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DRUCKER

TOWARD
the NEXT
ECONOMICS
— *and Other Essays* —



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PREFACE

These twelve essays have a common author and a common point of view. And though their topics are diverse, all are concerned with “social ecology,” and especially with the institutions—whether governments or organized science, businesses or schools—through which human beings attempt to realize values, traditions, and beliefs, and through which most people—and especially today’s educated people—gain access to livelihood and achievement, to careers, and to standing in society. All these essays also share the conviction that sometime in the last decade there have been genuine structural changes in the “social ecology,” most pronounced perhaps in population structure and population dynamics in the developed countries; but also in the role and performance of old-established and seemingly stable social bodies, such as government agencies or boards of directors, whether of businesses, hospitals, or universities; in the interface between sciences and society; and in fundamental theories that are still widely taught as “revealed truths.”

This is thus a “contemporary” book that addresses itself to current concerns such as the environment, retirement policies in aging populations, or the impacts of technology. Yet, in selecting the pieces for this volume from my writings of the last ten years, I have

excluded whatever might be called an article, that is, topical journalism, and have tried to confine myself to essays. To my mind, the difference is not one of style or length or level, but of intent. A good article catches the reality behind it, but it is concerned with the “here and now.” The concerns to which these essays address themselves are those of the time in which they were written—our time. The intention in every one was however to use the moment to gain understanding, to project, to see to the permanent through the transient. This, I believe, is most apparent in the two essays that open and close the book, “Toward the Next Economics” and “A View of Japan Through Japanese Art.” But the others are also informed by the same intent, and, I very much hope, convey to the reader the experience of self-knowledge, of immediacy, of direct understanding that a good portrait conveys, even though its subject may have been dead for centuries.

Most of the essays deal with concerns and challenges that are worldwide, or at least common to all developed non-Communist countries (and by and large to developed Communist countries as well). But since they were written in America, by an American and for publication in American journals, they heavily use American examples or figures. Only one piece however might be a little strange to non-American readers: the essay “Science and Industry: Challenges of Antagonistic Interdependence,” which was delivered to the 1979 annual meeting of the American Association for the Advancement of Science. In writing this essay, I became aware of the extraordinary differences in the way in which various countries have structured the relationship between organized “big” science and society. To a German, the friction between the two in today’s America must appear childish; to an Englishman or Japanese, on the contrary, the constant interaction between the two, however friction-laden, almost beyond belief. And all three might find it hard to accept that in an America renowned for its pragmatism, organized “official” Science has for a century indulged itself in an

extreme of virginal purity. Yet the concern of the essay: the growing divergence between the mind-sets and value systems of the producers of scientific knowledge, the scientists, and the users and consumers of scientific knowledge, government and industry, is just as pronounced in all other developed countries and presents just as great a threat, especially to science.

Two of the essays deal, however, with a special area rather than with worldwide developments and problems: the last two essays on Japan. It is a country in which I have been interested for almost fifty years and which I have now visited more than a dozen times. One fascination Japan holds for me is precisely that it is so different, that it is indeed *sui generis*. It is no more “Asiatic” than it is “Western”—and yet sometimes it is both. Few of what historians, sociologists, or theorists consider “universal laws” hold for Japan. Alone of all civilizations, it knew no property in land (except by temples and the Emperor) until a hundred years ago; it knew only rights to the land’s products. Alone of all civilizations, it voluntarily closed itself off from intercourse with the outside world for more than two centuries, while yet maintaining the liveliest interest in the arts, the learning, and the technology of the outside world, and the greatest respect for it. Alone of all civilizations, it knew no wars, whether external or internal, for more than two centuries, even though being governed during that period by a military dictatorship and living under a code of martial ethics. Above all, of all countries and civilizations I know of, Japan alone is accessible primarily through the eye rather than through the mind—and this despite being, for long centuries, from 1600 until the late nineteenth century, the country of the highest literacy rate. The last essay in this volume thus represents an attempt at gaining through perception, via design and the visual arts, the same access to Japan and the same understanding that one gains to other nations and other cultures through analysis, whether of philosophers or of institutions. Whether the attempt is successful, the reader must judge; but it is

surely important—Japan is too important in the world today not to be perceived by us in the West. And if this essay will move even a few Western—or Japanese—readers to look at Japanese paintings, either when next they visit a museum or in one of the many excellent art books now available, I—and they—will be amply repaid.

