An article from
Catholic Rural Life Magazine
Spring 2004 volume 46 number 2

ECONOMIC DEVELOPMENT AND TRUE DEMOCRATIC CAPITALISM

Stephen Martin, Ph.D.
Department of Religious Studies
Seton Hall University

IMPORTING LOW-WAGE JOBS, EXPORTING HIGHER-WAGE JOBS

Trade and trade policy have been ever-present issues of modernity. Domestic politics and international economics have became increasingly interlinked, most recently under the umbrella reality “global capitalism” and free-trade agreements such as NAFTA. Recently the issue has come to the fore in two ways in the U.S. political-economic arena. First, President Bush is seeking to address the import of (illegal) immigrant workers doing sub-minimum wage mostly agricultural jobs to the U.S. by making the workers’ stay in the U.S. temporarily legal. This is at least partly a result of American exports and overall economic policy which have cost agricultural workers their jobs and given them reasons to immigrate here.

Second, international economic development has crept onto the cover of TIME (“Are Too Many Jobs Going Abroad”)[1] and into the 2004 presidential campaign as companies begin to export, or “outsource” high-paying technology jobs to countries like India. Many workers who managed to “retool” after their manufacturing jobs were exported to other countries are now losing “information-age” higher-skilled jobs previously thought to be impervious to loss from globalization. When asked about this trend, Gregory Mankiw, the President’s Chief Economic Advisor, responded “Outsourcing is just a new way of doing international trade … More things are tradable than were tradable in the past, and that’s a good thing.” While politically inopportune in an election year, his response reveals the dominant international policy as market-driven, in his view deservedly out of the hands of both political and economic control.

“Managing” Trade

Both of these problems (and many other pressing ones) are linked to the way trade is managed, if indeed it should be “managed” at all. The answer to this has tremendous impact not only on the wealth of nations but also on the health (physical and spiritual) of people in the global economy, an aspect of economic development emphasized in Catholic social teaching’s insistence on “integral development.”[2] The purpose of this essay is to briefly compare differing theories of trade and economic development, beginning with the two dominant, “top-down” paradigms, Keynesian “development” trade theory dominant in the post-War period up to stagflation and debt crisis beginning around 1980; and the “globalization” trade theory closely

associated with the neoliberal “Chicago School” of economic theory.[3] One reason given for the current employment upheaval (echoed in Mankiw’s quote above) is Joseph A. Schumpeter’s notion of capitalism’s capacity for “creative destruction” which “incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one.”[4] The question of how this process can be creative without losing all its gains through destruction of local economies, ecologies and environments is provided through the alternative theories of trade and development of Jane Jacobs and Bernard Lonergan, S.J. I conclude by offering these two theories of economic development that most truly allow nations to practice *democratic* capitalism as a political culture “from below,” more consonant with the notion of “integral development” featured in Pope Paul VI’s *Populorum Progressio*.

Development theory, or developmentalism, has attempted to close the gap between the First and Third Worlds by focusing on industrialization in Third World countries. If the gap between the de-industrializing first world and the industrializing third world countries could be narrowed, gaps in relative shares of national income would narrow as well, or so goes developmentalist thought. As Giovanni Arrighi, Beverly J. Silver and Benjamin D. Brewer show, although the narrowing of the industrialization gap has definitely brought about “industrial convergence,” this “has not been accompanied by a convergence in the levels of income and wealth enjoyed on average by the residents of the former First and Third Worlds.”[5] As they show, the “north-south divide” has actually gotten worse both in periods of Keynesian “developmentalism” and neoliberal “globalization.” Not only have these benefits not accrued, there have been costs such as pollution, social and economic dislocation, and increasing alienation.

Industrial Convergence, Income Divergence

Developmentalism resulted from the success of post-World War II Keynesian economics, which advocated a strong role for government intervention in the economy. Keynesian economics rose to power because of its recognition of and powerful correctives to market failure when the economy is not managed (the prime example being the Great Depression), and it is credited for much of America’s post-war affluence. Developmentalism is built on the belief that once freed from the limits of colonialism and protected from Marxism, newly independent Third World countries would naturally emulate Europe’s successful recovery from World War II, when the Marshall plan guided European countries through foreign investment and reindustrialization with the result of increasing education and standards of living.

