



A Call Against Complacency

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Pick up a dictionary. And look up the word **incentivise**. You're likely to find a definition that reads something like this: “to provide [someone] with a good reason for wanting to do something.”

Many will agree that a system of incentives is, and has been, the backbone in the success of the capitalist economic system—that, over the centuries, a network of incentives has driven innovation, which in turn has encouraged the inventiveness that has led to the unparalleled generation of ideas, goods, and services across America and the industrialised West. Be they the inventions of yesteryear such as the steam engine, or modern day Google, incentives have made way for the ingenuity and advances that have transformed the manner in which people all over the world eat, communicate, transact, and travel today.

To some, the nature of the incentive is the prospect of garnering more money, while to others it is the possibility of solving some of the world's more intractable problems (such as poverty or environmental concerns), but whatever the case, a culture of incentives has been the engine that has powered industrialisation and economic growth. And thus it is a policy environment of positive incentives that separates and defines the most economically successful economies from those that perennially seem to be caught in a cycle of economic poverty and despair.

Indeed, the ability of policymakers to create an economic, political, social and physical environment that fosters positive incentives is critical for economic success and the achievement of better living standards around the world. It is, arguably, this point upon which the most successful economic upstarts today—such as China, India and Brazil—seem to have cottoned on.

Yet, given the evidence and importance of positive incentives, why over the past 50 years have policymakers embarked on a systematic and deliberate strategy of putting in place a catalogue of policies that disincentivise citizens from acting in a manner that could be beneficial to their economies, and to the world at large?

For an example of what I'm talking about, let's take the policy of sending aid to Africa.

No country anywhere, in the world today or in history, has achieved sustained economic growth or meaningfully reduced poverty by relying on aid to the extent that many African governments rely on aid today. Yet, despite the logic and evidence to the contrary, over the past 50 years around US\$1 trillion of aid (that is, roughly US\$100 for every man, woman and child on the planet) has been transferred from Western governments and institutions to African countries with unsurprisingly appalling results. During a period where Africa has increasingly become dependent on foreign largesse and aid, her growth has stalled and the proportion of her population that lives an impoverished existence has risen.

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For example, in the 1970's roughly 10 per cent of Africa's population lived on less than US\$1 a day, by 1998 close to 70 per cent live on less than a dollar a day. Amongst other statistics, it is this atrocious record that has lead Paul Collier, the economist and bestselling author of *The Bottom Billion*, to caution that Africa is "shearing off" from the rest of the world; that whereas, across the world, countries were posting significant economic growth and meaningfully reducing poverty, Africa was heading in the opposite direction. The good intention here is that we want to help Africa succeed, but the outcome is the worsening of economic and poverty statistics. Worse still, a culture of aid has meant that African officials are able to abdicate the responsibilities of delivering public goods—such as healthcare, education, infrastructure and national security—as international (aid) agencies offer to do their work for them. This leads African governments to (very rationally) court and cater to international donors, with little cares or accountability to their own people.

Unfortunately, unintended consequences are not only the domain of poor countries and the development aid agenda. Over the past 50 years, good intentions with bad economic consequences have also been the hallmark of policymaking in the West. In particular, a catalogue of policy errors have led to a systematic erosion of the three key ingredients—**capital, labor and productivity**—that drive economic growth, placing the most industrialised Western economies on a perilous path of economic decline. Guided by this three-point framework, a snapshot of the most developed economies is suitably revealing.

With regards to **capital**, for example, in the aftermath of the financial crisis, the world's leading economies (the US, UK and those across Europe) remain characterized by large debt burdens that are converging upon (and even surpassing) 100 per cent of GDP. Meanwhile, fiscal deficits that many fear are unsustainable hover at around 10 per cent of GDP. Worse still is the fact that institutions like the IMF project that the indebtedness of many industrialized economies is set to rise, and there is a respectable literature on how such degrees of indebtedness could act as a drag on economic growth in the foreseeable future.

Then there is **labor**. Many people will be familiar with the demographic shifts that are changing the make-up of the most industrialized economies. For example, forecasters estimate that between 2010 and 2050, the number of people 65 years old or older across the industrialised West will increase by 250 per cent, leaving a much smaller proportion of young people to work. Naturally, another artefact of this demographic trend is significantly rising pension and healthcare costs.

