

# 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

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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?

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- 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

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- 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

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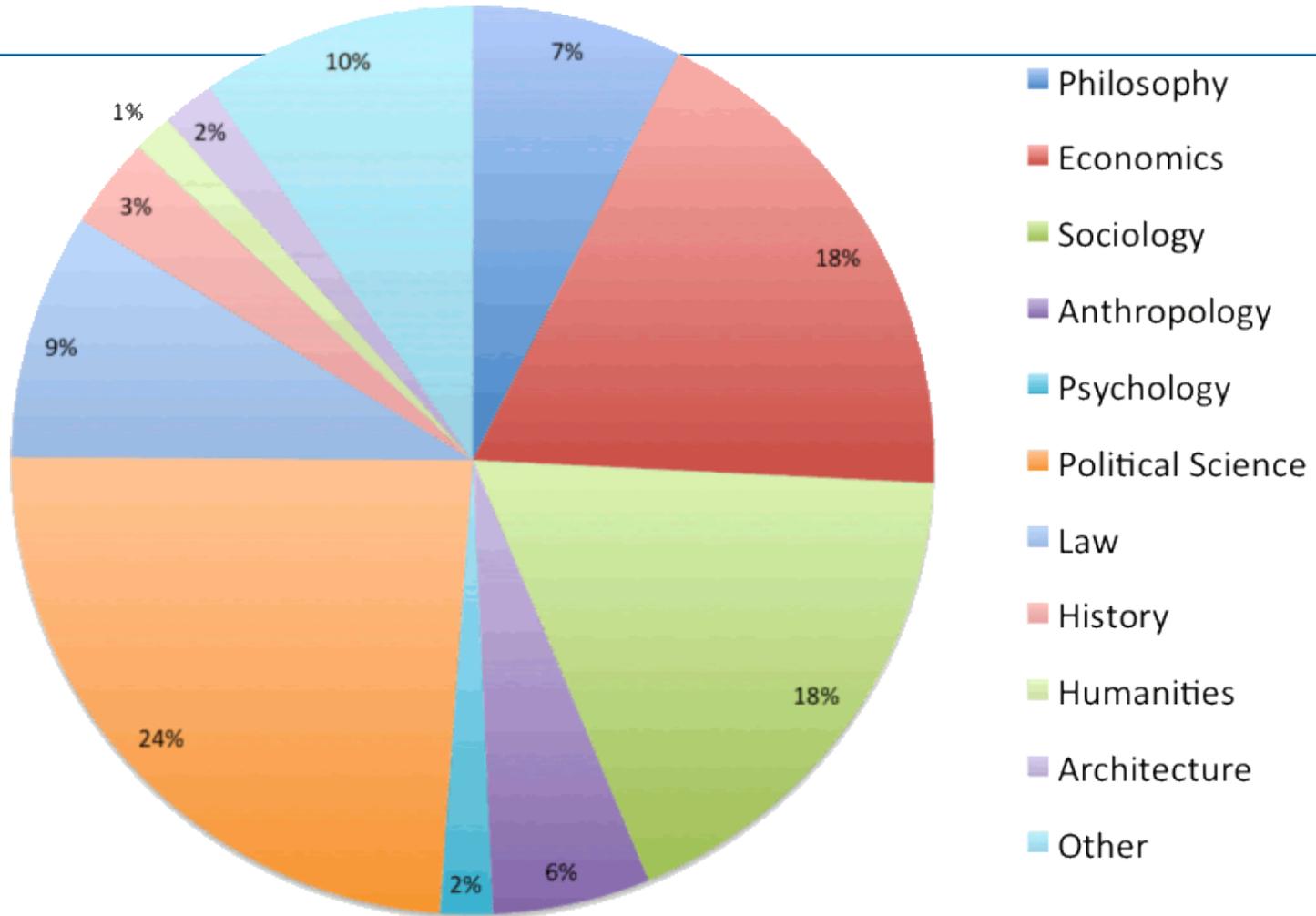
- Independent initiative led by global panel of social scientists
- Bottom-up and peer-based collegial project
- Non-binding funding (independent from governments, international organisations, lobbyists...)
- High value given to pluridisciplinary approaches and to stakeholders' feedback

