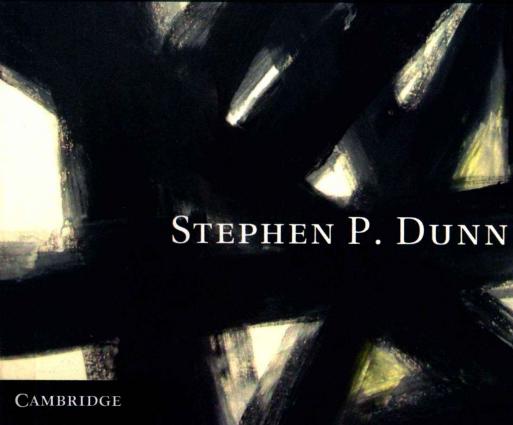


Introduction, Persuasion and Rehabilitation



The Economics of John Kenneth Galbraith

Introduction, Persuasion, and Rehabilitation

STEPHEN P. DUNN





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The Economics of John Kenneth Galbraith

The recent financial crisis has once again seen John Kenneth Galbraith return to the bestseller lists. Yet, despite the continued popular success of his works, Galbraith's contribution to economic theory is rarely recognized by today's economists. This book redresses the balance by providing an introductory and sympathetic discussion of Galbraith's theoretical contributions, introducing the reader to his economics and his broader vision of the economic process. The book highlights and explains key features of Galbraith's economic thought, including his penetrating critique of society, his distinctive methodology, his specific brand of Keynesianism, and his original – but largely ignored – contribution to the theory of the firm. It also presents, for the first time, a detailed examination of Galbraith's monetary economics and revisits his analysis of financial euphoria. This unique work seeks to rehabilitate Galbraith's contribution, setting out several directions for possible future research in the Galbraithian tradition.

DR. STEPHEN P. DUNN is Director of Strategy at NHS East of England. He is an international authority on John Kenneth Galbraith and has published numerous articles on Post Keynesian economics and the economics of the firm in leading international journals. In 2000 he received the prestigious K. William Kapp prize from one of Europe's largest economics associations. He is the author of The Uncertain Foundations of Post Keynesian Economics (2008) and the editor of the four volume reference collection John Kenneth Galbraith: The Economic Legacy (2011).

Praise for The Economics of John Kenneth Galbraith

"Richard Parker's book John Kenneth Galbraith is an intellectual and political history nestled inside a biography. Stephen Dunn's book is almost exactly the opposite. Parker's book is about the man. Dunn's is about the structure of what went on inside his brain and what appeared in his major books."

James K. Galbraith, Professor, LBJ School of Public Affairs, The University of Texas at Austin

"This is a remarkably rich and intelligent assessment of John Kenneth Galbraith's place in, and relevance to, modern economics. At a moment when Galbraithian analysis far better explains the global financial crisis than any of the standard models, Stephen Dunn's cogent handling of the richness of Galbraith's authentic originality will help provoke a muchneeded debate on where we are heading – and why."

Richard Parker, Official biographer of John Kenneth Galbraith and Senior Fellow at the Shorenstein Center, Kennedy School of Government, Harvard University

"In setting out to rehabilitate J. K. Galbraith, Stephen Dunn has done us all a great favor. This book would be important at any time. In the current global conditions, it is invaluable. It will provide a much needed impetus to encourage a new generation of economists and policy-makers to address the policy questions that so preoccupied Galbraith."

Patricia Hewitt, MP, Former Secretary of State for Health and Secretary of State for Trade and Industry

"Stephen Dunn has produced a timely, insightful and valuable introduction to the economic thinking of J. K. Galbraith. It deserves to be widely read. And it will inform debate in these interesting times."

Alan Milburn, MP, Former Secretary of State for Health and Former Chief Secretary of the Treasury "In the face of the financial crisis, Galbraith's work on the Great Crash of 1929 has gained particular attention for its many insights into the 'irrational exuberance' of the financial sector. This book demonstrates the vast breadth of Galbraith's work on capitalism, the dominance of large corporations, private affluence and public squalor, technological development, poverty and government policy as well as money, finance and instability. This is all set within an appreciation of Galbraith's methodological approach. A fine monument to the continuing relevance of J. K. Galbraith."

