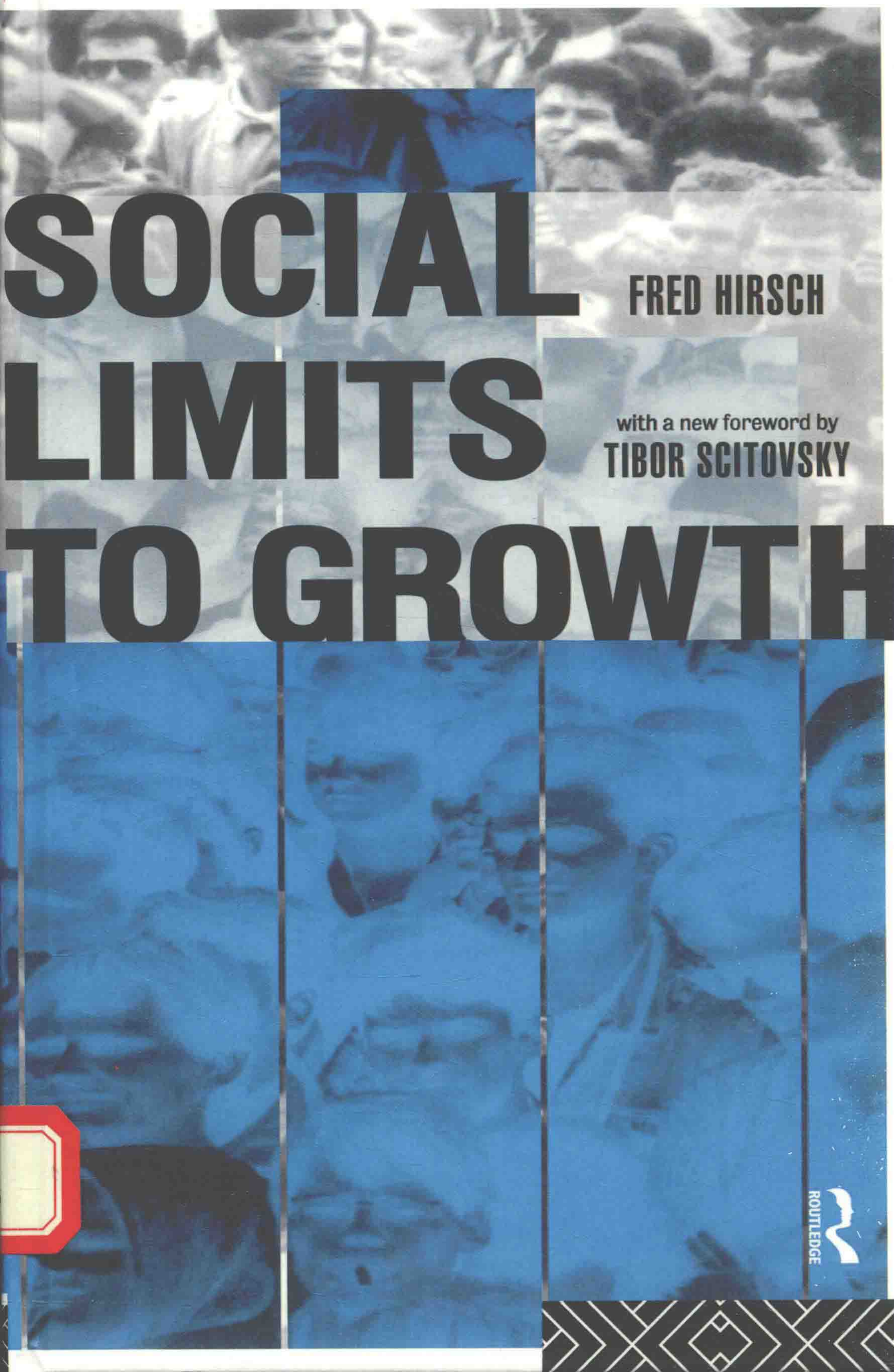

SOCIAL LIMITS TO GROWTH

FRED HIRSCH

with a new foreword by
TIBOR SCITOVSKY

ROUTLEDGE

SOCIAL LIMITS TO GROWTH

Revised edition

Fred Hirsch

Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First published in Great Britain in 1977
by Routledge & Kegan Paul Ltd

Published 2005 by Routledge
2 Park Square, Milton Park, Abingdon, Oxfordshire OX14 4RN
711 Third Avenue, New York, NY 10017

First issued in hardback 2015

Routledge is an imprint of the Taylor and Francis Group, an informa business

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library.

