Should Productivity Growth Be a Social Priority?

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INTRODUCTION

Perhaps the most fundamental axiom of modern economic science is that there is no such thing as a free lunch. It is this axiom that gives us the concept of opportunity cost, an idea that has led to enormous gains in the clarity of our understanding of individual and societal choice. But while continuing to endorse this fundamental axiom, many economists have also been extremely attracted by the appeal of increased economic efficiency. Efficiency gains are often treated, if not exactly as a free lunch, certainly about as close to a free lunch as one can get in this sublunar realm. As a result, economists often react with a certain incredulity when someone questions the need for such gains. It is tempting to suppose that the critic simply misunderstands the relevant concepts, or else fails to grasp the full set of constraints under which economic activity occurs.

Productivity growth is widely regarded as a subset of the efficiency gains that can be realized in our economy. Thus to question the need for increased productivity seems initially to fall under the same category of suspicion. Yet this is precisely what I intend to do. As a way of conferring some initial legitimacy upon this enterprise, I would like to start out simply by appealing to the "no free lunch" principle. To adopt productivity growth as a social priority is to set aside other objectives that we might like to pursue. Therefore, one cannot maintain rational adherence to a program of increased productivity without a clear sense of what the benefits of such a program are likely to be, compared to the other things that we might choose to do. The bulk of this paper consists of an attempt to evaluate the size and scope of these benefits. More controversially, I will try to show that these benefits are often exaggerated.

The conclusion that I draw on the basis of this survey will strike many as complacent. But it is a principled complacency. I argue that we have good reason, as a society, to strive for productivity gains, but that there is nothing *urgent* about this objective. Furthermore, we should not strive to *maximize* productivity gains, nor should we be overly concerned about our *relative* productivity levels. The note of urgency that is struck in much of the popular discussion is, I will argue, based on a widespread tendency to overestimate the contribution that economic growth will make to the welfare of individual Canadians. The underlying problem, I will argue, is that even though we live in an extremely rich society, we continue to think and act as though we lived in a poor one. Correcting this bias allows us to put the issue of productivity growth into perspective.

WHY PRODUCTIVITY GROWTH?

When evaluating the merits of increased productivity, it is helpful to begin by examining the benefits that have traditionally been thought to flow from productivity growth — or, more accurately, the benefits that were promised in much of the popular and academic writing on the subject. Needless to say, productivity is not an intrinsic value. It is a technical efficiency concept, stating in effect the ratio of useful economic output to some specified bundle of inputs.[1] Thus increased productivity, roughly put, allows us to do more with less, but it does not specify what it is that we intend to do. In order to evaluate the merits of increased productivity, therefore, we need to look at what these increases were supposed to allow us to do. Here are some of the benefits that have often been thought to flow from productivity growth:

Increased Leisure. This is the big payoff that has always been the expected outcome of increased labour productivity. It is certainly the payoff that has most widely captured the popular imagination. Between the late 19th century and the second half of the 20th, there was a steady decline in the length of the average workweek. It was assumed that productivity growth would allow this trend to continue. After all, if it takes us less time to produce all of the things that we need to lead happy and fulfilling lives, then it seems natural that we should have to work less. And even if the aggregate number of hours worked remains constant or increases, productivity growth should give individuals much greater freedom when it comes to choosing the number of hours that they themselves want to work.

Increased Consumer Satisfaction. Increased productivity essentially gives us a "bonus" that we can choose to spend in one of two ways, by cutting back on work hours or by producing more. It is natural that individuals will differ in their choice between these two options, and that a significant number will opt to increase their consumption of market goods rather than their leisure. As a result, productivity growth should generate economic growth, permitting increased consumption, which in turn should increase consumer satisfaction.

Elimination of Poverty. These first two points are not really that dissimilar — in both cases productivity growth is touted as a way of increasing welfare. Increases in productive efficiency are regarded here as a way to generate gains in Pareto-efficiency. (The fact that increased leisure needs to be treated in its own category is merely an artifact of the way that the system of national accounts is compiled.) However, the Pareto-efficiency standard is neutral with respect to questions of distribution. Thus it is quite possible for the benefits of productivity gains to be entirely "captured" by one stratum of society — and this would still count as an improvement according to the first two criteria. Nevertheless, it was often suggested that the benefits of productivity growth would be enjoyed by all classes of society. The rising tide would lift all boats. Thus absolute poverty would be eliminated.

