WHAT IS DEVELOPMENT? A GALBRAITHIAN VIEW

> *"A good economist is neither orthodox nor heterodox but rather pragmatic: he or she can frame good economic policy based on an open and modest theory that forces him or her to constantly consider and decide under conditions of uncertainty."* – Luiz Carlos Bresser Pereira (2010)

The Russian Revolution and establishment of the Soviet Union made concrete the possibility on a grand scale of a socialist republic freed from feudal, capitalist or fascist control, and the Soviet victory in WWII demonstrated the industrial and military potential of such a state, with the feat soon underscored by the outcome of the Chinese Civil War. Socialist prestige was high and as their colonial fiefs gained independence, the West needed to exhibit concrete and dramatic economic accomplishments as well as the advantages of political freedom. This necessity was underscored at home in the Western countries by the power of labor and the expectations of veterans. From these sources arose social democracy, democratic socialism and the welfare state, including in their international dimensions the Marshall Plan, the Bretton Woods Institutions, eventually the Alliance for Progress, Food for Peace, PL 480 and a raft of similar initiatives for *economic development*, all of them guided by the ethos of Cold War Liberalism. Three of whose major figures were Walt Rostow, Simon Kuznets and Albert Hirschman.

Rostow's contribution was a simple scheme for "stages" of economic growth, frankly subtitled "A non-communist manifesto" and written to project the model experience of the US and UK onto the world at large, free of dependency or conflict, each country rolling down the runaway to take off and eventually the plateau of high mass consumption. That flight at altitude cannot be sustained without fuel somewhat limited the aeronautical analogy but it was, at least, a message of hope and emulation. Rostow's theory lacked explicit distributional implications, although “high mass consumption” implicitly entailed the end-state of a middle-class society.

Simon Kuznets, an economist of high practical distinctions, sketched out a distributional theory of the development process. In simple terms the advent of urbanized industries in an economy previously dominated by peasant or yeoman agriculture must entail rising inequality until the share of peasants and farmers drops below a certain threshold, at which point the dynamics of workers’ organization and urban democracy take over and inequality declines again. This is the substantial basis of Kuznets' famous “inverted-U” relationship between inequality and income. The curve suggested that rising inequalities in the early phase of market-based industrialization were inevitable and implicitly urged acquiescence, as things would get better later on.

Hirschman rejected the big-push view of development in favor of a concept of linkages, backwards and forwards; his idea was that things should proceed in stages, first one thing and then something else, closely connected and feasible. Hirschman also explored the social-psychological complications of the Kuznets insight in his concept of the “tunnel effect.” In two lines of traffic stalled in a tunnel, the sight of one moving ahead lifts, rather than depresses, the spirits in the other line. However, Hirschman carefully noted that if the second line remains struck for too long, the effect will be reversed; hope will be replaced by frustration and eventually by rebellion. In the Cold War setting, Hirschman's work was an arch reminder that promises are not everything, and that simple schemes must be tempered by realism about administrative and technical limits, with everything adapted to suit conditions on the ground.

The Cold War liberals and postwar American Keynesians knew that their vision of economic development had to advance an optimistic view of controllable and progressive democratic capitalism. And political authority in the West, however tied to leading financial and business interests, did from time to time act on the message. The history of this period is one of irregular tension between a vision of effective and progressive policy, on one side – and the darker vision of direct or indirect control through force and fraud that was the meat-and-potatoes of the secret services, then and now. The doctrines of development represented the hopeful and relatively progressive face of world order, whose end-state was widely accepted to be social democracy, a consumer society and a welfare state.

In Sweden a specific strategy was based on egalitarian policy. There the Meidner/Rehn (1951; see also Martin, 1981) model specified compressed wage structures as a path to productivity and competitiveness, and Swedish social democracy implemented that model in a manner that drove Sweden over six decades to the top of the world income tables. The key insight was that the composition and technological level of industry in a small economy is endogenous. Floors on wages drive out weak players and place pressure on stronger ones to modernize. The result over time is a superior industrial mix and a higher standard of life both in absolute and relative terms. Moreover, an advanced industrial base can support a large and well-paid service sector; the downside is that high tax rates may force the expatriation of high net-income persons, a minor price. Still, the Swedish Model was a secret to all but the Swedes.