ISBN 13: 978-1-138-83494-1 (hbk)
ISBN 13: 978-0-415-11958-0 (pbk)

Preface

This book suggests that the current impasse on a number of key issues in the political economy of advanced nations is attributable in part to an outmoded perspective on the nature, and therefore the promise, of economic growth. The critique has some important immediate—mainly negative—implications for policy, and it opens up a wide range of consequential policy issues. It is for the reader to judge whether the theme developed here has sufficient validity and promise to justify the further analysis and inquiry called for by the approach put forward. Although the book has been a long time in the making—five years from first outline to final typescript—it represents little more than a starting point. It is devoted essentially to the frame in which the issues are seen and to the inferences for policy that follow and that need further investigation.

The support of the Twentieth Century Fund has made this book possible. The Fund financed my work from April 1972 until September 1974, while I was a research fellow at Nuffield College, Oxford. From its initial acceptance of the project through the slow journey to eventual completion, the Fund exercised unusual understanding and patience with the problems associated with a work of this kind. My appreciation for the support of the Fund, and particularly for that of its director, M. J. Rossant, therefore extends well beyond the conventional acknowledgment. I can only hope that the project has justified and not qualified the director's often expressed view that foundations should take chances.

Nuffield College provided the ideal environment for the work, and I express my warm thanks to the Warden and Fellows for offering me a research fellowship and for their hospitality and intellectual stimulus during my stay.

I have an unusually long list of individuals to thank for the personal help they gave me; presumably the extent of my indebtedness reflects the fact that I was immersing myself in a new branch of a subject. From the beginnings of the project, I have received invaluable guidance, stimulation, and criticism from Tibor Scitovsky. On a number of points, I doubt whether I have satisfied his exacting standards; yet, despite the usual disclaimer, he is in one sense responsible for the errors that follow, in that without his interest and continuing encouragement I am not sure that I would have persisted.

Another major acknowledgment is due Kenneth Boulding. His comments on the draft manuscript as a reader for the Fund contributed both general encouragement and much useful, constructive criticism. I am also grateful for comments and criticism of sections of the draft made at various stages by Brian Barry, John Flemming, John Goldthorpe, Richard Lecomber, Ian Little, Donald Moggridge, Mancur Olson, and Donald Winch; and by Walter Klein, Robert H. Nelson, and Peter Reuter of the Twentieth Century Fund staff, as well as two anonymous referees.

I am grateful to Arun Newell and Christopher Trinder for research assistance, to Stephen Carse for his work on checking of references, and to Theodore E. Young for editorial work. I am also grateful for the help given by my present secretary, Karen Kavanagh. As with my previous books, my wife, Ruth Hirsch, played a major part in the practical production process.

F.H.

Foreword

In its beginnings, economic theory focused on explaining how competitive markets work: how they curb the selfish interests of market participants by balancing them one against another in a way that results in the production of goods and services according to consumers' preferences and an efficient allocation of resources to their production. To make the argument simple, intelligible and convincing required a highly simplified model of the economy that focused on the satisfaction of man's bodily needs and left out every obstacle, imperfection and complexity that could actually or potentially interfere with the market economy's perfect functioning.

Once our economy's benefits were clearly stated and firmly established in the public's mind, however, the way was open for economists to recognize the existence and explain the consequences of all those omitted obstacles that the complexities of markets and the limitations of resources and human desires create. That turned out to be a very slow and still ongoing process; but it is a very important one, because it renders our picture of the economy increasingly realistic and thereby helps to explain and remedy, when possible, its peculiarities and shortcomings.

