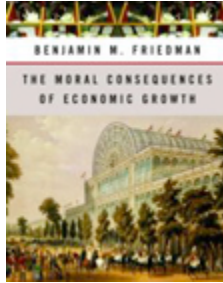




The Moral Consequences of Economic Growth

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Introduction

JOANNE MYERS: Good morning. I'm Joanne Myers, Director of Public Affairs Programs at the Carnegie Council.

I would like to thank you all for joining us this morning as we welcome Ben Friedman. He will be discussing his book, [The Moral Consequences of Economic Growth](#).

In an era of economic punditry, we often find that ideas about ethics or morality will be left out of the discourse, especially when speaking about matters focusing on economic growth and globalization. So when a widely acclaimed economist comes along and presents a moral perspective to the ongoing debate on the effects of economic growth and globalization, his arguments merit special consideration.

In *The Moral Consequences of Economic Growth*, Professor Friedman delivers a major contribution to the discourse on the issue of whether economic growth actually benefits or harms society. It is his belief that growth has not only obvious economic benefits, but moral benefits as well. He demonstrates that in developing countries particularly, where growth, rather than just the level of living standards occurs in a consistent manner, it encourages political and social reform, allows for the possibility of economic mobility and fairness, and provides the substance for democracy.

To support his argument, he draws on examples from the Enlightenment and from those thinkers whose ideas were both key to the creation of our own country and have remained central to Western thinking in general. Exploring two centuries of historical evidence, from income and unemployment data to period novels, our speaker elucidates connections between economic conditions, social attitudes, and public policy throughout the world. In general, Professor Friedman illustrates how economic growth is a basic prerequisite for the creation of a liberal, open society.

For many years now, our guest has been thinking, writing, and teaching economic policy. Most of these activities have taken place at Harvard, where he is the William Joseph Maier Professor of Political Economy and formerly Chairman of the Department of Economics there. His book, [Day of Reckoning: The Consequences of American Economic Policy Under Reagan and After](#), was widely acclaimed for masterfully underscoring the problems with Reagan's tax cuts. For this writing, he received the George S. Eccles Prize, which is awarded annually by Columbia University for excellence in writing about economics. Most recently, the International Honor Society for Economics granted him the 2005 John R. Commons Award in recognition of achievements in economics and contributions to the economic profession.

Just as he has challenged and nurtured so many minds with this teaching, today we welcome him to the Carnegie Council, where he will test our thinking and provide us with new ideas.

Please join us in welcoming Professor Benjamin Friedman.

Remarks

BENJAMIN FRIEDMAN: Thank you, Joanne, for that lovely introduction. I would like to outline the principal implications of the hypothesis about economic growth and its moral consequences that are quite important for our society, especially here in the United States.

Why do we care so much about economic growth? When we talk about microeconomic issues in economics, the conversation boils down to efficiency: How can we best organize economic activity—production, buying, selling, consuming—in order to keep the economy as close as possible to the frontier that represents the maximum possible production and satisfaction of the desires of all. Maximizing the use of our productive capacity dominates the microeconomic side of what economists do. Then, when we switch to macroeconomics, we are dealing with the use of government policies, in the first instance, to minimize the effect of recessions, in which business falls below the productive capacity of the economy, and then, even more important, to achieve economic growth, expanding that frontier of production over time.

Whether the economy falls 2 percent below its productive capacity, or 4 percent is considered a big to-do. Two percent down would be a modest recession; 4 percent would be a very significant one. Similarly, when we address issues of economic growth, whether the economy expands at 1 percent per annum so that we will double our standard of living over the next three-quarters of a century, or whether we have a 3 percent per annum growth, so that we achieve a doubling of our standard of living over the next generation, is again considered to be a very major item of concern.

Why is this so important to us? We have to be careful about who is the "us" in this question. For roughly three-fourths of the world's population, an answer would be immediately obvious. In countries where the standard of living is well below ours, economic growth and moving to a higher standard of living means that people live longer; they suffer from fewer diseases; they are more likely to have an adequate roof over their heads; they are more likely to have indoor plumbing, sanitation; they are more likely to be able to read and write. All of the very basic life necessities are in play for the majority of the world's population.

