John Kenneth GALBRAITH

The AFFLUENT SOCIETY

THIRD EDITION, REVISED

V V JOHN KENNETH GALBRAITH

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THIRD EDITION, REVISED

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Money: Whence It Came, Where It Went

To Emily,
Peter and Jamie

The economist, like everyone else, must concern himself with the ultimate aims of man.

— ALFRED MARSHALL

Introduction to the Third Edition

Following World War II in the United States, there was what could have been called the free enterprise, possibly the market, revival. It deeply engaged the conservative mind. Our conservatism is normally thought to depend on self-interest, moral indignation, vehement expression and something approximating religious revelation. This is unjust. The influence of ideas is ubiquitous and cannot be excluded anywhere.

The source of the ideas was a rediscovery of the Benthamite world of the nineteenth century as it was applied to economic policy by the classical economists and to sociology and politics by Herbert Spencer and William Graham Sumner. In 1944, it derived a new scholarly sanction from F. A. von Hayek's *The Road to Serfdom*, an alarming tract against socialism and the state, which, as the name implies, it identified extensively with servitude. And, in the years following, it achieved considerably more academic reputability from an energetic group of evangelists and scholars who gathered, along with von Hayek, at the University of Chicago with intellectual outriders in other academic centers.

As I shall notice presently, the academic proponents of the market revival were not imagined by most economists to have a large measure of practical relevance. But they had a strong and even impressive command of the economic theory to which the market (unlike practical public action) lends itself. And they could picture themselves as solidly in descent from the oldest tradition in western

economic thought — that of Adam Smith, David Ricardo, John Stuart Mill and Alfred Marshall. Economics, like the law although less so, has a sense of its prophets. Also, as a consequence of its rapid growth, the discipline includes a considerable number of participants who are, intellectually, a trifle insecure — who secretly doubt the depth of the scholarship which, for professional reasons, they avow. Being in an old tradition, the proponents of the market revival had no such doubts. They were reassuring company, men to be treated with respect by those who disagreed. In economics, it is professionally better to be associated with highly respectable error than uncertainly established truth.

The market revival spread rapidly outside the academic world. It was warmly embraced by the editors of Fortune, The Wall Street Journal, other business journals and by editorial writers, for whom it was an admirable way of placating socially backward publishers in an unexpectedly sophisticated way. In those years, also, numerous socialists were in retreat from Joseph Stalin. For John Chamberlin, the late William Henry Chamberlin, James Burnham and many others, it meant that the important social decisions would be taken, not by fallible, cruel and egotistical men but by a wholly automatic mechanism which, if also cruel, was impersonally so. Anything that so effectively excluded personal power was obviously an instrument of freedom. From these sources, the market revival went on into politics.

П

In its academic manifestation, the market revival stressed the social efficiency of the unmanaged market. It distributed resources—labor, capital, managerial and technical talent—to various uses in accordance with the ultimate command of the consumer. Any interference was damaging to this allocative efficiency; the most dangerously intrusive agency was the state. The state could interfere with the free movement of prices; it could also intrude

services of its own which had not survived the market test. The test of faith in the market, it followed, was the rigor with which one sought to minimize the role of the state.

Not that the efficiency of the market — cruel, as noted, but worth suffering — was the only basis for the academic opposition to government. Here too there was moral and political concern. Here too all who suspected authority, either its competence or its motive, were urged to align themselves with the impersonal market against the state.

In the academic world, there was a certain additional concern, often obeisant, on occasion actual, with private interference with the market. General Motors and General Electric, it was known. enjoyed no slight power as regards the prices they charged — a power that no prophet of the market economy could tolerate if exercised by the state. For here was authority and here also were both the power and the incentive to impose the restrictions on output (the inferior allocation of resources) associated with monopolv. So, in principle, such firms should be broken up. In principle, also, the ban on government intervention should be comprehensive. It should fall not alone on minimum wage legislation and public housing and support to collective bargaining, things of which conservative businessmen and politicians naturally disapproved, but also on the Federal Reserve System, subsidies to air transportation, and the tariff, of which, often devoutly, they approved. However, the academic doubts about General Motors and those government services needed and hence approved by the businessmen were not, on the whole, damaging to the market revival. Its proponents managed to convey the impression that this part of the program was liturgical, that the deeper enthusiasm lay with the defense of the market, and the attack on more iniquitous forms of government interference such as the welfare system or support to public education. In any case, professors are inconvenient people; it was inevitable that they would exact some rhetorical price for so great a doctrinal blessing. Accordingly, as it moved out into the less literal world of journalism and on into politics, the market revival hardened into a simple prescription against government services. The only exception, apart from those that conservatives needed and hence approved, was expenditures and other action to fight or resist communism. To exclude the war on world communism from the general ban on government activity seemed wholly logical. The communists were the greatest exponents of precisely the opposite system. One rightly invoked a lesser evil against the greater one. Considering the effects of defense expenditures on the economy, there were many reasons for being glad that this could be so.