Malthus was probably the first economist to recognize one of those obstacles, the limited availability of agricultural land, when he warned against overpopulation. Half a century later, John Stuart Mill pointed out the possibility of a general glut when people hoard money; and another half century later Marshall drew attention to externalities, i.e. the interdependence of different people's satisfactions, and the fact that activities are not only means to satisfy wants but can also be wanted for themselves, thereby recognizing that mankind's aspirations go beyond the satisfaction of simple bodily needs.

In our own century, those and other problems were dealt with and looked into much deeper when Keynes revolutionized macroeconomics, Ronald Coase developed the theorem named after him, Staffan Burenstam Linder accounted for the leisure classes' lack of leisure, William Baumol diagnosed the chronic tendency of the performing arts, health care and other such labor-intensive goods becoming ever more expensive, James Tobin and William Norhaus demonstrated the uselessness of the National Product as a welfare measure, Robert Frank and others showed the need for honesty and a social conscience to supplement people's pursuit of their selfish interests, and Nicholas Georgescu-Roegen brought entropy into the economic process, to mention just a few.

Most of those contributions, however, were looked upon as exceptions, special cases, minor blemishes or interesting peculiarities worth noting; but, with the partial exception of Keynes's explanation of unemployment, they were never integrated into the general body of economic theory.

The unique and important quality of Hirsch's *Social Limits to Growth* is that it goes a long way towards accomplishing that integration by attributing all those exceptions and blemishes to a single cause.

That growth has social limits was first noted by Sir Roy Harrod, the originator of the formal theory of economic growth, in a hardly noticed, very short contribution to a 1958 US symposium, which was written, he once told me, as his way of obtaining a cheap roundtrip airline-ticket from London to New York. That neither he nor others recognized its importance is shown by his failure to develop the idea further and its not even being mentioned in the seven-page long enumeration of Harrod's many contributions to economics in the *New Palgrave Dictionary of Economics*. For it is one thing to think of an idea but quite another to recognize and explain its significance; and it took Fred Hirsch's insight and imagination to turn it not only into a fascinating book but into a generalization that integrated many existing theorems into a coherent whole. Indeed, this book served and will, I believe, continue to serve as a fertile basis for subsequent work yet to come.

Hirsch, born in Vienna and brought up in England, started out as a financial journalist. He worked for *The Banker*, and later *The Economist*, whose financial editor he became, until he joined the International Monetary Fund in Washington as Senior Advisor of its Research Department. In each of these capacities, he found time and energy to write and co-author several excellent books and to contribute many memorable monographs and articles to a wide variety of journals on almost every aspect of international monetary problems and policies. But he was extremely original, imaginative, wide-ranging in his interests, and seems to have found both the subject of international monetary policy and the occupations of journalist and international civil servant too narrow and constricting, for aged 41, after five and a half years at the IMF, he quit to accept a research fellowship at Nuffield College, Oxford, to undertake something very different and much more original.

Before his return to England, Hirsch visited a cousin at Stanford, and on the occasion looked me up to ask what I considered a promising subject for him to work on. After some discussion, I xeroxed for him a two-page reprint containing Harrod's piece for the 1958 symposium, which he knew nothing about. Handing him those two pages turned out to be one of my best contributions to economics.

Harrod, an upper-class Englishman and enlightened elitist, showed in his short paper that certain privileges of the upper classes, such as domestic servants, homes in the choicest parts of New York and the best tables at the best restaurants, will never become available to everyone, no matter how much average real incomes rise. It is for this reason that he called those privileges oligarchic wealth to distinguish them from democratic wealth—and there he left the matter.

It was at this point that Hirsch picked it up and pursued it further. He pointed out that very many things beyond the privileges of the rich and powerful were, in some sense, in short and inaugmentable supply, unavailable to satisfy everybody; and he drew attention to their ever-increasing number as amenities, once free, taken for granted and seemingly plentiful, turning out to be in inaugmentable short supply as growing population, rising incomes and economic growth increase their utilization and make them scarce. The ozone layer, clean air, drinkable water, natural beauty, infrastructure (e.g. roads, sewers) and antiques are obvious examples. Hirsch called all such amenities, objects and privileges in short supply, positional goods, which rendered that category equal in importance to material goods whose supply could be, and was, increased in response to the public's rising demand for them.