Why, in a society as rich as ours, do we care so much about such matters? After all, the relationship of standard of living and life expectancy and what diseases we suffer and whether we can read and write and whether we have indoor plumbing has played itself out by the time an economy gets to a standard of living, say, half of ours. For example, the Portuguese or the Koreans have a standard of living no more than half of ours, yet, on all of these basic life dimensions, they are just as well off as we are. So why should we care?

We should care for a reason that goes well beyond the material benefits that economic growth provides. Societies like ours, and specifically including ours, are more likely to be successful at preserving and enhancing their basic moral values when the majority of the population has a sense of getting ahead.

By "basic moral values," I mean, for instance, whether the society provides opportunities to those who are able and willing to take them, whether the society is characterized by tolerance of people of other races, other religions, and different backgrounds. I have in mind whether we have a sense of fairness, generosity to those who are less advantaged, whether we are committed to the preservation and strengthening of our democratic institutions—in short, the whole range of characteristics of a society that thinkers since the Enlightenment have considered not only as explicitly positive characteristics, but also explicitly moral characteristics of the society.

I picture the average citizen asking himself or herself questions like, "How am I living compared to how I was doing twenty years ago?" "What's it like at my house compared to what it was like growing up in my parents' house?" For young adults, "How is my career starting out compared to what all of my uncles and aunts had in their day?" For people at a slightly later stage, "What am I doing in providing for my children compared to how I grew up myself?" For people at a yet older stage, "What are the career prospects for

my children compared to the prospects that I had as a young man or a young woman starting out?"

This is not a story about business cycles. This is not a story about people comparing themselves today to two or three years ago. This is about today versus ten or fifteen years ago, today versus a generation ago.

When a broad cross-section of the population looks back over those comparisons and is able to have the sense that they are getting ahead economically, that is the condition under which societies make progress in tolerance, mobility, fairness, and democracy. By contrast, when the broad bulk of the population has the sense of stagnation or, worse yet, falling behind, opportunity and tolerance erode, fairness falls by the wayside, and democratic institutions are allowed to wither.

I look back to the Civil War and trace the century and a half of experience since then and ask, when are the periods when American society made progress, and when did we fall back?

I also look at the traditional large European democracies—France, Germany, Britain—again asking, when did these democracies move forward as democracies, and conversely, when did they fall back?

I examine the experience of the developing world, where life's necessities are also in play, but I argue that the fairness and democracy of the developing world is also at stake when we think about economic growth.

There are four important implications of this hypothesis:

The first is very optimistic. If it's true that what matters for such aspects of a society's moral development is not how rich it is in terms of standard of living, but rather its growth in the sense of whether the average citizen feels he is getting ahead, then the very optimistic implication is that those countries in the world where incomes and living standards are far below ours do not have to wait, and will not have to wait, until they achieve Western living standards before they begin to democratize. We see evidence of this all over the world. Half a century ago, there were only about fifty functioning electoral democracies. Today there are over 100. Many of the new ones are indeed in what we think of as developing economies.

To take the most obvious example of a developing economy that is still not a democracy, China: If the Chinese continue to maintain the very rapid growth rate and increase in standard of living that they have achieved over the past twenty-five years, then within our lifetimes, we will see the beginnings of a political liberalization in China, to go along with the economic liberalization. Today, unlike when I first visited China twenty-five years ago, most Chinese are free to decide where they want to work, whether they want to work, whether to start a new business, whether to hire or fire somebody. But they can't decide on what form of government they want.

The tension that the Chinese now face between the increasing liberalization of their economic life versus the continued rigidity of what is a military dictatorship will be resolved in the direction of liberalization in the political sphere as well. That doesn't mean that it has to look like American democracy in every respect, but under conditions of economic growth, the Chinese will resolve this very fundamental tension in a positive direction.

This holds true in the developing world as well. Those developing countries that are able to sustain economic growth such that the broad majority of the population has a sense of getting ahead will make progress in these dimensions.

The second major implication is a very sobering one. Even in a country as rich as the United States, if what matters for these purposes is the growth of the economy rather than the level of people's incomes, then any time the economy stagnates, our basic democratic values are at risk. Despite a fairly strong American economy at the moment, the majority of Americans are not doing well. The Census Bureau reported recently that in 2004, for the fifth year in a row, the median income in the United States decreased after adjustment for inflation—five years in a row in which the family right at the middle of the

American income distributions saw a decrease in its income and standard of living.

