

## **Edmund Phelps: Mass flourishing: how grassroots innovation created jobs, challenge, and change**

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**Rosolino Candela**

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James Buchanan argued that the role of the political economist is to “stress the technical economic principles that one must understand in order to assess alternative arrangements for promoting peaceful cooperation and productive specialization among free men. Yet political economists go further and frankly try to bring out into the open the philosophical issues that necessarily underlie all discussions of the appropriate functions of government and all proposed economic policy measures” (1958, p. 5). Although Buchanan is never mentioned in *Mass Flourishing*, Edmund Phelps, a Nobel laureate in economics, embraces this role of the political economist in analyzing the positive and normative implications of modern economic growth that began in the West during the early nineteenth century.

From a standpoint of positive political economy, Phelps argues that an institutional framework that protects private property rights, enforces contracts, and upholds the rule of law is a necessary condition for the emergence of the informal norms and values, such as creativity, risk-taking, and innovation, that drive economic growth. Normatively speaking, he states that the “good” economy is one that provides the institutional conditions that protect the possibility for human flourishing among individuals (p. 288). Employing an Aristotelian notion of human flourishing, Phelps recognizes universality in human nature that “includes—at the highest level—a desire to express creativity, a relish for challenge, an enjoyment of problem solving, a delight in novelty, and the restless need to explore and to tinker. The pursuit and experience of these ‘highest goods’ is the way to human fulfillment—and to ‘becoming,’ which is a large part of it.” (p. 297). What justifies such institutions as private property, freedom of contract, and the rule of law is not merely the wealth created by exhausting the gains from trade and innovation, but the fact that such wealth creation also allows individuals to pursue their highest end, which is human flourishing.

Much like what Buchanan stressed throughout his research in public choice and constitutional political economy, Phelps’s argument recognizes the distinction between two levels of analysis: (i) the examination of the rules of the game, and (ii) the examination of

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R. Candela (✉)

Department of Economics, George Mason University, MSN 3G4, Fairfax, VA 22030, USA  
e-mail: rcandela@masonlive.gmu.edu

the play within those rules. Moreover, Phelps understands that fundamental reform of the modern economy, which he argues has declined since the late 1960s, must be conducted not on the level of policymaking that regulates market outcomes, but on the constitutional level of politics, or the “rules of the game”, from which market outcomes emerge.

*Mass Flourishing* explains the nature and emergence of modern economic growth and its implications for modern life. According to Phelps, the unprecedented gains in labor productivity and innovation beginning in nineteenth century England cannot be attributed to proximate causes of growth, such as the expansion of international trade, the accumulation of physical capital, or utilizing economies of scale, all of which by themselves exhibit diminishing returns to scale. Rather, the fundamental cause of modern economic growth are institutions, such as private property, contracts, and the rule of law. The consolidation of such institutions that protected economic freedom in eighteenth century England incentivized specialization and an increasing division of labor and exchange. However, the fundamental importance of economic growth that Phelps wishes to express throughout the book is that “an increased general level of wages is liberating: it enables persons confined to the lower reaches of the available wages—unskilled workers, in the usual terminology—to move from work they previously could not afford to reject work that is more desirable” (p. 47).

The crucial link between such institutions and such unprecedented economic growth lies with increasing returns to the division of knowledge embodied in the entrepreneurial market process. Not only are markets discovery procedures in terms of (re)allocating resources, but they are also procedures of self-discovery. According to Phelps, “The individuals’ freedoms to act (or not to act) on their unique knowledge, judgment, and intuition may be indispensable to people’s sense of self-sufficiency and self-worth. In this sense, the freedom to take charge of one’s own heading and make one’s own mistakes is a primary good itself, one of huge importance” (p. 59). Therefore, the fundamental basis of modern economic growth is not only the institutional conditions that foster economic freedom, but also the emergence of informal norms that encourage human flourishing, or the full realization of one’s potential. The modern economy is a “vast imaginarium, a virtual laboratory in which to dream up and try out new ideas” (p. 193) that are both lucrative and morally rewarding.

The economic and moral fruits that were generated by economic freedom of the nineteenth century were followed by a backlash against individualist values and the lure of socialism in the twentieth century. Socialism and corporatism promised to substitute “concerted action” and “social protection” (p. 140) for the uncoordinated anarchy and alienation of capitalism. As Phelps argues, however, the legacy of the corporatist welfare state has been to diminish both innovation and human flourishing while *reducing* employment and job satisfaction. Therefore, “relatively modern-capitalist economies are *more* rewarding in nonmaterial terms than the relatively corporatist or socialist economies” (p. 193, italics original).

According to Phelps, however, the most harmful consequence of the growth of leviathan has been the erosion of those institutions that have encouraged innovation, namely private property, and the commercial values, such as trust, creativity, and risk-taking, that it has encouraged. Unlike most other accounts of the productivity slowdown of the 1970s, Phelps “sees evidence to suggest that the handful of modern-capitalist economies *have been weakened by flaws in their institutional-cultural operating system and further weakened by political reactions*” (p. 240, italics original). Such political reactions have resulted in a post-1960s decline of the West characterized by increasing business regulation, rent-

seeking, and transfer payments. The overall result of such policies have been to shift the relative payoffs of entrepreneurship into unproductive activities. As Phelps notes:

The problem is that subsidies redirect the economy's innovation toward politicians, who lack deep specialized knowledge, and away from the private sphere, where judgments are made by idea men, entrepreneurs, financiers, and market people who consider whether there are not better initiatives to think about or develop (p. 255).

The logic of concentrating benefits and dispersing costs among politicians and rational ignorance among voters has promoted “the explosion of corporate welfare, self-serving regulations and deregulations, and a sea of social insurance” based on the “eagerness on the part of government officials and legislators to protect vested interest and to cater to special interests in return for electoral support and financial support” (p. 267). Without constitutional reform of the rules proscribing the procedures of government, government policies attempting to revive innovation and economic growth will be susceptible to new loopholes, subsidies, and other rent-seeking activities. Only by changing the rules of the game will there be policy outcomes that are conducive to individual liberty and a commercial culture that fosters economic growth.

*Mass Flourishing* is an inquiry into the nature, causes, and moral consequences of modern economic growth, drawing on the omnipresent entrepreneurial motives of individuals and their manifestation under alternative institutional arrangements. It applies many important aspects of Virginia political economy, making a contribution to understanding not only the positive, but also the normative implications of the rules of the game. As the opening quote by Buchanan suggested, Phelps has embraced the task of the political economist in assessing that economic freedom not only enables peaceful cooperation through mutually beneficial exchange, but that such institutions are “good” if, and only if, they reflect the ethical preference of individuals, namely the freedom to be entrepreneurial and pursue their own human flourishing. Moreover, its message has important ramifications for public policy. If we are to learn anything from Phelps fascinating new book, it is that demand-side or supply-side strategies to reforming the modern economy and reinvigorating innovation will prove futile. Rather, reforms must focus on changing the rules of the game which generate the incentives through which innovation endogenously emerges. If we are to regain the modern economy, based on economic freedom, innovation, and human flourishing, it will require us to “rehabilitate *modern capitalism* by clearing away blocks to its dynamism both in society's values and in its institutions” (p. 240, italics original).

## References

- Buchanan, J. M. (1958). The Thomas Jefferson Center for studies in political economy. *The University of Virginia News Letter*, 35(2), 5–9.