Decreased Social Inequality. While many proponents of productivity growth suggested that the problem of poverty could be eliminated through economic growth alone, without the need for redistribution, there was also, for a long time, the expectation that growth would make it easier to implement redistributive social policies. Society could therefore diminish not only absolute poverty but also relative poverty. This idea found expression in the ideal, widely shared in the 1950s, of a society in which everyone was essentially middle class. The thought, simply put, was that affluence would make people less possessive, that an excess of riches would make them less hostile to the prospect of sharing with others. This thought was of course not universally shared, nor was the underlying egalitarian project endorsed in all corners, but it did nevertheless serve as an important source of hope for many.

So, did productivity growth deliver on these promises? I think we must concede that, in the past 25 years, results have fallen significantly short of expectations. In some cases, productivity gains have provided necessary but not sufficient conditions for the realization of these objectives. In other cases, increased productivity seems to have contributed nothing at all.

As far as increased leisure is concerned, the last three decades of the 20th century were singularly unimpressive. Most significantly, the trend towards a reduced workweek, which dominated the first half of the century, seems to have come to a halt in North America.[2] Between 1981 and 1992, for instance, average working hours among employed Canadians increased by over 15 percent (Zuzanek and Smale 1997, 78). Furthermore, there has been a dramatic increase in the number of two-career households, corresponding to the widely shared perception that it is no longer possible to maintain a middle-class family lifestyle on the basis of only one salary. Thus achieving "work-family balance" has become increasingly difficult for many Canadians.

I think it is easy to lose track of how unexpected and puzzling this development (or rather this lack of development) is. If one had done a survey of Canadian economists in 1975, asking them to predict the length of the standard workweek in the year 2000, I wonder how many would have guessed that it would be unchanged? In fact, the goal of increasing leisure has come to seem so remote that it has almost completely fallen off the public agenda. The case for increased productivity is almost always made as a way of increasing per capita GDP. (Thus in the discussion that follows I will simplify the presentation somewhat by assuming that productivity is valued for the sake of increasing output, not decreasing input.)

As for increased satisfaction, there is also something of a puzzle here. While the standard of living has risen quite steadily, there is no evidence that this has led to any lasting gains in welfare. The issue here is not simply one of diminishing marginal returns to increases in consumption of market goods. Beyond a certain basic consumption level, there is simply no correlation between higher consumption and increased happiness (Frey and Stutzer 2001, 76-91; see also Easterlin 1974). Of course, there are important measurement problems when it comes to talking about people's level of happiness. Nevertheless, given the instruments we have, study after study has shown that in poor countries increased wealth is strongly correlated with increased subjective happiness, but that once the threshold of about US$10,000 GDP per capita is passed, happiness levels have no further tendency to rise in response to economic growth. As a case in point, average happiness in the United States fell by about 9 percent between 1946 and 1991, according to one measure (Frey and Stutzer 2001, 76).

With respect to poverty, it was widely assumed that capitalism would generate such a preposterous excess of wealth that nothing even vaguely resembling poverty could persist. Joseph Schumpeter (1950, 66), for example, in *Capitalism, Socialism and Democracy*, predicted that

> *If capitalism repeated its past performance for another half century starting with 1928, this would do away with anything that according to present standards could be called poverty, even in the lowest strata of the population, pathological cases alone excepted.*

Of course, capitalism did much more than repeat its past performance between 1928 and 1978, but this did not lead to the eradication of poverty.

Where there have been significant improvements in the welfare of the poor, it has largely been due to redistributive government programs, such as socialized medicine, or old age pensions. Thus significant reductions in the level of poverty were recorded in Canada after the Second World War, with the growth of the welfare state, but there has been no decrease in the rate of "basic needs" poverty since the late 1970s (see Sarlo 2001).

Finally, there has been a disturbing trend towards increased social inequality in the last 30 years in North America. This has been mitigated to some extent in Canada through progressive taxation and redistributive policies of the welfare state (see Wolfson and Murphy 2000). Nevertheless, popular wisdom suggests that resistance to such redistribution has been increasing. Certainly, tax resistance among the middle class has been growing, although it is not clear how much of this reflects a free-rider incentive and how much reflects genuine opposition to redistribution. In any case, it is difficult to imagine that the North American population has become more receptive to egalitarianism in the past 30 years.

This having been said, I think it would be entirely unreasonable to question the massive contribution that productivity gains in general have made to our overall quality of life. It is of course because of these gains that we now live in a rich society and not a poor one. But the fact that past productivity gains have given us so many of the things that we now enjoy does not guarantee that future gains will continue to deliver the same results. The track record on this score has become quite mixed in the last 25 years.

