

How Can We Achieve a Socially Sustainable Economy?

Rebuilding Macroeconomics Discovery Meeting

28/11/2017

We originally asked the question, “How can we achieve a sustainably economy?” with two focuses: physical and social sustainability. Both areas of discussion were rich enough to warrant two separate research hubs on each topic. These are the summary notes from the social sustainability half of that meeting; or as it is now called, the “Cooperation Hub.” To view the summary notes from the physical sustainability half, please click [here](#).

This meeting discussed the importance of social cooperation in macroeconomics. This is often neglected, but could have some profound implication for how we think of economic problems. We considered how social cooperation relates to the idea of inclusive growth, group identity and how preferences evolve from the influences of groups, ways of measuring the outcomes of cooperation, and the implications this could have on economic policy.

The Role of Caring Economics

Dennis Snower began by stating that social cooperation is the basis for economic cooperation and that social cooperation occurs within social groups. Social groups are formed and perhaps defined by identities. These groups are the ‘meso’ level in society, between micro and macro. Yet social cooperation and groups are largely absent in the neo-classical school that arose through the 1970s. If we wish to improve our economic understanding, then we need to extend our bands of cooperation.

Assuming individuals have exogenous, unique, temporally stable and internally consistent self-interested preferences blinds us to the possibilities of extending the boundaries of social cooperation by understanding the different motivations which we have. It is standard in Psychology to understand people as being driven by a variety of motivations, including but by no means restricted to the acquisition of resources which is the main feature of economic models. The promotion of the well-being of others, status-seeking, anger, and hostility, are all featured in economic decision-making: so if we divide our motivations into the three areas of competitive, cooperative and selfish, which have very different externalities, then we get a totally different understanding of what macroeconomics is meant to do. By looking at endogenous preference formation and how the economy engages with this process, very different perspectives can be taken. We get a very different understanding of the implications of technological progress.

The division between macro and micro and the exclusion of social groups is unhelpful. The inclusion and understanding of the mechanics of social groups and the fostering of cooperative relationships between social groups is a matter of importance within macroeconomics. By taking on the idea of social cooperation, we can extend our economic analysis to consider: which beneficial ‘trades’ are

not made (perhaps between hostile tribes) because contracts are incomplete and so the terms cannot be fully specified, the under-provision of public goods and even cooperative economic policy measures. Social co-operation can also help to overcome all sorts of information asymmetry problems.

Providing an appropriate forum within which social groups can interact and engage can have huge implications. Social network homogeneity is correlated with political intolerance and social fragmentation. There are issues of polarisation between different communities which can lead to residential segregation. Arguably, social groups can be much wider now than in the past. These are all endogenously generated issues which have huge implications for macroeconomics. If we are going to take on board these endogenous factors then we need to redefine our measures of "success." Ultimately, success is context dependent.

The role of human capital in the new digital age will depend very much on social competencies rather than mechanical skills. These will be influenced by social groups. Training and preparation is an important issue for society. It is possible that technology progress reduces overall well-being. The relation between inequality and growth depends critically on the social relations which we have with each other. Also, to what extent does influencing our social contexts influence macroeconomic outcomes? Our preferences induce us to act in ways that affect and determine our confidence in the financial system. The credit multiplier depends on such motives. Social fragmentation can lead, via the political process, to effects on fiscal policies.

The nature of power relationships between social groups was suggested could exert a strong influence on the approach being taken by Dennis and his colleagues. Groups may sacrifice concepts of the "greater good" in order to maintain their power. Dennis agreed that the power motive is important, but that it depends on social contexts and that these are not fixed and exogenous. The channelling of power motives towards the public good is an important research area.

Studying social cooperation and groups partly falls within the domain of psychology. There are thus issues as to how psychology can be implemented into a revised conception of macroeconomics. Scaling up individual motivations to the level of groups is not a straightforward process, and thought needs to be given to the required outcomes. Interaction with psychologists and neuroscientists is important to map people's multi-directiveness, which is context dependent. Work is also being carried out on the nature of group dynamics; it will be a question of bringing in macroeconomic issues.