If one is rich or even well-to-do and self-regarding, any doctrine that makes public services (and therewith taxes) uneconomic. politically regressive and possibly immoral is bound to seem benign. Anything so convenient must be right. But though proof was not needed, exegesis was welcomed and hence there was a considerable demand for prophets of the market. These quickly became available and in the years following World War II, service clubs, sales conventions, even suburban ladies' clubs listened to the gospel as revealed by John Stuart Mill, Herbert Spencer, William Graham Sumner, Friedrich von Havek and Ludwig von Mises. The last two defenders of the market they could then hear in person. Some of the consequences were not without charm. In 1948, Hubert Humphrey won election to the United States Senate over a man who had become enchanted by Jeremy Bentham. Over the length and breadth of Minnesota, he proclaimed his commitment to Bentham's doctrines until, it was said, some citizens looked for the philosopher's name on the ballot. Humphrey was able to persuade the farmers of the state, quite rightly, that Bentham would have opposed farm support prices. So they chose Humphrey instead.

Ш

Historical circumstance supported the market revival. The thirties had been a miserable time. Many had lost confidence in the economic system; many more had come to assume that it could

endure only as the result of more of the government intervention that had been the hallmark of the New Deal. This was grim news for conservatives. Then came the further great expansion in government controls during World War II. Many of the controls were annoying and even onerous, not alone on businessmen. Equally oppressive, without question, were many of those responsible for their improvisation and administration, of whom I was one. Additionally, shortages of goods and houseroom and restrictions on production and consumption resulting from the war were blamed on the controls. Without price ceilings, rationing, the allocation of scarce materials and restrictions on their less important use, the discomfort resulting from inflation and shortages would have been worse and the war would have been longer. But this was not easy to see. Many people were open to the argument that an obtrusive and intrusive state was deliberately making life difficult.

Meanwhile, with more skill than they have normally manifested in such matters, business spokesmen took credit for the superior industrial performance of the economy during the war. Output had greatly increased. Production of munitions and other requisites of war had been impressive. Not the strong demand, coupled with an improvised but highly rational planning design, but the natural virtuosity of American enterprise and the American market system was given credit for this success. If, after the war, the restrictive hand of the state could be dispensed with, things would be even better. The public, bedeviled by the regulations and regulators, was again in an excellent mood to listen. The 1946 elections were an indication of the attitude. Almost everywhere men ran in opposition to the state. The resulting Congress was the most conservative in modern history. Its more primitive members, so it is said, left behind in Senate closets, washrooms, and in the distant recesses of forgotten basements bronze tools, wall painting and pottery shards, all dubiously symbolizing their religion. The market revival was very much a product of the times.

It had some reverberations in other countries. In Germany in the late forties, weariness with wartime privation and controls was also

extreme and with rather more reason. Ludwig Erhard made the recovery of German industry after 1948 the product of the unaided market. This was a remarkable feat of oratory, for it coincided with the Marshall Plan, a vastly publicized effort in public intervention. and took place in a country where industry was extensively regulated and where per capita government expenditures were much higher, and those for welfare about twice as high, as in the avowedly socialist state of Norway (as it then was) where the level of individual income was then about the same. The message of the market revival was also carried to other countries by American businessmen who frequently revealed an enthusiasm for exuberant and unfettered price competition that they never displayed at home. In Japan, as also in Germany, it led to the dismantling of the great business trusts in the interest of a more effectively functioning market — a remarkable gift, in many ways, by a victorious to a defeated power. (The Japanese later reassembled the pieces.) The prophets of the revival gathered at intervals in international congresses to proclaim and thus to reinforce their faith. Still, the market revival was mostly an American phenomenon.