A second framing of the issue of inequality in relation to a policy for development builds on the model of Harris and Todaro (1970), who studied urbanization, minimum wages and unemployment in East Africa in the 1960s. Their sharp insight was that an unequal wage structure (say, across an urban/rural divide) generates migration and competition for the better jobs. If these are few and the pay gap is large, then job-seekers will outnumber jobs and unemployment necessarily results. The Harris-Todaro hypothesis can be extended to many different circumstances – migrations past and ongoing in Europe, North America and China come to mind.

More broadly, neoclassical economics predicts that more flexible-meaning unequal-labor markets will have less unemployment. The M/R and H/T models together predict the opposite, namely that societies with compressed and regulated wage structures will (within-limits) tend to enjoy lower unemployment, and (if they target investments cleverly) higher rates of productivity growth and larger manufacturing sectors than those who maintain their allegiance to "free and flexible" labor markets. The preference of employers for flexibility has everything to do with power, with a reactionary attitude toward modernization, and nothing at all to do with economic development.

More broadly still, these models can be taken as exemplars of development strategy and even of the meaning of development itself. Their rules for pay, wages, salaries, incomes and wealth are a type of regulation, involving in various ways the structures of compensation and ownership, the political rights of employees and the efficacy and incidence of the tax system. There are many other types of regulation: phyto-sanitary, product safety, transportation safety, construction codes, zoning, workplace conditions, environmental, prevention and mitigation of climate change, and much else besides. Not to mention the fair and effective enforcement of a civil and criminal code. The creation and application of regulations in all of these spheres requires a balance between technical (scientific, engineering) possibilities, administrative capacity, the willingness of critical players in the private economy to cooperate and comply, and the capacity for effective but not oppressive enforcement.

Regulation is central to development. The characteristic modern difference between a "developed" and a "developing" country is not (as neoclassical economics supposes) protection of property rights – a slogan to entrench the rich. Nor is it the extent of education for as everyone knows, poorer countries have rich histories and often produce exquisitely cultured peoples. Nor is it production techniques and technologies, which may be carried around the world put in place almost anywhere. Rather, in the modern world development consists in the main of the capacity to design and implement effective and efficient regulations and to obtain both the (largely) voluntary acquiescence of the population and enforcement against a minority of violators. These conditions permit citizens to enjoy a life largely free of the petty burdens of daily risks and elementary self-protection well-known to those who come from less-favored places. They are the sum-and-substance of economic progress. Where consensus and cooperation break down, so does the stable and normally peaceful framework of developed-country life.

The successful creation of a regulated framework for advanced economic activity was the great achievement of the twentieth century. It emerged in America from the Progressive Movement during the age of Theodore Roosevelt, Woodrow Wilson and Franklin D. Roosevelt, extending through the administrations of Lyndon Johnson and Richard Nixon, who signed legislation creating the Environmental Protection Agency. It formed the foundation of American industrial power and the appeal of the American social model by the middle of the century, eventually spreading to post-war Europe and to Japan.

The underlying principle of American capitalism was not the free market but the "concept of countervailing power" (Galbraith, 1952). And the great corporation which flourished in the context of countervailing power accepted the limits on its power given by an even-more-powerful representative State as well as by organized interaction with trade unions and with a citizen community (Galbraith, 1967). Finance after the catastrophe of the Great Crash was kept in check by regulation and largely played a service role. The model mobilized but contained the profit motive, and permitted a degree of decentralization, of checks-and-balances and of controlled technological progress that the socialist bloc could not emulate over the long term.

Needless to say, things have changed. Beginning in the mid-1970s, the American model was undermined from within by the re-emergence of a purist free-market ideology, which took control of the economics profession, largely in the service of a resurgent financial sector, combined with increasing stress between organized labor and capital in the industrial sectors of the heartland (Bluestone and Harrison, 1990). Financial deregulation combined with a harsh policy of macroeconomic destabilization crippled the industrial sector and brought an end to the age of countervailing power. With the decline of the Soviet model and the end of the Cold War, Western triumphalism prevailed and the pressure to perform for the general population came off; the narrative of progressive development was set aside in favor of a doctrine of "market reforms;" neoclassical orthodoxy writ large as the Washington Consensus. Needless to say, inequalities rose in rich and poorer countries alike.