During the period in which Keynesian economics occupied the “commanding heights” of geo-political economics (roughly 1938-1980), the proportion of manufacturing as a part of total gross domestic product (GDP) decreased from 28.9 percent to 24.5 percent, while the same proportion for the Third World as a whole increased from 21.6 percent to 24.3 percent, virtually closing the gap in industrialization. However, this “generally prescribed means of Third World developmental efforts” actually resulted in a decrease in income shares – the gross national product per capita (GNPPC) as a proportion of first world GNPPC decreased slightly from 4.5%. In 1960 to 4.3% in 1980, bringing also costs to ecology, environment, society, and culture. The rising tide may have risen all boats, but the First World’s continued to rise faster than the Third’s (10).

After the 1970’s onset of stagflation (increasing prices and high levels of unemployment) undermined confidence in Keynesian economics and state intervention in the managing of the economy, neoliberal economics ascended to the “commanding heights” in domestic and international economics. There emerged a new “ideological globalization” approach to trade and development in the 1980’s and 1990’s. As Arrighi, et al. relate, this approach, which removed support from statist to market approaches also intensified competitive pressure on Third World Countries, ending up with a new world order of “structural globalization.” Third-world countries, being influenced within and without by Chicago School economists,[6] further removed barriers to trade and movement of capital.

Nevertheless, this turn has resulted in no more weakening of the North-South divide than the Keynesian developmentalism it replaced. Though from 1980-1998 the Third World passed the First in proportion of GDP devoted to manufacturing, “equally striking is the continuing failure of this general convergence … to translate into convergence in income levels either between the First or Third World ... the GNPPC of the Third World as a proportion of the GNPPC of the First World increase[ed]” only marginally from 4.3 percent to 4.6 percent. The only significant change in intra-country world income distribution caused by the rise of structural and ideological globalization was the increase in regional unevenness, with Sub-Saharan Africa and Latin America suffering serious deteriorating and East Asia improving through its “economic miracle”(11).

“Creative Destruction”

Not only do Arrighi, et. al., provide statistical data that debunks links between industrialization and rising standards of living, they offer a Schumpeterian interpretation of why industrial convergence as practiced by developmentalism and then globalization hasn’t led to income convergence. This in turn leads to the need to consider alternative theories of development put forth by Jacobs and Lonergan. Schumpeter’s “creative destruction” is creative in the new products, means of production, and speculation it directly and indirectly brings about, usually in cycles of “discrete rushes separated from each other by spans of comparative quiet” (18).[7] As Arrighi, et. al. note, its destructive effects come from its transformation of competition “into a cutthroat competition that inflicts widespread losses by making preexisting combinations obsolete” (16). The consequence of both effects are to reward spectacular prizes to only a small minority of winners, the remaining large minority receiving very modest return, no return or less than no return. On the international level, Arrighi, et. al. argue that along with these revolutions clustering in time they also “cluster in space,” where predominating prosperity in the First World is accompanied by predominating depression in the Third. In short, this is because innovations generally originate in the more developed and wealthier First World and gradually work their way into the more poor, less developed Third. In the First World, this creates what Arrighi, et. al. call a “virtuous circle” which generates even higher income and innovations, but by the time these innovations reach the Third World, they are no longer innovations. Thus, instead of reaping the same benefits as developed countries, the countries struggling to develop through industrialization “tend to be subject to intense competition [increasingly with each other] and no longer bring the high returns in the wealthier countries” (16). Possibly just as egregious, they suffer losses in environmental quality, economic and social dislocations, and increasing alienation which they are less able to ameliorate than is the First World. In Schumpeter’s terms, they are willing to endure these losses because they underrate their chances of becoming losers in this competition [18].

This accounts for the lack of income convergence during the Keynesian program of developmentalism from 1960-1980 despite the transfer of technology and industry that did result in industrial convergence. But during the 1980’s-era ideological and structural globalization, this competition became even more acute. As First World countries could no longer compete in many ways with the industrializing Third World, they moved to competing in capital – with the Third World overburdened with debt incurred while trying to catch up.

