous

• Technological development depends on incentives to innovate

• Innovators have to receive share of profit resulting from their efforts
Technology and institutions

• What ensures that innovators are rewarded?

• How can their *right* to the created value be assured?

• MacLeod (1988): England developed first modern patent system in the 16th century

• Acemoglu et al. (2005), Hall and Jones (1999): functioning institutions make the difference between misery and prosperity

• Acemoglu and Robinson (2012): development is slow process of gradually transferring power from small elite towards the people

• Transfer of power started with Magna Carta in 1215 in England
Institutions, freedom and capitalism

• What makes institutions so central to technology and growth?

• Easterly (2013): Institutions give freedom to individuals and grant individual rights

• Institutions create a reliable link between effort and reward

• Institutions provide basis for capitalism, which is based on incentives

• Welfare theorems: markets can create efficient allocation of resources

• Regulation by government can be used to ensure market functioning
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Capitalism as exploitation/alienation

Four major problems of growth-focused capitalism

1. Wealth concentration at the top
2. Overuse of natural capital
3. Unrestricted corporate power
4. Too narrow focus on material consumption
Increased wealth concentration

- Increased gap in wealth ownership between top 1% and the rest of the population (Piketty, 2014; Piketty and Zucman, 2014)

- The share of capital income going to the top 1% increased from 17% to 27% in the period between 1980 and 2000 (Alvaredo et al., 2013)

Source: Piketty and Zucman (2014)
Overuse of natural capital

- Strong correlation between per capita GDP growth and emissions

- Greenhouse gas emissions are an externality which cannot be addressed if the market is left to its own devices

- Jackson (2011), Kallis (2011) and others argue for de-growth as only solution

- Jakob and Edenhofer (2014): new concept of social welfare is needed. (De-)growth focus not helpful

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Source: Edenhofer et al. 2012
Unrestricted corporate power

• A globalized economy gives rise to large corporations with enormous market power and large political influence

• Corporations exercise their power through lobbyism, trade regulations and liberal financial markets (Stiglitz, 2006)

• They can move abroad to avoid strict local regulations such as environmental policies and labor rights (Stiglitz, 2006)

• They can even erode beneficial health, environmental and labor regulations by suing governments in front of international courts (Sud et al., 2015)

• Tax avoidance and tax competition can lead to an underprovision of public goods

Source: By Valenciano (Own work) [CC BY-SA 4.0 (http://creativecommons.org/licenses/by-sa/4.0)], via Wikimedia Commons
Too narrow focus on consumption

- “social limits to growth” due to status seeking (Hirsch, 1977)

- Layard (2011): consumers overestimate the pleasure they will derive from new purchases

- Rather weak positive effect of personal income on subjective well-being (Kahneman and Deaton 2010)

- Alternative welfare measures needed that go beyond GDP

- Well-being is multidimensional: need a dashboard of indicators (Stiglitz, Sen and Fitoussi, 2009)

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The future of capitalism

Capitalism as liberation
Capitalism has liberated humans from many material scarcities

Capitalism as exploitation
Capitalism has developed harmful dynamics

Third way
Keep capitalism, but put effective controls on it:
• Provide public goods
• Enhance effective environmental policy
• Cooperate internationally to control corporate power
• Provide efficient form of redistribution

Some of these controls would imply large changes from status quo
Capitalism and welfare

• Capitalism very successful in providing material consumption

• Consumption is only one factor of human welfare

• Other factors
  • Equality
  • Environmental quality
  • Security
  • Social interactions
  • …

• From consumption to welfare
  • Material consumption no longer a pressing need in developed countries
  • Focus on consumption threatens other factors of welfare
  • Capitalism can be restrained and regulated to serve social welfare

Source: Jakob and Edenhofer (2014)
Public goods

- Public goods play an important role for efficiency and for equity

- Examples: energy, transport, health and education infrastructure


- Chatterjee and Turnovsky (2012), Klenert et al. (2016): public capital reduces inequality
Environmental policy

- Environmental policy is required to control negative externalities

- Most powerful instrument: Pigouvian pricing
  - Very high Pigouvian taxes can implement strong sustainability

- Complementary policies:
  - subsidies for renewable technologies (Acemoglu et al., 2012, Mattauch et al., 2015)
  - public investment into sustainable infrastructure (Guivarch and Hallegatte, 2011)

- Important: Pigouvian taxation may reach very high levels (>100$/t CO₂)

Control corporate power

• Underlying problem: international corporations can exploit “weakest” countries to evade social and environmental responsibility

• This can be addressed through
  • International environmental agreements to avoid “pollution havens” (Paris Agreement)
  • Coordination on social protection and labor standards (ILO)
  • International tax harmonization
  • Financing of legal assistance to developing countries

• Idea: Coordination against “race to the bottom”

• Problem: Potential backlash against perceived loss of sovereignty
Address inequality

- Two types of inequality (Marrero and Rodriguez, 2013):
  - Inequality due to effort: positive effects on growth
  - Inequality of opportunity: detrimental effects on growth

- Policy objective:
  - Maintain adequate inequality due to effort (necessary as incentive)
  - Minimize inequality of opportunity

- Possible policy instruments to achieve policy instrument:
  1. Inheritance taxation
  2. Public investment
  3. Taxation of economic rents, competition policy to stop rent-seeking

- Addressing inequality requires careful economic analysis
  - Redistribution policies have effects on equity and efficiency
  - Adverse effects on efficiency can make everyone worse off (example: capital taxation)
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How to think about the future

Purpose of IPSP

- Explore future possibilities, develop maps
- Ask radical questions: Which economic system works best?

Narratives are more than evidence-based arguments but narratives should rely on evidence-based arguments

Broader scope than IPCC: IPSP can exploit independence