Driving this process was the renewed dominance of the financial sector or what is known as "money-market capitalism," a corporate ethos of "shareholder value" – meaning subordination to Wall Street – and eventually the rise of globalized value chains, all of which undermined the social consensus and political capacity – in particular, to provide infrastructure – that had constituted the American model. The technological function escaped from under the control of industrial corporations and re-situated to its own sector, one of relatively small, relatively young companies with out-sized market capitalization. American growth was sustained in the 2000s only by tolerating a fraudulent financial engine, doomed to fail in due course (Black, 2014). Ultimately there resulted the present dual-economy, combining technology with decay, inequality with instability (Galbraith, 2012), and creating the conditions – runaway deregulation – that led in 2007 to the great financial crisis (Galbraith 2014).[1]

The consequences of this retrogression in the American model were masked by the even-more-rapid collapse of the socialist bloc in the late 1980s and early 1990s, followed by a catastrophic experiment with free-market economics in the Russian Federation. Similarly, a massive financial crisis following deregulation affected Japan in the early 1990s and much of the rest of Asia in 1997. And in the wake of the Great Financial Crisis, the US economy was rescued, to the degree it was rescued, by a combination of Keynesian "stimulus" and the automatic stabilization measures – largely, social insurance programs – that had survived from the New Deal and Great Society, while much of Europe languished under the *ordo-liberalism* of the European Union.

The result after forty years is a global order with a new player in the first rank – namely China, the country that has by far effected the most successful strategy of economic development and poverty-reduction in the history of the world. How was it done? Through a program of gradualism, of state-directed advances in infrastructure and urbanization, the development of advanced national corporations alongside support for millions of small firms, and above all a policy of stable and predictable basic prices (Weber 2017), social balance (Galbraith 1958) and continued close regulation of financial interdependence with the rest of the world. Unlike Korea, China did not deregulate banking and open its capital account in the 1990s and so did not sustain the check to development and growth of the Asian financial crisis. For product quality, China pursued a strategy of knowledge importation and technology transfer, alongside

1 The economy of the United Kingdom, even more dominated by Big Finance, followed a track similar to that of the United States, with comparable political/spatial resentment, leading ultimately to the referendum on Brexit.

liberal use of external regulatory standards – those imposed in Western markets – to raise the quality of producers for both the domestic and export markets. In this way a formerly and still partly socialist country cracked the conundrum of how to satisfy the infinite palate of consumer preferences with a comparable diversity of non-standardized goods.

China is not alone in having advanced along a path of this general type; indeed it is a follower, not a leader, albeit on gigantic scale. Galbraith's model of the firm continues to prevail in Germany and Japan. Korea is yet another example. The new pragmatism of Grzegorz Kolodko (2014) with its influence on the relatively-successful Polish transition (Kolodko 2009) and the new developmentalism of Luiz Carlos Bresser-Pereira (2010, 2019) express many of the same insights. Both call for a strategy of open trade and technological improvement under irreversible globalization, but combined with effective control over global finance. Under favorable conditions and pragmatic political leadership in the first two decades of this century, Brazil, Argentina, Chile, Uruguay and Ecuador made remarkable strides toward more stable economic conditions and poverty reduction.[2] That progress, however, is not now being sustained.[3]

So we have the leading cases – without exception those that evaded, ignored or rejected the "Washington Consensus." Indeed the strongest cases of postwar reconstruction and economic development in the modern era share a distinct adherence to the Galbraithian principles of corporate organization, focused on long-term improvement of productive capacity, reputation for excellence, global market share, effective regulation, and a

2 Although Hugo Chavez once described himself as a "Galbraithiano," Venezuela could not escape from the perils of oil wealth and Dutch Disease.

3 Among European scholars the tradition of J.K. Galbraith has remained alive mainly in dissident circles, such as the work of the Federico Caffè Society (Amoroso and Jesperson 2012), the Veblen Institute (Frémeaux *et al.* 2014), and the project of the Green New Deal of DiEM25.

checks-and-balances relationship with unions and the state. In short, countervailing power.

And one may point to movement in this direction in the Russian Federation, notably advocated in the work of Bodrunov (2017, 2019), Koshkin and Kretov (2018) and others who have explicitly taken my father – and let me say to my pleasure – as the guiding spirit of their cause. It is perhaps not surprising that having seen the disadvantages of the extremes – of central planning on one side and of "free markets" on the other, that Russian scholars should take an interest what actually worked at one time in the United States – and still works in the most successful advanced *and* developing countries of the modern world.

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