Oligarchic vs. Democratic Wealth

As a result, both in the Keynesian phase and more recent neoliberal phase, “democratic” wealth – involving “command over resources that, in principle, all can attain in direct relation to the intensity and efficiency of their efforts” – is sacrificed to “oligarchic wealth”, where there is no relationship between effort and result and wealth is “never available to all” because the effort required to attain it “raises costs and reduce benefits for all actors involved” (19). Despite its sometimes good intentions, developmentalism created this oligarchic wealth, while globalization, with more ambiguous intent, has sought to preserve it.

As First World countries began to lose the industrial foundations of their oligarchic wealth, a corresponding threat arose to American economic and political hegemony. In response, following the ideological precepts of Chicago School economists such as Milton Friedman (author of the immensely popular book and PBS series, *Free to Choose*), the U.S. undertook drastic changes in lowering taxes for the wealthy and "unrestricted freedom of action for capitalist enterprise" (20). Capital began to flow into the U.S. instead of out as in developmentalism. As outlined by Arrighi, et. al, in the drive to maintain its dominance, the rules of the game were changed to privilege the type of capital –(finance capital) that the First World specialized in, while the arena of less and less marginal returns – manufacturing – was being turned over to the Third World. This falling rate of returns led to a relative capital drought and enhanced Third World countries' balance of payment difficulties, further damaging their ability to compete for the new prize of finance capital.

In effect, neoliberal policies invited Third World countries to abandon the statist and inward-looking strategies advocated by development theory and play by the rules of an altogether different game—that is, to open up their national economies to the cold winds of intensifying world-market competition and to compete intensely with one another and First World countries in creating within their jurisdictions the greatest possible freedom of movement and action for capitalist enterprise (22).

From the standpoint of the hegemonic power, these strategies had the advantage of widening and deepening the reach of the U.S.-centered global money market, thereby even further "increasing the effectiveness of financialization in reviving U.S. wealth and power" (23). Though Arrighi, et. al. argue, as evidenced by demonstrations against the WTO, Third World countries seem less likely to accept the rules of the game. Also, as seen in outsourcing of increasingly well-paying white-collar American jobs indicates problems of maintaining oligarchic wealth and the veneer of economic democracy that Friedman and Mankiw's "freedom to choose" ideology seeks to maintain.

"Import-Replacement," as Means to Democratic Wealth

Though I cannot delve too deeply here into their sophisticated theories, I would like to examine briefly Jane Jacob's and Bernard Lonergan's views of international development that I believe restore more democratic means of wealth creation and income distribution - without sacrificing the innovation implicit in the idea of development.

Author, urban critic, economist and activist Jane Jacobs has argued strongly against a developmental model "from above."[8] As one of her characters relates in *Nature of Economies*, "development isn't a collection of things but rather a process that yields things. Not knowing this, governments, their development and aid agencies, the World Bank, and much of the public put their faith in a fallacious 'thing theory' of development that equates development with providing "things" such as schools, tractors, whatever..."[9]

Import replacement involves “a trial and error process of innovation, utilizing existing productive capacity of a city, and turning this capacity to new uses, adding new works to old”.[10] In this process, countries earn imports with exports that emerge from a region or country becoming more and more self-reliant. For example, San Francisco was able to import fruits and jams with income from gold and wheat and cattle in the mid-1800’s. Second, it began to produce its own fruit and jams, which it consumed domestically more and more instead of jams and fruits from the East, while still importing metal containers for the jams, etc. Along the way of course, it began to export fruits, jams, etc. to purchase further imports and then to replace them, producing its own metal containers, and so forth. The resulting jobs from these processes raise effective demand to enable import replacement as well as to create capital for investing in new schemes.[11] As older enterprises produce lower rates of return or become obsolete, regions turn to new imports to “stretch” and replace. While this process involves some “creative destruction” there is no evidence that this cannot be a positive sum game in which there are not necessarily winners and losers and thus an enduring “North-South” divide in the development process. Enterprises are more diverse, maintaining effective demand in a region or country is emphasized, and as this integral development proceeds, regions become better able to weather shocks when successes of other regions encroach upon their successes.