Essays 2 to 10 are reprinted in chronological order; it seemed the easiest and least contrived. The opening essay is quite recent, however. My long-time editor at Harper & Row, Cass Canfield, Jr., suggested it be put first, as it deals with a subject likely to be of most interest to the widest spectrum of readers and yet normally rendered unintelligible, even to the highly educated among them, by the economists' propensity for technical jargon. And essay 11 is more recent still. It was written after my last trip to Japan in the summer of 1980, to answer all the many questions in the West about Japan's sweep into industrial leadership, all the questions about the "secret" of Japan's success. And it seemed only logical then to put essay 12, "A View of Japan Through Japanese Art," next to Essay 11 and at the very end.

In an essay volume there is always a temptation to rewrite. I have resisted it. All I have done is to clear up a few ambiguities. Where, for instance, an essay written in 1978 talked of "last fall," I have changed this to "1977," but have not changed anything else. I think it only fair to let the reader decide how well the author's opinions, prejudices, and predictions have stood the test of time. One essay, however, I have had to revise extensively: that on "A View of Japan Through Japanese Art." Originally, this piece was my contribution to the catalogue "Song of the Brush," which John M. Rosenfield of Harvard and Henry Trubner of the Seattle Art Museum edited for a major exhibition of Japanese paintings shown in 1979 and 1980 in New York; Cambridge, Massachusetts; Denver; San Francisco; and Seattle. The essay contained numerous references to paintings shown in the exhibition and illustrated in the catalogue, which have had to be deleted. The words that replace them are a poor

substitute for pictures in a singularly beautiful catalogue, but the meaning still comes across, I trust.

This is my third volume of essays; the two earlier ones, containing selections spanning thirty years of writing each, were published respectively by Harper & Row in New York and by William Heinemann in London: *Technology, Management & Society* in 1970 and *Men, Ideas & Politics* in 1971. Both volumes were well received and gained a wide circle of readership, in the original hard-cover editions and, more recently, as paperbacks. I can only hope that this present volume will similarly renew many old and make many new friendships for me. For to a writer, even the most critical reader is a friend.

Peter F. Drucker
Claremont, California
New Year's Day, 1981

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Toward the Next Economics

IN ITS FOUR-HUNDRED-YEAR HISTORY economics has passed through four major changes in its world view, its concerns, its paradigms. It is now in the throes of another, its fifth “scientific revolution.”

Economics today is very largely “The House that Keynes Built.” Even in the English-speaking world only a minority of economists are Keynesians in their specific theories. But the great majority, perhaps even in the Communist countries, are Keynesians in their “mind-set,” in what they see and consider important, in their concerns, in their basic assumptions. They tend to define themselves largely through their relationship to Keynesian economics, are “near Keynesians” or “non-Keynesians” or “anti-Keynesians.” Their terminology—Gross National Product, for instance, or money supply—assumes the economic aggregates on which Keynesian economics is based. The views of economic activity, economic policy, economic theory which Keynes around 1930 propounded—or at least codified—have, fifty years later, become the familiar environment, the home-ground of economists regardless of persuasion.

First published in *The Crisis in Economic Theory*, a special 1980 issue of *The Public Interest*.

The Keynesians may not muster the biggest battalions. But they have occupied the commanding heights and thereby define the issues.

Yet both as economic theory and as economic policy Keynesian economics is in disarray. It is unable to tackle the central policy problems of the developed economies—productivity and capital formation; indeed, Keynesian economics must deny that these problems could even exist. Nor is it able to provide theory that can encompass, let alone explain, observed economic reality and experience. And it has been proven to be entirely irrelevant to the economic needs and challenges of developing Third World countries, if not harmful to them.

Indeed, the two theoretical approaches which alone during these last ten or fifteen years have shown consistent predictive power are both incompatible with the Keynesian model: the theories of the Canadian-born Columbia University economist Robert Mundell, and those of the “rational expectations” school. Mundell, after thorough empirical studies, concluded more than ten years ago that Keynesian policies do not work in the international economy. He correctly predicted the failure of currency devaluations to correct the balance of payments, stem inflation, and improve competitive position. The “rational expectations” school goes even further; it postulates that governmental, that is, macro-economic, intervention is not just deleterious; it is futile and ineffectual.

But these new approaches are equally incompatible with pre-Keynesian theories, whether Neo-Classic or Marxist. What makes the present “crisis of economics” a genuine “Scientific Revolution” is our inability to go back to the economic world view which Keynes overturned. To be sure, most of the economic theorems, economic methodologies, economic terms found in the textbooks today will be found in the textbooks tomorrow. They will only be reinterpreted—the way quantum physics reinterprets Newton’s Optics. After all, Keynes did not discard a single theorem of classical economics. He even retained “Say’s Law,” according to which

savings always equal investments; it became a “special case.” And one of the most advanced tools of modern economics, Input-Output Analysis, goes back to the first attempt at economic analysis, the Physiocrats’ *Tableau Economique* more than two centuries ago. But as economic world view, or as economic system, the earlier theories—e.g., the disciplined orthodoxy of the “Austrians”—will not do. What made Keynes so compelling fifty years ago even to a doubter (as I must confess myself to have been even then) was the new vision he forced on us; we suddenly had to see a whole new reality—and that reality is still with us and will not disappear. The Next Economics will be “post-Keynesian.” It cannot ignore Keynes, but it will have to transcend him.

