The Journal of Socio-Economics 42 (2013) 43–50

Contents lists available at SciVerse ScienceDirect

The Journal of Socio-Economics

journal homepage: www.elsevier.com/locate/soceco

The moral consequences of economic growth: An empirical investigation☆

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ARTICLE INFO

Article history:
Received 29 November 2011
Received in revised form
28 September 2012
Accepted 5 November 2012

JEL classification:
Z1
O1

Keywords:
Growth
Morality
Welfare state
Redistribution
Preferences
Values

ABSTRACT

In *The Moral Consequences of Economic Growth*, Benjamin Friedman argues that growth reduces the strength of interpersonal income comparisons, and thereby tends to increases the desire for pro-social legislation, a position he supports by drawing on the historical records of the US and several Western European countries. We test this hypothesis using a variable from the World Values Survey that measures an individual's taste for government responsibility, which we interpret as a measure of the demand for egalitarian social policy. Our results provide support for a modified version of Friedman's hypothesis. In particular, we find that the taste for government responsibility is positively related to the recent change in the growth rate and negatively related to the change in income inequality. We conclude by discussing the implications of these findings for attempts to further the egalitarian social goals.

1. Introduction

In *The Moral Consequences of Economic Growth*, Benjamin Friedman (2005) weaves together economic, political, intellectual and social histories into a compelling narrative that illustrates the link between economic and social progress. According to Friedman, "Economic growth . . . more often than not fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness and dedication to democracy." (p. 4) Friedman's remarkable book is a challenge both to the common belief that societies face a fundamental trade-off between doing well and doing good and to the consequentialist moral yardsticks of welfare economics, according to which the social good is associated with the unintended impact of self-interested behavior. In Friedman's account, growth produces broad social gains specifically because it alters the psychological balance between envy and altruism, leaving individuals more generous and more solicitous of the wellbeing of others.[1]

Turning first to US history, Friedman finds that periods of economic progress are characterized by the passage of significant legislation aimed at reducing social, economic and political inequality. Thus, the era of rapid industrialization following the Civil War gave rise to the Civil Rights Act of 1875, the boom years of the early twentieth century saw the passage of the Seventeenth and Nineteenth Amendments, and the two decades of prosperity following World War II concluded with a raft of Great Society legislation.[2] In contrast, periods of economic decline are characterized by social retrenchment, such as the reversal of minority voting rights that followed the Panic of 1893 and the reduction in popular support for affirmative action, welfare programs, and liberal immigration policies following the economic turbulence of the 1970s. Friedman observes much the same pattern in the social and economic evolution of Western European states. In England, the economic growth of the early decades of the twentieth century coincides with the "new Liberalism" with its overt concern for the poor and the passage of legislation intended to reduce political and economic

☆ We are grateful to Stephen Schmidt, the editor of this journal, and an anonymous referee for comments on an earlier draft of this paper. Any remaining errors are our own.

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[1] See, for example, Friedman's discussion (p. 79–80) comparing the impact of low unemployment on labor market discrimination with that of economic growth on tolerance and attitudes toward social justice. This notion of morality goes beyond consequentialism and is closely linked to Kant's more demanding criterion that morality cannot be divorced from good intentions.

[2] The Seventeenth and Nineteenth Amendments established the direct election of senators and granted women the franchise. Great Society legislation includes the *Economic Opportunity Act* of 1964, *the Civil Rights Acts* of 1964 and 1968, the *Voting Rights Act* of 1965, and the *Social Security Act* of 1965, which established the Medicare and Medicaid programs.

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http://dx.doi.org/10.1016/j.socec.2012.11.007

inequalities, while in Germany the economic devastation of the interwar years ushered the Nazi Party into power.

Rather than positing a political mechanism at the heart of the relationship between economic and social progress, Friedman identifies a more fundamental link, rooted in the impact of economic progress on individual preferences. Friedman argues that in evaluating their material wellbeing, individuals evaluate their current income level relative to that of their neighbors as well as to their own past income.[3] Moreover, according to Friedman (p. 92) these modes of comparison are substitutes: "By continually giving most people the sense of living better than they or their families have in the not very distant past, sustained economic growth reduces the intensity of their desire to live better than one another."

As might be expected of a work of this depth and scope, Friedman's book has been the subject of significant attention. For example, Stiglitz (2005) cautions that Friedman's analysis should not be understood as a blanket endorsement of any growth promoting policy, while on the political right Wilkinson (2006, p. 201) has questioned what he sees as Friedman's "rather parochial American welfare-statist conception of political morality." However, neither of these reviewers considers the more fundamental question regarding Friedman's hypothesis: Does the link between economic and social progress that Friedman claims to have identified actually exist?

