

**Center on Capitalism and Society
Columbia University
Working Paper #107**

A Vital People: A Necessity for a Good Economy

Edmund Phelps
Honoris Causa Ceremony
Libera Università Internazionale degli Studi Sociali Guido Carli
Rome, Italy
January 18, 2018

Honoris Causa, LUISS Rome
January 18, 2018

A Vital People: A Necessity for a Good Economy

Edmund Phelps*

My subject is what Western countries must do if it is to develop on a wide scale the prospering and flourishing that are at the heart of the Good Life and thus central to the Good Economy.

In the West, nations have been suffering for a long time from a familiar set of *symptoms*: meager rates of return to investment, national wage levels and national income both growing at a snail's pace, reduced job satisfaction especially among the young, high wealth-wage ratios weakening incentives to work and save, pathological public debt levels in most countries, and (in some countries) a considerable rise in working-age people unwilling or unable to participate in the labor force. Some writers speak of “the end of “capitalism.

What are the causes? Some economists, notably my friend Lawrence Summers, speak of “secular stagnation,” echoing the term coined by the Keynesian Alvin Hansen in the Great Depression to suggest that “effective demand” is depressive; and another economist, Ben Bernanke, speaks of a “global saving glut,” thus a deficiency of “effective demand,” as Keynes called it. But, although “demand” has not been really strong over the long “stagnation,” it has not been weak enough to produce the telltale signs of deflation or disinflation.

*Edmund Phelps, the 2006 Nobel laureate in economics, is director of the Center on Capitalism and Society at Columbia University and author of “Mass Flourishing” and “Rewarding Work.”

In my view, the *immediate cause* of the stagnation in the West is the mentioned. The boom underway in America and Europe can be expected to boost productivity levels on the upswing, though it may well erase such cyclical gains on the way down. However, booms are not an augury of faster long-term growth.

The *underlying cause* of the productivity slowdowns in these economies, broadly speaking, is the *net losses of aggregate indigenous innovation* – losses *net* of gains brought by the digital revolution and other sources. The net losses were most severe in the US, UK and France. These losses alone were enough to slow the growth of productivity throughout the Western economies. It is striking that Germany lost most of its impressive indigenous innovation (President Roosevelt at one time worried that Germany would overtake America) in the late 1930s, and it has still not got much of it back, though it has found success as a “trading nation.” It is also striking that Italy, which had a high rate of “imported” innovation during the catch-up years of the '50s and '60s, had only begun building up significant “indigenous” innovation around 1980; then it lost nearly all of that innovation by 1995 or so. These findings derive from estimates by a research team at the Center on Capitalism and Society.¹ I have also benefitted from the work on Italy by Gianni Toniolo and collaborators.²

¹ The estimation procedure underpinning this sketch was developed and carried out by Raicho Bojilov, a member of the research team.

² See Chapter 14 of Gianni Toniolo, ed. *The Italian Economy since Unification* (Oxford University Press, Oxford, 2013)

The concern that many of us attach to these findings on Italy may seem puzzling to some. After all, levels of average wage rates and productivity – labor productivity, capital productivity and so-called total factor productivity – especially among older people, are still pretty high in Italy, thanks to Italy's achievement at *importing* new methods and products conceived and pioneered abroad. But most of us would not be satisfied with an economy in a stationary state. Many people in the West would find it disquieting to be told that innovation in the West will be limited to whatever will be achieved by the monopolists of Silicon Valley.

So what is the *significance* of these net losses of innovation? In the view of *some* economists, such as my friend Joseph Stiglitz, the *main significance* of the losses of innovation – in Italy, France, Britain and America – is mainly that participants in the labor force have felt deprived by the *slowdown* in the *growth* of wages. But how many centuries of wage growth does a country need to have until people have enough? Frank Ramsey and John Maynard Keynes thought in 1928 that people would be satiated with consumption and leisure within several decades. The clamor for wage growth is beginning to ring false, at least to my ears.