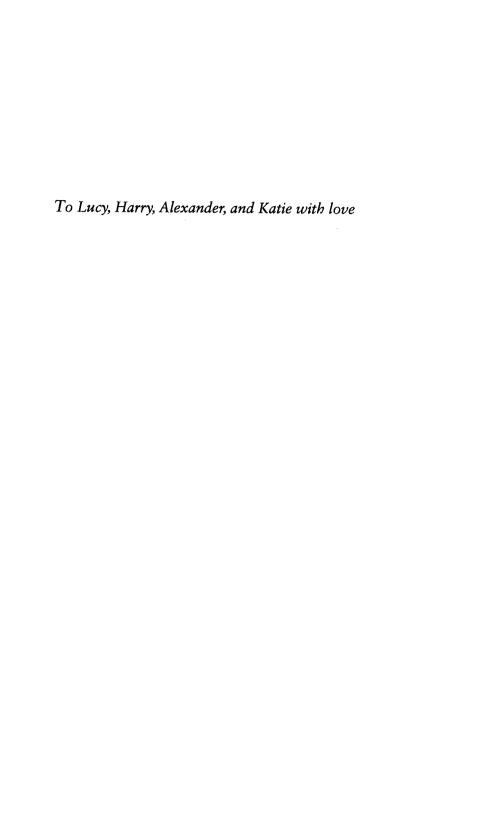
Malcolm Sawyer, Professor of Economics, University of Leeds

"Stephen Dunn has done more than anyone else in the last decade to keep the ideas of John Kenneth Galbraith alive. In this volume Dunn establishes the breadth and depth of Galbraith's vision, and the force and contemporary relevance of his analysis. This work is a timely and engaging monument to one of the greatest economists of the twentieth century."

Geoff Hodgson, Research Professor in Business Studies, University of Hertfordshire

"Stephen Dunn's book on Galbraith is comprehensive and scholarly and an absorbing read. Dunn writes clearly, providing detailed suggestions for further research and developments based on Galbraith's contributions."

Geoff Harcourt, Emeritus Professor, Adelaide University, Emeritus Reader in the History of Economic Theory, University of Cambridge and Emeritus Fellow, Jesus College, Cambridge



A prophet is only despised in his own country, among his own relations and in his own house.

Mark 6:4

Foreword

JAMES K. GALBRAITH

My father passed his centennial birthday on October 15, 2008. Within two weeks of that milestone, one of his books, *The Great Crash*, 1929, was back on the best-seller lists. That is no doubt mainly because the book is famous as a master narrative, combined with the eerie similarities between the years of Our Lord 1929 and 2008.

But why do the similarities seem so great? One reason, perhaps, is that we understand the events of October 1929 in the first place through a theoretical framework created by *The Great Crash*, 1929. It is a framework that emphasizes the role of speculative euphoria as a catalyst for imaginative fraud, theft, and abuse, and that illuminates the incentives for, and consequences of, complaisance by public authority. But above all, it places the financial sector in context, recognizing, and illustrating its role as a catalyst for prosperity and disaster in the larger spheres of economic life.

None of this was fully clear to economists before Galbraith; much of it has been highly disputed by many economists since. In Milton Friedman's telling, it was the tight policy of the Federal Reserve that converted slump into depression. In Jude Wanniski's, it was the Smoot-Hawley tariff. If Mr. Kevin Hassett of the American Enterprise Institute is to be believed, it was the cartel-friendly policies of the National Recovery Administration and the union-friendly policies of the Wagner Act. But the fact remains, for most readers, the most theoretically coherent and therefore persuasive telling is that of John Kenneth Galbraith. And all the more so today, when the key elements have been so plainly reprised in modern times.

