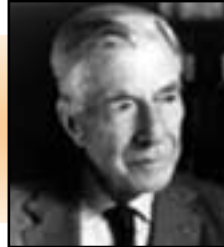


JOHN KENNETH GALBRAITH

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John Kenneth Galbraith, the world famous American economist, was not a follower of the cult of the invisible hand of the market. His analyses and evaluations do not move in the closed abstract



theoretical economic model, but start from the urgent and real problems of the modern economy. In this spirit, he also developed an analysis of the causes of inflation and the ways to control it.

John Kenneth Galbraith was born on 15th October 1908 at Iona Station in the Canadian province of Ontario. When he was aged 90, Galbraith recalled his childhood in a speech, when he received an honorary doctorate from the London School of Economics: „I was born and grew up on a farm in Canada. I still get up in the morning with a feeling of satisfaction that I do not have a day of hard monotonous work in front of me.“

His journey to theoretical economic research was not very direct. During his university study, he directed his attention to the economics of agriculture. He gained the degrees of master in 1933 and doctor in 1934 in agrarian economics at the University of California in Berkley. From 1934 to 1939, he taught at Harvard University in Cambridge and in 1939-1940 at Princeton University. He gains US citizenship in 1937.

During the Second World War, he worked in the state administration in the area of monitoring of prices. Later he was director of the Strategic Bombing Survey, director of the Office of Economic Security and adviser to various government institutions. He was awarded a high American decoration – the Medal of Freedom for his activity during the war. After the war he permanently returned to Harvard University, where he gained the professorship bearing the name of Paul M. Warburg. He worked at the university until his retirement in 1975.

He occupied a leading position among American economists, when he published his books „American Capitalism. The Concept of Countervailing Power“ in 1952 and „The Affluent Society“ in 1958. The literary level of this book led to it gaining two prestigious prizes from the book market – the Tamiment Book Award and the Sidney Hillman Award. Translations of Galbraith's works began to appear in other countries, and in the sixties he was one of the most famous American economists in the rest of the world.

As an author, who did not accept the self-regulating activity of market forces, he also expressed his views in further works. Among them, it is necessary to men-

tion „The New Industrial State“ (1967) and „Economics and the Public Purpose“ (1973), an excellent translation of which appeared in Slovakia in 1984. Galbraith devoted considerable attention in his writings to questions of inflation, monetary policy and money in general. Eventually, he wrote a separate book about money with the title „Money. Whence it Came, Where it Went“ (1975).

In spite of the fact that, thanks to his sarcastic criticism of neo-classical views, Galbraith did not belong to the mainstream of economic thought of his time, he was elected president of the American Economic Association, the leading organization of American economists, in 1972. Numerous honorary doctorates and other awards from many American and foreign universities and academic institutions, testify to the world response to his works.

However, his activity was not limited only to the area of economic theory. He worked as a newspaper and television commentator for many years, and from 1943 to 1948 he was editor of the well-known magazine *Fortune*. As an active member of the Democratic Party, he helped to write election speeches for A. Stevenson, the Democratic candidate for the office of president of the USA in 1952 and 1956. He was economic adviser to Senator John F. Kennedy in his presidential campaign. In 1956, he advised the Planning Commission of the Indian government, and from 1961 to 1963, he was American ambassador to India. The president of India has awarded the 92 year old Galbraith the second highest Indian civil award: the Padma Vibhushan.

The brilliant and effective literary style of his economic books and articles, such as we rarely find in the works of world economists, and perhaps also the authorship of the novel „Triumph“ (1968), the most popular of its time, led to Galbraith being elected one of the fifty members of the American Academy of Arts and Literature in 1982, after the death of the poet Archibald MacLeish.



The Dual Character of the Modern Economy

The starting point for Galbraith's approach to explanation of the processes occurring in the modern economy, including inflation and monetary policy, is recognition of the dual character of this economy, its division into two systems.

The first includes business organizations, which are not able or in some cases are able only to a limited extent, to influence prices and costs, and are completely unable to influence consumers and the government that is their external environment. They are companies endeavouring to maximize their profits and in the end they are subordinate to the market and so to the consumer. They form the sphere of the economy, which Galbraith calls the market system. This system is a combination of competing companies and smaller monopolies. In his view, the principles of neo-classical economics, which is the basis of the main orientation of recent economic thought, can be applied in this system.