The main significance of what we are witnessing, as I see it, is that the losses of innovation, especially the indigenous kind, have deprived many participants of *individualistic* rewards, which go much deeper than “collective” rewards like earning the general wage rate and buying at the general price level or enjoying the security of a fiefdom. Let me explain.

To begin, we humans are not machines. What is most precious to us is our sense of *agency* and the *scope* of the agency we can exercise.

This was what the 19th century was all about. A new way of life was spreading: going one's own way, taking one's chances, seizing one's opportunities. Novelist Charles Dickens depicted and historian Emma Griffin documented the emergence of a new society in which people increasingly took control of their lives - many of them having careers they could not have foreseen.³ (Dickens himself led an enterprising, audacious life.) The historian Paul Johnson, documenting the beginning of this phenomenon, dubbed it the "birth of the modern" - modern life in a modern economy.⁴

Modernistic satisfactions are *individualistic*, not "collective" I see three kinds of rewards of that sort. *First*, one may take satisfaction in achieving something through one's own efforts and may find satisfaction from the better terms or greater recognition that might result.

These rewards are experiential and may have a creative aspect. They are about "succeeding," or, to use a narrower term, *prospering* (from the Latin *prospere*, meaning as hoped, according to expectation). Successes come in many forms: an office worker winning a raise in recognition of her unusual achievement in her job, a craftsman seeing his hard-earned mastery result in a better product, a merchant's satisfaction at seeing "his ship come in," or a scholar's sense of validation from being awarded an honorary degree.

Second, a person may find satisfaction from the unfolding of his or her life in rewarding ways: the thrill of voyaging into the unknown, the excitement of the challenges, the gratification of overcoming obstacles and the fascination

3 Griffin finds evidence of the new attitudes in her recent book *Liberty's Dawn* (Yale, 2013). Her more recent focus on 19th century materials can be expected to be even more revealing. One worker, after being promoted to the position of riveter, exclaimed how gratifying it was to be able to use his "creativity."

4 Paul Johnson, *The Birth of the Modern* (HarperCollins, 1991).

with the uncertainties. Emerson wrote that "a life is a journey, not a destination."

Last, but not least, there is the satisfaction of “acting on the world” (in Hegel's term) and, with luck, “making a mark,” perhaps changing the world – “making a dent,” as the Beatles put it. It seems to me that these last two kinds of satisfactions are what is meant by the term *flourishing*.

Is there any evidence to support my claim that a large loss of indigenous innovation in a country causes employed people a serious loss of human satisfaction? My book *Mass Flourishing* – coming out in Italian, I’m happy to report – points to evidence drawn from the *World Values Surveys*.⁵ It shows that in 1990-91 the mean level of reported *job satisfaction* was very low in the countries suffering low levels of indigenous innovation – Italy and France, for example– and relatively high in countries with relatively high indigenous innovation - notably Switzerland, Denmark and America. Now the same research team has extracted evidence from 2008 data in the *European Values Surveys*.⁶ It shows that, among 13 economically advanced western European countries, those ranking *lowest* in reporting “high” or “somewhat high” job satisfaction– Spain, France and Italy – ranked very low in indigenous innovation as well (9th, 11th and 13th respectively) and those ranking *highest* in job satisfaction –Switzerland and Denmark – ranked very high in indigenous innovation (in 2nd place and 4th place, respectively).

What was the *source* – the wellspring – of the indigenous innovation that, in several countries, brought the satisfactions I call prospering and flourishing? And what has been causing the losses of this innovation?

⁵ The data are from the *World Values Survey*. See *Mass Flourishing* (Princeton, Princeton University Press, 2013), pages 196 and 197.

⁶ Data in the *European Values Surveys* are usually found in *World Values Surveys* but not in cases where American data to accompany them are not available.