IV

The market revival brought no very drastic action. Desirable as sharp curtailment of federal regulation or civilian spending might be in principle, it was something to be approached with circumspection in practice. Only much later, in the presidential campaign of Barry Goldwater, did the ideas of the market revival — the elimination of social security, an end to the farm programs — become a program and many wiser men were prompt to warn their candidate that action was never intended. By the time of the Nixon Administration, it was accepted that the government could simultaneously endorse competition while doing all possible to secure the favored from its effects. The sincerity of such market evangelists as Professors Milton Friedman and George Stigler of the University of

Chicago was conceded but it was not imagined that they would be taken too seriously in practical matters. They were meant to be studied, perhaps called on for advice, but not too seriously followed. Still, in Washington and in statehouses, city halls and school districts across the land, the case for public spending became the case against freedom. This added powerfully to the older arguments about the grievous burden of taxes. In the deeper intellectual wastes of Orange and Harris counties, attitudes were more severe. To be for new schools, against air pollution or in favor of stronger zoning laws was to be in support of the first awful step down the steep slippery path to communism.

Meanwhile, and remarkably, these ideas were meeting no very effective attack from liberals. The main thrust of liberal economic thought flowed in different channels. And it was able, in one important aspect, to find common cause with the market revival.

v

In the years following World War II, Keynesian fiscal policy became the *summum bonum* of liberal economic policy. An adequate level of output and employment in the economy was assumed to solve nearly all economic and most social problems. Inadequate production and employment made all other problems insoluble. So not without a sense of strategy, liberal economists concentrated on policies designed to ensure an adequate level of demand and therewith of output and employment.

Acceptance of the Keynesian ideas involved, for conservatives, one of those strange combinations of misapprehension and paradox which make the otherwise tedious study of economics so fascinating. In the broadly liberal view of those who first introduced the Keynesian system to the United States, the regulation of aggregate demand — the total of all spending at any time — required no fundamental revision of the role of the state in the economy. When there was unemployment or an inadequate rate of growth, the

government would increase its expenditures for useful purposes without a parallel increase in taxes. When this support to the economy was not needed, it would defer or even reduce expenditures and therewith the deficit. This regulation would be supplemented and reinforced by the automatic increase in some expenditures, notably those for unemployment compensation, welfare and farm price supports, in periods of unemployment and inadequate growth and by the counterpart reduction in periods of high employment and rapid expansion. Over time, the scope and functions of the state would not be changed appreciably.

Since it made the private economy function better without greatly enlarging the role of the state, this model of the Keynesian system should not have too profoundly aroused conservatives. But it did. It required deficit financing on occasion. This, always a symbol of fiscal sloth, became affirmatively wicked. It was seen also as an excuse for a soft policy on public spending. The name of Keynes thus became mildly coordinate with subversion. Keynesian ideas came to the United States in the thirties primarily by way of apostles at Harvard, most notably Professors Alvin Hansen and Seymour Harris. Following World War II, conservative members of the Harvard governing boards conducted an investigation of the Harvard Department of Economics to see if his influence there was excessive and found it was. Elsewhere too, circumspect scholars were careful to explain that their commitment to Keynes was subject to cautious and intelligent reservations. And then the Keynesian system became respectable and accepted, not through the above-cited balancing measures which left the state small, but by a fundamental enlargement of the role of the state. And this — and this is the paradox — was highly acceptable to conservatives.

The decisive application of Keynesian policy came about in the postwar years as the result of a large increase in public spending supported by a large increase in taxation. This spending was highly

¹ James B. Conant, then President, rejected the finding. My election to a professorship had also been thought a manifestation of the danger.

reliable, not a subject of serious controversy. And the personal and corporation income taxes by which it was sustained fell with special force on those revenues — corporation profits and surtax income — which increased most in periods of expansion and diminished most with stagnation or contraction. In consequence, the tax system increased its yield more than in proportion in periods of economic expansion and diminished its yield more than in proportion with contraction. The role of the state being large, these effects were quantitatively adequate. And this large role of the state was acceptable to conservatives because it served a function of which conservatives strongly approved, the maintenance of a strong military defense against communism. It was also exceptionally pleasing to those industries which were recipients of the spending involved.

