Are we making progress toward a civilized society?

Abstract: This paper explains, in terms of Galbraith’s “conventional wisdom” and “innocent fraud” of mainstream economics, why the U.S. economy has experienced significant backsliding from the degree of progress our economic policies and institutions made toward producing a civilized economic society. It then sets out policy proposals for making progress toward a twenty-first-century “good society.”

Key words: comparative advantage, international balance of payments, minimum wage, outsourcing, universal health care.

In 1988, an alumnus of the Kennedy School (Greg Davidson) and his economist father (me) wrote a book entitled Economics for a Civilized Society (Davidson and Davidson, 1988). Of this book, John Kenneth Galbraith wrote: “This remarkably informative, wide-reaching book is the civilized product of two civilized authors.” In 1996, this book went into a second edition at the same time that Galbraith’s The Good Society (1996) was published. In a copy of Galbraith’s Good Society he sent to me, he wrote: “To Paul Davidson, to whom I, and this book, owe so much!”

Economics for a Civilized Society, like Galbraith’s book The Good Society, was concerned with preventing any significant backsliding from the degree of progress our economic policies and institutions had made toward producing a civilized economic society in the 25 years following World War II as well as with promoting further progress in those areas where progress was possible. Unfortunately, the United States as well as
the global economy in which we live have become less civilized since both of these books were written.

To give but one example, the cost of Hillary Clinton’s 1993 universal medical care program was deemed by most of the economist talking heads on TV as too expensive even though the quality of thousands of lives, especially of the poor, would be improved and extended by creating a universal health care system. Compare the cost of universal health care to the cost of George W. Bush’s attempt to democratize Iraq with its loss of thousands of lives and maiming of many more U.S. servicepeople, often from the poorer segments of U.S. society. Some have estimated the Iraqi adventure as costing more than a half billion dollars per day—a cost that, apparently, decision makers in Washington believe the United States can bear for the indefinite future.

Now, there is no question in my mind that the “good” part of Bush’s war is the jobs and profits created for corporations such as Haliburton, and so on. This military Keynesianism appears to be the only form of Keynesianism that politicians, whether they are Republican or Democrat, implicitly accept. Is there not a bit of irony in the fact that the only form of Keynesian spending to avoid unemployment and promote prosperity and economic growth, is this one that stimulates the profits and appetites of what Dwight D. Eisenhower warned us of was the military industrial complex. Poor Keynes, who clearly had pacifist tendencies and might, according to his biographers, have been a conscientious objector to World War I had he not already had a military exemption because of his government position in the British Treasury.

Can economists make any contribution to helping us produce a civilized, good society?

In 1945, at a Royal Economic Society dinner given in his honor, John Maynard Keynes offered a toast to “economics and economists who are the trustees, not of civilisation, but the possibilities of civilisation” (Harrod, 1951, pp. 191–192). To Keynes, the existence of human distress resulting from the inability of the economic system to persistently generate a fully employed economy and the gross inequalities of income and wealth produced under the existing free market, entrepreneurial economic system should not go unheeded. While preserving personal liberty (Keynes, 1936, p. 380), Keynes advocated the development of institutions and policies to abolish these uncivilized faults of the economic system in which we live (see Harrod, 1951, p. 192).

Galbraith, in many ways, was the Canadian-American counterpart to Keynes in his belief that economists could, at a minimum, reduce the distress created by a laissez-faire market system by proposing “socially
desirable changes” (Galbraith, 1996, p. 4). In Galbraith’s *The Good Society*, every member of society “should have access to a rewarding life” and, in a market-oriented economy, access to income is a necessary condition for access to a rewarding life. Thus, government fiscal and monetary policies should strive not for a natural rate of unemployment but rather to guarantee every worker access to income and the dignity of a good job in a fully employed economy. To the extent we do not achieve full employment, then Galbraith argued for a social safety net of minimum income so that “no one can be allowed to starve or be without shelter” (ibid., p. 27), even if the social safety net assurance may inevitably lead to “some abuse” (ibid., p. 26). Galbraith also noted that our society is more harsh in its view of any abuse of the social safety net by the poor, or what Ronald Reagan called “Welfare Queens,” than the abuse of the system of those who enrich their own position by using inside information or conveying false accounting and auditing information or even corporate executives who control their board of directors who set executive salaries and bonuses (ibid., p. 28).

Galbraith and Keynes have much in common. First, neither won the Nobel Prize in economics. Given the view of mainstream economists today, neither Keynes nor Galbraith would even make the Nobel Prize short list if they were alive today.

Second, both men had an important impact on civilizing government policies after World War II—perhaps until the 1960s. Since then, a classical conventional wisdom has come to dominate both academic economics and government policies. The result has been a backsliding from the civilized advances that followed for a quarter century after World War II.

