

# **The Economics of the Good Life**

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# development as freedom

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- **‘Development can be seen...as a process of expanding the real freedoms that people enjoy.’ Amartya Sen, *Development as Freedom*, 2000.**
  - **Political freedom, such as the ability to choose who governs and how they do so and to be able to write and speak freely.**
  - **Economic freedom, such as the ability to consume, produce and exchange, and to do rewarding work.**
  - **Social opportunities, such as the provision of public goods like healthcare and education.**
  - **Transparency guarantess, such as clear and truthful information about current affairs and politics, and what is being offered to whom.**
  - **Protective security, such as protection against risks like unemployment, crime, famine, environmental damage and war.**

# growth miracles and disasters

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## Annual Average Growth Rate of GDP per Worker 1960-1990

<b>Miracles</b>	<b>Growth</b>	<b>Disasters</b>	<b>Growth</b>
<b>Korea</b>	6.1	<b>Ghana</b>	-0.3
<b>Botswana</b>	5.9	<b>Venezuela</b>	-0.5
<b>Hong Kong</b>	5.8	<b>Mozambique</b>	-0.7
<b>Taiwan</b>	5.8	<b>Nicaragua</b>	-0.7
<b>Singapore</b>	5.4	<b>Mauritania</b>	-0.8
<b>Japan</b>	5.2	<b>Zambia</b>	-0.8
<b>Malta</b>	4.8	<b>Mali</b>	-1.0
<b>Cyprus</b>	4.4	<b>Madagascar</b>	-1.3
<b>Seychelles</b>	4.4	<b>Chad</b>	-1.7
<b>Lesotho</b>	4.4	<b>Guyana</b>	-2.1

*Note:* Figures for Botswana and Malta based on 1960-1989.

*Source:* Jonathan Temple, "The New Growth Evidence", *Journal of Economic Literature*, 1999.

# growth across the world, 1950 to 1995

## Annual Average Growth Rate of GDP per Capita

	<b>Growth</b>	<b>Ratio of GDP per capita at end to beginning</b>	<b>Share of World Population, 1998</b>
<b>More developed</b>	2.7	3.1	20
<b>Less Developed:</b>	2.5	2.9	80
<b>China</b>	3.8	5.0	21
<b>India</b>	2.2	2.5	17
<b>Rest of Asia</b>	3.7	4.6	21
<b>Latin America</b>	1.6	1.9	9
<b>Northern Africa</b>	2.1	2.4	2
<b>Sub-Saharan Africa</b>	0.5	1.2	11

*Source:* Richard Easterlin, "The Worldwide Standard of Living Since 1800", *Journal of Economic Perspectives*, 2000.

# democratic institutions

From a minimum of 0 to a maximum of 1.

	Executive		Legislative	
	1950-1959	1990-1994	1950-1959	1990-1994
<b>More developed</b>	0.72	0.92	0.81	0.85
<b>Less Developed:</b>	0.33	0.34	0.52	0.56
<b>China</b>	0.00	0.00	0.20	0.33
<b>India</b>	0.90	0.80	1.00	1.00
<b>Rest of Asia</b>	0.32	0.34	0.53	0.50
<b>Latin America</b>	0.32	0.69	0.70	0.73
<b>Northern Africa</b>	0.08	0.04	0.27	0.32
<b>Sub-Saharan Africa</b>	0.25	0.14	0.46	0.35

*Notes:* The measure for the executive branch is based upon four components: the competitiveness of political participation; competitiveness of executive recruitment; openness of executive recruitment and constraints on the chief executive. The measure for the legislative branch is scaled as follows: 0 = no legislature exists, 0.3 = ineffective legislature, 0.7 = partially effective legislature, 1.0 = effective legislature.

*Source:* Richard Easterlin, "The Worldwide Standard of Living Since 1800", *Journal of Economic Perspectives*, 2000.

# **is GDP a good indicator of welfare?**

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- **GDP measures stuff not welfare. But presumably in general we think that people prefer more stuff to less!**
- **Problems with GDP:**
  - **Measurement over time: inflation, technological change.**
  - **Measurement between countries: exchange rates.**
- **Other omissions:**
  - **Depreciation of physical, human and environmental capital.**
  - **The black market and non-market activities.**

# **the winner takes all society**

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- **Inequality of pay and work;**
- **Long working hours;**
- **Long commutes;**
- **Advertising and gambling.**

# **regional inequality**

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- **In April 2001, claimant count unemployment was about 975,000 people. Unemployment (ILO) measure was 1,478,000, about half a million lower than at the 1997 election.**
- **However, over 2 million people are on Incapacity Benefit, four times as many as twenty years ago.**
- **The proportion of adults in work (the employment rate) differs dramatically across regions. In the South East, 80 per cent of adults of working age are in work, in Wales 68 per cent, and on Merseyside, 62 per cent.**
- **Earnings have also become more unequal. According to the New Earnings Survey, the dispersion of earnings across British regions doubled between the late 1970s and the early 1990s.**
- **For example, in 1975, Welsh earnings were slightly below the British average. By 1995, they were eleven percentage points lower, with most of the fall occurring in the eighties.**



# **why has inequality increased?**

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- **Skill-biassed technological change:**
  - Industries that are R&D and computer intensive have been the source of new jobs and higher wages. The returns to skill have risen.
- **Increasing Globalisation:**
  - But inequality has risen across the board, not just in industries that compete with developing nations.
- **Deregulation and Liberalisation:**
  - The decline in the power of trade unions; the abolition of the link between earnings and benefits; governments have increasingly lost their desire to redistribute income and to operate regional policy.
- **Educational Outcomes:**
  - The increasing inequality of qualifications has worsened the prospects of the unqualified.