Another, no less important difference between material and positional goods is that our demand for the former is satiable and therefore limited; whereas our demand for the latter seems unlimited. The conflict and interaction between those two differences, the limited demand for things with augmentable supply and the unlimited demand for those whose supply is limited, have created a great number of peculiarities and problems in our society, which become easier to understand, deal with, and live with, after reading this book.

Indeed, Hirsch with his journalist's eye and analytic mind, was very much aware of our society's many economic and social problems and their probable causes; and when he came to see me, he must have been looking, not just for a fascinating subject to write about but for one that would integrate and account for all the many economic and social problems he worried about and wanted to discuss and explain. He found such a subject in Harrod's two-fold classification of goods.

Readers of this book must remember that within the realm of material goods, all the accomplishments we economists attribute to the invisible hand of the competitive market economy hold true. That is why the classical economists managed drastically to simplify the economic problem when they focused their attention narrowly on mankind's bodily needs. That made demand and increases in demand always into a good thing, leading to the creation of employment, income and output; it showed competition to be a beneficent force that diminished monopoly profits and caused market prices to reflect costs and preferences; and it made quantification possible by rendering per-capita national product estimates an ordinal measure of the economy's contribution to welfare.

All that neat, elegant simplicity of our subject comes to an end when one introduces into the picture scarce positional goods whose supply is not enough to satisfy everybody. They not only throw a spanner into the works but seem to be partly or wholly responsible for almost all the great number and variety of seemingly disparate problems, nuisances and frustrations which bedevil our lives in the modern world.

The simplest examples of those problems and nuisances are external diseconomies. The scarcity of a positional good renders different people's enjoyment of it interdependent, so that one person's increased consumption or use of it reduces its availability for other people's enjoyment. That is what we call external diseconomies. They looked like exceptional and minor nuisances when first mentioned in Pigou's 1920 *The Economics of Welfare*, probably because the world's population at the time was only 1.7 billion and the number of scarce positional goods relatively small. However, by the time Hirsch was writing his book in the mid-1970s, world population had more than doubled to over 4 billion, greatly increasing both the number of scarce positional goods and their scarcity, which rendered external diseconomies the bane of our existence. Smog, traffic jams, the deterioration of our inner cities, the spoiling of much natural beauty by overcrowding and too many tourists, the poisoning of the soil and ground water by the burying of toxic waste products are a few examples. Yet, those and other aspects of the worsening of our environment are just one, though admittedly the most obvious one, of the problems which positional goods create. Readers of this remarkable book will be impressed by its author's keen eye and sharp logic in tracing back to the increasing scarcity of positional goods such things as consumerism, money-mindedness, conspicuous consumption, our declining friendliness and social life, the privatization of what once were common-access facilities, the failure of our rising per-capita real income to make us better off and feel better, and the slow erosion of the honesty, compassion and social conscience we inherited from the pre-capitalist days of our feudal society, which are so essential for the functioning of our economy, and which were seldom if ever mentioned by the classical economists because they took them for granted.

Hirsch's awareness of those and other such problems is the more remarkable because he did not set out to integrate his fellow economists' work on some of those specific problems; indeed, with the exception of Keynes's *General Theory* and Linder's *The Harried Leisure Class*, he may not even have been familiar with them, because several were published only after he wrote his book and he nowhere refers to those published before. It was his observation of the world around him that made him notice all those problems and he was pretty successful in tracing all of them back to the same cause.

Much of the book deals with the way in which the increasing scarcity of positional goods raises our demand for what he calls intermediate goods. These are material goods that satisfy no human need and are not substitute for positional goods, but serve as symbols of their possession (conspicuous consumption), as means for preventing, offsetting or, at least, slowing the process of the worsening quality of such positional goods as air and water, and as instruments to make scarce positional goods more enjoyable or more accessible. As examples of this last, Hirsch mentions education to facilitate professional and social advance, and cars to render accessible more elegant homes in more distant suburbs. The ever-increasing proportion of such intermediate goods and services in our national income and product estimates is the main reason for the latter's increase; and it explains why that increase, when it represents a price-corrected increase, often indicates, not a rise in our standard of living, but the need for increased effort to keep our standard of living from falling.