And here was the basis for a coalition — or at least a tacit working arrangement between conservatives and liberals. Liberals did not entirely forget their earlier commitment to the public services — so long a distinguishing feature of American liberalism. But this was now secondary to a successful Keynesian policy. In consequence, the conservative warnings that public education, public housing, better sanitation, control of water and air pollution, improvement of environment were threats to liberty evoked only a modest liberal challenge. Meanwhile, large defense expenditures were underwriting the Keynesian policy and thus accomplishing the major liberal goal. In the early postwar years, Stalin's policy in Eastern Europe and the Korean War made these expenditures seem essential. Thereafter, they became more or less habitual. Even the man who argued for more domestic outlays prefaced his case by conceding the higher priority of national defense. Liberal uneasiness over the role of defense expenditures in the Keynesian system was assuaged by observing that outlays for domestic purposes would serve just as well. With the Vietnam conflict, military expenditures acquired the further sanction of war. By 1969, a conservative President could announce his conversion to Keynesian principles with little rebuke.

Such were the ideas, here writ slightly larger than life, that were

contending for public attention and belief in the United States in the years after World War II. They were ideas — both the market revival and the Keynesian preoccupation with employment qua employment and production qua production — that seemed to me damaging. Contemplating them in the early 1950s, I began work on this book.

VΙ

I had been considerably a part of the environment I was examining. Like others of my generation, I was, in the late thirties and early forties, an aggressive evangelist for the Keynesian system in its standard form. The writing, accordingly, involved a heavy effort to detach myself from my own past beliefs. I discovered how difficult this could be. I have read on occasion that I find a perverse pleasure in attacking the conventional myth. I do not, and on the contrary, it is very hard work. Some day for recreation I intend to write a book affirming fully all the unquestioned economic truths.

I was kept going by the conviction that, in starving our public services and in placing so much of our faith in the general curative powers of increased production, we were inviting grave social ills. (I was less aroused then than later by the imbalance in public outlays, especially those for defense.) It is unwise to reflect excessively on one's foresight, for to do so is to invite critical attention to those other forecasts which bring one's score back to normal. But while there have been many explanations of our urban disasters of recent times, some designed, not without thought, to direct attention away from remedies that would cost money, few can doubt that persistent and continuing underinvestment in needed services is one. Further, while something must be attributed to the fact that some citizens are black and some white, no one has yet shown how to overcome this condition. But we can have good schools and well-paid teachers and ample and attractive housing and clean streets and sufficient and well-trained policemen and plenty of parks and well-supervised playgrounds and swimming pools and adequate divertissement on hot summer nights. These will help even if they will not completely cure and they require only a willingness to tax and pay. Not many would now challenge the efficiency or morality of such outlays. And even the stalwart conservative who dares not venture out in the street at night, pays heavily for private security guards, thinks often about kidnaping and hesitates on occasion to drink the water or breathe the air must, on occasion, wonder if keeping public services at a minimum is really a practical formula for expanding his personal liberty.

That some balance must be maintained between the public and private sectors of the economy - between increased private expenditures and the facilities for removing the waste that results — is now widely agreed, at least in principle. Practical economic policy has also moved in the direction of this book. Few economists would now argue that a sufficiently expanding economy will sweep away other social problems. Since the first edition, there have been many years of expansive Gross National Product. Social tension has, if anything, increased, not lessened. If the expenditure that produces this expansion is for military purposes — for example, for a war in Vietnam — not many will suppose that it will do much to relieve the agony of the urban ghetto. Throughout the Kennedy Administration, there was a friendly but vigorous battle over whether to reduce taxes in order to expand private income and expenditure and therewith employment and economic growth. The alternative was to keep up the level of taxes and press instead for more public spending for social purposes - education, urban renewal and improved welfare standards. Since Congress would be reluctant, this would be slower, so a larger allocation of resources to public purposes would be won at the price of a slower rate of total growth. While I argued the second case, not without some encouragement from the President, the weight of reputable economic opinion was solidly on the other side. The outcome was never really in doubt and, in 1964, taxes were reduced. Now, though the decision in a liberal administration might not be