Galbraith's larger work, considered as a whole, is rooted partly in Marshall's theory of the firm, partly in Veblen's economic anthropology, partly in Keynes' macroeconomics, and partly in Schumpeter's vision of technological change. But a consistent theoretical orientation is to the work of students of large organizations, from Weber, to Berle and Means, to Herbert Simon, to James Burnham and others of

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the American mid century. The Affluent Society is my father's reconsideration of what is now called neoclassical economic theory in view of this work, and The New Industrial State was his comprehensive effort to bring the large corporation into focus as the centerpiece of economic life and organization.

Needless to say, on all these matters Galbraith met resistance – but not only resistance. At the hands of professional colleagues he met something worse: a studied non-recognition that his work was theory, that it was even economics. The fact that his work was presented in clear English, in elegant style, to audiences of millions, only made it easier for academics to dismiss him from view. To the next generation of economists, it is fair to say, he is today little known, even as in many cases they struggle to reinvent his ideas.

In this book Stephen Dunn begins the task of bringing Galbraith's theoretical achievements into focus. Dunn, a scholar with the most comprehensive grasp of my father's extant published work, is ideally qualified for this task. In a concise, well-ordered argument he takes us through the major critical and constructive elements of Galbraith's thought – the theory of the consumer, of the corporation and of technology, of government and public purpose, of money and financial instability, of poverty and development. Here the work of many books and many years is brought within the reach of a contemporary professional reader.

Beyond that, Dunn does a fine job of capturing Galbraith's frame of mind, his intellectual style and mode of analysis. It is a mode that is fact based and synthetic – an approach that as Dunn recognizes and argues is scientific to the core, in a precise sense. And this is true, even where the eye of the disciplined scientist is concealed, to a degree, behind the pen of a literary master.

Preface

Political economy is an art as well as a science. John Kenneth Galbraith has always been a creative artist in formulating theories of the social world. His fabrications constitute the stuff of economic science.

Paul A. Samuelson (1989: 128)

April 29, 2006 marked the end of an era – it was the day that John Kenneth (Ken) Galbraith died. This was a great loss. Galbraith was a hugely influential figure in shaping and influencing the course of events and intellectual debate over the long twentieth century. Nevertheless, many of the tributes and obituaries that followed identified him principally with a vision of the postwar economy dominated by large bureaucratic corporations, unfettered by the demands of consumers and financiers alike – something unthinkable today. In the days that followed his death, little serious reflection was given to Galbraith's lasting contributions to, and place in, the study of economics. The purpose of this book is to seek to fill this gap and offer an accessible introduction to Galbraith and his ideas, and present some suggestions for further research and analysis in the Galbraithian tradition.

This book draws on previous writings that have been brought together to facilitate Galbraithian scholarship. I have sought to reduce duplication and adopt a more coherent approach to Galbraith's economics, seeking to achieve four principal objectives. First, I have sought to provide an introductory and sympathetic discussion of the salient theoretical contributions of J. K. Galbraith. The second objective is to consider Galbraith's work as a coherent whole – introducing the reader to Galbraith's economics and his vision of the economic process. The consequence of these first two aims is a focus on what I consider to be Galbraith's mature view, rather than an outline of the historical evolution of Galbraith's thought.

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The third objective is to evaluate Galbraith's place in the study of economics. I believe that Galbraith was a hugely original theorist, whose contributions are now so widely assimilated that their originality and lasting force is easily overlooked. The argument made here is that Galbraith espoused a distinctive methodological approach that underpinned his highly original and distinctive theory of the firm, his approach to power and development, his study of financial markets, and his ardent Keynesianism. In doing so, I argue that Galbraith should be seen more squarely within the Post Keynesian and Institutionalist traditions of economics - even offering the prospect of integrating them in a foundational vision of the economic process. This aim also links to the fourth objective, which, through reviewing Galbraith's contribution, enables us to establish new directions for future research in the Galbraithian tradition. That is to say, the aim is to contribute to the serious study, rehabilitation, and development of Galbraith's ideas. In doing so critical discussion is focused on development.