Third, both Keynes and Galbraith opposed the conventional wisdom of the mainstream economists of their day. As Keynes put it,

> The celebrated optimism of traditional economic theory, which has led to economists being looked upon as Candides, who, having left this world for the cultivation of their gardens, teach that all is for the best in the best of all possible worlds provided we will let well enough alone. . . . It may well be that the classical theory represents the way in which we should like our Economy to behave. But to assume that it actually does so is to assume our difficulties away. (1936, pp. 33–34)

And Galbraith has written: “It is the nature of privileged position that it develops its own political justification and often the economic and social doctrine that serves it best. No one likes to believe that his or her personal economic well being is in conflict with the greater public need.
To invent a plausible, or if necessary implausible ideology in defense of self interest is thus a natural course. A corps of willing and talented craftsmen is available for the task." (1996, p. 5, emphasis added).

I leave it to the audience to figure out whom Galbraith would include in this corps of talented craftsmen. But I should point out that in his last book, The Economics of Innocent Fraud, Galbraith noted that for 70 years, he devoted his professional life to exposing the difference between reality and the innocent frauds derived from "traditional economics and its teaching" (2004, p. 1). Unfortunately, politicians of both political parties have bought into and accept without question the "innocent frauds" of the teaching of today's mainstream economics. And, I believe, it is the "conventional wisdom" or "innocent fraud" of our economics profession that has provided the rationalizations that have justified the backsliding movement of the past three decades away from the goals of a good society.

Through his economic teachings, writings, and advising to governments, Keynes developed and championed a revolutionary economic theory to overthrow the nineteenth-century classical economic theory that had dominated economic thought for more than 130 years. Even though his revolutionary theory was misunderstood by most American Keynesian economists and textbook writers (see Davidson, 2006), Keynes's policy prescriptions were followed by post–World War II governments to develop prosperous economic conditions. The result was an era of historically unprecedented real economic growth for both developed and less-developed countries, more rapid rates of per capita growth even then during the industrial revolution of the nineteenth and early twentieth century. Simultaneously, income inequalities lessened dramatically.

Nevertheless, in the 1970s, the reintroduction of the conventional wisdom—innocent fraud—of the efficiency of markets free from all government regulations as an overriding principle reversed the postwar progress that had been made in reducing the two major faults of the capitalist economic system.

Let us remind ourselves that immediately after World War II, when Keynes's policies were socially and politically acceptable, the main Keynesianism policies to reduce unemployment and inequality and promote economic progress took on a more civilized societal approach of a Marshall Plan, the GI Bill for education—the greatest entitlement program in U.S. history, Eisenhower's Interstate Highway Program, and even Lyndon B. Johnson's "Great Society" approach to civil rights and, do not forget, Medicare. How many conservatives in 1964 claimed that Medicare would bankrupt this country?
In his book *The Good Society*, Galbraith listed aspects of what he thought the "good economy" should strive for, including the stabilization of aggregate effective demand "that is sufficient to utilize the available capacity, encourage the requisite expansion therein and employ all the available workers including those in the arts, service industries, education and much more. . . . While some difficulty in fitting specialization to need is inevitable, it is the total employed that . . . set the upper limit on the productive capacity of the economy. . . . The failure to do so—resulting in cyclical or enduring unemployment—is inconsistent with the goals of a good society" (Galbraith, 1996, p. 34). In my mind, and I am sure in Galbraith’s as well, the willingness to accept either a 5 percent unemployment rate as a "natural rate of unemployment," or to accept the outsourcing of high-paying manufacturing jobs to the competition of countries that employ child labor and workers in sweatshop conditions at real wages per hour of labor far below the American standard is a disgrace. It has robbed many American workers of their dignity, as Louis Uchitelle has graphically described in his book *The Disposable Americans* (2006).

Nevertheless, many justify the practice of "outsourcing" production with the old innocent fraud known as the economic "law of comparative advantage." Despite the obvious loss of high-wage jobs by American workers to lower-wage foreign workers, a chair of the President’s Council of Economic Advisors claimed that outsourcing is beneficial to both the U.S. economy and the rest of the world. In the long run, it is claimed, free trade results in more income and wealth for all nations by creating new higher-value jobs for workers in the United States whose original high-value jobs have been outsourced as well as the jobs created in the nations to which production has been outsourced. Unfortunately, the law of comparative advantage’s claim of the creation of new high-valued jobs for outsourced workers in the United States requires at least two basic assumptions that are not applicable to the real world in which we live:

1. There is no mobility of labor or capital across national boundaries.
2. There is never a lack of global aggregate demand for all the additional products that can be produced (under comparative advantage) by fully employed labor forces in all trading nations.

This second assumption is better known as Say’s Law, a law that Keynes demonstrated was not applicable in either the short run or the long run in a money-using entrepreneurial economy. Moreover, if capital is mobile across national boundaries, as the conventional wisdom drive for a liberalized capital market requires, then in the absence of Say’s
Law, international production patterns depend on absolute advantage and not comparative advantage. Hence, the jobs lost to outsourcing will not automatically be replaced by higher-value technical jobs that American workers supposedly have a comparative advantage in.