There may be no “Economics” in the future. Totalitarian regimes, while greatly concerned with the economy, do not tolerate the postulate on which any discipline of economics must base itself: economic activity, though constrained and limited by non-economic rationality, concerns, and values, constitutes a discrete and separate sphere. Totalitarian regimes cannot accept economic activity as autonomous, internally consistent, and “*zweckrational*” within its boundaries. In a totalitarian regime, economics inexorably becomes a branch of accounting.

But if there is a future economics, it will differ fundamentally from the present one. We do not yet know what the economic theories of tomorrow will be. But we do know what the main problems, the main concerns, the main challenges will be. We do not know the Next Economics; but we can outline its specifications.

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To do this, we have to look paradigmatically—that is, as methodologists rather than as economists—at the economic world views underlying the four “Scientific Revolutions” in economics that preceded the one in which we find ourselves, and especially at the basic

world view and at the assumptions of the last, the Keynesian system.

Economics begins with the Cameralists and Mercantilists of France in the first half of the seventeenth century. They first saw the economy as autonomous. Earlier there was no economics, however great the concern with trade and livelihoods, with wealth, coinage, and taxes. As a system, a world view, Mercantilism was macro-economic and its universe was a political unit, the territory controlled by the Prince. Indeed the definition of the “national state,” as it emerged at the end of the sixteenth century, was essentially an economic one: the unit controlled by the Prince through his control of coinage and foreign trade. Mercantilism was supply-focused economics. To produce the largest possible export surplus, and with it the hard currency needed to pay professional soldiers, was its central concern.

Despite its preoccupation with supply, Mercantilism failed however to produce it. Mercantilism collapsed as a system in what we would today call a “productivity crisis.” The more the French government promoted manufacture for export and for the generation of specie, the poorer the country became—especially by contrast with the non-mercantilist, unsystematic, and unscientific English across the Channel. At the same time, Mercantilism also failed to spur capital formation. There were few economic statistics in those days other than foreign trade figures, the price of bread, and tax receipts; but there is no doubt that the French savings rate dropped sharply, while savings in non-mercantilist England steadily went up.

The Physiocrats started their “Scientific Revolution” with the paradox that under Mercantilism Europe’s “richest country,” France, had become one of its poorest ones, and was becoming the more wretched the more specie it earned. They solved the paradox by applying Gallic logic to Anglo-Saxon pragmatism. Their system remained as much supply-focused as was that of the Mercantilists. But they turned micro-economist, with the individual piece of land

and its cultivator the economic unit. This then forced them into the first economic theory of value—that is, the first theory that did not equate “wealth” with “money.” The Physiocrats’ source of value was nature in its economic manifestation, that is, land as producer of human sustenance. With this economics had become genuinely autonomous, had become a “discipline.”

Classic Economics—the third of the economic world systems—took from the Physiocrats both the concern with supply and the focus on micro-economics. But it shifted the theory of value from “nature” to “man.” With the Labor Theory of Values, economics became a “moral science.” It is to this, as much as to its success in producing wealth, that Classic Economics owed its success and its rapid rise as the star amongst the new disciplines. But very soon, by the time of the mature John Stuart Mill in 1850 or so, the Labor Theory of Values became an impediment and the cause of serious theoretical turbulence.

This underlay the third of the Scientific Revolutions, the one that occurred in the second half of the nineteenth century: the shift from Classic to Neo-Classic economics, from the disciples of Ricardo to Leon Walras in Belgium and the Austrian pioneers of marginal utility. The shift was primarily philosophical. The Neo-Classics shifted from “value” to “utility.” They shifted from human needs to human wants. They shifted from economic structure to economic analysis. To a non-economist this may not seem like a major shift, and may hardly deserve the name “Scientific Revolution.” But it introduced a new spirit that has animated economics and economists alike to this day.

This third Scientific Revolution also split economics. Marx and the Marxists refused to abandon the Labor Theory of Value. This then forced them to spurn economic analysis. And they were forced also to subordinate economics to non-economic “historical forces.” The Classics’ micro-economics, with its built-in equilibrium, they asserted, would work only if and when meta-economic obstacles to labor’s obtaining its full share of the social product

would have been removed through political upheavals generated by the system's "economic contradictions"—or, as Lenin later redefined it, by the system's "political contradictions." Then the state would wither away, then micro-economics would take over: then there would be equilibrium.

