

Why Growth Is So Important

Growth is not everything, but without growth there is nothing! The importance of economic growth for the welfare of a country can be summarised in this simple formula. There is no doubt that other aspects, such as social, ecological and ideological goals, are just as important for some and may be even more important for others. It is also indisputable that economic success cannot be the only dictate of a society, and not even the highest one. Peace and freedom, security and justice have a higher position on the socio-economic pyramid of goals. After all, the relationship between “growth” and “poverty” is not necessarily free of conflict. The weighing of “efficiency” against “equality” is one of the traditional optimisation problems of economic science. It is certain, however, that the more developed countries and their social systems are dependent on economic growth in order to be able to fulfil the task of income redistribution. With the demographic ageing of the societies in the European Union and their decreasing population, growth becomes even more important to finance the increasing burden of social pension systems.

A quick glance at the growth performance of the European Union and especially Germany does not find a hopeful picture. The German economy is suffering from a weakness of growth. Unemployment is too high. The state is over-powerful. In a slowly growing country the economy has comparatively fewer goods and services at its disposal – which also leaves less latitude for redistribution in favour of the weaker members of society. Growth is not only the source of welfare. Growth is also the source of redistribution!

The fundamental problem of a persistent weakness of growth is that the macroeconomic consequences only make themselves noticed after a delay. In the first years the economy lives on its capital. Above all, however, behaviour which is rational from an individual point of view leads to a downward spiral for the economy as a whole. People adapt to periods of uncertainty by limiting their consumption. Firms reduce their investments. What is microeconomically reasonable for the individual – to consume less and save more – leads macroeconomically to a decrease in domestic demand. Thus a demand-side impulse is lost which could lead the economy out of at least a cyclical downswing phase.

The higher the level of welfare already achieved in an economy, the longer can it cover up the effects of the insidious decline. “Weakness of growth” does not necessarily mean that nothing is possible and a country will perforce slither into a deep economic crisis. That may be the case, but it does not have to be so. The most dangerous thing about a weakness of economic growth is the insidious process of a slow decline which is at first not noticed in everyday life. Decline is defined primarily as a relative lagging behind other countries which are growing faster. In an economic sense – as opposed to the physical sense – “standstill” therefore does not mean “staying in one place” but “a step backwards”. To stand still in a world which is changing and in a world economy which is growing means to fall behind!

Argentina, Uruguay and Chile in Latin America, and the United Kingdom and Belgium in Europe, were forced in the last century to experience how long the phase of relative decline can last and how far one can fall behind, as well as – above all – how difficult it is to stop the process of falling behind and to turn it around. For more than a decade Japan has had difficulties in getting back into step macroeconomically.

Why it is so difficult to overcome a persistent phase of economic weakness can be well illustrated using the concept of the “rent-seeking society”. According to this concept people have two possibilities of obtaining income. They can engage in productive economic activities (rent creation) and offer the goods and services thus produced on the market. But they can also attempt to induce state institutions to introduce redistribution measures in their favour (rent seeking). Their income has no productive quid pro quo: they receive an “income” which is financed by the productive activities of other economic actors.

In the course of time in a stable society the number of rent-seeking interest groups and their influence on income distribution increases. The more people and groups shift their (economic) activities away from productive ones to political redistributive ones, the lower the productivity in a society will be. The rent-seeking society thus bears the seed within itself of a self-reinforcing "vicious circle". The more society complies with the dictates of rent-seeking interest groups the more will the incentive increase for individuals to become rent-seekers themselves. With the increase in the number of rent-seekers, the costs to the individual of disguising the fact that he is not striving for entrepreneurial success but is seeking political rents will fall. The reason for this "vicious circle" lies in the high fixed costs which have to be met by rent-seeking opponents of reform in order to get hold of the political controls. Once the reform-opposing interest groups have established themselves in the seat of power, however, rent-seeking activities show increasing returns to scale. The more people join the rent-seeking interest groups, the higher will be the costs to the economy as a whole because the allocative distortions steadily increase and ever more resources are removed from productive activities and used for rent-seeking.

The inefficiency of a rent-seeking society is of particular importance where innovative people, instead of setting up or managing businesses in the rent-creating sector and thus supporting innovations, are active in the rent-seeking sector because it appears easier to achieve political rents than business profits. The activity of the creative, talented people in the rent-seeking sector causes this sector to expand at the cost of the rent-creating sector. This is the case, for example, if a career in the state bureaucracy, in the church or in the army is more attractive than entrepreneurship or if state regulations so limit the development opportunities of a business manager that the search for state-legitimated monopoly positions appears more attractive from the point of view of the individual firm than the striving for innovations.

The concept of the rent-seeking society illustrates why a prolonged weakness of growth leads to the insidious decline of an economy. If the cake is not (or hardly) becoming larger, the struggles over distribution will become harder and harder. The small rent-seeking groups are usually better organised and more powerful than the usually unorganised, comparatively heterogeneous, large rent-creating groups. It is almost inevitable that in "developed" democracies a government will ultimately give way to the pressure of individual interests (and their electorate!) to the extent that "institutional sclerosis" develops. The rent-seeking interest groups push back all those forces which threaten to change the existing politico-economic constellation of power. If structural change ebbs, however, development and therefore growth will also slow down. An "ossification" then takes place which leads to a sinking of the rate of real economic growth and in the long run to stagnation and decline.

The political million dollar question is how can we free the rent-creating sector from the iron grip of the rent-seekers. A potential answer is to proclaim that without a strong rent-creating sector there will be no growth and without growth there will be nothing to redistribute in the long run. In other words, a growth-oriented policy is the best social policy. Only a strong economy will be in a position to support the weak members of society. For the potential victims of structural change and other rent-seekers it is therefore not in their interests to block reforms. As paradox as it might sound, precisely the opposite is the case. Only if the economy as a whole grows thanks to rapid structural change can the needed opportunities for redistribution develop. Without growth there will be no solid financing of social policy in the long run and thus no "social" justice, no matter how this is defined. That will endanger social peace in Germany and in Europe incomparably more strongly than any reform in favour of stronger economic growth!

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