Thinking Ahead Institute

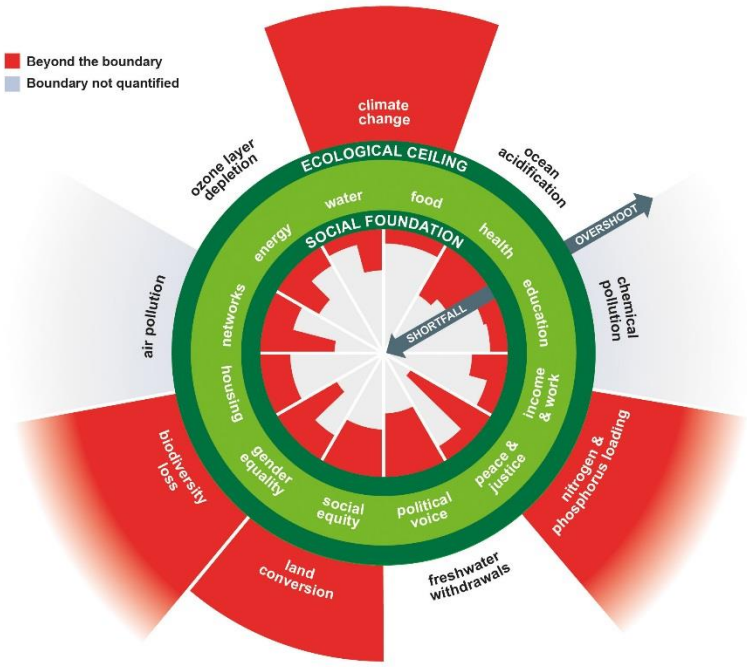
Book review

Doughnut Economics, Seven Ways to Think Like a 21st-Century Economist
Kate Raworth

Doughnut Economics, Seven Ways to Think Like a 21st-Century Economist Kate Raworth

This book is suffused with strong values, and it is now the fourth book on my 'investment essentials' reading list[1]. So it is possible that my personal values fit so precisely that the intellectual content is not that strong. However, I believe I am being objective when I argue that Raworth's intellectual arguments are as strong as her values. I think this is an excellent book which offers a brave and coherent new framework – with the intention of changing economics and by doing so, changing public policy choices. It is also written in an attractive and engaging style, with interesting anecdotes and important references to economic history. It was, for me, a pleasure and a joy to read.

The book starts by acknowledging the power of framing. The words used to describe things have a powerful effect – cue interesting aside on Sigmund Freud's nephew inventing PR. For example, the phrase 'tax relief' neutered the political left as you can't be against tax relief – you end up reinforcing the use of the framing owned by the political right. A similar situation occurred during the Brexit campaigning where a false proposition (an extra £350m per week to the NHS) couldn't be refuted as it reinforced the idea that more money for the NHS would be good, even if £350m per week was the wrong figure. But if words create a powerful frame pictures, being worth a thousand words, provide even more powerful frames. And so Raworth sets out to re-draw the pictures used in economics. There are seven new pictures, the first of which is the doughnut (a hollow one – no jam here).