However, they are not acceptable for modern economics, because since the beginning of the twentieth century, its important and ever larger part consists of business organizations of a different category – huge corporations, which make full use of their instruments of power not only to set prices and costs, but also to influence the behaviour of consumers, communities and governments. They also influence the processes occurring in the framework of the market system. Their ability to adapt to their external economic environment enables and even forces them to plan their future activity, so Galbraith also calls the sphere of big corporations the planned system.

Limitation of the sovereignty of the consumer

Starting from the dual character of the modern economy, Galbraith cast doubt on the validity of the cornerstone of neo-classical economic theory – the thesis of the sovereignty of the consumer in the modern market economy, according to which the consumers determine the producer by means of the market, which they have to form. He considered it unacceptable for an economy in which huge corporations dominate.

The neo-classical textbooks state that people have a tendency to choose those goods and services, which have the highest value, the highest utility to them. The market submits all the expressions of the individual will of the consumer to the producers. The producer is finally subject to the orders of the individual. The wishes of the sovereign consumer, his interests, preferences and tastes are the cause, and the actions of the producer the result.

However, Galbraith points out that the chain of causes and effects does not begin with the consumer, but in a modern economy very often with the producer, because in it, the wishes of the consumer are not given by factors operating outside the economy, such as biological, cultural or other factors, but at least partly by forces operating within the economy – the producers. In many cases, the utility of products and services for the consumer does not result from the objective needs of the consumer, but, to a significant degree, these needs are created by the producers.

This is done especially by the all-penetrating advertising and other components of modern marketing, which shape the tastes, wishes and desires of the consumer according to the interests of the producers, by influencing his instincts, uncertainties, children and so on. Producers often create consumer interest in goods and services, which are not really objectively necessary to the consumer. The powerful propagation of the products of all corporations shape the views of the population on goods in general and make them the central meaning of life.

Thus, Galbraith overturns the whole neo-classical theoretical structure of the sovereignty of the consumer, which depends on the assumption that the preferences and wishes of the consumer are given and not created within the economy. He proves with numerous examples, that demand, and so also the content and range of products, is often determined in the end, not by the preferences of the consumers, but very often by the producers themselves.

In the course of its development, neo-classical economics had to accept that monopoly and oligopoly producers in many areas are not subject to the market, but control prices and costs. However, according to Galbraith, it remains distant from real life, when it still assumes that the sovereignty of the consumer remains unaffected. Galbraith, known as the American Keynesian, also writes that Keynes was mistaken not to see that power is passing from the consumer to the producer, and so neglected the growing difference between the aim of the producer and the aim of society.

Technostructure and the maximization of profit

When explaining the dual character of the modern economy, Galbraith devotes special attention to the system of large corporations and the place a new social group – the technostructure – occupies in it. Galbraith's explanation of the causes of inflation also starts from knowledge of its importance and the importance of the action of the large corporations. The technost-



structure is composed of the leading representatives of the corporations, directors and leading employees, lawyers, scientists, engineers, auditors and marketing specialists. This complex of specialists represents the directing mind of the company. No individual, but the whole complex has decision-making power. In a mature corporation, it takes power from the shareholders. It pursues its own aims, especially its own financial interests, and not the interests of the owners of the company.

As in the case of a small company, the technostructure also pursues protective and positive aims of its activity. The protective aim of the small businessman is to achieve at least a minimal profit. If he fails in this aim, he loses the business. He achieves his positive aim, when he achieves a maximum profit.

The technostructure has two protective aims: like the small businessman, it must secure its existence and avoid dissatisfied shareholders or creditors "throwing it from the saddle". The basic strategy is to secure a certain, not necessarily low level of profit, which satisfies the shareholders. If the level of profit is inadequate, the shareholders will come together to resist the management of the company, which can lead to its removal, or they will sell their shares, which will come into the possession of another capital group and this can change the composition of the technostructure. An adequate level of profit also secures the necessary capital resources for the company. This protects it against creditors and against their intervention in its affairs, including personnel changes directly concerning the technostructure

Thus, the strategic protective aim of the technostructure is to secure an adequate level of profits, not a maximal level, but a stable level. When costs, demand and prices change, profits are usually unstable. Therefore, the technostructure must plan and direct not only prices and costs, but also the demand from consumers by directing their preferences and even influence the activity of the state.