SOLVING THE MYSTERY

If there is one trend that I think should be most disturbing to proponents of productivity growth, it is the failure of economic growth to increase happiness. After all, what is the point of producing more if the result is no net gain in consumer satisfaction? Productivity growth was supposed to create something of a "bonus," to create some slack in the average consumer's budget. It was assumed that society would react to growth in much the same way that individuals react to getting a raise or a tax refund. It should have allowed us to relax a bit, not work as hard, indulge some tastes that previously could not be satisfied, and perhaps even share a bit more with those less fortunate than ourselves. Unfortunately, even the prosperous middle classes continue to feel "squeezed" economically. Despite decades of growth, people continue to act and feel as through they were under a severe budget constraint.

What could possibly explain this? The most obvious explanation is simply that consumption standards have increased at approximately the same pace as economic growth. This will be pretty obvious to anyone who has seen a recently constructed suburban home. Not only has the average size of new single-family dwellings increased, from 1,100 square feet in the 1950s to over 2,000 square feet today, but even base models now include amenities that were once available only to the very rich (Frank 1999, 21). Most new homes, for example, contain at least one bathroom *per bedroom*. Yet are people any happier once they move into these houses? All available evidence suggests that the answer is no. Yet they still buy them. And not only do they buy them, they pay more for them. Hence the puzzle — why no increase in satisfaction?

The issue acquires greater urgency when we realize that, if expanding production is not the route to increased happiness, perhaps there is something else we might be doing with our time and energy that would be more effective. Thus it will pay to explore some of the hypotheses that have been advanced to explain the "gap" between wealth and happiness, in order to map out these possibilities more perspicuously.

One way of approaching the issue is to note that the no-happiness outcome would not occur if markets and welfare were tied together in the way that the first fundamental theorem of welfare economics presupposes. Thus a promising strategy is to look at the assumptions needed for this result to hold, and consider which ones may not be satisfied. The first theorem, for instance, assumes that consumers are never satiated, that their preferences are fixed and that their consumption does not generate any externalities. These assumptions are tolerably close to reality in cases where people are extremely poor, but it is not at all obvious that they remain plausible in more affluent societies. It is possible that one or more of these effects has become large enough that it has begun to negate the welfare gains achieved through increased satisfaction of consumer demand.

There is, however, considerable disagreement over the source of these effects. We can discern roughly three currents of thought in the literature.

Proliferation of Desire

The most common diagnosis of the problem can be referred to, following John Kenneth Galbraith (1976), as the "squirrel-wheel hypothesis." According to this view, increased consumption does not generate lasting increments in welfare because the process of production itself generates new wants and needs.[3] The standard pro-growth picture imagines that humans have a relatively fixed set of desires, and that, as time passes, we acquire the capacity to satisfy more and more of them. If welfare is a function of how many of our desires get satisfied, or to what extent, then increased production should lead to greater welfare. However, if the process through which we satisfy our desires generates new ones, then consumption will not necessarily increase welfare. This is the hypothesis that Galbraith entertained.

Such a process could occur through an entirely internal psychological mechanism.

The idea that attempts to satisfy our desires might have a self-defeating character is one of the oldest, and more recurrent, ideas in the history of philosophical reflection on the nature of the good life. According to most Greek philosophers of the classical period, for instance, the problem with hedonism was that it could not generate satisfaction or happiness. As soon as you satisfy one desire, another one springs up to take its place. Furthermore, this second desire is likely to be more extravagant and difficult to satisfy. As a result, we are much better off in the long run if we try to moderate our desires, and control their proliferation. This is what makes self-mastery such an important moral idea in classical Greek philosophy.

Put in more contemporary terms, one can summarize this theory as the view that consumption in general has the structure of an addiction. For example, Tibor Scitovsky (1992) argues that the feeling of subjective well-being is generated not by the state of having one's desires satisfied, but rather by the stimulus associated with the process of satisfying them. As a result, acquiring some new good generates an initial burst of pleasure, but this feeling tapers off quite quickly as the individual adapts. In the same way that individuals can "feel" only acceleration, not velocity, we experience pleasure only from changes in our consumption, and not from its absolute level. Thus just as individuals get "velocetized" when travelling at high speeds, they get "consumerized" when living with high levels of absolute consumption.

Other theorists have advanced somewhat "thinner" psychological theories to explain the phenomenon. Richard Easterlin (1996), for instance, argues that the level of satisfaction an individual derives from his consumption will be relative to his expectations. As a result, when the general consumption level rises, expectations rise along with it, leaving satisfaction constant. More generally, there is an influential current of popular social criticism that blames advertising for the "manufacture of desire." According to this view, advertising creates demand for products by stimulating dissatisfaction, continuously reminding us of what we don't have and the pleasures that we are missing out on.