I have maintained for years that the source was the rise of the *modernism* that sprung up in southern Europe in Renaissance times. One could argue that the modernist influence began with the great scholar Pico della Mirandola.⁷ He openly argued that mankind possesses *creativity*. The voice of some other figures stirred people to use their creativity – the ambition of Cellini, the individualism of Luther, the vitalism of Cervantes and the personal growth of Montaigne and, later, the need for imagination in Hume and the acceptance of the unknown in Kierkegaard. Some 19th century philosophers, such as Charles Peirce, William James, Friedrich Nietzsche and Henri Bergson embraced uncertainty and relished the new.

In my book I also maintain that innovation was also *pervasive* – in all or most industries –and *inclusive* – from the grassroots of society on up. Much, perhaps *most*, of the contribution of innovation to economic growth can be laid to the new ideas of *ordinary people* engaged in ordinary business life. The work they did every day led them to conceive of possibly better methods in farms, factories and offices – though they must have been aware that commercial *success* was uncertain. Pico would have understood this.

You may be wondering: Is there evidence to back the thesis that the desire to innovate is fueled by *values*? Yes there is, thanks to some ingenious research: A statistical analysis by the same research team of data from a cross-section of 18 countries in the OECD shows that the countries with higher economic performance (as measured by job satisfaction and labor force participation rates) tend to have higher levels of the right values or lower values of the wrong ones. See the Figure appended.⁸

⁷ I am told that at Oxford as late as the 17th century Aristotle was known as the Philosopher, since he had appeared to have thought through so much of what was to be understood, and Pico was known as the Scholar, because he knew everything that was known in his time.

⁸ The statistical procedure behind this chart employs a method created by Harold Hotelling and was carried out by Gylfi Zoega, a member of the research team.

Accordingly, I maintain – regarding the present day – that the serious deficiency of indigenous innovation in one country after another in western Europe and North America has come *not* from an absence of profitable possibilities and *not* from any omissions of the public sector (like bridges and tunnels not built) but from a *decline* of the modern values that sparked the desire to innovate.⁹

Economists missed this. They were either Schumpeterians believing that the innovations we observe were obvious applications by an experienced entrepreneur of a scientist's discovery, or they were Hayekians believing that what we really observe are merely the "adaptations" that result when unseen and evolving opportunities are intuited by an insightful businessman."¹⁰

What has happened in the realm of values that may account for the weakness of indigenous innovation in Italy and Britain, in France and in America? When we think of the momentous innovations in those countries it is almost unimaginable that modern values have been lost or opposed.

How about *vitalism*? Do we still score high on that? I am not convinced. I wonder whether Americans are still do-ers. Do they love to compete as much as in the decades from, say, the 1850s up to the mid- 1960s, say? Or are they still the couch-potatoes, that was once said about them? Are they fixed on all the *tweets* coming in by the hour?

It appears to me that in the present age – since the war – there is a *dread* of “Knightian” uncertainty (named after Frank Knight¹¹ – Keynes also introduced

⁹ This is a critical thesis of my book *Mass Flourishing* (Princeton University Press, 2013).

¹⁰ See Joseph Schumpeter's 1912 landmark *Theorie der wirtschaftlichen Entwicklung* and, Friedrich Hayek's widely known article, "The Use of Knowledge in Society," reprinted in his essays, *Individualism and Economic Order* (Chicago, University of Chicago Press, 1948).

¹¹ Frank H. Knight, *Risk, Uncertainty, and Profit* (Houghton Mifflin Co., 1921).

the concept.)¹² The Pope just commented on this. People came to be uncomfortable with the directionlessness that modernist values injected into the economy. The *loss* of their former fascination with voyaging into the unknown – which is an element of *expressionism* – is one of the causes of the serious loss of dynamism, thus a serious loss of innovation. (I did not say *disappearance* of innovation, only a serious *loss* of it.)