There is always the challenge of how far quantification was possible in this area. Quantification is increasingly possible, and that problems of group calibration are being addressed via concepts developed in physics. He said that it was necessary to be clear about what can be changed and what cannot. Social cooperation could go anywhere, but the question of what is socially sustainable is important. The social dimension to political and economic policy issues is essential.

To what extent does this approach suggest the meanings people attribute to things, and the beliefs they hold, are causative? People are bombarded by many sensations, most of which are ignored. The remainder are put together into narratives which include motivational inputs. These narratives have enabled humans to co-operate in very large groups. These narratives also filter our perceptions, resulting in echo chambers, and the establishment of norms. But is the right object of study should then be the narratives, rather than the motivations and their neuro-chemical bases? The issue is not

necessarily about narratives and motivations, but should be focused on the reflexive interaction between the two. There is a micro foundation for macro, but also a macro foundation for micro. This is because these social norms and values feed back into individual behaviours.

How do we manage the “tragedy of commons” in a time, and planetary boundaries context? Is the social context a critical area for understanding this because it relates to many aspects of the social management of resources? There are physical scientists who are indeed looking at these social science issues. Shaping contexts in order to shape preferences is something that macroeconomics has ignored, and should now consider.

Jesse Norman’s speech at the RM launch event about the purposes of economics, mentioned the provision of work. An understanding of sustainability would depend upon an appreciation of the narratives and beliefs relating to interpretations of the role of economics.

Does “caring Economics” need to be reconsidered within macroeconomics? The dynamic between power, inequality and economic structure was central to Piketty’s argument about a rise in inequality being attributable to a decline in the growth rate. Although, it was argued this reasoning was flawed in its assumptions over the ease with which labour can be replaced by capital, but these kinds of power relations are central to macroeconomics.

There is always the difficulty of making the subject quantitative. Should it be possible to work out quantitatively how much it would cost to change people’s perceptions and thus how expensive it would be to implement a policy? However, it was also argued that shaping people’s perceptions was not and should not be a policy objective. Instead, looking at dysfunctional societies or failed states, it should be possible to establish common agreement that trust and progress is better. The question is then how to reach that superior level. The shaping of political context should not be left entirely to business, but should be based on incentives to reform social norms, such as in the example of recycling.

Angus Armstrong noted that in the financial world, trust is exercised to the extent that it is commercially worthwhile; which is a very different approach to that taken in medicine, where trust is an existential requirement, and is enshrined in professional practice. A different narrative is thus created. The narratives with finance, economics and regulation are much worse. The same is true about the private and public sector aspects of the economy. Is it the role of the public sector to influence private preferences e.g. the BBC. Can we model the public sector like this in a DSGE framework? It might be possible to move these more trustworthy narratives into economics.

One way of looking at what a macroeconomic model needs to deal with is by a starting with a definition of success that allows us to include multiple objectives, including well-being. With that definition, it is possible to make progress in measuring the impacts of government policy; and to look at what it would for the reporting of these kinds of effects. On that basis, macroeconomic policy could be extended beyond financial benefits to include kinds of social motivations and positive externalities which currently tend to get crowded out. The role of narratives could also be included in terms of helping to explain actions; and this would all be included in the realm of macroeconomic policy. This would put us in a “loop” which would help macroeconomic policy that would lead to more fulfilling lives. This would need to be formatted in a way that would help central bankers. One way of doing this would be to move from using a unique set of preferences in macroeconomic models, to using multiple context-dependent preferences, for which contexts can be identified in

terms of strategic complementarities and substitutions among agents, which would be reasonably simple. This would give a loop in which preferences and contexts would determine one another.

What Psychological Insights Can We Bring to the Economic Treatment of 'Desires' Within the Context of Sustainability Issues?