Competitive Consumption

While there is clearly some truth in the squirrel-wheel hypothesis, there are some aspects of the no-satisfaction puzzle that it seems unable to explain. In particular, there is an unmistakable correlation between income level and experienced happiness *within* every society (Frey and Stutzer 2001, 83). In other words, while the *absolute* income level seems not to be that important beyond a certain point, the *relative* income level remains quite central (Frank 1999, 111-115; also Scitovsky 1992, 134-136). If consumption just generates a further proliferation of desire, it is unclear why such a pattern should obtain.

The most obvious explanation for the relationship between happiness and income level can be referred to as the "neo-Veblenian" analysis. In *The Theory of the Leisure Class*, Thorstein Veblen (1979) observes that goods have both material and "honorific" properties. Consumption of a good not only satisfies a given individual need, but also communicates important information to others about the consumer's status, class, upbringing, taste and aspirations. These messages help to position the consumer within a variety of different social hierarchies. The problem with this second dimension of consumption is that the relevant set of hierarchies has a zero-sum structure. The intrinsic logic of a status, for example, is that for one person to acquire more, another person must have less. Similarly, beauty is entirely relative — when one very beautiful person shows up, everyone else starts to look somewhat less beautiful.

In Veblen's terms, the value of such goods depends upon some aspect of "invidious comparison." As a result, consumption of these goods creates what we would now refer to as a prisoner's dilemma, or a collective action problem, because everyone's consumption generates negative externalities for others. If one person works a bit harder in order to purchase an exotic imported automobile, everyone else's car begins to look somewhat inferior. This may prompt the neighbours to follow suit. Once they are all driving exotic automobiles, this cancels out whatever gain in status may have accrued to the first person who got one. Thus escalating material consumption can easily coincide with an absence of gains in satisfaction, simply because the goods are being purchased primarily for their social properties rather than their intrinsic ones. Under such circumstances, the absolute consumption level will be poorly correlated with welfare, whereas relative consumption will be more determinative, simply because it is relative consumption that determines the position that one is able to achieve in the various social hierarchies.

Robert Frank, perhaps the most influential contemporary neo-Veblenian, has emphasized that individuals need not be superficial or status-obsessed in order to fall into this sort of competitive consumption. The central issue is whether the goods consumed derive some significant fraction of their value from a comparison with others. For example, the adjective "nice" is often used to flag the comparative value of goods. One can go out for dinner to a restaurant, or one can go to a "nice" restaurant; one can buy a simple corkscrew for a friend, or one can buy a "nice" corkscrew, and so on. What makes the good in question "nice" is its superiority to the plain one. Thus wanting to live in a house with nice things implicitly commits one to the logic of competitive consumption, because as others acquire nice things as well, what was once nice becomes increasingly plain.

Frank points out that the concept of a "spacious" home has the same structure. What counts as spacious is very much dependent upon the size of everyone else's home. Extremely rich people in New York city live quite happily in apartments that would seem impossibly cramped by the standards of Palo Alto. These apartments actually feel quite spacious when one is in New York, simply because they are large relative to what other people have. But because of this comparison, the only way to satisfy such a preference is to buy a home that is of above-average size. When everyone does this, the average size creeps upwards. Thus more resources are invested in home construction and maintenance, while the increase in satisfaction associated with the feeling of spaciousness is quickly eroded.

People are often forced to engage in this sort of competition even if they have no desire to surpass others, but simply a desire to keep up. This can be thought of as "defensive consumption." Such consumption generates no welfare gain; it just forestalls a loss induced by negative externalities from other consumers. For example, a candidate for a job may increase his or her chances of success by purchasing a very expensive suit. As a result, the other job candidates may be forced to do the same, even though it does not increase their chances beyond the prior probability — it simply prevents them from falling behind. This process goes on in many different areas (the amount that one must spend in order to purchase a respectable wedding present, to take a date to a nice restaurant, etc.), creating a general tendency for standards of consumption to "ratchet up" over time.

Positional Goods

The neo-Veblenian critique focuses on the social character of certain goods as a source of unproductive competition. There is a closely related strand of discussion in the literature, stemming from the work of Fred Hirsch, that focuses simply on the fact that the supply of some goods is necessarily fixed, and so not subject to expansion with the rest of the economy. Insofar as these goods are coveted, this means that one's access to them will be determined not by one's overall level of wealth, but rather by one's relative ability to pay. Hirsch refers to these as positional goods.