Already, it is estimated that between 2010 and 2050 there will be a 164 per cent increase in people with diabetes, with the largest increase in Type II diabetes. And as if that were not enough, over the next five years, 60 per cent of the existing cohort of diabetes sufferers across developed economies will have more than one long-term condition, including (but not limited to) chronic heart disease, chest maladies, muscular ailments, vascular problems or neurological complications.

The US will not be spared, with estimates from the US Alzheimer's Association suggesting that over the same period, the associated costs of Alzheimer's could top US\$1 trillion (roughly 7 per cent of the country's GDP in today's terms for just that one disease).

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Finally, there is the matter of **productivity**, which economists believe explains at least 60 per cent of why one country grows while another does not. Although there are divergent trends within industrialized economies, the broader medium to long-term outlook for productivity gains do not bode well for their future economic success. The Bureau of Labour Statistics shows that US productivity across most economic sectors has remained on a steady path of growth over the last decades, whereas in the decade leading up to 2010 nearly all economic areas in the UK showed a decline in productivity, including in many key sectors. Where productivity is concerned, the more fundamental problem for the West is this: if nothing else changes, there is a real risk that developed economies will see productivity declines, particularly in the key innovation and technological sectors. Already, the Organisation for Economic Co-operation and Development's (a club of the world's wealthiest countries) PISA (Programme for International Student Assessment) rankings show that students across the West (and in the US and UK, in particular) are lagging behind their emerging market peers in mathematics and sciences, the very subjects needed for the West to remain competitive in the economically important technological and R&D sectors.

So where, in the US, are the unintended consequences—the good intentions that have yielded the bad economic outcomes? Nowhere have the consequences of good policy intentions yielding bad outcomes been so stark as when the west's own policies have undermined western competitiveness.

To be sure, the intent of globalization—the free movement of trade, capital and even to a good extent, labor—is laudable. It promised to “lift all boats,” not only by granting many hundreds of millions of people access to Western goods, services and know-how, but it would also raise the wages of Westerners as they supplied the world with much more of their output. All this made sense in theory, but the practical results are another matter entirely.

It is true that global income inequality has narrowed and, thus, improved with many more people in “emerging markets” seeing dramatic improvements to their incomes and livelihoods, and converging to Western living standards. However, the economic benefits expected across the West have not been borne out. In particular, not only have real wages across Western economies remained largely flat over the last few decades, but University of Chicago economists find that for many Western economies GDP growth rates in pre and post liberalization in the 1980’s, were pretty much identical. In the comparison of average growth rates in the US between 1950 and 1980, and 1980 and 2007, for example, they find that the average growth rate across both periods was identical at 2.1 percent.

How can this be?

Well, for one thing, many westerners, and Americans in particular, simply missed out on the globalization trade. Individuals chose to invest their household wealth domestically and specifically in their houses, rather than opting to invest in emerging market portfolios and thus capitalizing on and garnering benefits from their rapid growth.

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A confluence of factors made housing investments look much more attractive than other investments. For one thing, the growing population of baby boomers meant there were natural buyers in the market placing upward prices on real estate, and making housing investments look much more alluring.

But beyond this, and herein lie the policy errors, the US government driven by the “Housing for All” policy, kept interest rates artificially low and provided a system of inducements that would make housing (artificially) look more attractive. These inducements in the form of subsidised mortgages (think Fannie Mae and Freddie Mac) and guarantees led the good intention (housing for all) to yield bad economic outcomes as millions of Americans have been left encumbered with debts, unimproved wages and income, and ultimately unemployment. More generally, the evidence indicates that income inequality has worsened as the top 1 percent (largely the owners of capital) have seen their wealth increase three-fold, while that of the bottom third (largely owners of labor) have seen only a 10 percent increase.

The problems around capital, labor and productivity that the West faces today are essentially a manifestation of the very rational obsession of Western policymakers with dealing with the short-term, politically expedient problems, and ignoring more long-term structural problems such as education, infrastructure and looming resource (arable land, water, energy and mineral) demand versus supply imbalances.

We all know the problems, but where are the aggressive policies to ensure, for example, that Western economies do not falter under the weight of the looming healthcare crisis it will face over the next few decades? Or the global discourse on how we will distribute energy (without conflict) in 2050 when there are 9 billion people on the planet? The history of the Apollo program, its personalities, its spirit of adventure, provides a contrast. Putting a man on the moon remains one of the most celebrated moments in American (and world) history, and rightly so. But it is also the supreme example of the confluence of capital, labor and technology, each at the height of

its powers and all of them working as one. America had the capital, it had the labor, and, ultimately, it had the technology.