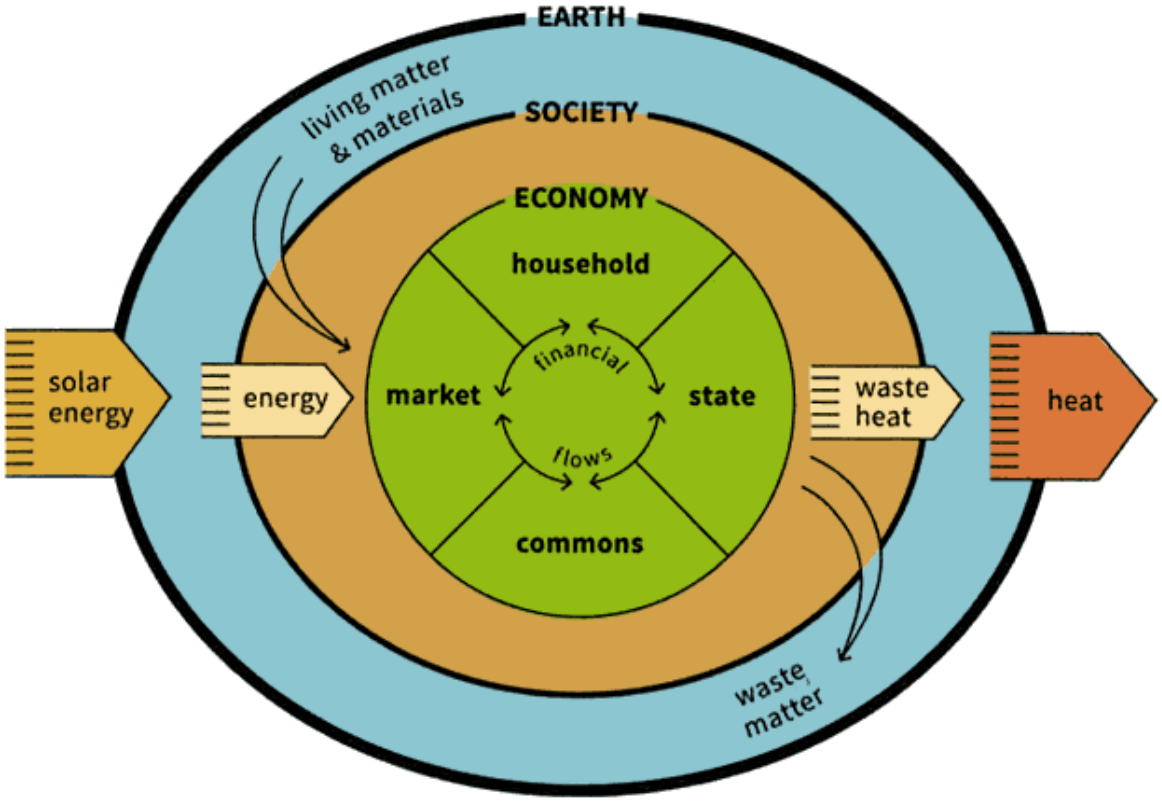


The doughnut has two rings with the inner one being the social floor (or foundation), and the outer being the ecological ceiling. Between the rings is the 'safe and just' space for human flourishing. This is (forgive me, should be) the goal of economics, and therefore should replace the old picture of the exponentially upward march of GDP. I will assert for now that the outer ring is unarguable in that it represents the boundary conditions for maintaining life on earth as derived from science as we currently understand it. Clearly the figure representing the boundary condition can be argued – is it 350 parts per million of CO_2 equivalent (per this book) or a different number? – but the fact that a boundary exists should be self-evident. The social floor is more arguable, because it concerns humans and therefore puts us into a moral and ethical space where values matter, and not everybody's values

[1] #1 chapter 12 of Keynes' General Theory, #2 The origin of wealth, Eric Beinhocker, #3 Fooled by randomness, Nassim Taleb

align. It will hopefully help acceptance that the elements making up the floor come from the UN's sustainable development goals.

My favourite picture, however, is the embedded economy (see below) which is pitched as a replacement for Paul Samuelson[2]'s circular flow diagram. Raworth makes a big deal of Samuelson's delight of getting the 'first lick' of an economics student's *tabula rasa* (blank slate – we are back to the power of owning the framing). The point, I believe, is that everyone who knows anything about economics, knows about the circular flow between households providing labour to and receiving wages from business, which they spend on the goods and services – highlighting the importance of labour and product markets. Raworth argues, appropriately, that the economy is so much more than that. Sticking with households for a moment, what is the value of the unpaid labour? Cue an aside on Adam Smith moving back in with his mum to write The Wealth of Nations – she cooked, cleaned and did his laundry, enabling the production of the book we hold in such high regard, and yet she receives no credit. The book quotes a 2014 survey in the USA, which calculated that if a stay-at-home parent received the going hourly rate for each function undertaken, their annual pay would have been $120,000.