Acknowledging these aims explains why I do not dwell on the historical evolution of Galbraith's thought and the discussion and reflection that often surrounded it. But while several excellent critical appraisals have been produced on Galbraith, many fail to get under the skin of his theoretical system or consider its lasting salience. This is the purpose here. I offer two supporting arguments for such a contention. First, I believe the reappraisal of Galbraith's key ideas presented here is profoundly original and typically missed by earlier treatments. As we shall see, Galbraith: espoused an oft ignored and distinctive methodology that underpinned his divergence from the conventional wisdom; made an important contribution to the theory of the firm that anticipated many of the concerns and issues raised by the New Institutional Economics and proponents of a resource-based or capabilities view of the firm; developed a theory of advertising and consumer manipulation that is deeper and more complex than the persuasive view with which he is commonly associated, and; was an avowed Keynesian who anticipated recent developments in macroeconomics, as embodied in the New Consensus, which acknowledges the endogeneity of the money supply. Second, I was personally struck by Galbraith's suggestion, in private correspondence, on the study that forms the basis of chapters 7 and 8 that I "was one of the first to xvi Preface

read [The New Industrial State] like I hoped might be more generally the case." Such an admission suggests that Galbraith himself believed that the full force of his contribution had not always been fully appreciated.

The book also presents the first attempt at a comprehensive bibliography of Galbraith's works. This has been principally conducted in the excellent library facilities in the Graduate School of Business at Stanford University. In an ideal world I should have liked to triangulate this research with a systematic consideration of the materials deposited in the Galbraith collection at the Kennedy library. This, alas, has not been possible. Nevertheless, I believe I have been sufficiently rigorous in approach and that this represents a major contribution to the renewal of Galbraithian scholarship.

I should also record that I have not sought to emulate Galbraith's masterful prose. One should not try to imitate a master, as it will only invite ridicule and unfavorable comparison. Similarly I have resisted the temptation to attempt to copy his acclaimed wit. Krugman (2008c: 7) argues that "one temptation that often afflicts writers on economics, especially when the subject is so grave, is the tendency to become excessively dignified ... Too often, though, pundits imagine that because the subject is serious, it must be approached solemnly; that because these are big issues, they must be addressed with big words; no informality or levity allowed. As it turns out, however, to make sense of new and strange phenomena, one must be prepared to play with ideas." Although I find both Krugman and Galbraith's incisive wit penetrating, I have nevertheless sought to avoid "the grave risks in a resort to humor" (Galbraith, 1979a: 291). In seeking to highlight Galbraith's economic contributions, I have therefore focused largely on his ideas, and not his invective. Those seeking to be so regaled by Galbraith's wit should read Galbraith for themselves, or look elsewhere (see, for example, Stanfield, 1996: 8-17; 2001: 8-10).

Finally I should apologize for relegating too much scholarship to footnotes. As McCloskey (2000: 48) observes, footnotes are nests for pedants and can detract from the argument and flow. I agree. In an ideal world many of the points made in the footnotes would have been developed in the broader narrative. I am seeking, however, to introduce the general reader to the economics of J. K. Galbraith. This is why I have sought to avoid distracting digressions in the main text and relegated important but peripheral scholarship to endnotes. I would

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encourage all but the committed professional reader to avoid these. I hope, nevertheless, that the devoted scholar will be rewarded. Many of the endnotes highlight the similarities between Veblen, Knight, Keynes, and Schumpeter, provide evidence for the claims I make, and provide further suggestions for supplementary research.

Acknowledgments

I should first like to convey my thanks and appreciation to the Galbraith family. It was Jamie who strongly encouraged me to bring to his father's attention my work on his contribution to the theory of the firm. This led to a series of unsolicited and supportive correspondence from Ken Galbraith himself on the ideas developed in this book. It resulted in a visit to the Galbraith's home and a hugely enjoyable and instructive afternoon with both Ken and Kitty, the product of which was an interview on the origins of Galbraith's thought, reproduced here as chapter 12. For their warmth and hospitality, I am greatly appreciative.