One further point about unemployment in the real world. Another conventional wisdom is that unemployment, or even the movement of Uchitelle’s displaced workers to lower-paying less-productive jobs, is blamed on the workers’ own fault. An unemployed worker or a displaced worker needs only to pursue more education and they will always get a better job, we are told, without a smile on the face of the perpetrator of this innocent fraud! But as Galbraith noted: “Education, training is, indeed, central to a good society . . . but it is not relevant to the [unemployment problems] . . . that are here discussed” (1996, p. 41). Galbraith wrote: “A call for better-prepared workers as the remedy for recession induced unemployment is the last resort of a vacant liberal mind.” And I would add a similar call for workers displaced by outsourcing is also a measure of a mind that has not thought through the problems of trade patterns in a freely trading global economy where child labor, unsafe working conditions, environmentally damaging production, and a host of other factors that are devastating to the progress of a good society are permitted.\(^1\)

In the long run, given the current international payments system and liberalized trade structure and the obvious lack of full employment among most of the trading nations of the world, most employment in the advanced economies of the world will ultimately be concentrated in industries where transportation and communication costs make foreign trade prohibitive (nontradables), and in niche industries such as defense, and so on, where political or social reasons prevent the outsourcing of production.

Time will not permit me to develop the argument against the innocent fraud of outsourcing, or the new International Financial Architecture solution that can deal with this problem. In my book *Financial Markets, Money and the Real World* (Davidson, 2002), I developed such a financial architecture plan as a twenty-first-century variant of the Keynes plan.

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\(^1\) Were the Chinese to build a factory in California and operate it as it would be operated in mainland China with child labor and other workers working more than 40 hours per week, in unsafe working conditions, at a wage much below the minimum wage in the United States, and polluting the surrounding environment, U.S. laws would prevent the rest of the United States from trading with this factory because of its uncivilized operations. But if the same factory is located in China, economists, government officials, and enterprises encourage such trade.
that was rejected by Harry Dexter White at Bretton Woods. An even more complete analysis of this outsourcing problem and its solution is presented in my forthcoming book, *John Maynard Keynes* (2007) in the soon to be announced Palgrave/Macmillan series of books on Great Thinkers in Economics.

Finally, some comments on income distribution. What about minimum wage legislation? Nothing assures the dignity of each person in a civilized society than the right and ability to be able to earn a decent living wage. And, as it is often suggested that Martin Luther King said: “There are no such things as menial jobs, just menial wages.” Yet, despite our economic growth and increase in income per capita since World War II, our government policies in recent decades have encouraged the degradation of the minimum wage in real terms to uncivilized levels.

Another innocent fraud that is currently popular and affects income distribution and job creation is the belief that central bankers should be independent in their attempt to target a rate of inflation by manipulating the interest rate. Keynes, on the other hand, noted that in a good society, “the remedy for a boom is not a higher rate of interest but a lower rate of interest! The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom” (1936, p. 322). Or, as Galbraith noted, the quasi-religious belief of an independent central bank “removed from the pressures of democratic processes” is a myth perpetuated by those “associated with large pools of money” to perpetuate their economic comfort at the expense of others (1996, pp. 36–38).

We should be clear that for a central bank to successfully target some low rate of inflation, the central banker is required to institute an incomes policy of fear—fear that if inflation is above target, the central bank will destroy profit opportunities of entrepreneurs in order to threaten the job security of their employees and potential employees.

We should also recognize that behind every rising price is someone’s rising money income. Inflation is a symptom of struggle over the distribution of money income domestically or internationally. Certainly, domestically, we should try to ameliorate this struggle by some form of civilized “incomes policy.” Galbraith, given his experience as OPA administrator during World War II, always favored a civilized incomes policy such as the Wallich-Weintraub tax-based incomes policy. We must rule out any uncivilized incomes policies such as inflation targeting, or planned stop-go fiscal policies that create weak markets in an attempt to keep workers and entrepreneurs in their place. Ultimately, a
civilized society requires cooperation between workers, entrepreneurs, profit recipients, and pensioners—rentiers.

In the globalized economy of the twenty-first century, this will require insulating each nation's domestic economy from international complications and adverse policies undertaken by foreigners. This can be accomplished by a New International Financial Architecture that I have developed elsewhere. Under such a New Financial Architecture system, for every nation "[i]t is the policy of an autonomous rate of interest, unimpeded by international preoccupations, and a national investment programme directed to the optimum level of domestic employment which is twice blessed in the sense that it helps ourselves and our neighbors at the same time. And it is the simultaneous pursuit of these policies by all countries together which is capable of restoring economic health and strength internationally, whether we measure it by domestic employment or by the volume of international trade" (Keynes, 1936, p. 348).

REFERENCES