In this regard, Friedman's book is subject to a number of concerns common to works of economic history. One such concern regards the potential for narrative arguments to give disproportionate weight to supportive evidence. For example, the experience of the US in the Great Depression seems to fit Friedman's hypothesis at best awkwardly, and the welfare reforms instituted in the *Personal Responsibility and Work Opportunity Reconciliation Act* of 1996 follow the shocks of the 1970s with a significant lag. A second concern regards the generality of Friedman's claim. While he turns his attention to the developing world in the fourth section of the book, the bulk of Friedman evidence is drawn from the US and Western Europe. Friedman's reliance on the experience of Western industrial countries raises the question of whether the relationships he identifies might be specific to societies at a particular stage of development or, perhaps, to those that share Western cultural or political institutions. We address these concerns by providing empirical evidence regarding the moral consequences of economic growth in a broad sample of countries.

Any empirical evaluation of Friedman's hypothesis faces a significant challenge in deciding on how to measure the dependent variable. An attempt to develop an internationally comparable measure of egalitarian of social policy would face numerous and probably insurmountable measurement issues. Because of this, we focus on the relationship between economic growth and the *taste* for egalitarian social policy, which we measure using survey data regarding attitudes toward government responsibility from the World Values Survey. Thus, our analysis focuses on how growth affects the desire for an egalitarian society, which Friedman identifies as the first link in the causal chain between growth and social progress, and not on the ability to realize it. Focusing on this relationship also allows us to set aside significant issues regarding the manner in which different political systems aggregate policy preferences.

Our analysis reveals strong support for a modified version of Friedman's hypothesis. While the relationship between the rate economic growth and the taste for government responsibility is not significant, we find support for a positive and robust relationship between the taste for government responsibility and the *change* in the growth rate. Thus, the demand for egalitarian social policy appears to be high not when the growth rate is high but when it is rising. A similar result applies to income inequality: the demand for egalitarian social policy is low not when inequality is high in an absolute sense, but when it is high relative to its long run average. Moreover, our estimates suggest that both of these effects are economically large. Using our baseline model, a one-standard deviation increase of the growth rate over its five year average corresponds to a 0.20 standard deviation rise in the taste for government responsibility. Similarly, a one standard deviation increase in the Gini coefficient over its long run average corresponds to a .24 standard deviation fall in the taste for government responsibility.

In addition, our findings do not support concerns that the Friedman hypothesis, in its modified form, is specific to developed countries or to countries with Western cultural roots. In particular, the effects of changes in growth and inequality are robust to the inclusion of controls for a country's regional location and the religious composition of its population. Indeed, our results suggest that changes in the growth rate matter more for policy preferences in developing countries, while changes in inequality matter more in developed countries. As discussed further below, these findings are broadly consonant with the understanding of preference formation that underlies the Easterlin paradox and, if anything, suggest that the modified Friedman hypothesis may apply more to developing than developed countries.

The remainder of this paper is structured as follows. Section 2 considers the relationship of Friedman's hypothesis to the existing literature. Section 3 describes the data set and empirical methodology. Section 4 presents our empirical results, and the final section discusses the implications of our findings.

2. Literature review

Due to the sweeping nature of Friedman's hypothesis, it is related to a number of areas of active economic research. An extensive literature addresses the secular rise of government, a stylized fact known as Wagner' law.[4] An important distinction is that this work relates the rise of the government to the effect of income levels on the taste for redistribution, as in Hughes (1993), whereas in Friedman's account it is the rate of income growth rather than the level of income that matters. Moreover, in attempting to explain the rise of government, much of this work posits a monotonic relationship between economic development and the expansion of government, such as arises due the ratcheting effect in Higgs (1987), and thus, unlike Friedman's hypothesis, it does not provide a systematic explanation for fiscal and social retrenchments that Friedman documents in the US 1890s and 1980s.

A closely related literature, nicely assessed by Alesina et al. (2001), addresses the determinants of the size of the welfare state. This literature finds that the size of the welfare state or the extent of redistribution depends on a variety of factors including the degree of economic openness (Rodrik, 1998), the structure of political institutions (Persson and Tabellini, 2003), the racial and ethnic composition of the population (Alesina et al., 1999, 2003) and cultural beliefs regarding the role of luck in material success (Benabou and Tirole, 2006). Friedman's hypothesis departs from this literature in part because it concerns a broader set of phenomena, addressing non-economic dimensions of social inequality such as the political rights of women and minorities. A second difference is that much of this literature appeals to a political mechanism to

[3] The literature on subjective wellbeing finds support for the existence of both interpersonal and intertemporal income comparisons, which are known as status preferences and habituation. See Clark et al. (2008) for a recent review of this literature.

[4] See Peacock and Scott (2000) for a review of the literature on Wagner's law.