The Economy of Services

Keith Rankin, 15 September 2015

I wrote last week about how just about everyone – even economists who should know better – regard the economy as a production system. We imagine a whole bunch of goods that are produced and then, through their sale, turned into money. Thus, in this view, the economy is all about making stuff in order to make money. The more stuff we make the better. And the more people work (both more people and more work), then the more stuff, then the more money. Further, if we can increase the amount of stuff made per unit of work effort (productivity), then we can make even more stuff and therefore even more money.

The obvious critiques lies around whether we really can (or indeed want to) buy so much stuff; and that many resources used to make as much stuff as we can now will be depleted for future making-of-stuff. The make-as-much-stuff-as-quick-as-we-can ethos represents both waste and intergenerational theft. Picking the low-hanging fruit as fast as we can today is not conducive to making high amounts of stuff tomorrow.

As all economists know in their heart-of-hearts, 'the economy' is a welfare system; a balance between 'goods' and 'bads', between benefits and costs. Labour (work) is the principal human cost, so, like all costs, should be minimised not maximised. While we say that economic benefits are 'goods and services' (and indeed both goods and services are sold for money), the final 'consumable' benefits of 'the economy' are entirely services.

So food (which we buy) give three types of service: calories for energy, nutrients for health, and flavour for pleasure. Computers give us services directly – eg computation, word-processing and filing – and give us access to other services, via the internet. Goods are valued for the services they confer upon us. We get other services directly from the market, such as theatre performances. And we also get environmental services from nature. Thus conserved forests gives us many services (eg habitat, hydration, anti-erosion, shade), just as harvested trees (as construction materials) may give us shelter (a service) and (as paper) literacy services.

Clothing gives us multiple services: warmth, modesty, protection, identity and vanity. One very rich person might spend 100 times as much on clothes as another person, but only draw say twice as much service in total from their clothes. In that case, the value of clothing services per dollar spent on clothes would be fifty times higher for the poorer person than for the rich person. Thus the economic welfare arising from the poorer person's clothing will be much greater than that arising from the richer person's clothing. For every dollar of cost incurred in making those poorer person's clothes, the benefit (in clothing services) is fifty times greater.

When economic benefits are properly understood as services, it becomes very clear that, in any highly unequal society, reduced inequality in itself dramatically increases the amount of services enjoyed, and hence the economic welfare of the society. Clothing that remains in the wardrobe gives minimal service. Service output is more dependent on the use we make of what we buy than it is on the amount of dollars we spend on our purchases.

Does that mean that perfect equality gives the maximum welfare? No. Some people should enjoy more services than others.

Some people sacrifice more; they work harder, or do more unpleasant work, or do more difficult work, or do work with greater consequences if it is not done well. They deserve to enjoy more services. Others may have a greater capacity for constructive happiness, for example through literacy and higher education. A 'cultured' person will generally have more capacity than others to benefit from cultural services. A person trained in 'kapa haka' – for example – will have more capacity to benefit from related cultural services than a person not so trained. So an equal distribution of services will not mean a maximisation of welfare.

Inequality confers other benefits. People with higher incomes are best placed to try out new services first, when those services are expensive. Inequality creates markets for new services which, if any good, may become services eventually accessible to most people. Whether we are refe rring to cycling, driving, or making calls from 'brick' cellular phones, the rich enjoyed them first. If they had not done so, they would not have got cheaper and better. They would not have become mass consumption activities if the rich hadn't purchased the means to these services first.

Marginal utility diminishes, however. Some rich people may have 10 cars, but don't get to spend much time in any of them. The extra enjoyment gained by the tenth car is quite small. Thus, already sated with pleasure from the services available to them, people of comfortable means may defer extra consumption. Instead they save now with the intention of buying more service-conferring goods later. Or they insure against future loss of service, through precautionary saving. These people tend to die with thousands or millions of dollars of unspent purchasing capacity. Others must enjoy today the services these savers have foregone, albeit as debt. It is appropriate that debtors, who gain more services earlier, should incur more costs (such as work) later.

Happiness (utility) includes some risk-taking, meeting challenges; enjoyment is not all comfort and pleasure. An economy that maximises welfare must always ensure ample opportunities for accessing adventuring services.

Some people – rich or poor – may gain pleasure from the unhappiness of others; for example, they may enjoy prime real estate knowing that they have excluded others from that land. This is happiness arising from positional services. The improved position of one person – with a good solicitor or tax accountant – is countered by the worsening position of one or more others. When one person gets ahead, another gets behind. While possibilities for upwards social mobility (success?) are undoubtedly economic benefits, they also depend on downwards social mobility (failure?). So a welfare-maximising society must have the capacity for providing compensating services for the downwardly mobile, and for those who do not achieve their aspirations. Downward-mobility is a prerequisite for upwards social mobility.

The economy is a welfare system. Welfare represents – at a societal level (indeed at a global societal level in a globalised society) – a balance between service benefits and expended resources. Both benefits and costs will be incurred unequally. However, if inequality extends beyond its modest optimal level, then welfare losses become very great. Rich people cannot gain anything like the amount of service benefit per dollar spent than can people on modest incomes.

And we might note that a dollar borrowed typically generates much more added service utility to the borrower than the loss of utility incurred by the lender. While debt spending substantially ameliorates present inequalities, massive indebtedness coexisting with massive inequality is a second-best solution.

An optimal welfare economy – an economy of equity, service and conservation – is characterised by modest inequality, and hence relatively low levels of offsetting financial behaviour.