Seen against the paradigmatic background of economics, Keynes was indeed right in the claim he voiced in his Cambridge seminar in the thirties that his economics represented a far more radical break with tradition than Marx and Marxism. Keynes not only went back to the Mercantilists in being macro-economic. He stood all earlier systems on their heads by being demand-centered rather than supply-centered. In all earlier economics, demand is a function of supply. In Keynesian economics, supply is a function of demand and controlled by it. Above all—the greatest innovation—Keynes redefined economic reality. Instead of goods, services, and work—realities of the physical world and "things"—Keynes' economic realities are symbols: money and credit. To the Mercantilists, too, money gave control—but political rather than economic control. Keynes was the first to postulate that money and credit give complete *economic* control.

The relationship between the "real" economy of goods, work, and services, and the "symbol" economy of money and credit had been a problem since earliest times. Few economists were satisfied with the way the Classics (following the Physiocrats) dismissed money as the "veil of reality." Well before Keynes, economists of stature, e.g., MacCulloch, otherwise a devout Ricardian, or, in the generation before Keynes, the Swede Karl Gustav Cassel and the German Georg Friedrich Knapp, had attempted to replace a thing-based economics with a symbol-based one. But it was Keynes' observation that in the recession of the 1920s the English labor unions treated money wages as "real" and as "income," even when this actually resulted in lower purchasing power for their members, that then produced a genuine "Scientific Revolution." In Keynesian

economics commodities, production, work, are the “veil of reality.” Or, rather, these *things* are determined by monetary events: money supply, credit, interest rates, and governmental surpluses or deficits. Goods, services, production, productivity, demand, employment, and finally prices, are all dependent variables of the macro-economic events of the monetary symbol economy. Philosophically speaking, Keynes became an extreme nominalist—it was perhaps not entirely coincidence that he and Wittgenstein were contemporaries at Cambridge.

Looked at paradigmatically, Milton Friedman is as much a “Keynesian” as the Master himself, rather than the “anti-Keynesian” as which he is commonly depicted. Friedman accepts without reservation the Keynesian world view. His economics is pure macro-economics, with the national government as the one unit, the one dynamic force, controlling the economy through the money supply. Friedman’s economics are completely demand-focused. Money and credit are the pervasive, and indeed the only, economic reality. That Friedman sees money supply as original and interest rates as derivative, is not much more than minor gloss on the Keynesian scriptures. It is “fine-tuning” Keynes. And what has made Friedman stand out is not so much his monetary theory as his insistence on economic activity as being autonomous, on economic values as the hinge on which economic policy and behavior must turn, and on the free market—on all of which Keynes himself would have been in full agreement.

To Classics, Neo-Classics, and Marxists, the Great Depression of the 1930s originated in the “real economy,” in the impoverishment of Europe in World War I, further aggravated by Reparations and by a sharp drop in the productivity of European agriculture and industry. To a Keynesian, however, including Friedman, the Great Depression was the result of the Stock Exchange crash of 1929, of “speculation,” or of a contraction in the money supply, that is, of events in the symbol-economy.

The present “crisis in economics” is a failure of the basic assumptions, of the paradigm, of the “system,” rather than of this or that theory. Keynesian economics has run into the most severe productivity crisis since that of France in the eighteenth century which discredited Mercantilism. This productivity crisis in all developed countries—and worst in the two most faithfully Keynesian countries, Great Britain and the United States—invalidates the Keynesian theorem of the demand-control of supply. The crisis in capital formation which we are facing at the same time—again at its worst in Great Britain and the United States—could not, within Keynesian economics, have happened at all; it is theoretically impossible within the Keynesian paradigms.

Keynes was fully aware of the importance of productivity. But he was also convinced that productivity is a function of demand and determined by it. In the early thirties, the great years of the Keynes seminar in Cambridge, one heard again and again of Keynes being asked by one of the first-rate minds in the seminar, Joan Robinson perhaps or Roy Harrod, or Abba Lerner, “What about productivity?” He always answered: “We can take productivity for granted, provided that employment and demand remain high.”

The Classics had not taken productivity for granted. On the contrary, central to classical economics is the “law” of the diminishing return of all resources. Marx had based his forecast of the imminent demise of the “bourgeois system” (the term “capitalism” was not coined until after Marx’s death) on this axiom. What made Marx different was only his meta-economic, semi-religious belief that the end of “alienation” would release such enormous human energy as to reverse the diminishing return on resources in an outburst of “creativity.” But just when Marx, in the last unfinished volume of *Das Kapital*, most confidently predicted the demise of the “system” because of its inherent productivity crisis, productivity began to go up sharply. In part this was the result of the systematic approach to