THE UNBOUND ECONOMY

Rethinking the Growth Imperative

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2012-01-02

Rethinking the Growth Imperative

CAMBRIDGE – Modern macroeconomics often seems to treat rapid and stable economic growth as the be-all and end-all of policy. That message is echoed in political debates, central-bank boardrooms, and front-page headlines. But does it really make sense to take growth as the main social objective in perpetuity, as economics textbooks implicitly assume?

Certainly, many critiques of standard economic statistics have argued for broader measures of national welfare, such as life expectancy at birth, literacy, etc. Such appraisals include the United Nations Human Development Report, and, more recently, the French-sponsored Commission on the Measurement of Economic Performance and Social Progress, led by the economists Joseph Stiglitz, Amartya Sen, and Jean-Paul Fitoussi.

But there might be a problem even deeper than statistical narrowness: the failure of modern growth theory to emphasize adequately that people are fundamentally social creatures. They evaluate their welfare based on what they see around them, not just on some absolute standard.

The economist Richard Easterlin famously observed that surveys of "happiness" show surprisingly little evolution in the decades after World War II, despite significant trend income growth. Needless to say, Easterlin's result seems less plausible for very poor countries, where rapidly rising incomes often allow societies to enjoy large life improvements, which presumably strongly correlate with any reasonable measure of overall well-being.

In advanced economies, however, benchmarking behavior is almost surely an important factor in how people assess their own well-being. If so, generalized income growth might well raise such assessments at a much slower pace than one might expect from looking at how a rise in an individual's income *relative to others* affects her welfare. And, on a related note, benchmarking behavior may well imply a different calculus of the tradeoffs between growth and other economic challenges, such as environmental degradation, than conventional growth models suggest.

To be fair, a small but significant literature recognizes that individuals draw heavily on historical or social benchmarks in their economic choices and thinking. Unfortunately, these models tend to be difficult to manipulate, estimate, or interpret. As a result, they tend to be employed mainly in very specialized contexts, such as efforts to explain the so-called "equity premium puzzle" (the empirical observation that over long periods, equities yield a higher return than bonds).

There is a certain absurdity to the obsession with maximizing long-term average income growth in perpetuity, to the neglect of other risks and considerations. Consider a simple thought experiment. Imagine that *per capita* national income (or some broader measure of welfare) is set to rise by 1% per year over the next couple of centuries. This is roughly the trend *per capita* growth rate in the advanced world in recent years. With annual income growth of 1%, a generation born 70 years from now will enjoy roughly double today's average income. Over two centuries, income will grow eight-fold.

Now suppose that we lived in a much faster-growing economy, with *per capita* income rising at 2% annually. In that case, *per capita* income would double after only 35 years, and an eight-fold increase would take only a century.

Finally, ask yourself how much you really care if it takes 100, 200, or even 1,000 years for welfare to increase eight-fold. Wouldn't it make more sense to worry about the long-term sustainability and durability of global growth? Wouldn't it make more sense to worry whether conflict or global warming might produce a catastrophe that derails society for centuries or more?

Even if one thinks narrowly about one's own descendants, presumably one hopes that they will be thriving in, and making a positive contribution to, their future society. Assuming that they are significantly better off than one's own generation, how important is their absolute level of income?

Perhaps a deeper rationale underlying the growth imperative in many countries stems from concerns about national prestige and national security. In his influential 1989 book *The Rise and Fall of the Great Powers*, the historian Paul Kennedy concluded that, over the long run, a country's wealth and productive power, relative to that of its contemporaries, is the essential determinant of its global status.

Kennedy focused particularly on military power, but, in today's world, successful economies enjoy status along many dimensions, and policymakers everywhere are legitimately concerned about national economic ranking. An economic race for global power is certainly an understandable rationale for focusing on long-term growth, but if such competition is really a central justification for this focus, then we need to re-examine standard macroeconomic models, which ignore this issue entirely.

Of course, in the real world, countries rightly consider long-term growth to be integral to their national security and global status. Highly indebted countries, a group that nowadays includes most of the advanced economies, need growth to help them to dig themselves out. But, as a long-term proposition, the case for focusing on trend growth is not as encompassing as many policymakers and economic theorists would have one believe.

In a period of great economic uncertainty, it may seem inappropriate to question the growth imperative. But, then again, perhaps a crisis is exactly the occasion to rethink the longer-term goals of global economic policy.

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