Economic Growth and the Moral Society, by Dr. Benjamin M. Friedman

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The premise of economic growth has come under question, in many parts of the world today, from a variety of directions. We are aware, of course, that moral thinking in practically every known culture enjoins us not to place undue emphasis on our material concerns. But today there is more to it than that. With heightened sensitivity to the strains that industrialization often brings, including the possibility of permanent climate change, many people in the higher-income countries now question whether further economic expansion is worth the costs. In the developing world, where the advantages of rising incomes are more evident, some people question whether economic growth, and the policies that promote it, are just vehicles for exploitation by foreigners. And now that the current financial crisis has sharply depressed production and incomes in many countries, both industrialized and not, an unusually large number of citizens sense that their economies aren't growing anyway.

A turn away from economic growth is not what anyone should want, however—and not just on narrowly economic grounds. The experience of many countries suggests that when a society experiences rising standards of living, broadly distributed across the population at large,

it is also likely to make progress along a variety of dimensions that are the very essence of what a free, open, democratic society is all about: openness of opportunity for economic and social advancement; tolerance toward recognizably distinct racial, or religious, or ethnic groups within the society, including new immigrants if the country regularly receives in-migration; a sense of fairness in the provision made for those in the society who, whether on account of limited opportunities, or lesser human endowments, or even just poor luck in the labor market, fall too far below the prevailing public standard of material well-being; genuinely contested elections that determine who controls the levers of political power; and democratic political rights and civil liberties more generally. Conversely, experience also suggests that when a society is stagnating economically—worse yet, if it is suffering a pervasive decline in living standards—it is not only likely to make little if any progress in these social, political, and (in the eighteenth-century sense) moral dimensions; all too often, it will undergo a period of rigidification and retrenchment, sometimes with catastrophic consequences.

The chief reason so many societies behave in this way stems from the familiar tendency of most people to evaluate how well off they are not by considering their incomes or living standards in absolute terms but relative to some benchmark. More specifically, there is substantial evidence for two separate benchmarks by which people judge such matters. Most people are pleased when they are able to live better than they, or their families, have lived in the past. And they are pleased when they are able to live better than their friends, neighbors, coworkers, and any others with whom they regularly compare themselves.

The pervasive tendency for people to evaluate their economic situation on these relative benchmarks, rather than absolutely, explains a variety of familiar features of economic and psychological behavior that otherwise would be puzzling—for example, the fact that within any one country, at any given time, people with higher incomes are systematically happier than those with lower incomes, but there is no corresponding increase over time in how happy people are on average even though average incomes may be steadily increasing. As Adam Smith observed long ago, "all men, sooner or later, accommodate themselves to whatever becomes their permanent situation," so that "between one permanent situation and another there [is], with regard to real happiness, no essential difference." Hence the critics of growth who maintain that higher incomes per se will not make people happier are mostly right.

But this tendency toward a relative rather than an absolute perspective in such matters also explains why market economies, as long as they deliver rising living standards to most of a society's population, lead more often than not to tolerance, generosity, democracy, and many of the other recognizable features of an open society. The economically self-protective instinct that underlies racial and religious discrimination, antipathy toward immigration, and lack of generosity toward the poor naturally takes a back seat to other priorities when people have the sense that they are getting ahead.

An important consequence is that many countries throughout the developing world probably will not have to wait until they reach Western levels of per capita income before they begin to liberalize socially and democratize politically. If they can manage to grow economically (alas, many parts of what we call "the developing world" are not actually developing), and if the fruits of that growth are shared among their populations, in time liberalization and even some forms of democratization are likely to follow.

The experience of the Western democracies also makes clear that the connection between rising living standards and either social attitudes or political institutions is not limited to low-income countries. In the United States, for example, eras in which economic expansion has delivered ongoing material benefits to the majority of the country's citizens—the decade and a half following the Civil War, the decade and a half just prior to World War I, the quarter-century immediately following World War II—have mostly corresponded to eras when opportunities and freedoms have broadened, political institutions have become more democratic, and the treatment of society's unfortunates has become more generous.

