

## SECTION 5 GROWTH & DEVELOPMENT

### Chapter 16 Economic Growth as a Policy Objective

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To the general public and policy makers, the desirability of economic growth, as a policy objective, is axiomatic. In general, however, the justification for it is based on some intuitive reasoning rather than on any specific principles. The purpose of this essay is, therefore, to try to present some of the relevant issues which have arisen in the debate concerning the desirability of economic growth, both in terms of the objectives itself and in relation to other proximate policy objectives of government. Finally, some problems regarding the current method of measuring growth, and the subsequent proposed alternatives, will be discussed.

The conventional definition of economic growth is the rate of change of real G.N.P per capita. The primary argument used to justify it as a policy objective relates this basic definition to one of the assumptions underlying liberal welfare economics, i.e. that the welfare of an individual is a positive function of the goods and services he/she consumes. But this argument lacks a dynamic component. Economic growth involves a trade-off between consumption now and consumption at some future date. On the above assumption, therefore, the pursuit of economic growth implies a reduction of welfare to the individual due to a decrease in current consumption.

The optimum level of growth hence depends on how fast one discounts the future; the faster one discounts it, the less of a policy objective economic growth should be.

Individuals tend to discount the future rapidly because of myopia, because holding assets entails risks, or, most critically, because providing for future generations is a public good. As individuals, they are powerless to provide for them, but as a society they are not.

It is argued that the optimal discount rate, and hence the optimal level of economic growth, can be attained through the market system and through government intervention to correct the market discount rate. But the power of government to fulfill this role is constrained by the many ways in which the electoral system fails to adequately reflect social preferences.

Galbraith has questioned the ability of the market system to fulfill this role, even ignoring conventional instances of market failure by claiming that wants are created by producers through advertisement and by consumption which acts as a suggestion to create more wants. Thus, for Galbraith, it cannot be assumed that welfare is greater at a higher level of consumption because the market system distorts peoples' preferences and reflects only the manipulation of consumers by producers. This argument does, however, appear to be a highly condescending one, as it makes a dangerous supposition concerning free will and the control of one's mind. If the individual is incapable of determining what is in his/her own interests, who is to make these choices for him/her, and what constraints are to be placed on his/her power?

Besides, it could surely be argued that advertising could not act as an enticement unless some underlying demand or want was present. There are several advertising "failures", such as Guinness Light and Cherry Coca-Cola, to

support this argument.

Economic growth implies greater output and consumption at some future date, as has been outlined. However, there are certain costs involved in the actual process, and pursuit, of growth itself. One of the most influential arguments against it concerns the depletion of the earth's limited resources, a post-industrial argument. According to this theory, the period of relative peace and affluence, following the Second World War, has led to a satisfying of our physiological needs of sustenance and safety and, consequently, we take these for granted in the Western world. These needs are then replaced by post-material values concerning self-esteem and the quality of life. Economic growth is seen as entailing negative externalities (e.g. pollution or depletion of finite resources), and is hence rejected.

The lynchpin of this argument would seem to be the concept of 'quality of life'. Those who favour economic growth see a better quality of life in a society where output and income is higher and greater consumer demands can be satisfied. Critics see a better quality of life in a society where the environment has improved, or at least remained intact. It is this argument which has gained particular prominence in West Germany.

This conservation argument seems strong and is becoming popular. Could it not be argued, however, that it is not economic growth as such which has damaged the environment, but rather previous failure to guide and control growth in the optimal directions? Surely the implementation of direct environmental controls on industrial activity would reduce the social costs of economic growth, and hence some of the validity of the post-material argument.

Hirsch put forward an alternative contrasting idea. He argued that once a given level of affluence has been attained, all that people want are positional goods which entail a certain social status (e.g. property or valuable paintings). Hirsch seems to view the satisfying of such demands through the market system, and the pursuit of economic growth, with some disdain. This argument could also be expressed in terms of the basic assumptions of liberal welfare economics. The welfare of individuals could be looked upon as a positive function, not of their consumption in absolute terms, but of their consumption relative to the norms of the society in which they live. At an individual level, boosting consumption may hence be desirable, but growth (for society as a whole) is simply a positional game. Thus, although the post-industrial argument, and that of Hirsch, evolve from very polar viewpoints of the impact of affluence on society, for post-industrialists, it lessens material urges, while for Hirsch, it rechannels them into demands for social status.