# Another bland report?

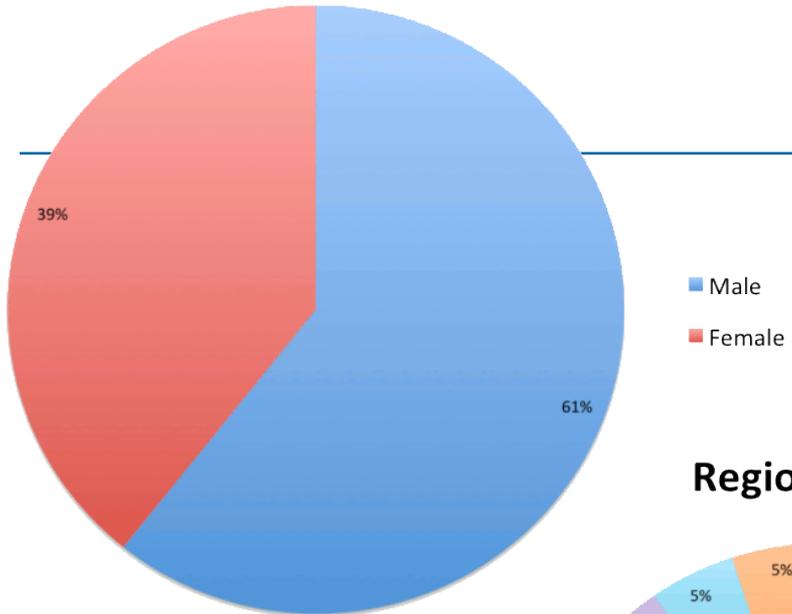
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- Social context
  - People are anxious about the future
  - People are anxious about inequalities (1%, poverty eradication, development)
- Contents
  - Focus not on academic hair-splitting but on one applied question: can society be improved?
  - 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”