Dan Nixon began by noting that a mainstream economic lens leads to a narrow notion of what success looks like, in terms of metrics like GDP per capita. There is a large well-being literature that questions whether, across time, increasing income leads to overall increases in happiness, such as the Easterlin Paradox. Perhaps people consume continuously more because of habits, conformance to social norms, or over-estimating the contentment that can be derived from consuming.

All of this raises the question of how far psychological insights feature in macroeconomic discussions. We know the very significant contribution that has been made in behavioural economics to the picture of homo economicus that we typically start with. But behavioural economics still largely focuses on *exogenous* desires. Is that right? Are there inputs that might be made into the macroeconomic discussion by other approaches, e.g. in positive psychology, that look at desire formation and mind-sets? Research suggests that people who have consumerist mind-sets, which look like conventional views of economic man, report *lower* levels of subjective wellbeing. Alternative mind-sets and attitudes can be cultivated. If there is evidence that consumeristic attitudes are not necessarily in the long-term interests of individuals, there is a question of whether efforts should be made to develop alternative metrics of success. If so, whether such motivational and attitudinal dimensions can or should be included in macroeconomic models.

Consumption may depend on habits, on conformance to social norms, or on over-estimating the contentment that can be derived from consuming. Research suggests that people who have consumerist mind sets, which look like conventional views of economic man, report lower levels of subjective wellbeing. Do outcomes really match our prior expectations? Alternative mind sets and attitudes can be cultivated. If there is evidence that consumeristic attitudes are not necessarily in the long-term interests of individuals, there is a question of whether efforts should be made to develop alternative metrics of success. If so, whether such motivational and attitudinal dimensions can or should be included in macroeconomic models.

Reference was made to the earlier discussion of power, and questioned as to whether persuading people to be less materialistically focused could actually be seen as a form of control, and of diverting attention from social differentials in wealth. He also raised the idea of 'norms' as a method of coordinating around the selection of competitive equilibria. Important economic interactions are mostly repeated thus bringing into play the Folk Theorem. By using narratives in this way, we bring into play multiple equilibria and a huge number of degrees of freedom in terms of selecting outcomes. But, it is important not to impose characterisations on certain groups in society, given that there is considerable variation present in all such groupings.

It is difficult to radically change human perceptions and behaviour. One of the major challenges to macroeconomics is to understand properly what has been learned from behaviouralism, given that past models have been based largely on rationality. Economists will agree that modifications need to be made to deal with deviations from rationality, but quantitative methods have had limited success in incorporating factors beyond rational expectations.

The capacity now exists to integrate different understandings of this question into models, though this shift has not as yet taken place to any great extent. We have economic structures which incentivise and reward high levels of consumption, but that these may not be socially optimal.

Are there broader ranges under the headings of 'exogenous' and 'endogenous' than has been conventionally assumed by macroeconomic models? For example, the nature of preferences as being fixed, revealed in markets, and social in nature; and that macroeconomics has actually *endogenised* a very circumscribed view of human behaviour into its models, without sufficiently varying them. If variation is allowed, a degree of endogeneity can be achieved. Importantly, this does *not* require embedding a fully articulated psychological theory into the model – it just requires allowing heterogeneity across individuals by introducing (and varying) certain key parameters that represent certain psychological features or traits.

In a market economy, the information available is oriented towards consumption. In the digital age, market power tends to accumulate in basically monopolistic companies, who are willing to give out free products, such as apps, in return for information about customers. This free exchange of items starts to restrict how well economic models can work. Anthropology might provide a source of evidence as to how social groups can and do learn to live and work together.

Where there are multiple possible equilibria, an understanding of the micro foundations of macroeconomics, and the associated psychological and behavioural influences, is increasingly essential in order to make macroeconomics a useful, predictive science.

If we think in terms of macro modelling frameworks such as DSGE models, by endogenising a new variable such as desires, we need to explain the drivers for that variable. And if this is done by the private sector (as currently e.g. advertising) then it emerges this may well not deliver a socially optimal outcome, hence the case for policymakers to consider the tools available to improve welfare.