I should also like to extend my sincere thanks to Malcolm Sawyer. Malcolm continues to be a friend, mentor, and inspiration. Without his advice and instruction over the years, I doubt I would have sustained my interest in both Galbraith and Post Keynesianism. He also commented extensively on several papers and earlier versions of the manuscript, greatly improving the clarity of the argument. I hope he is pleased with the final product. Geoff Hodgson also deserves singling out. Without his encouragement to pursue my ideas on Galbraith while walking in the Czech mountains, I doubt whether I would have resolved to begin to document what I believe is his neglected contribution. Geoff continues to provide advice, support and friendship beyond that which could be reasonably expected from a fellow academic. Paul Davidson also continues to be a major influence on my thinking and his ideas, contributions and correspondence have shaped my understanding of both Keynes and Galbraith. Geoff Harcourt, another warm and supportive scholar, also warrants a special mention. Geoff provided insightful comments on the whole manuscript that has, I hope, resulted in a clearer exposition. Ron Stanfield provided help, support, and copies of books and manuscripts to support the final push and also deserves singling out for a warm thank vou. Kate Duncan, Linda Merrill, and Lister Wilson also read and commented on the whole manuscript, greatly improving the final draft and the clarity of argument. For this I am most grateful.

I must also thank my joint authors for their help and support and permission to use and edit material that we have worked on together. Paul Davidson, Steve Pressman, Stacey Anderson, and Andrew Mearman are wonderfully engaging and original scholars who have influenced the development of my ideas on Galbraith and to whom I am profoundly in debt. I hope they are pleased with the resultant book.

I should also like to thank those who provided comment on earlier papers that have been extensively revised here. I would especially like to thank Ben Alamar, Philip Arestis, Dorie Apollonio, David Bunting, Charley Clark, Dan Cook, Paul Davidson, Dan Dohan, Paul Downward, Peter Earl, Eirik Evenhouse, Keith Glaister, Mark Groom, Geoff Hodgson, Jamie Holland-Jones, Christopher Jewell, Graeme Iones, Stefan Kesting, John King, Thorbioern Knudsen, Tony Lawson, Fred Lee, Hal Luft, Jeff Madrick, Foad Mardukhi, Huascar Pessali, Rick Pollay, Warren Samuels, Suzaynn Schick, John Smithin, Engelbert Stockhammer, Pavlina Tcherneva, Phil Tomlinson, and Joanna Weinberg for their discussions, critical comments, and other assistance in the development of the ideas contained therein. Simon Leary and Ian Wootton, senior partners at PricewaterhouseCoopers, also deserve a mention for encouraging me to continue in my endeavors amidst a busy job, and for discussions on the Great Crash, 2008. Similarly I am grateful for the encouragement of Sir Neil McKay and Sir Keith Pearson and colleagues in and across the NHS in the East of England to complete this book. Notwithstanding all this help and encouragement, I should point out, however, that I am solely responsible for the views expressed herein.

The Commonwealth Fund, a New York City-based, private, independent foundation, supported part of the research undertaken here. Especially I must thank Karen Davis and Robin Osborn, who continue to be so supportive in all that I do. Nevertheless, the views presented here are those of the author and not necessarily those of The Commonwealth Fund, their directors, officers, or staff. The Royal Economic Society also provided a research grant that enabled me to visit and interview Galbraith in Cambridge, Massachusetts.

Perhaps most importantly I should thank my family. My mother, father, and my brother, Russell, continue to provide the love and

common sense that an academic needs. Kate and Roger Duncan also deserve a warm thank you for all their kind support and hospitality. Lucy, my wife and partner, continues to support my interest in intellectual matters with selfless regard. Such pursuits clearly limit the time we have together. Harry, Alexander, and Katie also warrant a special mention for taking me away from the computer to engage in the joys that are part of family life. From this point onwards I promise to devote to them the time they deserve.

Finally I should like to acknowledge the following publishers for permission to use material from previously published articles: M. E. Sharpe, Association for Social Economics, Routledge, and Cambridge University Press.