The flagrant *short-termism* of corporate heads and our representatives in legislatures – witness the tax cuts proposed in Washington – is another hypothesis. Answering a query from Larry Summers, I looked into what has happened to the steepness of the yield curve since the earliest period to recent periods. The trend has been up. In the period 1925-32, the average 10-year rate was only 0.05 points above the average 3-month rate. In the period 1994-96 it was 1.93, in 2003-2005 and in 2016-17 it was 1.51.¹³ These observations are consistent with the hypothesis that asset managers and clients are more averse to long-term assets, with their relatively high element of uncertainty, than they were in the span of *normal* years in the Interwar period. However, the hypothesized rise of short-termism is *not* outside my framework of *modernist values*. It looks to me like a loss of *vitalism*.

I also sense there has also been a decline of *individualism* in the West. Where are the Horatio Alger stories? Where are the young people asking the Horace Greeleys in what direction to go? I am shocked that young Americans report in opinion surveys that they want to remain in their home town, live

¹² John Maynard Keynes, *A Treatise on Probability* (Macmillan & Co., 1921).

¹³ Thomas S. Coleman, Lawrence Fisher, and Roger G. Ibbotson, *Historical US Treasury Yield Curves* (New York: Moody Investor's Services, 1993); For later data see the "Resource Center" of the U.S. Department of the Treasury's website.

close to their friends or even continue to live at home!¹⁴ This is a portrait of America that is almost unrecognizable to me. Certainly it is not the nation that Norman Rockwell painted and Willa Cather wrote about.

There are other hypotheses, most of them a reversion to the tenets of corporatism, about which I will say more a little later. There is the rise of the “money culture,” as John Dewey called it. There is also the strange and perverse love affair of most Americans and Europeans (including Brits) with houses – Rome and New York are rare exceptions – which is another kind of materialism.

There is more than a *deficiency* of modern values behind the decline of innovating. Society has come to subscribe to some *antithetical* values, which may interfere with modern values. A new set of values arose under the name of *corporatism* in the 1890s – in Germany, France and Italy – and put into practice in the Interwar period. The essence of this doctrine is that the society is a coordinated “body” (*corpore*), so companies ought not to do what would harm the state and may be obliged to act for the good of society, is antithetical to individualism. A would-be innovator might well be looked at as selfish and, to the extent he or she succeeds, disruptive and thus anti-social.

In recent decades, neo-corporatism sees it as an obligation of society to extend *social protection* to various groups and to ensure that all groups advance in lockstep. Neo-corporatism also sees it as acceptable that companies protect themselves from competition from others. Call it *self-protection*. This has led to an unprecedented acceptance of monopoly power.