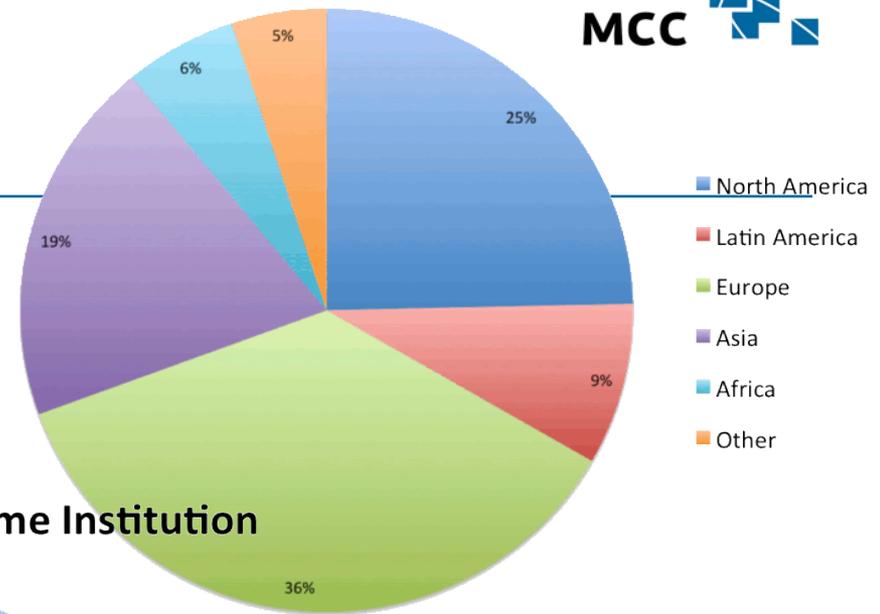
# Author Discipline



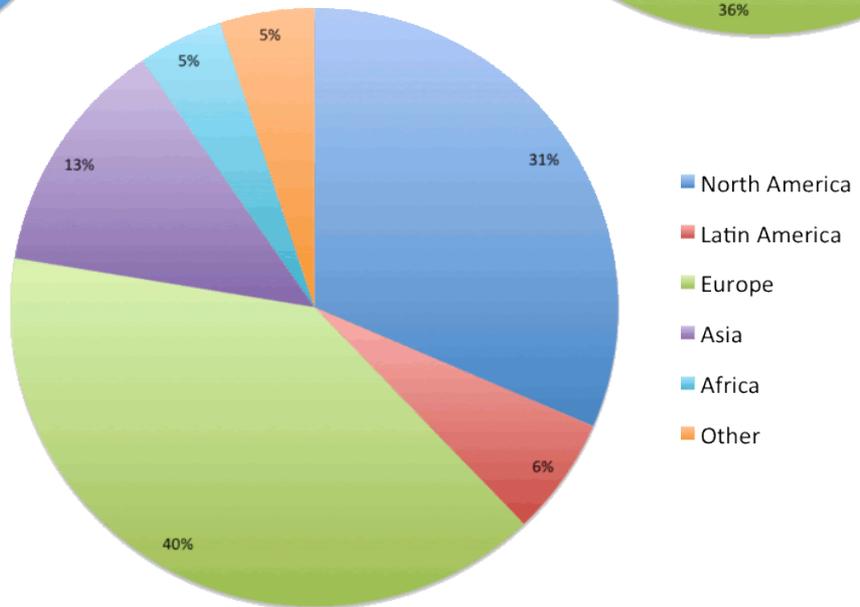
### Gender ratio of Authors



### Regional Origin



### Region of Home Institution



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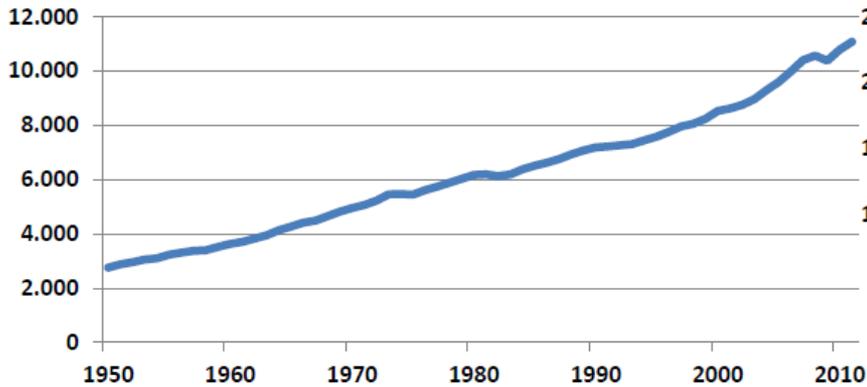
# Capitalism as origin of today's wealth

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- Malthus (1798): endless cycle of small technological improvements and ensuing small increases in population
- Economy in vicious cycle of stagnation until 18<sup>th</sup> 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

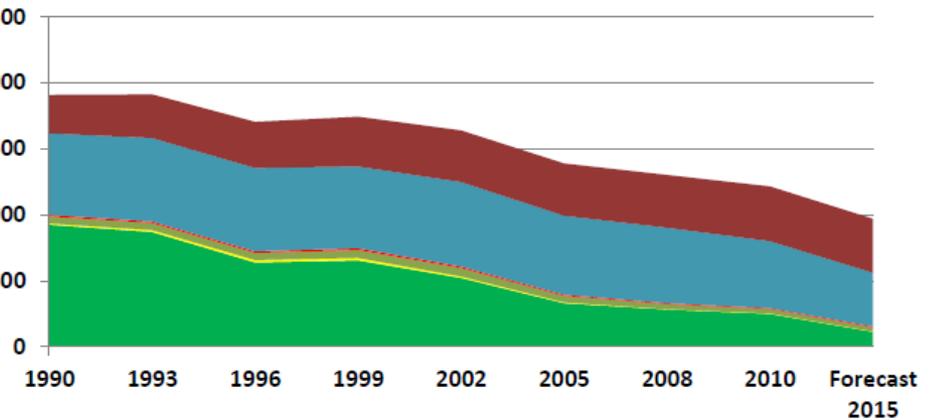
# Capitalism as origin of today's wealth