My argument is not about business cycles, but about longer periods of time, people thinking back a generation or at least ten or fifteen years. If we arrest this decline in incomes for the median family in the United States, then five years could look like a blip. But by contrast, if we remain mired in the current situation, then the lessons of my book are rather sobering. At times in the past when our citizens have not had a sense of getting ahead, predictable pathologies have flourished in American society in ways that we all regret.

Whether we look at attitudes towards immigrants or race relations or religious prejudice, generosity to the poor, the ebbing and flowing of the strength of our democracy, the times like the 1880s and 1890s or like the 1920s or like the period from the OPEC years right up through the early 1990s, when the majority of American citizens have been stagnating or falling behind, have not been episodes that we would like to repeat.

Think about attitudes towards immigrants. A question that I pose in the book is, why did we have a wave of anti-immigrant violence in the 1850s? Why did it go away after the Civil War? Then in the 1880s and 1890s, why did we have a wave of ugly anti-immigrant agitation? After the turn of the twentieth century, why did that give way to a period in which the predominant attitude was to welcome immigrants, but to Americanize them?

This was the origin of the high school movement. At the beginning of the twentieth century, there were almost no public high schools in the United States. The fraction of the American population that had a high-school education as of 1900 was 3 percent. But the idea was that if we were to welcome all of these immigrants, we had to Americanize them. This is also where the Social Studies curriculum came from.

In those days, the 4th of July was called Americanization Day. It even became fashionable for Americans who were not native-born white Anglo-Saxon Protestants to claim, often falsely, that they were born on the 4th of July. For example, Samuel Goldwyn always claimed, falsely, that he had been born on the 4th of July. Louis Armstrong always claimed, falsely, that he had been born on the 4th of July. It wouldn't occur to someone of my generation to do that, but for people who were born or arrived in this country between the turn of the twentieth century and World War I, this was the thing to do.

Why did this attitude of welcoming immigrants give way in the 1920s to not only the strictest immigration quotas the United States has ever seen, but the most discriminatory? We had the national origin acts, which not only placed numerical quotas on immigrants, but discriminated according to which part of Europe you came from. If you came from northwestern Europe, that was okay. If you came from the Italy-Greece-Balkans part of Europe, that was bad. If you came from the Poland-Lithuania-Russia part of Europe, that was very bad.

Why were these quite offensive acts completely thrown out in the 1960s? Why did we have anti-immigrant agitation that we had in the 1980s and on into the early 1990s? Then why did it go away again in the latter part of the 1990s, so that the one candidate who, in the 2000 election, ran on an explicitly anti-immigrant platform—namely, [Pat Buchanan](#)—got so few votes, even in the Republican primaries, that he had to change parties? In my book I document how this ebb and flow of the legislative, the political, and the private behavior of American citizens lines up with the economics.

In an era in which we are now, for half a decade running, seeing the average American citizen lose ground economically, this is a very sobering thought. My late colleague at Harvard, Alexander Gerschenkron, having in mind not the United States in the twenty-first century, but Germany in the 1930s, wrote that even a long democratic history does not prevent a nation from becoming a democracy without democrats. There is a risk that we could go that route as well.

The third implication that follows from the argument in the book is one for economic policy. We frequently hear the argument that the right role for economic policy is to stand back and let families save however much they want to save, let businesses invest however much they want to invest; the result will be a market-determined growth rate, and that, because it comes out of the market process, will be the right

growth rate for our economy. The implication that follows is that that's wrong. The reason is analogous to the way that the market mechanism, to cite a standard example, left to its own devices, will over-provide pollution or noise or congestion. When I drive my car and pump noxious fumes out the back, the market mechanism doesn't levy any price for putting out fumes that other people have to breathe. That's why we understand that there is a role for government policy to superimpose itself on the market mechanism and limit pollution and noise and congestion.

For reasons that are exactly analogous to why the market mechanism over-provides pollution, the market mechanism, left to its own devices, under-provides economic growth. The reason is that there is no market in which people buy and sell fairness. There is no price at which we trade tolerance. There is no market where we can have an exchange for rights to democratic political values. These are all positive byproducts of the growth process that stand aside from the market mechanism. Because the market mechanism doesn't price and trade these aspects of our society that we value, the market mechanism, left to its own devices, under-provides economic growth, and the right rate of economic growth is more than, is faster than, what the market, left to its own devices, will provide.