Alternatively, one may question the benefits of economic growth from a theoretical welfare economics perspective. Even if welfare is a positive function of consumption, it may also be a positive function of one's expectations in relation to consumption. Economic growth boosts both consumption and one's expectations. It seems likely (especially in a prosperous society) that these two effects would roughly cancel each other out. So, economic growth could sometimes be thought of as a zero-sum game.

To discuss the desirability of economic growth further, it is necessary to examine it on a wider scale, in particular, with respect to its relationships with other policy objectives. Trade-offs will always exist between pursuing the goals of economic growth, full employment and equality.

In the short-run, any change in growth or employment must lead to a change in the other variable in the same direction, unless a change in productivity occurs

to neutralize it. But Keynesian demand stimuli, although they boost employment in the short-run, will, if financed by borrowing, ultimately reduce employment. Such a scenario occurred in Ireland in the early 1980's.

Economic growth may likewise conflict with, or complement, equality. The argument that redistribution reduces work incentives, and hence growth, is a key feature of the dominant political school of thought of the 1980's and one which is becoming increasingly prevalent in Ireland. Opposition parties have criticized the 1989 budget for reducing the work incentive by potentially making it financially more attractive for some people to remain on long-term unemployment assistance rather than working. Equality, therefore, can reduce economic growth. But, in a growing economy, redistribution becomes easier in the sense that the relative distribution of economic rewards can be altered without making anyone worse off in absolute terms. Economic growth can hence facilitate the pursuit of equality. The nature of the relationship, at least in terms of the two arguments given here, can be considered either as one of conflict or complementarity, depending upon which direction of causation one chooses to look at.

It seems appropriate, finally, to consider some of the issues arising out of the measurement of economic growth itself. Economic growth is measured, conventionally, by the rate of change of real G.N.P. per capita. Due to the aforementioned assumption, that an individual's welfare is a positive function of his/her consumption, it is widely held that this is a good measure of economic growth because it is a good proxy for welfare. This is obviously not entirely true. Firstly, G.N.P. excludes many activities which contribute to well-being, most notably unwaged labour (e.g. housewives). This, therefore, gives rise to the much quoted anomaly that G.N.P. will actually decline if a man marries his paid housekeeper! G.N.P. also fails to take account of many negative features of economic growth, e.g. pollution or loss of leisure. Finally, it ignores the question of distribution; it would be widely agreed that a more equal distribution of economic rewards would increase society's welfare.

These problems with G.N.P. have led to several proposals for alternative measures of economic growth. Net Economic Welfare (N.E.W.) is, perhaps, foremost among these. It is obtained by deducting the cost of negative externalities from G.N.P. and adding the values of non-market activities and leisure. But economics treats concepts of costs and value in the framework of the market and evaluates them from the market. Markets do not exist for the components of N.E.W. not in G.N.P., so it is difficult, subjective and expensive to evaluate N.E.W.

A more explicit attempt to incorporate the idea of social welfare into a measurement of economic growth has also been developed by the Overseas Development Council. It has presented what it calls a "Physical Quality of Life Index" whereby life expectancy, infant mortality and the rate of literacy are taken into account. This alternative was designed specifically for less developed countries in an attempt to show the inadequacy of G.N.P. as a measure of economic welfare. For example, many African countries, although poor, have a primary school programme, whereas in some Middle Eastern countries no such programmes exist despite having higher national incomes. Many of those who have attempted to use alternative measures of social welfare have cogently argued that the growth of the past twenty-five years has been offset by negative externalities and is illusory, not real.

Thus, the complexity of the whole issue can be seen. The desirability of economic growth as a policy objective cannot simply be assumed. It must be the subject for active debate, not dogma and assumption.