There is significant overlap between this analysis and the neo-Veblenian one. In both cases the supply of a given good is governed by a zero-sum logic, and so consumers can get caught up in unproductive competition when they try to acquire them. In the case of positional goods, however, there is not necessarily an element of comparison involved in their valuation. For example, the amount of waterfront property in a given region is fixed. As a result, one's access to this good is always going to be determined by one's relative level of wealth. Economic growth is, in general, not going to increase any particular individual's chances of acquiring it.

The second major component of Hirsch's analysis is the view that, in our society, the primary differences between the consumption habits of the rich and the poor all involve access to positional goods. In a poor country, absolute deprivation often means that the rich have material goods that the poor do not: food, shelter, clothing, clean water and so on. This makes it possible to narrow the gap between rich and poor through increased production. After a while, however, the poor wind up with approximately the same material goods as the rich. At this point, the only outstanding differences are ones that involve access to positional goods — that is, goods that the rich have access to precisely by virtue of their relative, rather than absolute, level of wealth.

According to Hirsch, this is why economic growth in our society, rather than reducing the frustration of the broad middle classes, has tended to exacerbate it. "What the wealthy have today can no longer be delivered to the rest of us tomorrow, yet as we individually grow richer, this is what we expect" (Hirsch 1976, 67). It is easy to imagine, for instance, the nice house that one could buy with a 10 percent increase in salary. But if this 10 percent increase is achieved through economic growth, one will be in no better position to purchase that house than before, simply because all the people that one is competing against to get the house will have more to spend as well. The fallacy here is one of composition. "To see total economic advance as individual advance writ large is to set up expectations that cannot be fulfilled, ever" (Hirsch 1976, 9).

This affects welfare in several ways. Hirsch argues that the national accounts inevitably generate false expectations because they treat all household purchases as final consumption. Many of the purchases made within the household, though, have a purely instrumental character.

Individuals derive no satisfaction from the good itself; they simply use it to acquire access to some other good that they want. Almost all of the money spent on transportation, for example, has a purely instrumental character. The problem, then, is that as competition for positional goods intensifies, households may be forced to make greater investments in instrumental consumption goods.

As an example, many people move to the suburbs seeking a positional good — easy access to both city and countryside. Because of this, they are forced to make certain investments in transportation. But suburban development is notoriously unstable, since it just encourages the next generation of suburban migrants to "leapfrog" existing developments and build up the nearest countryside. Suppose, then, that in order to retain access to the positional good in question, a family is forced to move to a more outlying district, and thus to purchase a second car. This consumption has a purely instrumental, defensive character, and thus generates no increase in welfare. Yet it shows up as an increase in their wealth.

When we talk about productivity gains and economic growth, what we are really talking about is an expansion of the *material economy*. The process of expansion does not increase the quantity of positional goods available; it increases their relative prices only. Thus, as individuals get richer some goods become easier to acquire while others continue to recede over the horizon. The material goods that they can acquire, however, are subject to diminishing returns in general. Thus the unsatisfied demand for positional goods acquires greater relative urgency. As a result, individuals may even neglect outstanding material needs in order to purchase goods that are instrumental in achieving positional goods, only to find themselves frustrated as others make the same investments.

Thus we have a tendency to greatly overestimate the contribution that further economic growth will make to our quality of life, because we fail to "factor out" all of the positional goods, which economic growth will not make us any more likely to obtain.

WHY NOT PRODUCTIVITY?

These three strains of critical inquiry each identify a mechanism through which consumption can fail to generate satisfaction. Put very crudely, we can imagine consumers engaging in three different types of "non-productive" consumption: compulsive, defensive and instrumental. If all economic growth is absorbed into one or another form — and there is no reason why people cannot engage in all three simultaneously — then a situation can arise in which no increase in satisfaction is observed, either in the aggregate or at the individual level.

However, this does not show that we should not strive to achieve productivity gains. Suppose that we have available to us a more cost-effective industrial process, which allows us to boost output with no increase in either capital stock or labour intensity. Even if we are sceptical about the possibility that an increase in the supply of goods will generate any lasting satisfaction, there is still no reason *not* to implement the improved process. It is a pure efficiency gain, and as such would seem to generate no losers. Similarly, Galbraith's diagnosis of the modern economy as a giant squirrel-wheel does not present a compelling case against increasing production. All it says is that as far as overall satisfaction is concerned, we are standing still when we try to move forward. This may not be such a problem. Perhaps the voyage is more important than the destination.