The protective aims of the technostructure also require that consumers, trade unions or the state do not intervene in its decisions. In this case, the generally held view that intervention in private business decisions is unnecessary and abnormal, fulfills a protective function for the technostructure.

In everyday decision making, the protective aims of the technostructure overlap with the positive aims. The primary positive aim of the technostructure is growth of the company, which not only strengthens its protective aims, but also best serves the direct financial interest of the technostructure.

In a company, which is not growing, the progress of an individual depends on the positions of people in high

her levels of the service hierarchy becoming vacant. However, in a growing company new positions are created and opportunities for promotion cease to be a zero sum game, in which somebody loses what another gains. Pay and various privileges also increase with the growth of the company. Thus, according to Galbraith, maximization of profits is not always the primary aim in all corporations, but growth of the company, which especially serves the interest of the technostructure. The model of the neo-classical company, which has the main aim of maximizing profits, cannot always be applied in the theory of the company.

Galbraith also brings a new view on the activity of large corporations, which influences the whole economy. It is this creation of the need to plan. Logic is the starting point. If a process or product is more complex from the technical point of view, the time between the initial investment and the final production of the product will be longer. Therefore, it is necessary to plan to avoid the loss of capital as a result of events before the beginning of production and to avoid circumstances, which could threaten sales and so also the return of capital and the expected profits. This means that prices and costs must remain under control, that it is necessary to endeavour to ensure that the consumer will react favourably to the given product, and if the consumer is the state, it will be contractually obliged to buy the product and that the government will support the company. The company must plan not only its own operations, but also those of people and the state, if their activity influences its operations. It cannot wait for the orders of the market.

Inflation and monetary policy

In the majority of Galbraith's works, the problems of inflation and monetary policy overlap as an inseparable part of the development of the modern economy. A prepared longer treatise about economic management and monetary stabilization led to his extensive book "Money. Whence it Came, Where it Went" - fascinating reading about the history of money, banking and monetary policy.

Where inflation is concerned, he states in his writings that historically it was usually associated with wars and natural disasters, but after the Second World War, it continued into the period of peace and growing prosperity, and acquired a chronic character. Inflation happens if the demands on an economy reach roughly the level of capacity of the works and the employed labour force. In this situation, increased demand may cause increased prices, that is inflation. However, in the dual economy, it is necessary to distinguish between the two parts



of the national economy in connection with inflation and counter-inflationary measures.

In one part, the market system, prices grow automatically as a reaction to increased demand, which may be caused mainly by a growth in the quantity of bank and other credit and increased government spending. Both can be regulated, so that demand is reduced and the rise in prices is stopped. However, the trade unions may complicate the situation, if they win higher wages, which mean increased production costs and the resulting increased prices of products.

In the second part, the system of large corporations, the situation is different, because the company has the power to control prices. An important part of this power is the possibility to transfer any higher wage costs to the consumer. Although raising prices damages growth, from the short term point of view, uninterrupted production is often more advantageous for growth than a strike. In contrast to the situation when the owner of the company is a businessman, for whom increasing prices increases costs and so reduces income, the people who form the technostructure do not pay the increased costs from their own resources. Galbraith concluded from this that acceptance of the wage demands of trade unions is a normal tendency for large corporations. Trade unions endeavour to have expected increases in the cost of living taken into account in agreements, which means that price rises cause further pay rises. For this reason, the system of large corporations has a tendency to a continually rising spiral of wages and prices and to chronic inflation.

The main stream of recent economics assumes that if greater demand arises than the economy can satisfy at existing prices, the prices of goods and labour will increase, bringing inflation. In this case, it is necessary to limit demand by means of fiscal and monetary measures – reducing public spending, raising tax and limiting private spending using credit. Prices should then stop rising, and with stable or lower prices or lower production, the labour force will cease to be overpaid. That is, inflation should be treated by using the opposite of the measures used to treat inadequate demand.