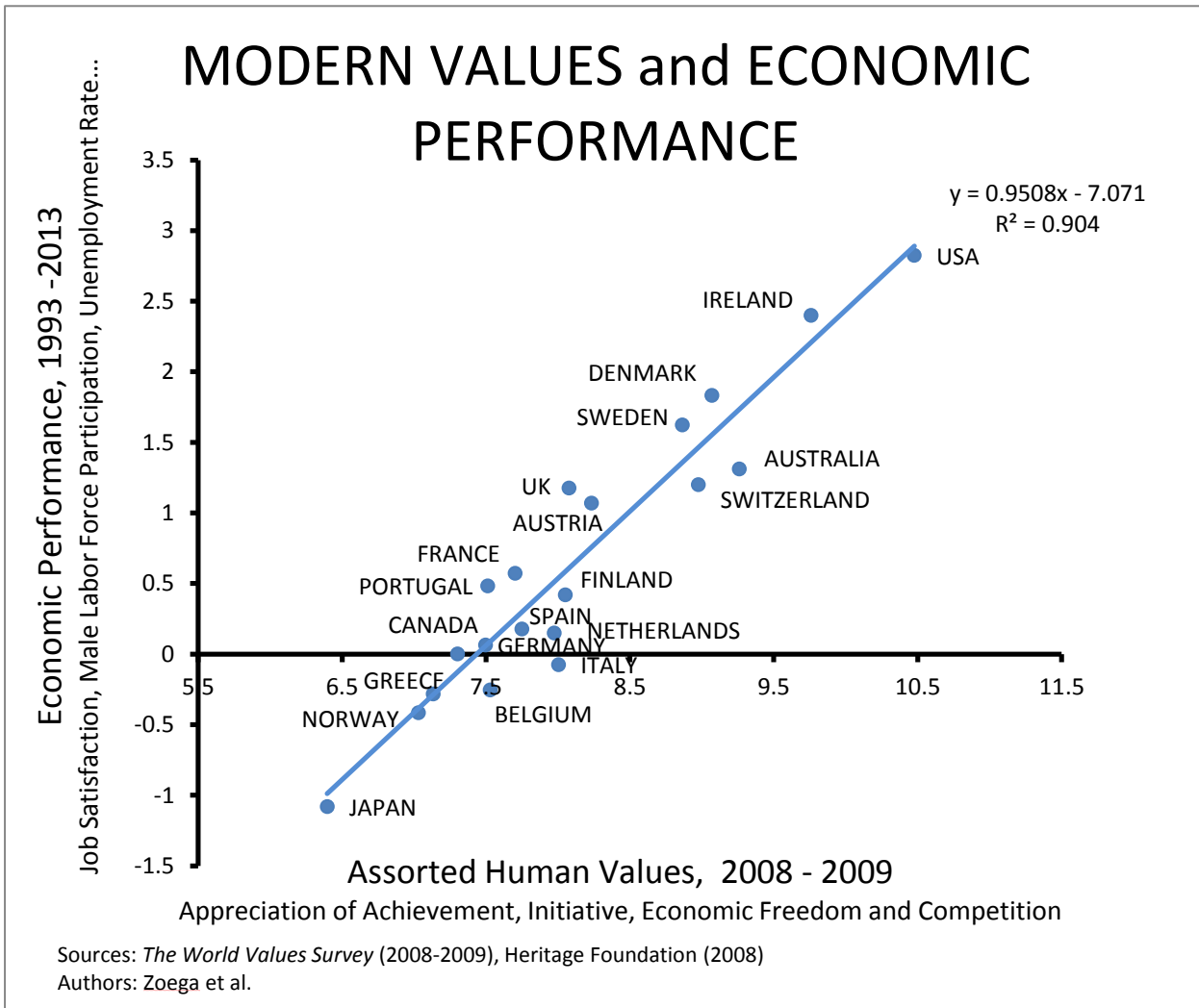
¹⁴ See Brad Tuttle, "Being 30 and Living With Your Parents Isn't Lame - It's Awesome," *Time Magazine*, March 20, 2012.

The emergence of *abusive use* of patents and *protectionist* regulations are other examples. I would only make the point that an economy needs some basic patent protection and some basic regulations, but a forest of regulation and patents makes it burdensome for individuals to start new companies and presents legal hazards to employees and managers inside existing companies who would have liked to try out new methods or policies. Why has society allowed these governmental abuses to arise? In part, my answer is that, much of the citizenry have lost their allegiance to modernist values.

Finally, politicians have taken ad hoc measures that directly *block competition from new ideas*. The entry of startup firms is impeded through a variety of actions—from tariffs and quotas to outright aid to incumbents—to save established companies from losing market share. Furthermore, when incumbents become safe from firms with new ideas, they can afford to cut back whatever defensive innovation they might have done. All this represents a serious rejection of individualism in favor of collective action.

So we are faced with significant alienation from the modern values—the necessary individualism, vitalism and expressionism— that drove massive innovation in the lead economies of the West. And we are faced with a rise of post-modern values that celebrate every non-profit enterprise more than any commercial one. To regain the dynamism of old we need to return to those modernist values and reject the post-modern ones.

I want to wish all the students here lives of creating, exploring, discovering and achieving – without fear of the unknown.



Notes: The procedure gives each country a score on its values – some positive values, some negative. The procedure also gives each country a score on its performance data. The chart shows the estimated correlation between scores on performance and scores on values.