The case becomes more difficult to make, however, when we talk about dedicating significant resources to the pursuit of increased productivity. There have been calls, for instance, for the government of Canada to make significant investments in research and development in order to further a productivity agenda. There have also been calls for various types of tax reductions, with the same end in view. Of course, if we had nothing else to do with these resources, there would be nothing wrong with funnelling them into such projects. But given that alternative uses are available, we need to consider the possibility that they could be better employed elsewhere. In particular, given that economic growth is not likely to generate much further increase in satisfaction, we must consider the possibility that other forms of investment will be more effective at enhancing the welfare of Canadians.

When it comes to considering what these other uses might be, one way of organizing the conceptual space is to think of the individual as a consumer of a variety of different types of goods. It has become conventional to divide these up into private goods (bought and sold through the market), public goods (provided by the state, paid for through taxation) and club goods (provided collectively within an organization) (Cornes and Sandler 1996).[4] We can then bisect this categorization with the distinction between material goods and positional goods (with "material" as a somewhat crude term for the set of goods whose supply can be expanded). Economic growth essentially tracks increases in the output of material private goods, along with some material club goods.

Now, as Galbraith has pointed out, just as increased consumption of any single good will tend to generate less and less of a gain in satisfaction, the entire set of private material goods will also be subject to diminishing returns. People will satisfy their most important desires first, then move on to less important ones. As a result, we get less "bang for the buck" out of economic growth as the country becomes wealthier. However, because economic growth directly increases only the set of private material goods available, we can easily find ourselves in a situation in which we have satisfied all of our urgent needs for private goods, but in which we still have serious, unresolved needs for goods that private markets fail to supply. But because of unresolved collective-action problems in the non-market sector, we may continue to consume more private goods, even though we would all prefer to spend our money on goods that markets are failing to supply.

Reasonable people may disagree as to whether we currently suffer from an imbalance in private and public spending. Galbraith thought that the United States did, hence his characterization of American society as having a peculiar combination of "private opulence" and "public squalor." Certainly the expressed preference of many Canadians for increased spending on health and education suggests that Canada suffers from such an imbalance. But regardless of where one stands on this empirical question, the analytic framework is important because it shows that in order to make the case for increased productivity, we need to show that this point has not been reached. In other words, the value of a straightforward expansion of the private material economy is not self-evident. Thus when it comes to committing public resources to a "productivity agenda," it is not clear that the money would not be better spent on the direct provision of public goods.

The same analytical framework is quite helpful when we consider the fact that all production and consumption creates externalities, both positive and negative. This is in fact a monumental consideration when we keep in mind that all measures of productivity growth ignore externalities. It is quite possible for the negative externalities associated with a particular production process to completely outweigh the value of the goods produced. There is good reason, for instance, to think that the negative externality associated with the use of leaded fuel represented a much larger total cost to society than the positive economic value associated with improved valve lubrication. Thus to ask whether productivity growth is, in general, a good thing is to propose a cost-benefit analysis that takes into account only some of the costs and benefits. It is of course impossible to provide an assessment of such a proposal without finding out what the missing costs and benefits are.

The problem, of course, with externalities is that their magnitude is very difficult to measure. This is in fact why they remain externalities — if we could quantify them, it would be much easier to internalize them. Thus it is not obvious that one can say anything at a general level about the relative size of these "external" costs and benefits. But in this context again, Galbraith's analysis provides us with some helpful ideas. Analytically, we can divide the problem into two questions: How large are the positive and negative externalities relative to one another?, and How large is the net value of these externalities relative to the economic value of the good?

Positive Versus Negative Externalities. Economists sometimes speak of externalities as if they were an isolated occurrence. This is deeply misleading. Externalities are ubiquitous, a necessary consequence of every production and consumption process. If I enjoy watching the patrons in a café having a drink, then their consumption generates a positive externality. But if they have taken up all the seats, so that I am forced to have my drink standing, then their crowding creates a negative externality for me. Because of this, the set of externalities produced by every good is extremely complex. This would seem to make it difficult to say anything general about their relative level. If most goods generated positive externalities on balance, we would have nothing to worry about. Unfortunately, we have reason to believe that such will not be the case. It is a structural feature of the market that firms have an incentive to "externalize" costs whenever possible, along with an incentive to "internalize" benefits as much as they can. Thus if a regulatory regime remains unchanged, we can expect the balance of positive and negative externalities to shift toward the negative. Firms will find ways to "monetize" portions of the value they create that has traditionally escaped in the form of positive externalities, just as they will find ways to shift costs around in such a way as to displace them onto those who cannot demand financial compensation for the loss.