Gross World Product Per Capita



— Gross World Product Per Capita

People living in extreme poverty



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

# Growth and technology

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- 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

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- 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

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- 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

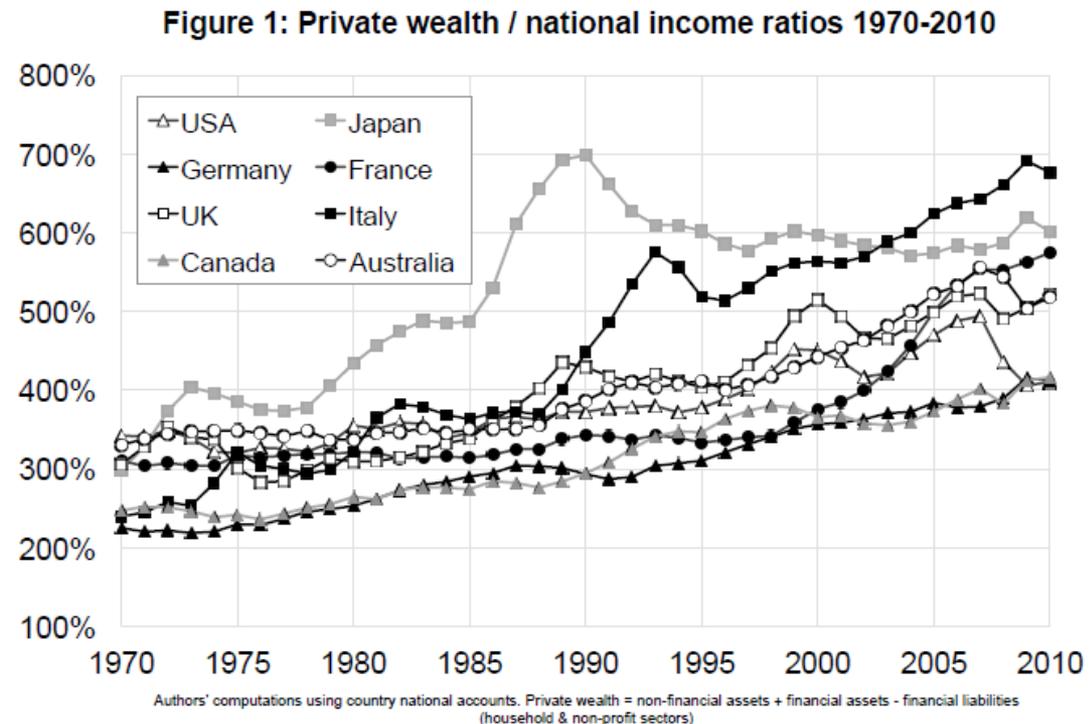
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Four major problems of growth-focused capitalism