A minor blemish of this very thoughful book is that no single idea can ever explain everything; but Hirsch could not resist the temptation to deal also with a few problems whose connection to the book's main idea seems somewhat tenuous. That slight logical inconsistency is a price well worth paying for the wonderfully broad scope of the book that is not nearly long enough to deal exhaustibly with all the problems it raises; and it was a tragedy that its author should have died within a year of its publication, at the age of 46, before he had time to follow it up with more work on some of the issues it deals with.

The only other blemish I find is that Hirsch's preoccupation with the many ways in which the rising shortage of positional goods stimulates the demand for material goods, led him to overlook the possibility of its occasionally *restricting* such demand. Yet, the rising prices of some increasingly scarce positional goods not only prevent the demand for them from rising beyond the point where it can still be satisfied but may also divert demand from the material-goods sector and thereby depress some other markets and with them the macro-economy.

The market for paintings by dead painters, another positional good, provided a good example of this point. During the three decades immediately following the Second World War, their prices were rising by almost an annual 10 per cent faster than the cost-of-living index, which diverted some of the savings not only of rich people but of some insurance companies, pension funds and other businesses into speculative holdings of pictures from real investment or other spending on material goods. I presented that argument in my 1986 Fred Hirsch Memorial Lecture and published a generalization of it in 'Towards a theory of second-hand markets', *Kylos*, 1994. Needless to say, such blemishes will be welcomed by readers stimulated by them to develop ideas of their own furthering the seminal topic of this book.

References

Baumol, William J. and Bowen, William G. *Performing Arts—The Economic Dilemma* (New York: 20th Century Fund, 1966).

Coase, Ronald. 'Coase Theorem', *New Palgrave Dictionary of Economics*, vol. 1, pp. 457–60.

Frank, Robert H. *Passions within Reason: The Strategic Role of the Emotions* (New York: Norton & Co., 1988).

Georgescu-Roegen, Nicholas. *The Entropy Law and the Economic Process* (Cambridge, Mass.: Harvard University Press, 1971).

Nordhaus, William D., and Tobin, James, 'Is Growth Obsolete?' in W. D. Nordhaus & J. Tobin (eds.), *Economic Growth* (New York: National Bureau of Economic Research, 1972).

Scitovsky, Tibor 'Towards a Theory of Second-hand Markets' *Kyklos*, vol. 47 (1), 1944, pp. 33–52.

— 'Growth in the Affluent Society: Fred Hirsch Memorial Lecture' *Lloyds Bank Review*, Jan. 1987, pp. 1–14; reprinted in Christopher Johnson (ed.) *Lloyds Bank Annual Review: The Market on Trial*, vol. 2, (London & New York: Pinter, 1989) pp. 151–62.

Contents

1 Introduction: The Argument in Brief

This book tries to give an economist's answer to three questions.

(1) Why has economic advance become and remained so compelling a goal to all of us as individuals, even though it yields disappointing fruits when most, if not all of us, achieve it?

(2) Why has modern society become so concerned with distribution —with the division of the pie—when it is clear that the great majority of people can raise their living standards only through production of a larger pie?

(3) Why has the twentieth century seen a universal predominant trend toward collective provision and state regulation in economic areas at a time when individual freedom of action is especially extolled and is given unprecedented rein in noneconomic areas such as aesthetic and sexual standards?

Let us call these three issues (1) the paradox of affluence, (2) the distributional compulsion, and (3) the reluctant collectivism.

My major thesis is that these three issues are interrelated, and stem from a common source. This source is to be found in the nature of economic growth in advanced societies. The heart of the problem lies in the complexity and partial ambiguity of the concept of economic growth once the mass of the population has satisfied its main biological needs for life-sustaining food, shelter, and clothing. The traditional economic distinction between how much is produced, on what basis, and who gets it then becomes blurred. The issues of production, of individual versus collective provision, and of distribution then become intertwined.