Value of Externalities Versus Economic Value. Just as we can expect the relative size of negative externalities to grow relative to the positive ones, we can also expect them to grow relative to the economic value of the goods produced. This is again due to the diminished urgency of our need for more private material goods. This means that under a static regulatory regime, it is inevitable that social cost will eventually come to exceed private economic benefit. At this point, the welfare-maximizing course of action is to adopt a zero-growth policy — even though opportunities for expansion of the sphere of private material goods are available. Of course, the regulatory regime is never static, since government does tend to respond to new problems as they arise. The point is more a conceptual one. It is that there is no reason *a priori* to prefer increased growth over increased regulation as a strategy for improving the welfare of Canadians. The case must be made on empirical grounds.

Both of these arguments suggest that focusing on productivity growth may mean ignoring potential Pareto-improvements — and thus would be inefficient in the welfare economist's sense of the term. Thus the argument here is not a disagreement over values. The question is simply whether productivity growth is able to deliver what its own proponents have promised. The first consideration — that there may be an imbalance in the relative satisfaction levels of consumers of private and public goods — suggests that the resources consumed in expanding the private material economy may be misallocated, and hence wasted. The second consideration — which focuses on externalities — suggests that such an expansion may mean not only that certain other opportunities are foregone, but also that the expansion itself may directly generate harms that negate any welfare gains associated with the goods produced. Furthermore, there is no reason why these two considerations may not come into play simultaneously. Thus, the case for increased growth is a lot harder to make than it may initially have seemed.

ALTERNATIVE PRIORITIES

You can't beat something with nothing. So if not productivity growth, what? What other broadly "economic" objective might we establish as a social priority? Here are a few suggestions, in no particular order. It is worth noting that none of these proposals is *necessarily* antagonistic to a policy of increased productivity, although in each case one can easily imagine situations in which the two might conflict. My goal is simply to identify some other policy agendas that would be, in my view, as likely to improve social welfare as a commitment to increased productivity.

Internalize Externalities. We might choose to pursue the ideal of a society in which all externalities are fully internalized. Call it the "pay as you play" society. The goal would simply be to have each individual pay the full cost that his or her choices impose upon others. At the moment, we make only a half-hearted effort in this direction, and we have not dedicated nearly enough creative energy to the task of designing appropriate incentive mechanisms. There is clearly enormous room for improvement, most obviously when it comes to the environment. Even if one does not believe that catastrophic environmental collapse is imminent, the mere risk of inducing such a collapse is difficult to justify when these risks are being run in the service of a growth policy whose welfare gains have become either negligible or non-existent.

Reduce Crowding. One of the most significant structural transformations taking place in Canadian consumption patterns involves the erosion of suburban lifestyles. This is largely caused by intense competition for positional goods. The result has been a significant increase in crowding and congestion, which in turn has generated significant quality dilution of the goods sought. It is this phenomenon that, in my opinion, has generated the widespread feeling of being economically "squeezed" among the middle classes. Part of the problem stems from public complacency on the issue of crowding, simply because Canada has such a low overall population density. But these statistics are very misleading. Canada is currently one of the most highly urbanized societies in the world. Thus crowding is likely to become an increasingly important quality of life issue for many Canadians. Designing and implementing systems to manage access to positional goods therefore has enormous potential welfare benefits.

Increase the Supply of Public Goods. Public opinion surveys of Canadians consistently show a very low level of concern for increased consumption of private goods, combined with a strong desire for increased consumption of public goods, including health, education, communication and even transportation (Bricker and Greenspon 2001). This generates a strong presumption in favour of the hypothesis that there is currently an imbalance between spending on private and on public goods. The root cause of this imbalance is tax resistance — which is rational at the level of the individual citizen and consumer, insofar as it reflects a free-rider incentive, but is often irrational at the level of public policy.

Promote Leisure. Implicit in the discussion of productivity growth is often the assumption that increased productivity should be used to increase economic output. This has certainly been the trend in the past 25 years. However, given the increase in complaints about time pressure and work-family balance, we might consider taking more assertive measures aimed at reducing the workweek. Regulatory intervention, along the lines recently undertaken in France, might be welfare-enhancing.

Increase Security. Studies have shown that unemployment has a serious negative impact on subjective well-being (Frey and Stutzer 2001, 95-102). Furthermore, the risks that individuals face in the marketplace generally, and the labour market in particular, represent a source of disutility that, like leisure, is largely invisible from the standpoint of the national accounts. Policies aimed at reducing labour market volatility could lead to significant welfare gains (even though they might also produce overemployment, and hence reduced productivity).