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

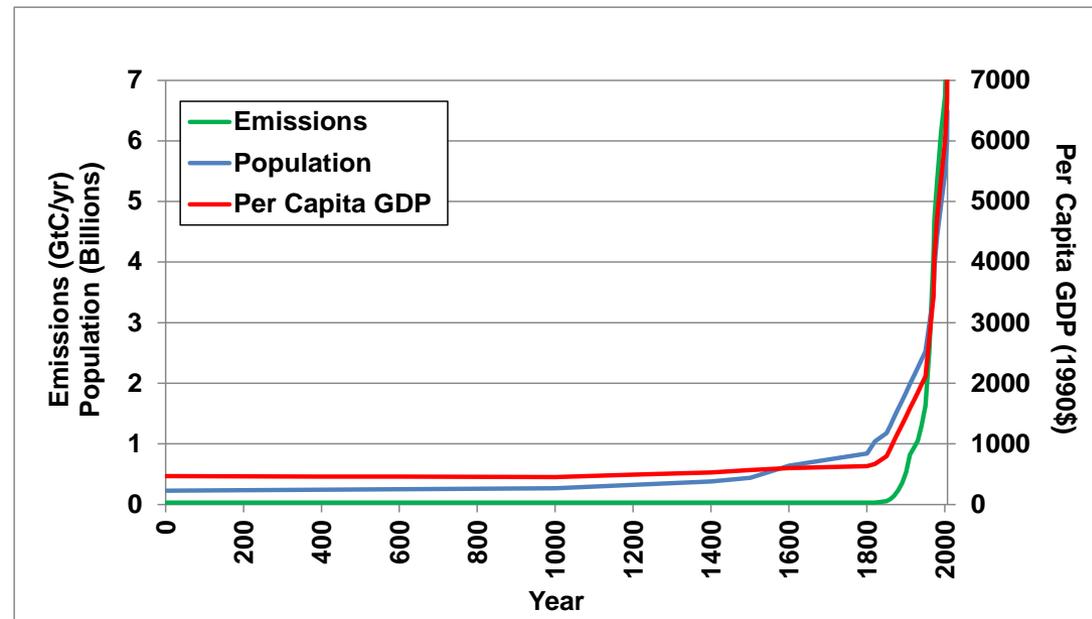
- Increased gap in wealth ownership between top 1% and the rest of the population (Piketty, 2014; Piketty and Zucman, 2014)
- The share of capital income going to the top 1% increased from 17% to 27% in the period between 1980 and 2000 (Alvaredo et al., 2013)



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



Source: Edenhofer et al. 2012

# Unrestricted corporate power

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- A globalized economy gives rise to large corporations with enormous market power and large political influence
- Corporations exercise their power through lobbying, 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)



Source: Wilkinson and Pickett (2009)

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# The future of capitalism

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## **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

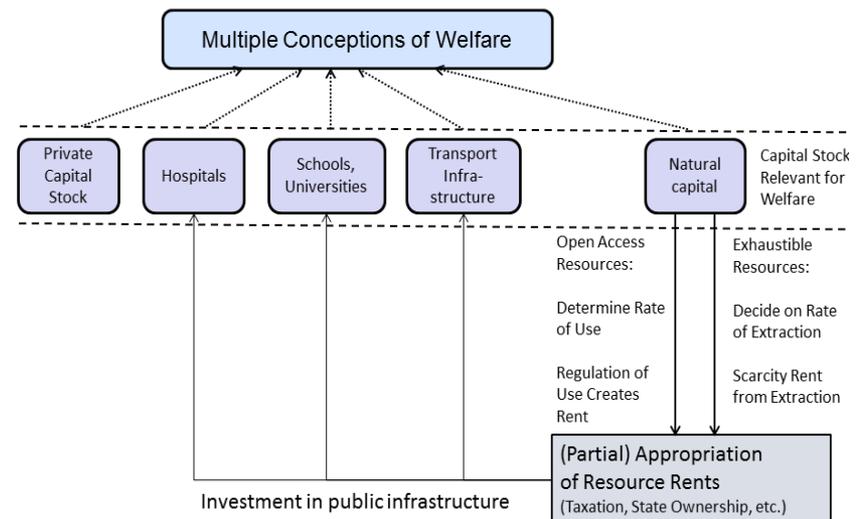
- Capitalism very successful in providing material consumption
- Consumption is only one factor of human welfare

- Other factors

- Equality
- Environmental quality
- Security
- Social interactions
- ...