One of the lessons of this is for economic theory. Jacobs accuses mainstream economists of neglecting the economic reality she identifies: “The theorists after [Adam] Smith retreated into their own heads instead of engaging ever more deeply with the real world … Emphasis on co-development would have thrown deep suspicion on economic specialization and on the supposed efficiency of monopolies and deliberately specialized economic arrangements of imperial powers which have worked so much harm on world’s economies and people who depend on them.”[12] In terms of wealth, an emphasis on co-development would have encouraged democratic wealth over the oligarchic wealth which has instead prevailed.

Lonergan and True Democratic Capitalism

I would like here to briefly locate Lonergan’s approach in relation to the problems of the two dominant forms of international economic development discussed here, developmentalism and globalization, and along the way to Jacob’s ideas. The focus is on all economic agents intelligently, reasonably, and responsibly managing economic decision-making for the good of all.

First, Lonergan agrees that expansions in standard of living of economies typically result from increases in technology and resultant industrialization on some scale. This involves promoting the growth of the surplus circuit of the economy – those goods that are used over and over to produce other goods – in order to bring about an expansion of the basic circuit - those goods that constitute our standard of living. He also agrees with Jacobs and Arrighi, et. al. that mere transplantation of these processes through free trade and foreign aid from developed to developing countries as occurs under developmentalism and globalization is not the way to healthy economic development.

Lonergan shows also that this ends up hurting even the developed countries because it tends to bypass the basic expansion in the developed countries and short circuits development of the surplus expansion in the developing countries. An historical example he provides is nineteenth century English overseas colonialization and expansion. Instead of the technological improvements of the Industrial Revolution

resulting in relatively immediate prosperity for the English working class (as Adam Smith envisioned), which would have led to lowering of profit margins for capitalists, they instead sought to maintain very high profits by expanding overseas markets for their goods and technology. So, while England began its economic takeoff around 1790, wages in England did not begin to rise until 1870.[13]

In a previous issue of *Catholic Rural Life*, Bruce Anderson summarizes and extends Lonergan's trade and development theory of economic thought. Lonergan highlights the damage caused by developed countries exporting or even giving surplus goods to developing countries in order to stimulate surplus expansion in a developing country – the goal of industrialization policies of developmentalism. If surplus goods like new ploughs, tractors, factories, etc. are exported to developing countries, those countries, typically being poor, have to borrow money from the World Bank to purchase them. Even if financed through exporting of basic goods, then the money gained must leave the basic circuit to the surplus circuit, and then the basic sector - in other words, standards of living, must contract. "Then any increases in the money earned from using the new tractors would go toward paying off the principal and interest on the foreign loan," thus leaving the developing country and little money would be added towards the surplus expansion that is needed for that country to grow. "The anticipated basic expansion and a better standard of living would be a distant dream."[14] Even if surplus goods are given to developing countries, the money to purchase them goes to the surplus circuit of the developed country and developing countries still must purchase replacement parts from the more developed, requiring more foreign aid and little or no development of the surplus circuit of the poorer country and the "North-South" divide remains or is even exacerbated as Arrighi, et. al. show.

Thus the only way to authentic development is through entrepreneurship and encouraging import-replacing economies where a country learns to produce its own surplus goods and develops sources of expansion and credit in its own economy. Echoing the E.F. Schumacher (*Small is Beautiful*) dictum that what we need to do is find out what people are already doing and assist them, Anderson writes, "Economic success would then be seen in terms of inventing, starting and cultivating local industries that are relevant to local problems rather than using developing countries as outlets for the export business of developed countries,"[15] processes that exacerbate income gaps even within developed countries as export business serves to postpone the basic expansion and the increases in standard of living to all in the domestic economy that it brings. Though not outlined here, in his two economic volumes Lonergan adds the normative economic theory needed to enable agents to democratically guide the economy, especially ways to avoid the business cycle that plagues domestic economies and affects foreign ones, a phenomenon even Jacobs sees as mysterious and inevitable.[16]

Conclusion

I have showed how Schumpeter, Arrighi, et. al., Jacobs, Anderson and Lonergan illustrate approaches to economic development that bypass “oligarchic” wealth in favor of “democratic” wealth, and that Jacobs and Lonergan have showed how bottom-up political cultures are more effective than the “top-down” economic visions of Keynesian developmentalism. Bruce Anderson extends this analysis in this issue to show how Lonergan’s economics functions through the role of the “local economist.”