The final and perhaps broadest implication is that we need to change the way in which we talk about economic growth in our public conversation. We all understand that with economic growth, our standard of living rises, we live in bigger houses, we put more things in them, we drive bigger cars, we buy more expensive clothing, and medical care becomes more available. At the same time, we have become increasingly aware of drawbacks to the economic-growth process, not just pollution and noise, but, especially, environmental degradation, extinction of species, and other factors to which we rightly attach a moral overtone.

As a result, our public conversation about matters of economic growth and, importantly, about policies that either promote or retard growth, often takes on the flavor of evaluating material benefits against moral negatives. We think that all of the benefits are material; we think that all of the drawbacks are moral. Therefore, people are led to believe that their image of themselves, their placement of themselves on the spectrum of "Do you care mostly about moral things or do you care mostly about material things?" somehow maps into, should they be in favor of economic growth and in favor of policies that promote growth, or should they disapprove of growth and resist policies that will give us more growth?

But if it's true that growth delivers these positive moral advantages—the democracy of our society, our sense of fairness, our tolerance, our willingness to provide opportunity and mobility—then it isn't true that all of the benefits of growth are material and that all of the moral considerations are in the other side of the balance. There are very important moral advantages of growth. Thinking of the growth debate as material benefits versus moral negatives is a false way to present the choice.

Similarly, thinking that how we envision ourselves as people who value either material things or moral things or some combination, thinking that that somehow maps into what our stance should be in debates over economic growth—that's a false mapping as well. It's important to move away from the false choice of material benefits versus moral drawbacks, and recognize that growth has important moral benefits as well.

The importance of the matter lies in our reluctance to undertake the kinds of economic policies that would lead us back to an era of sustained economic growth for the majority of our citizens. Most people understand what we need to do. But we don't take the steps that we need to take, primarily because we don't understand how important growth is, not just for the material benefits it brings, but the moral dimensions as well.

The greatest advantage I would like to flow from my book would be to influence our debate on economic growth in a way so that we could once again return to the kinds of economic policies that would deliver meaningful growth for the broad majority of citizens.

JOANNE MYERS: I'd like to open the floor to discussion.

Questions and Answers

QUESTION: While the economic argument is persuasive, and it is a necessary condition, sometimes it is not a sufficient condition. If you take the United States today, it is true that over the five-year period, median incomes have not increased. But at the same time, a very important factor behind some phenomena that may be in some parts of society is also because of Islamic terrorism, what happened on 9/11, and the government discourse that has followed, the laws that have been devised to tackle that.

If you look at India, in Hinduism, the Lord says that "Whosoever comes to me by whatsoever path, I reach him." There is a tradition of acceptance of religions. There is a democratic tradition.

But at the same time, if you look at the economic growth, Gujarat recorded very high rates of economic growth. Incomes were rising. Yet there was colossal anti-Muslim sentiment for two reasons: one, because of inequality that the economic growth brought about; and second, because of cross-border terrorism from Pakistan.

In the case of Bihar, which is a very backward state, you certainly have increased activity by communists, but you have absolutely no discrimination, no intolerance on ethnic or religious grounds, largely, again, because of tradition, because of equality, and because of absence of any cross-border terrorist attempts.

When you apply these criteria to a wider field, there are very important exceptions. [Weimar Germany](#), under [Stresemann](#), made a lot of progress through the [Dawes Plan](#) in economic matters. There are historians who feel that, in spite of the depression, progress was being made even in the post-Stresemann period in tackling those effects. But there was absolutely no democratic tradition. Weimar Germany rested on foreign arms, and when foreign arms were removed, it had to collapse.

BENJAMIN FRIEDMAN: The overarching aspect of your remarks is that nobody would think that the economics would be the only factor that matters in such things. You rightly point to a variety of issues, including war and peace. Military conflict throughout history has trumped reform tendencies in one economy or one society after another.

The positive tendencies in the United States—attitudes towards immigrants, but also race relations and a variety of other matters of American society—were moving in what, from an Enlightenment perspective, one would clearly think of as a positive direction in the period under the Republican Roosevelt and the Democrat Wilson. This was arrested by World War I.