- From consumption to welfare

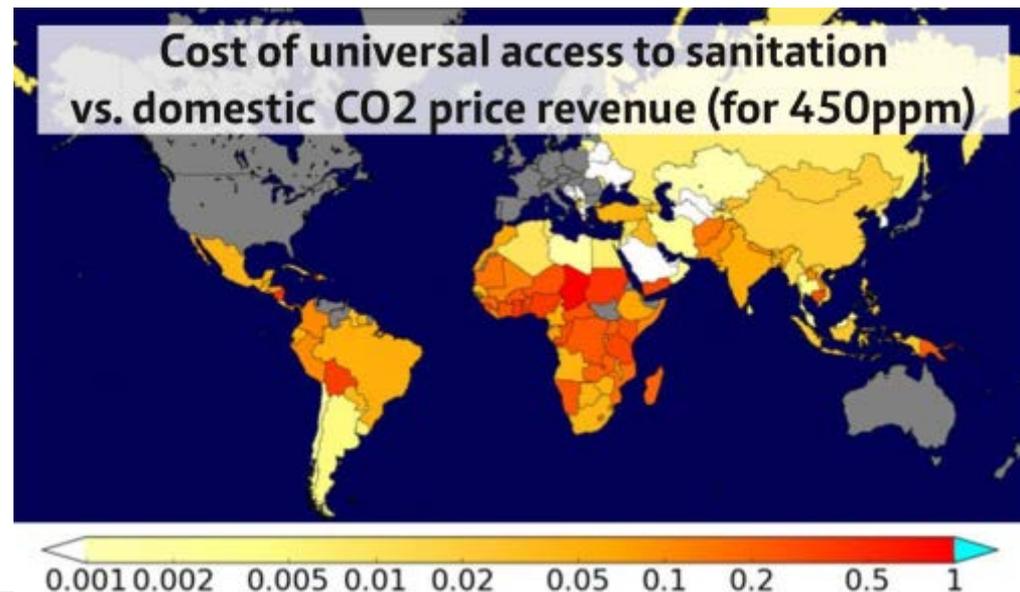
- Material consumption no longer a pressing need in developed countries
- Focus on consumption threatens other factors of welfare
- Capitalism can be restrained and regulated to serve social welfare



Source: Jakob and Edenhofer (2014)

# Public goods

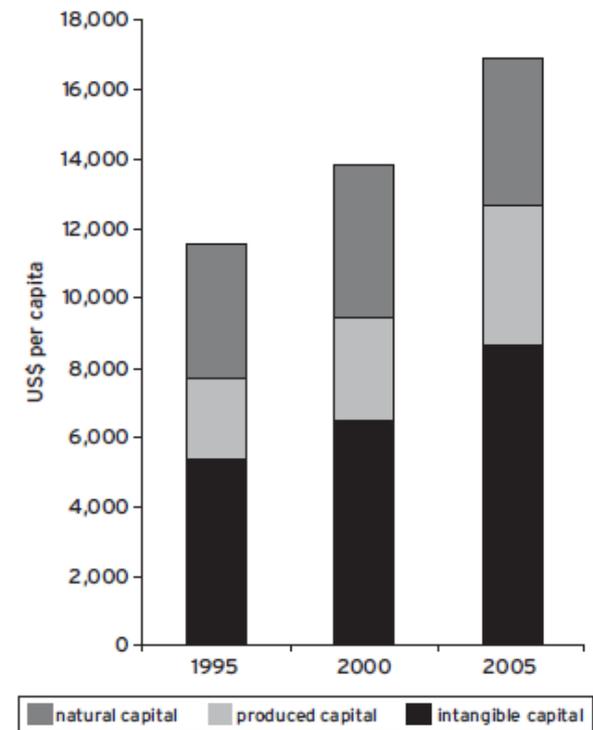
- Public goods play an important role for efficiency and for equity
- Examples: energy, transport, health and education infrastructure
- Bom and Ligthart (2014), Estache and Fay (2007), Romp and Haan (2007): too little investment in public infrastructure
- Chatterjee and Turnovsky (2012), Klenert et 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 CO<sub>2</sub>)

Changing Volume and Composition of Wealth in Lower-Middle-Income Countries, 1995-2005



Source: World Bank (2011): The changing wealth of nations

# Control corporate power

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- 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

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- 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