For Raworth, then, the economy comprises four sectors – the household, market, state and commons. Yes, there are financial flows between these sectors, but this is an enabling function not an end in itself. The economy is embedded within society that has access to living matter and natural materials, and throws off waste matter. Society is embedded on planet earth, and at this scale the only input is sunlight, and we export waste heat to the universe. This is where I became excited, as this year I have been pursuing a hunch within the value creation work stream that the second law of thermodynamics is the key to understanding both value creation and sustainability. In essence, we need a constant input of energy to counteract the forces of decay (entropy). As (a) entropy always increases, but (b) we value entropy being reduced (we pay for cleaners, not for 'messy-uppers'), the key becomes where we draw the value creation boundary. Inside the boundary we use energy (and other matter) to create value, but outside the boundary we necessarily increase entropy (ie increase disorder / destroy value). This is source of externalities – carbon in the atmosphere, plastic in the ocean, nitrogen and

[2] Paul Samuelson is known as the father of modern economics or, in Raworth's caption under his picture "the man who drew economics"

phosphorus poisoning in rivers and lakes. If we do not respect the ecological ceiling of the doughnut, human life on planet earth will become unstainable.

From here the book takes on the rest of the faults of economics: it kills off the idea of rational economic man; replaces mechanical equilibrium with dynamic complexity; calls out the lie that growth will eventually cure inequality; and that growth will clean up the pollution it is creating in the process; and confronts the brutal truth that if we remain addicted to growth, we will die. If this description sounds rather anti-growth, then I am mispresenting the ideas slightly. The phrase Raworth uses for a chapter title is "be agnostic about growth" – but even this is a massive shift away from the growth imperative pursued by public policy and enthusiastically supported by the business and investment constituencies. For what it is worth, I have previously written an opinion piece arguing that the only sustainable growth rate is 0% per annum[3].

In my view Doughnut Ecomonics is a very impressive analysis and reconstruction – but other book reviews have raised the objection that it is light on policy recommendations. I counter that Raworth has done more than enough in creating a new thinking framework – it is only fair that she leaves some room for others to come up with the 'so whats'. Given the likely readership of this review, it is worth specifically mentioning that there could (will?) be deep implications for investment here. Investment is about wealth accumulation, duh, but living within the doughnut will be (1) agnostic to growth and (2) more about redistribution. Regarding the former, our current investment system is built on the growth imperative. For the latter, Raworth posits ownership of an enterprise remaining with employees while capital needs are met more through bond-like securities. It is not a well-developed thought, but it is enough for us to work with. What kind of returns would a sustainable world throw off? And who will, and who should, benefit from them? This is a very good book, but it looks more like the start of an important journey than an answer in itself.

Tim Hodgson

[3] https://www.thinkingaheadinstitute.org/en/News/Public/News/2017/06/Long-term-investing-Limits-to-growth

Limitations of reliance

Limitations of reliance – Thinking Ahead Group 2.0

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About the Thinking Ahead Institute

The Thinking Ahead Institute seeks collaboration and change in the investment industry for the benefit of savers.

It was established by Tim Hodgson and Roger Urwin, who have dedicated large parts of their careers to advocating and implementing positive investment industry change. Hodgson and Urwin co-founded the Thinking Ahead Group, an independent research team in Willis Towers Watson, which was created 15 years ago to challenge the status quo in investment and identify solutions to tomorrow's problems.

What does the Thinking Ahead Institute stand for?

- Belief in the value and power of thought leadership to create positive investment industry change
- Finding and connecting people from all corners of the investment industry and harnessing their ideas
- Using those ideas for the benefit of the end investor.

The membership comprises asset owners and asset managers and we are open to including membership of service providers from other parts of the industry. The Thinking Ahead Institute provides four main areas for collaboration and idea generation:

- Belief in the value and power of thought leadership to create positive investment industry change
- Working groups, drawn from the membership, and focused on priorities areas of the research agenda
- Global roundtable meetings

One-to-one meetings with senior members of the Institute.