Again, it is worth stating that none of these objectives is necessarily in tension with productivity growth. For example, if it is true that "work expands to fill the time available for its completion," then legislatively imposed limitations on the workweek could lead to important productivity gains. However, increased leisure could also be promoted through the introduction of a more progressive income tax. It is widely believed that such a tax regime would dampen productivity growth. The choice of how to prioritize the various objectives is therefore political, in the broadest sense of the term. The claim here is simply that a negative impact on productivity growth should by no means be sufficient to take any of the options off the table.

Finally, it should be noted that each of these proposals is motivated by a desire to improve the efficiency of our economic institutions (understood in terms of welfare, not wealth).[5] The underlying intuition is that since economic growth seems to have been generating no payoff in terms of individual satisfaction, any one of these policies seems more likely to improve welfare as a policy of productivity growth. I have not even ventured to consider some of the other values that we might like to promote, beyond mere efficiency. It could easily be argued, for instance, that as a society we have been willing to accept considerable inequality in the distribution of wealth in order to promote economic growth, but now that economic growth has ceased to provide significant social benefits, these outstanding inequalities have become increasingly unjustifiable. Such an argument would be much more controversial than anything advanced here, which is why I have chosen to limit myself to efficiency concerns.

CONCLUSION

Consider the following, surprising fact: the average speed of traffic in the city of London is the same now as it was 100 years ago — 11 miles per hour. How can this situation be improved? In the first half of the 20th century, the solution might have seemed obvious: "faster cars." But can anyone still believe this?

Believing that productivity growth is the key to resolving our problems is essentially the same as believing that faster cars will speed up the traffic in London. If the proposed solution hasn't worked so far, it is not likely to start working any time soon. This doesn't mean that we shouldn't build faster cars, if we have the means and opportunity to do so. Similarly, there is nothing wrong with productivity growth. But we shouldn't delude ourselves into thinking that it is going to accomplish very much.

The commitment to productivity growth becomes somewhat pernicious, however, when we assign it lexical priority, or when we try to maximize it. Furthermore, there is no particular reason to be concerned about our relative productivity levels.[6] After all, what do we lose by falling behind? Unless one misunderstands the logic of comparative advantage in international trade, it is difficult to see where the downside lies. When we talk about the relative "standard of living" of Canadians, it is important to remember that this, for the most part, means relative "consumption of private material goods." Since preferences over this bundle of consumption goods may vary, there is no reason why a decline in relative "standard of living" should entail a decline in relative "quality of life." In fact, if over-investment in the production of private goods in another country stems from unresolved collective action problems in its public sector, there is no reason why our "quality of life" could not increase relative to theirs, even as our relative "standard of living" drops.

Furthermore, it is worth noting that the vast majority of Canadians compete only with other Canadians for positional and status goods. As a result, lower productivity here is unlikely to affect their relative position when it comes to this competition. And in cases where it does, there are often relatively simple legislative remedies available. Thus the welfare of the average Canadian is unlikely to be affected by the superior purchasing power of foreigners. The same cannot be said for the small "international set" of privileged Canadians who fancy purchasing real estate in New York or Paris. For them, slow productivity growth leads to an erosion of their relative position. But it should be recognized that their interests are those of a very small, albeit vocal, minority.

One of the great conceptual revolutions of the 19th century was the discovery that the production and consumption of wealth is not a zero-sum game, and thus that growth can be much more powerful than redistribution when it comes to improving the welfare of the lower and working classes. But with the growth of riches comes a steady erosion of the positive-sum character of our economy. Increasingly, the difference between social classes in our society is not that one class has a lot of stuff and the other does not. More often, they both simply have different *versions* (often, different *brands*) of the same stuff. No increase in general prosperity will ever narrow this gap. As a result, we are now in danger of overestimating the amount that can be achieved through growth, and underestimating the power of redistribution.[7]

NOTES

1 I distinguish a "technical" efficiency concept from a "welfare" efficiency concept, such as the Pareto principle.

2 For an overview of developments, see Wong and Picot (2001).

3 I lump wants and needs together because any distinction between the two relies upon an extremely controversial and problematic normative judgement.

4 Note that I am not using the more restrictive definition of a public good popular among some economists — a good that is "non-rival and non-excludable." I take a good to be public in cases where an underlying market failure makes it more efficient to organize the transactions through taxation. Thus I treat government health insurance as a public good, for example, even though it is easy to exclude individuals from enjoying the benefits.

5 For a more general discussion of this distinction, see Heath (2001).

6 It is also important to note that concern over relative productivity, in an international context in which at least one nation is trying to maximize productivity, implicitly commits one to a policy of maximization.

7 Here I am rephrasing suggestive remarks by Hirsch (1976, 67).

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