We have seen this frequently. War and peace is an example, and there are many other factors as well, some of them systemic, like tradition, and some of them quite idiosyncratic.

I highlight the exceptions to see what we can learn from them rather than sweep them away. The classic economic expression is "outlier observations." By identifying something as an outlier, my colleagues mostly say, "This is off in some other part of the universe. We don't have to do this."

Again, to return to the American example, in my review of the 150 years of American history, the outstanding exception is the Great Depression experience, clearly a time when everybody knew that he or she wasn't getting ahead. Yet the predominant tendency in American society was in the direction of greater generosity, tolerance, fairness, and strengthening of institutions. This is an exception.

I write about the implications of inequality and conditions under which people are prepared to tolerate inequality widening and under which they are not, what drives that, and also for how long. We have a lot of experience that leads us to believe that people in the developing world have a tolerance, albeit limited, for widening inequality. Maybe this is a warning sign for countries like India, and China as well, where the inequality has been widening.

The three countries that now have almost identical degrees of inequality are China, India, and the United States. By standard measures, all three countries are in almost exactly the same place on inequality. Twenty years ago, China in particular, but India as well, would have had less inequality than we do. It's not that we are coming down; we are drifting up in inequality as well.

QUESTION: Let's take outsourcing today, which is a major concern for most people and is one of the causes for the lack of growth at the median level in the United States. This hits not only manufacturing workers but also knowledge workers. On the other hand, let's take India, where so much of the outsourcing of the knowledge workers is going. Yet, from a recent article in *Fortune*, or many other studies, India, while being more democratic than many countries, beginning with China, has had difficulties in harnessing its resources for economic growth.

How would you address the general question of outsourcing and its effect, both in the United States, where there is a tendency to be negative about other countries, and the possibilities for generating more economic growth in India and elsewhere?

BENJAMIN FRIEDMAN: What do we think about outsourcing? Parts of what you said are quite right and I have reservations about on thing you mentioned.

The part that is quite right is that the outsourcing phenomenon highlights the need for us to move forward on a range of reforms in our educational system. I'm not talking about the Harvards or the NYUs of the world. I'm talking about the K-8s of the world, and I'm talking about before K. We need to move forward on educational reforms that will make more of our citizens more productive in ways that will allow them to compete in a world marketplace, where we want our workers to have a standard of living, and therefore a wage, that is higher than that of other countries. We therefore need them to be more productive than workers in other countries. Some of that higher productivity can come from our greater degree of physical capital that we can give them. The typical worker in the American business sector now has about \$120,000 worth of physical capital behind him or her. That's way ahead of most countries.

But that isn't enough. If these American workers do not have adequate human capital to go along with the physical capital, then we know they will not be productive.

It's not a great mystery what we need to do with the American education system. We know both what is to be done and we know that it can be very expensive.

It turns out, sadly, that more than 50 percent of the student-to-student variation in eighth-grade mathematics performance is predictable on the basis of characteristics of the child that the teacher writes down on the very first day that the child walks into kindergarten. I pick eighth-grade mathematics performance because, going forward, we also know that this performance is a very strong predictor of labor market success and wage trajectory.

It is distressing to realize that more than 50 percent of the game is over on the first day that the child walks into kindergarten. Nobody can think that this is because of lack of effort of the child. If somebody graduates from high school not knowing how to read or write, you can say, "Well, that's the student's fault." If it comes down to the first day of kindergarten, who could ever think that this is the child's fault?

We know that we have programs like [Project Head Start](#). Project Head Start doesn't raise academic scores, but it does influence who finishes high school, who goes on to college, which girls get pregnant, which boys get in trouble with the law, who is likely to have a job, who earns how much and wage trajectories.

But what we know is that it's expensive. The "let's get together with the student for a chat every once in a while" approach doesn't work. Intensive programs like Head Start that start very young do have these demonstrated effects.

So we need to persuade ourselves that this is a good investment. One line of argument says that that kind of investment is good strictly on economic terms. If you think about delinquency, for example, it turns out that our most expensive social program in the United States is prison. It costs \$30,000 a year to keep somebody in prison. Compared to that, \$5,000 a year for Head Start is inexpensive.