It remains here to put Lonergan’s economic analysis in the context of market-oriented, Chicago-school type economics which relies upon and reinforces the current ideological and structural globalization. Anderson puts it well in terms that can also be related to the goal of Catholic social teaching to promote “integral development” instead of development which instead tends to exploit Third-World economies, natural resources and peoples, and the answer to why industrialization has not led to lessening of the North-South income divide, while at the same time adding costs:

> The drive for maximum, yet stable, growth, innovation for the sake of innovation, the rhetorical quest for full employment, the frantic pace of mergers and acquisitions, the pathology of the bull market, central controls over taxation, interest rates, and trade, success measured in terms of income, stock options, and conspicuous consumption, the exploitation of resources irrespective of environmental destruction: all these favour a surplus expansion and, of course, those people who hold to the centrality for economics of the profit motive. People with this and related perspectives hold, at least implicitly, that the basic expansion and steady state phases of an economy are undesirable and aberrant, but the perspective doesn’t even fit with intelligently managing a surplus phase. We need to re-orient economist’s attitudes toward our economies. We cannot do that without getting them to admit the failure of present economic theories, thus getting them to face the challenge of replacing them. That is the heart of the present crisis.[17]

EndNotes

1) *TIME* , March 1, 2004: 26-31

2) The political, social and economic ends of the authentic or integral development prescribed by Paul VI in *Populorum Progressio* are greater assurance of finding subsistence, health and stable employment, increased share of responsibility without oppression, and greater political freedom for the third world vis-a-vis first including autonomous growth, and socially and economical improvements resulting in full human enhancement and equality with developed nations.

3) This transition from Keynesian to neoliberal economics as dominant influence in domestic and international economics is well chronicled in the Daniel Yergin and Joseph Stanislaw book and accompanying PBS series *Commanding Heights: The Battle Between the Government and the Marketplace That is Reshaping the Modern World* (New York: Simon & Schuster, 1998).

4) Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper & Row, 1942), 83.

5) Arrighi, Giovanni, Beverly J. Silver, and Benjamin D. Brewer. "Industrial Convergence, Globalization, and the Persistence of the North-South Divide." *Studies in Comparative International Development*, 38:1 (Spring 2003): 3-31. Numbers in parentheses refer to page references to this article.

6) Free-market Chicago-School economists not only gained favor in Washington and London but also exercised direct influence in removing government controls in places such as Chile and the Czech Republic (*Commanding Heights*, 239, 270).

7) The authors quote here from Schumpeter's *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process* (New York: McGraw Hill: 1964): 80.

8) See especially her *The Economy of Cities* (New York: Random House, 1969), *Cities and the Wealth of Nations* (New York: Random House, 1984) and *The Nature of Economies* (New York: Modern Library, 2000). These in turn build upon her seminal work in urban planning, *The Death and Life of Great American Cities* (New York: Vintage Books, 1961).

9) *The Nature of Economies*, 32.

10) Kenneth Melchin, "Economies, Ethics and the Structure of Human Living," *Humanomics* 10 (1994): 39.

11) *The Nature of Economies*, 74-6.

12) Ibid., 107.

13) Bernard Lonergan, *Macroeconomic Dynamics: An Essay in Circulation Analysis. Collected Works of Bernard Lonergan*, Vol. 21 (Toronto: University of Toronto Press, 1999), 82.

14) Bruce Anderson, "Trade and the Failure of Economic Theory," *Catholic Rural Life* 45:2 (Fall 2002), 11.

15) Ibid.

16) Jacobs, *Nature of Economies*, 115-6.

17) Anderson, 12.

National Catholic Rural Life Conference
4625 Beaver Avenue
Des Moines, Iowa 50310-2199
(515) 270-2634
email address: ncrlc@mchsi.com
website: www.ncrlc.com

This article was published in the spring 2004 issue of Catholic Rural Life©. No portion of this article may be reproduced without written permission from The National Catholic Rural Life Conference. To purchase the spring 2003 issue of Catholic Rural Life, please contact The National Catholic Rural Life Conference office at 4625 Beaver Avenue, Des Moines, Iowa 50310-2199, call (515) 270-2634, or e-mail NCRLC@mchsi.com. The cost is $2[50] an issue plus postage and handling.