This development marks a profound change. It is a change that economists in particular find difficult to accept because it has the appearance of scientific retrogression. Traditionally, the contribution of the economist to charting a way to economic progress has consisted largely of unscrambling the aspects of economic activity just mentioned—distinguishing between the share of the pie and its size, between the motivation of individual actions and their collective result. It was on these distinctions that the science of economics was launched by Adam Smith two centuries ago. Smith showed that pursuit by individuals in an uncoordinated way of their own interests could yet serve the interests of all and that the poor man in the rich community could live better than native kings.

The progress of economics has been devoted largely to developing and refining these insights, which has resulted in enormous advances in the quantification of economic phenomena. This quantification in turn supports not merely the claim of economics to primacy in the ranking of the social sciences but also its established primacy in the agenda of public policy. In the past generation, electoral politics throughout the industrial world, and beyond it, has been increasingly dominated by the big economic numbers—gross national product, personal disposable income, and the rate at which these indicators of material prosperity grow.

Yet in advanced societies, those in which the mass of the population has risen above merely life-sustaining consumption, the stage may now have been reached where the analytical framework that the economist has come to take for granted—but that the sociologist has long disputed—has become a hindrance in understanding some key contemporary problems. Confronting these problems in the framework of the traditional analytical separation leaves the answers in the air. The three broad questions listed at the outset—the paradox of affluence, the distributional compulsion, the reluctant collectivism—are puzzles or paradoxes when viewed in isolation. A clue to their resolution is to approach them as interconnected products of a neglected structural characteristic of modern economic growth. That is what this book tries to do.

I

The structural characteristic in question is that as the level of average consumption rises, an increasing portion of consumption takes on a social as well as an individual aspect. That is to say, the satisfaction that individuals derive from goods and services depends in increasing measure not only on their own consumption but on consumption by others as well.

To a hungry man, the satisfaction derived from a square meal is unaffected by the meals other people eat or, if he is hungry enough, by anything else they do. His meal is an entirely individual affair. In technical terms it is a pure private good. At the other extreme, the quality of the air that the modern citizen breathes in the center of a city depends almost entirely on what his fellow citizens contribute toward countering pollution, whether directly by public expenditure or indirectly through public regulation. Clean air in a metropolis is a social product. In technical terms, it is close to a pure public good.

These polar cases, however, are relatively few in number. It has recently become recognized by economists who specialize in these matters that the major part of consumption is neither purely private nor purely public. What is generally referred to as private or personal consumption is nonetheless affected in its essence—that is, in the satisfaction or utility it yields—by consumption of the same goods or services by others; and in that specific sense it can be said to contain a social element. Correspondingly, what is generally referred to as public consumption contains some of the characteristics of private goods, in the sense that its costs and benefits are or can be confined to a limited group.

The range of private consumption that contains a social element in the sense described is much wider than is generally recognized. In textbooks on economics, public goods are discussed in the context of goods and facilities that can be provided only, or most economically, on a collective basis, open to all and financed by all. City parks and streets and national defense are prominent examples. In addition, elements of public goods are recognized in side effects of private transactions such as pollution and congestion occurring in particular identifiable situations. But a more general public goods element can be attributed to a wide range of private expenditures. Thus the utility of expenditure on a given level of education as a means of access to the most sought after jobs will decline as more people attain that level of education. The value to me of my education depends not only on how much I have but also on how much the man ahead of me in the job line has. The satisfaction derived from an auto or a country cottage depends on the conditions in which they can be used, which will be strongly influenced by how many other people are using them. This factor, which is social in origin, may be a more important influence on my satisfaction than the characteristics of these items as "private" goods (on the speed of the auto, the spaciousness of the cottage, and so forth). Beyond some point that has long been surpassed in crowded industrial societies, conditions of use tend to deteriorate as use becomes more widespread.

Congestion is most apparent in its physical manifestation, in traffic jams. But traffic congestion can be seen as only a special case of the wider phenomenon of social congestion, which in turn is a major facet of social scarcity. Social scarcity is a central concept in this analysis. It expresses the idea that the good things of life are restricted not only by physical limitations of producing more of them but also by absorptive limits on their use. Where the social environment has a restricted capacity for extending use without quality deterioration, it imposes social limits to consumption. More specifically, the limit is imposed on satisfactions that depend not on the product or facility in isolation but on the surrounding conditions of use.

What precisely is *new* about this situation? The limits have always