Fall 2016: Hobson’s Imperial England

Hobson's Imperial England

By Craig Hafer, President

October 1, 2016

The Great Recession of 2008-09 will be remembered for the housing bubble that led to the Dow’s biggest single-day point drop in history on September 29, 2008. Yet, its legacy is the amount of time that it took the nation to recover. It has been eight years since the recession started and only now is the economy nearing full employment and seeing the median wage increase significantly. While many (including us) have written about the growing disparity of wealth, few suggested that it would lead to the slowest economic recovery since World War II. It is a scenario that was anticipated over 100 years ago, however, by an outcast named John A. Hobson.

Imagine a country with no laws to regulate business. No environmental laws. No labor laws. No consumer protection laws and little-to no taxes on income and property. The only “law” was that a market would regulate itself (***laissez-faire capitalism.)*** You do not need to imagine such a world, however. Simply read about Victorian England, or the United States during the early Industrial Revolution. During these times, both nations experienced robust economic growth with little regulation and government involvement.

It is in Victorian England that one of the most loathed economists lived—his name was John A. Hobson. (If you think “loathed” is too strong of a word, think again: the title of his autobiography is *Confessions of an Economic Heretic*.) Hobson looked out on Victorian England and saw the disparity of wealth that existed. He saw pollution, poor working conditions (especially for child laborers) and the vast amount of wealth that was being created by the industrialists. While many economists of his time lauded England’s “free market” capitalist economy, Hobson saw a major flaw. He wrote that while capitalism can be highly efficient and create vast amounts of wealth, it provided no way to deal with the lopsided distribution of wealth that it created, and that this can have unforeseen effects on a nation’s long-term economic health.

According to Hobson, inequality of wealth would lead to a quandary where neither the rich nor the poor could consume enough goods to grow a nation’s economy. The poor could not consume enough because their incomes were too low, and the rich would simply consume enough to meet their demands. Hobson concluded that a vast disparity of wealth would cause the economy to grow less robustly, and that the industries (and wealthy investors) of England would begin to look overseas for new markets. Thus, the age of imperialism was born as an offshoot of capitalism.

While Hobson is not a well-known economist, he is recognized as being one of the first to challenge the ***laissez-faire*** economics of his time and for advocating that the state be an active participant in the economy. It is this very question that is at the heart of the 2016 presidential debates: how involved should the government be in the economy? Before Hobson advocated for greater government involvement, the answer was, not at all!

If we apply Hobson's theories to today's economy, we learn several things. First, his claim that a growing disparity of wealth causes a reduction in consumption has not manifested in our country. As income inequality in the U.S. has reached its highest level since 1928, overall consumption has continued to grow.

The chart below shows Real (after inflation) Personal Consumption from 1999 to 2016. For this entire period, personal consumption has grown an average of 5.2% per year, far greater than the growth of the U.S. economy during this time, as measured by the Gross Domestic Product (GDP).

For investors, the past decade has been a rewarding one. As U.S. consumption grew, many companies were able to increase their earnings by selling products made overseas which were produced at a lower cost. Due to lower overall manufacturing costs, there has been little-to-no inflation during this period. While the consumption of these products grew, the economy (as measured by the GDP) has not grown as vigorously. However, with increased profits, the stocks of many of these companies did well. This is similar to, but not exactly, what Hobson would have expected to occur.

If one were to find fault in Hobson's work, it would be that he did not address the relationship between wages and the unemployment rate. Economic theory tells us that as a nation's economy reaches full employment, wages will begin to rise as companies need to compete for employees. The U.S. unemployment rate has fallen to about 5% from a high of

10% in 2009 at the height of the recession. As expected, the U.S. Census Bureau reported on September 13, 2016 that real median household income grew by 5.2% last year, marking the first annual increase since 2007.

That is not to say that Hobson's work is without merit, for it inspired economists such as John Maynard Keynes, who later explored the relationship between the unemployment rate and wages. In his acclaimed book, *The General Theory of Employment, Interest and Money,* Keynes gives credit to Hobson for being decades ahead of his time. For it was Hobson who wrote that as the disparity of wealth increases, so does the length of time required for economic recovery. With the disparity of wealth in the U.S. at historic levels, the recession of 2008-09 did indeed have the longest recovery period of any postwar recession.