By contrast, when incomes have stagnated or declined, reaction and retreat have been the order of the day. The rise of Jim Crow laws and the widespread anti-immigrant (and anti- Catholic and anti-Semitic) agitation of the 1880s and 1890s; the extraordinary appeal of the reborn Ku Klux Klan, and the adoption of the most discriminatory immigration laws in our nation's history (the Emergency Quota Act and then the National Origins Act) during the 1920s; and the rise of the right-wing "militia" movement, together with a new groundswell of anti-immigrant sentiment, in the 1980s and early 1990s (before the strong economic growth of the mid and latter 1990s effectively arrested both), are all familiar examples. A major exception in U.S. experience was the depression of the 1930s, which instead led to a significant opening of American society and strengthening of American democracy—perhaps because the economic distress of that time was sufficiently widely shared that the sense of being in the same sinking ship together overwhelmed the more competitive instincts that usually prevail when people realize they are not getting ahead.

Jews have often been targets of the rise in intolerance that follows when incomes stagnate. Many of the most prominent leaders of America's Populist movement in the 1880s and 1890s were openly anti-Semitic. Both Ignatius Donnelly, who wrote the Populist Party's platform, and William Harvey, who wrote the leading free silver economic tract of the time, also wrote novels replete with Jewish villains. (Even Harvey's best-selling financial tract included a cartoon with an English octopus, labeled "Rothschilds," strangling the world.) Mary Ellen Lease, the fiery Populist orator who brought the free silver campaign to popular attention, called President Grover Cleveland an agent of Jewish bankers and British gold. In the 1920s the revived Ku Klux Klan was proudly anti-Semitic. Few Congressmen spoke openly of the religious bias inherent in the new immigration policies enacted in 1921 and 1924, but the reflection of the religious map of Europe was plainly evident in the legislation; under the new laws U.S. immigration from areas from which Jews primarily originated shrank from 700,000 per year to 20,000. Although the 1930s ultimately proved a time of broadening of American democracy, an increasingly strident anti-Semitism was clearly on the rise. Father Charles Coughlin drew 40 million listeners to his bigoted weekly rants on the radio, and Charles Lindbergh's America First movement likewise enjoyed widespread popular support. Although the U.S. Senate confirmed Felix Frankfurter to replace Louis Brandeis on the Supreme Court in 1939, the hearing (far more so than Brandeis's in 1916, in a different economic climate) exhibited open anti-Semitism. Even in the immediate aftermath of Kristallnacht in November 1938, both the public and Congress opposed the idea of admitting 20,000 German Jewish refugee children.

The United States is hardly the only long-established Western democracy where a connection between rising living standards and the strengthening of democratic freedoms is evident. Other countries' experience displays similar patterns. Conversely, many of the horrifying anti-democratic phenomena that so marred Europe's twentieth-century history ensued in a setting of pervasive economic stagnation or decline. Hitler's rise to power in the wake of the economic and political chaos of the Weimar Republic is a familiar story, but it is worth recalling that as late as 1928 the Nazi party drew only 2.8 percent of the vote in German national elections.

What made the difference, soon thereafter, was the onset of the Great Depression, which affected Germany more than any other European country. (Earlier on, what many historians consider the first major push of modern German anti-Semitism appeared during Germany's economic stagnation in the 1870s and 1880s.) Similarly, France's Vichy regime, which willingly collaborated with the Germans—during the war France was one of only two European countries to turn over to the Nazis Jews from territories that the Germans did not occupy—emerged out of a protracted period of French economic stagnation during which right-wing nationalist and anti- Semitic groups such as the Action Francaise, Jeunesse Patriots, and the Croix de Feu ("Cross of Fire") worked, both behind the scenes and through street violence, to undermine French democracy. As my late colleague, the economic historian Alexander Gerschenkron, observed during the war, "even a long democratic history does not necessarily immunize a country from becoming a 'democracy without democrats.'"

The connections between economic growth and the democratic character of society need not be one-directional. The idea that rising living standards foster tolerance and democracy does not preclude the parallel notion that these features of society enhance the ability of any economy, but especially one based primarily on private initiative and decentralized markets, to achieve superior performance over time. Different political institutions and different legal frameworks, as well as different public attitudes and private behavior, help account for why some countries enjoy more economic success than others. The evidence is especially strong that effective "rule of law," including the protection of property rights, matters for economic growth. It does not require an advanced degree in economics to know that barring half of the population from certain jobs because they are of the "wrong" sex, or still others because they are of the "wrong" race or "wrong" religion, does not result in the most efficient allocation of an economy's human resources.

As a result, a society may find itself in a virtuous circle in which economic growth and democratic freedoms mutually reinforce one another or, less fortunately, stuck in a vicious circle in which the stagnation of living standards blunts any movement toward democratic reform while adverse political institutions and the absence of basic freedoms retard economic improvement for most citizens. Leaving aside the periodic ups and downs of market-driven economic growth in most Western societies, the long-term experience of countries like the United States is a rough example of the former. The current plight of many countries in sub-Saharan Africa presents even sharper examples of the latter.