However, Galbraith holds the view that these measures have an insignificant impact on the system of large corporations, which dominates in a modern economy.

Especially public expenditure on purchasing the products and services of this system cannot be significantly reduced, because this expenditure is mainly „in the interests of the higher aims of national security“. If it is necessary to reduce spending to prevent inflation, then cuts are made in the civil services of the state – social needs, municipal services, education and so on. These do not affect the system of large corporations, but the public sector and the market system.

Limitation of demand by increasing tax also has different effects on the two systems. The system of large corporations has extensive control of prices by producers. Therefore, large corporations can transfer costs connected with higher taxes on goods and services or incomes to the consumer, both individual and public, by means of prices. In this situation, raising tax may not have a counter-inflationary effect. The market system lacks such possibilities. The owners of businesses, which cannot determine prices, pay tax on company profits. The increased tax leads to limitation of demand from them.

A further method of limiting demand is monetary measures directed towards increased interest rates and so reduced credit, which leads to a decline in spending on investment and consumption. Different effects on the two systems also appear in this case. Since one of the main protective aims of the technostructure is protection of its independence from external credit resources, it endeavours to create savings. As a result, counter-inflation measures directed towards raising interest rates and limiting credit have relatively little effect on the large corporations. Moreover, if they need credit, the banks will willingly grant it. However, in the market system, companies really feel the effects of a policy of increased interest rates, because they have a significant dependence on credit resources. Limitation of access to credit resources can lead to a decline in demand.

Thus, orthodox measures against inflation cannot be effective in a system of large corporations. The structure and aims of this system and its relationship to the trade unions mean that, according to Galbraith, there is no hope of them being effective. Since this system includes the greater part of the economy, the limited effectiveness of these measures applies to the national economy as a whole.

The above mentioned measures to stop inflation limit mainly the demand, price rises and incomes in the market system. In the system of large corporations, prices are under control and strong trade unions influence the level of wages. Limitation of demand effects the level of production and employment in this part of the economy, but not the incomes of employed workers, which are not reduced, apart from loss of pay for overtime. Thus, although limitation of demand mainly affects the area of the market system, it only has an unfavourable influence on overall economic growth and employment, which is finally in conflict not only with the positive aims of the technostructure of the large corporations, but with the interests of society as a whole.

Galbraith does not see the solution in monetary policy and measures of the central bank or in fiscal policy, but in direct state intervention in the area of wages and prices, in spite of the view of the prevailing conventional



economic thought. Using several examples from the development of the American economy in the sixties and seventies, he shows the effectiveness of temporary application of wage and price controls, without disturbing the basic structure of the free market, thanks to which price stability was maintained during a simultaneous increase of production and employment. However, he also ironically adds that the idea prevails in politics, that when a certain state policy is effective, it is necessary to abandon it. This also happened when the policy of controlling wages and prices moderated the rate of inflation: most of the control measures were abolished.

However, Galbraith is not very optimistic about the

possibility of applying a policy of state regulation of wages and prices, because he sees problems in gaining approval by the politicians. In addition, since this policy has no weight among recognized economists, few teach their students, how it is possible to control prices or wages in a market economy. Galbraith's views on the causes of inflation, as on many other aspects of the modern economy, place him among the unconventionally thinking economists. It is only possible to agree with the truthful summary of the long career of John Kenneth Galbraith, stated by Professor Lester C. Thurow: "He is an economist standing out of the mainstream of economic thought, but in the mainstream of economic events".

The most important economic works of J. K. Galbraith

- A Theorie of Price Control (1952)
- American Capitalism. The concept of countervailing power (1952)
- Economics and the Art of Controversy (1955)
- The Affluent Society (1961)
- The Great Crash: 1929 (1961)
- Economic Development (1962)
- The New Industrial State (1967)
- Economics and the Public Purpose (1973)
- Money. Whence it Came, Where it Went (1975)
- The Age of Uncertainty (1977)
- The Nature of Mass Poverty (1979)
- The Voice of the Poor (1983)
- The Anatomy of Power (1983)
- Economics in Perspective (1987)
- A Journey Trough Economic Time (1994)
- The Good Society: The Humane Agenda (1997)