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A new governing paradigm?maximising national wealth [1]

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How should governments decide on policy? One answer is that policy should follow a particular ideology, such as libertarianism or socialism. Another answer?direct democracy?is that policies should be arrayed in front of the populace at large so they can pick. Another is that the people at large should choose people who vote on policies from options selected by a third group of people?roughly the Westminster system. Absolute monarchy would give a family and their descendants control of policy. But an under-considered method of choosing policy is via markets.

Here I don't mean getting rid of social democracy and having most or all goods provided by the market; instead I mean choosing policies?whether free market or interventionist, right- or left-wing?with respect to the result of a hypothetical prediction market [3], specifically, one looking at some measure of national wealth.

Why wealth? Well what we really want to do is make people have better lives?increase their well-being. But measuring well-being directly is controversial and difficult. The two leading theories of well-being are that well-being consists in happiness/pleasure [4] and that well-being consists in satisfying one's desires or preferences [5]. We know wealth makes people happier, particularly when they are poor, but even when they are already well-off [6], and we know more wealth means more ability to satisfy most different preferences.

Thankfully, both measures (like the official ONS statistic [7]) and proxies (like the total market capitalisation of, FTSE All-Share firms, which make up 98% of total business wealth [8]) of wealth are fairly widely available. Of course, these happen after the fact?so while we could easily judge past governments by their effects on these metrics, we couldn't judge current policy proposals. But that needn't hold us back! We already have markets in future RPI inflation in the UK (and CPI inflation in the US), called TIPS spreads. [9] These take the price differential between RPI-linked and regular gilts or T-bills to work out what the market expects inflation will turn out to be. We know this because if it didn't represent the market opinion, then traders could buy and sell bonds to achieve a higher expected return [10] (i.e. take arbitrage opportunities).

Even a simple, TIPS-like market in national wealth would help us rationally guide policy. It's not exactly clear whether central banks check TIPS markets, but if they did, the markets would give them advance guidance on whether their policy would help them hit their target level of inflation, based on reactions to policy changes, suggestive speeches, and explicit forward guidance like the Carney or Evans rules [11]. In the same way, important policies would shift the wealth markets, and governments could use that as evidence for doubling down on wealth creating policies and for getting out of wealth-destroying moves.

However there are important distinctions between the Bank of England's role in stabilising the nominal side of the economy, and the government's role in making policy that makes it likely that lots of real wealth is generated. The best nominal policies, like NGDPLT [12], focus on stabilising, or ensuring the stable growth of, some nominal variable. The optimal result is extremely reliable stable growth. But that's not what we want in real wealth. When it comes to real wealth, the more the better. That a policy boosted the markets' expectations of national wealth by 10% in five years would not prove it was an optimal, or even good policy, if there was an alternative that could boost wealth by 50%.

So when it comes to national wealth we need conditional prediction markets. We need markets that tell us what would happen if we implemented a given policy. The specifics of implementing these sorts of markets become quite complex and difficult, as we do not want to restrict the policy choice too much, but it may also not be practicable to open up a gilt market for every permutation of every major political idea. But if we could start conditional prediction markets up, we'd have a range of policy options with very interesting and suggestive evidence of what is best for the country's social welfare.

I think there are some persuasive objections to the results of these markets, and?further?to running policy in any rigidly-linked way to these markets. But I also think they can all be plausibly dealt with, and I will attempt to do so in a blog post tomorrow.

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