Especially in the wake of the financial crisis that began in 2007, many citizens of countries around the world have sensed that they are not getting ahead. But importantly, in many higher-income countries the problem dates to well before the crisis began. In the United States, for example, even before the onset of the latest downturn, most people had seen little economic improvement throughout the 2000s. In 2007, the median family income (the income of families exactly in the middle of the U.S. income distribution) was $63,700 in today's dollars. Back in

2000 the median family income, again in today's dollars, was $63,400. The gain—not per annum, but over the entire seven years—was less than one-half of one percent. The U.S. economy as a whole expanded solidly during these years, but the gains from that expanding production accrued very narrowly, mostly to people already at the top of the scale. The rest of the nation's families saw little improvement. Although the precise timing differs, the populations of Italy, France, the U.K., and many other countries as well have experienced roughly similar income stagnation.

Then came the crisis. The current financial crisis and the recession that followed have constituted one of the most significant sequences of economic dislocations since World War II.

In many countries (the United States included), the real economic costs—costs in terms of reduced production, lost jobs, shrunken investment, and foregone incomes and profits—exceeded those of any prior post-war downturn. Most American families were not immune. In 2008, the U.S. median family income fell to $61,500, a lower level than in any year since 1998. We do not yet have the figure for 2009, but it seems clear that last year family incomes dropped again. Here too, the pattern is similar in many other countries that have likewise suffered in the financial crisis and then the economic downturn.

Nor do we have any solid basis for expecting a rapid recovery of incomes, either in the United States or abroad, now that the worst of the crisis has passed and many of these countries' economies have started to turn around. Just now the greatest challenges appear to be in Europe, where the combination of current monetary institutions and the legacy of past fiscal practices present what seems to be an insurmountable bar to vigorous recovery. But near-term growth prospects in the United States are modest as well, and they, too, are vulnerable to a host of contingencies.

The majority of American families, therefore, have now gone through an entire decade—or perhaps longer—with no increase in their incomes or improvement in their living standards.

And unless the economy recovers rapidly, the situation may persist a good while longer. Past experience suggests that the consequences of this kind of prolonged stagnation—here as well as in other countries—will spill over well beyond the realm of economics and business. The collateral damage will include our race relations, our religious tolerance, our generosity toward the disadvantaged (as Adam Smith also wisely observed, "before we can feel much for others, we must in some measure be at ease ourselves; if our own misery pinches us very severely, we have no leisure to attend to that of our neighbor"), and the civility of our political discourse. No informed citizen can be unaware that the damage, in each of these areas, has already begun to occur. Given the country's historical demographic make-up, the most frequently observed reaction in such circumstances has been a hardening of attitudes toward new and recent immigrants, and this has already begun. Other countries, presumably with differing specifics, will probably face similar experiences. The symptoms often differ from one country to the next, but the disease of economic stagnation is not a pleasant one anywhere.

The urgent need, therefore, is not merely to get the economy's production increasing again, although that is a necessary first step, but to enable the majority of families once again to earn rising incomes and enjoy improving living standards. Most citizens, in the United States no less than elsewhere, have exhibited impressive patience. It is best not to try that patience too far.

If a key part of what matters for tolerance and fairness and opportunity, not to mention the strength of a society's democratic political institutions, is that the broad cross-section of the population have a confident sense of getting ahead economically, then no society—no matter how rich it becomes or how well-formed its institutions may be—is immune from seeing its basic democratic values at risk whenever the majority of its citizens lose their sense of economic progress.

The current disillusionment with economic growth—in some quarters, even a fashionable hostility—reflects a failure to recognize these broader relationships. But that failure, and the rejection and hostility to which it gives rise, are, in turn, impediments to restoring both our economy and our society to a more beneficial (and benevolent) trajectory. Changing economic course normally requires policy action. In a democracy, making policy choices requires public support.

The familiar balancing of material positives against moral negatives when we discuss economic growth is a therefore false choice. The parallel assumption that the way we value material versus moral concerns neatly maps into whether we should eagerly embrace economic growth or temper our enthusiasm is wrong as well. Economic growth bears benefits that are both material and moral. As we take up the hard decisions that will inevitably surround any effort to restore our economy's vitality in the aftermath of the worst financial crisis and the deepest and most protracted economic downturn in two generations, it is important that we bear these moral positives in mind.

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