I argue that there are moral consequences that follow, and if we don't train people accordingly, they will not be productive. They will lose their jobs to folks in other places, their incomes will stagnate, and we

will have adverse implications that I treat in explicit moral terms.

I disagree with what you said on the Indian issue. The Indians have not been as successful as the Chinese, but their growth rate is impressive. India began to achieve a very rapid growth rate in the early to mid-1980s, but it was accomplished in a way that was not sustainable. Therefore, there was a currency/debt-type crisis, a budget crisis, in the early 1990s, followed by reforms led by the current prime minister, Manmohan Singh. Since the early 1990s, India has continued with an economic growth rate that is about 5 percent per annum. Moreover, because of the nature of reforms, the growth is now on a sustainable basis.

I don't know India as well as China. I've been going to China for a very long time. But I have spent some time in India in recent years. I'm persuaded that the Indians are on the right path.

QUESTION: A number of years ago, I was moderating a panel at the city bar association on the Argentine dictatorship at the time. The issue on the table was, should there be an economic embargo of Argentina to show our disdain for their lack of support for democratic institutions? I was a lone wolf saying, "No, we shouldn't, because that would have an adverse effect on the economic conditions of the people, and that, in turn, would undermine democratic institutions." I said, "But this is just anecdotal. I have no proof for this." I was accused of being sort of a Nazi, because this was the type of philosophy that had been used in pre-World War II Germany. If I'd had your book and your research to support me, I wouldn't have lost that debate.

With regard to Latin America, over the last decade there has been a policy of the Washington consensus, economic liberalization, privatization, opening of markets. That has fallen into some disrepute, because people in certain countries have said that it's not working; the poor folks have suffered more rather than having their economic standards improved. Maybe these are income-distribution issues.

In the United States, different levels of American society feel differently about their prospects. For example, well-to-do middle-class people feel that if they're lucky, their children will do as well as the parents have done. Other groups feel very optimistic about their opportunities here.

With all these variations, how can your thesis can be implemented and worked in today's society, or in Latin America's? Who is articulating the virtues of economic growth? Who has the platform? If you look at Latin America, certain political leaders have undermined the Washington consensus. Other political leaders have supported it. It's a longer-term process, but decisions and policies are made on the basis of short-term political expediency, rather than these longer-term growth issues.

BENJAMIN FRIEDMAN: First, on your being put in a tight spot, I would not want to say that there is never any country that we would regard as so opprobrious that we would refuse to deal with them. There are organizations I would not join. There are political figures that I would not advise. I deal with political figures in both parties, but there are some whom I would rather not talk to.

But assuming that Argentina was not in that category and is not in that category, if we want to promote democratic evolution in countries that are currently lagging behind, we want to allow them and encourage them to achieve rising living standards for their populations.

What I mean by economic growth is rising living standards for the bulk of the population. In the same way that the mere fact that the economy as a whole is expanding doesn't mean that the average citizen is expanding—we only need to look at the United States today to see that contrast—we also have to look at policies that promote economic growth, and some ways of promoting economic growth are more likely to lead to advancing prospects for the average citizen and others are likely to undermine them.

If our reason for wanting to promote growth is to achieve greater democracy and fairness and mobility and opportunity, it makes no sense to promote growth through policies that undermine those features of the society. At the very least, we want to promote growth in ways that are congruent with those broader features of the society that we are after. If at all possible, we want to find ways of promoting growth that, even indirectly, enhance those features of society. That is why I chose Head Start as an example to

address your question. Head Start is a way of enhancing our economic growth, but it also simultaneously promotes the broadening of opportunity in the society.

As to the constituencies, no one can be surprised that individual constituencies advocate policies that are in their self-interest. This is like the inspector in the movie *Casablanca* who was shocked—shocked!—to discover that there is gambling going on in this institution. Let's not be shocked that political constituencies are promoting policies that are in their self-interest. But civil society has a role to play in a democracy. What lines of argument like the one in my book do is to inform the participants in civil society and help shape the conversation that takes place in civil society, in such a way that, despite the role of self-interested constituencies, a democratic system can move forward in a way that ultimately proves to be beneficial. That doesn't always happen, but the object is to strengthen civil society so as to ensure that it has the best prospect that we can give it.

JOANNE MYERS: Thank you so much for sharing your ideas with us this morning.

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