# **the economics of superstars**

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- **Small numbers of people earn enormous amounts of money and dominate their respective sectors of the economy: bond-trading, acting, baseball.**
- **Not only are there large differences in earnings between sectors, but there are large differences within sectors too.**
- **But why?**
- **On the supply-side, there is imperfect substitution between people, such as winner-takes-all situations. If a baseball player scores ten per cent more home runs than his peers he will received more than ten per cent higher wages.**
- **On the demand-side, high quality sellers have a competitive advantage. Alfred Marshall wrote that as long as the number of people who could be reached by a human voice was limited, there must be a limit on how much any one performer can command. Technological advances have raised this ceiling.**

# **the economics of investment banking**

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- **Monopolistic competition (price exceeds marginal cost, firms have large fixed costs).**
- **Business is often awarded by tournament (beauty contests etc) where quality is much more important than price.**
- **Firms have large teams of people: the extra benefit from having a large team is big, since there is a good chance that someone will come up with a great (and convincing) idea.**
- **The internal structure of firms is also a tournament. Firms recruit many analysts from university each year, but far fewer survive two years and become associates. Workers also receive much of their pay in the form of bonuses related to performance.**
- **Therefore workers bear a great deal of risk and are willing to work very long hours.**
- **Typically about 85 per cent of value-added is paid to workers in investment banks, compared with about 65 per cent in the rest of the economy.**

# commuting

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- **The average one-way commute in London is now 38 minutes, 33 minutes in the South East, and 21 minutes in the rest of the country.**
  - **Commuting times are especially long among home-owners, the highly educated, and those who work in large offices and plants.**
  - **People with degrees spend fifty per cent more time commuting than those without.**
  - **Full-time workers in London spend 70 minutes a week more time commuting now than in 1990.**
- **Workers paid high wages tend to have longer commutes. This reflects the necessity to pay more to compensate for longer commuting times.**
  - **After adjusting for other factors and controlling for the effect of long commutes on wages, there is a negative relationship between commuting time and wage rates.**

# advertising

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- **Some advertising provides information; it alerts consumers to new varieties and qualities of goods, or it sharpens competition between firms by making price an issue.**
- **Most advertising encourages brand-switching. Persil, Daz and Bold are very similar products. But as long as Unilever advertises Persil, P&G must advertise Daz.**
- **In 1998, £14,307 million was spent on advertising in Britain.**
- **36% of UK adults believe advertising is the biggest influence on childrens' lives.**
- **'If the media did not accept advertising we would have to pay a good deal more for our newspapers and magazines and without advertising Independent Television would not exist at all'. The Advertising Association.**

# the status game

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		Bobby buys status good		Bobby buys other good	
Luigi buys	status good	Luigi is not too happy	Bobby is not too happy	Luigi is very happy	Bobby is not at all happy
		Luigi is not at all happy	Bobby is very happy	Luigi is fairly happy	Bobby is fairly happy

# **status goods**

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- **A similar argument can be applied to many other choices that affect other peoples' happiness.**
- **Consider two colleagues deciding how many hours to work. Status in their office might well depend upon who works the longest (since actual effort and/or output might be unobservable).**
- **Consequently, both will work long hours.**
- **Similarly, consider the choice of school-leavers deciding whether to take local jobs or to move away to high status jobs in the City.**

# the evolution of happiness

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- Britain is nearly three times richer than in the first half of the twentieth century. However, reported levels of happiness (SWB, or subjective well-being) are no higher.
- People are motivated by the pursuit of happiness:
  - Psychologists find that the effect of major positive and negative life-events on happiness is transitory. Their effect is largely gone within three months and completely gone by six months.
  - People possess a 'permanent level of happiness', to which they return after the impact of a specific event is absorbed. Between 50 to 80 per cent of this level is heritable.
- But why aren't we all happy?
- John Rawls and the Thin Veil of Ignorance:
  - 'Would I prefer to be born today, or at some point in the past, given that I do not know what place I will occupy in society?'
  - Public goods, social justice and equality all increase Rawlsian happiness.



# summary

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- **Competition is often a very good thing. It gives strong incentives for innovation and improvement.**
- **However, competition can be too harsh, especially among individuals. Often we might prefer cooperation.**
- **Many structures in society either promote (e.g. scholarships) or restrict (e.g. marriage) competition among individuals.**
- **Recently, however, there has been a growth of structures that serve to weaken the incentives for cooperation and reciprocal altruism.**
- **The answer lies in changing the games people play rather than in changing people themselves.**

# Freud on Civilisation

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- **"The fateful question for the human species seems to me to be whether and to what extent their cultural development will succeed in mastering the disturbance of their communal life by the human instinct of aggression and self-destruction. Men have gained control over the forces of nature to such an extent that with their help they would have no difficulty in exterminating one another to the last man. They know this, and hence comes a large part of their current unrest, their unhappiness and their mood of anxiety."**