To be sure, short-term management of debts and deficits matter enormously in planning for future sustained economic prosperity. And, of course, there has been tacit acknowledgement of the multitude of risks that America faces over the longer horizon.

However, Western economies seem now to have a fundamental weakness: that attempts to remedy its economic malaise tend to focus on short-term tactical problems, with relatively little policymaking devoted to longer-term, structural considerations. So, against this backdrop, how can the West win? It is, after all, in the interest of the entire global community that the West get its economic situation right.

Clearly, these economies must remain globally competitive and, to achieve this, devote a significant amount of political capital and economic resources to addressing the seemingly more intractable structural constraints. These are the perennially niggling policy questions that politicians prefer to kick into the future, and leave for the next policy maker in line, such as education, infrastructure and resources. But if there is to be a real chance for a sustained economic turnaround for the industrialised West, these structural constraints must take precedence on already crowded policy agendas.

The very construct of Western society, where the rights, choices and freedoms of the individual are sacrosanct and take precedence over the society overall, means that government solutions to structural problems must necessarily embed some form of incentives. That is to say, successful policymaking must induce individuals to make the (right) choices that will encourage them to pursue capital, labor and productivity choices that will benefit the whole economy over the long-term.

Of course, taxes to deter behavior should, in theory, also work, but for the most part taxes are seen as impinging on people individual freedoms. Countries like Mexico and Brazil (as well as trials being undertaken by Mayor Bloomberg in New York) are experimenting with incentive-driven policy

strategies. These conditional transfers, as they are termed, pay, reward and even subsidise individuals to “do the right thing.”

For example, citizens are “rewarded” in cash for everything from children meeting school attendance thresholds, to receiving immunizations. In the context of the Western economies, for example, this would look like special payments made to people who choose to study mathematics or the sciences, or simply meet certain health related targets in reducing cholesterol (noting that the increase in Type II diabetes is primarily linked to lifestyle factors such as obesity and food intake).

Of course, if skewed political incentives are at the heart of the problem, then stripping out politics from the myriad of political decisions is also a good way to go. Quite clearly, an artefact of the current democratic system with regular elections is that politicians and policymakers are rewarded (by votes) for focusing on short-term issues, and hence very rationally do so. In order to make democratic politics and politicians work more efficiently, therefore, political incentives to attain and retain office at the expense of better economic policymaking must be kept at bay. Put another way, the ability for shorter-term political motivations to cloud policymakers judgement must be minimised and, ideally, stripped out completely.

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This is not a call to become anti-democratic, or autocratic, as there is room to make the democratic system itself better. One example of this would be to extend the terms over which a policymaker, once elected, can hold office. For example, if the President could hold one eight-year term, rather than regularly (once every two years facing some form of election, be it midterms or a Presidential election) there would arguably be much more room for the incumbent to focus on more structural issues, and hence be much less beholden to the myopia that comes with regular electoral cycles.

The notion that the state should pay people to do the things that they should do anyway will, no doubt, seem radical or even unfair to some. And the idea that we should overhaul a democratic system of government that has seemingly worked over centuries may seem draconian. But the bottom line is this: without actively re-skilling the population and meaningfully re-directing capital towards constructive investment rather than parasitic consumption, the West is on a perilous path of long-term economic decline.

The incentives currently in place focus attention on the short-term and call for political expediency instead of economic expertise. A way can, and must be found to concentrate capital, labor and productivity on longer-term goals instead of settling for short-term relief. It is that formula that put a man on the moon, **and it is with that formula that we can combat complacency.** 🇺🇸



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Dambisa Moyo is an international economist who comments on the macroeconomy and global affairs. She is the author of the New York Times Bestseller *Dead Aid: Why Aid is Not Working and How there is a Better Way for Africa*. In 2009 Ms. Moyo was named by *TIME* magazine as one of the “100 Most Influential People in the World,” and was nominated to the World Economic Forum’s Young Global Leaders Forum. Her writing regularly appears in economic and finance-related publications such as the *Financial Times*, *The Economist* and *The Wall Street Journal*. Her latest book is *How the West Was Lost: Fifty Years in Economic Folly—and the Stark Choices Ahead* (Published by Allen Lane in the UK, and Farrar, Straus and Giroux in the US). See dambisamoyo.com for more information.

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