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Brexit and prosperity

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Michael Caine, the famous British actor, made a rare excursion into the political economy of Brexit recently with his dramatic assertion that he "Would rather be a poor master than a rich servant." No prizes for guessing which side of the debate he is on but it's interesting that that he captured the popular British conception of the European Union as a "power" relationship; even as a conflict.

Seen from the European perspective, the European Union is a consensual sharing of national sovereignty in a supra-national context of mutually agreed rules to facilitate trade, security and growth. In other words, a means to promote the common good.

The Europeans seem genuinely mystified by the British given, as is becoming increasingly clear from the deferred investment intentions of both domestic and international firms, that the European market matters greatly to British prosperity but rather less to Europe.

Whilst they are not normally as public as distinguished actors, economists have been making more headlines in the last few years than perhaps is normal or even healthy. You may remember Thomas Piketty's "Capital in the Twenty-first Century" which made considerable headlines and the unusual achievement of turning an equation into a minor celebrity:

$$r > g$$

meaning that return on capital "r" will grow faster than the economy "g".

This raised serious issues about wealth creation and the concentration of wealth given the implication of the equation is that wealth concentrates in fewer and fewer hands over time.

This is not new. Many years ago, Vilfredo Pareto (1848-1923), an Italian economist scoured economic data from around the world and he derived a similar rule:

$$\text{Log } N = \log A + m \log x$$

Where N is the number of people with wealth higher than x.

He found that the distribution of wealth in any society is not a pyramid but it resembles a champagne glass. From this observation, he derived the famous 80/20 rule: 80% of wealth is owned by 20% of people; 80% of a firm's sales come from 20% of a firm's customers and so on.

This is relevant because he also came up with a powerful notion, still in use today, of "*Pareto-optimality.*" A Pareto change is a change where making one actor better off makes no-one else worse off.

The whole Brexit issue has been clouded by obfuscation seasoned with mendacity but one way to think about Brexit is in terms of Pareto-optimality.

The impending change in Britain's relationship with Europe is a good thing if it makes one person better off without making anybody else worse off.

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