



# Economics, ideology and the possibility of endogenous development

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ECONOMIC theory is not neutral, and the results when it is followed owe much to the implicit and explicit assumptions embedded in particular theories. That such assumptions reflect specific ideologies is most obvious in the case of the neoclassical economics that underlies neo-liberal economic policies.

## The Magic of Neoclassical Economics

Neoclassical economics begins from the premise of private property and self-interest. Whatever the structure and distribution of property rights, it assumes the right of the owners— whether they are the owners of land, means of production or capacity to perform labour--- to follow their self-interest. In short, neither the interests of the community as such nor the development of human potential are the subject matter for neoclassical economics; its focus, rather, is upon the effects of decisions made by individuals with respect to their property.

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Logically, then, the basic unit of analysis for this theory is the individual (Himmelweit, 1977). This individual (whether consumer, employer or worker) is assumed to be a rational computer or automaton maximising mechanically on the basis of given data. Change the data and this ‘lightning calculator of pleasures and pains’ (in the words of the American economist Thorstein Veblen) quickly selects a new optimum position (Veblen, 1969:73).

Raise the price of a commodity, and the computer as consumer chooses less of it. Raise the wage, and the computer as capitalist chooses to substitute machinery for workers. Raise unemployment or welfare benefits, and the computer as worker chooses to stop working or to remain unemployed longer. Increase taxes on profits, and the computer as capitalist chooses to invest elsewhere. In every case, the question asked is— how will that individual, the rational calculator of pleasure and pain, react to a change in the data? And, the answer is always self-evident— avoid pain, seek pleasure. Also self-evident are the inferences to be drawn from this simple theory— if you want to have less unemployment, you should lower wages, reduce unemployment and welfare benefits, and cut taxes on capital.

But, how does this theory move from its basic unit of the isolated, atomistic computer to draw inferences for society as a whole? The essential proposition of the theory is that the whole is the sum of the individual isolated parts. So, if we know how individuals respond to various stimuli, we know how the society composed of those individuals will respond. (In the words of Margaret Thatcher, there is no such thing as society— just individuals.) What is true for the individual is true for the economy as a whole. Further, since each economy can be considered as an individual— one who can compete and prosper internationally by driving down wages, intensifying work, removing social benefits that reduce the intensity of job search, lowering the costs of government, cutting taxes— it also follows that all economies can.

To move from the individual to the whole in this manner, though, involves a basic assumption. After all, those individual atomistic computers may work at cross-purposes; i.e., the result of individual rationality may be collective irrationality. Why isn’t *that* the conclusion of neoclassical economics? Faith. The belief that when those automatons are moved in one direction or another by the change in given data, they necessarily find the most efficient solution for all. In its early versions the religious aspect was quite explicit— that instantaneous calculator of individual pleasure and pain was understood to be ‘led by an invisible hand

to promote an end which was no part of his intention.’ For Adam Smith (1937: 423), it was clear whose hand that was— Nature, Providence, God— just as his Physiocratic contemporary, Francois Quesnay, knew that ‘the Supreme Being’ was the source of this ‘principle of economic harmony’, this ‘magic’ being such that ‘each man works for others, while believing that he is working for himself’ (Meek, 1963:70).

But the Supreme Being is no longer acknowledged as the author of this magic. In his place stands the Market, whose commandments all must follow or face the wrath of the Market. The unfettered Market, we are told, ensures that everyone benefits from a free exchange (or it would not occur) and that those trades chosen by rational individuals (from all possible exchanges) will produce the best possible outcomes. Accordingly, it follows that interference with the perfect market by the State must produce disaster— a negative-sum result in which the losses exceed the gains. So, the answer for all right-thinking people must be— remove these interferences. Remove the interference of the State. In Galbraith’s well-chosen words, the position of the fundamentalist preachers is that in a state of bliss, there is no need for a Ministry of Bliss (Galbraith, 1952: 28).

And, if force and compulsion are necessary to bring about that world of bliss (i.e., to make the world conform to the theory), this will simply be ‘short term pain for long-term gain’. As Friedrich Hayek explained in an interview (12 April 1981) in Chile’s *El Mercurio* in 1981, dictatorship ‘may be a necessary system for a transition period. At times it is necessary for a country that there is some form of dictatorial power.’ When you have the invisible hand on your side, destroying obstacles to the market is just helping Nature (in Adam Smith’s words) to remedy the ‘bad effects of the folly and injustice of man’ (Smith, 1937: 638).

So, remove all restrictions on the movement of capital, remove all laws which strengthen workers, consumers and citizens against capital, reduce the power of the State to check capital (while increasing the power of the State to police *on behalf of* capital). In the end, the simple message of neoclassical economics (and the neo-liberal policy it supports) is— *Let Capital Be Free!*

Of course, it can be said (and, indeed, *was* said by George Stiglitz at these meetings two years ago) that nobody believes this simple message anymore. After all, economists have demonstrated the very strict (and impossible) conditions necessary for this theory to be logically supportable, have exposed the simplistic theory of information it contains, and have revealed the many cases of ‘market failure’ that call for an ameliorating role for government. Not the least of these common critiques stresses the interdependencies and externalities that are minimised by neoclassical theorists and which lead them often to commit fallacies

of composition (the assumption that what is true for one is necessarily true for all). *And, yet, as the close fit between the simple neoclassical model and neo-liberal policies demonstrates, all these sophisticated partial critiques of the simple message don't count for very much; in fact, that message (even if 'defunct') continues to be believed, and it functions as a weapon to be used on behalf of capital.*

## **The Keynesian Alternative**

The only successful challenge from within this basic model focused on the problem of the fallacy of composition and, accordingly, the need to consider the importance of the whole. Rejecting the familiar neoclassical argument offered during the Depression of the 1930s that generalised wage cuts will lead to rising employment, Keynes stressed the interdependency of wages, consumption spending, aggregate demand and thus the general level of output and employment. (The neoclassical movement from the part to the whole in this case, he held, depended upon the assumption that aggregate demand was constant— i.e., unaffected by wage cuts.) What neoclassical theory had ignored was the link between individual decisions and the whole. Since it did not understand how the interaction of individual capitals could produce a state of low investment by those capitals, it failed to recognise the potential role of government in remedying this particular market failure.

With his emphasis upon the whole or macro-picture, Keynes' theoretical perspective provided support for a set of policies less directly based upon the immediate interests of individual capitals. Keynes himself advanced his arguments as critical to the interests of capital as a whole— the crisis of the 30s for him was simply a crisis of 'intelligence' (Lebowitz, 1990); however, his framework became the basis for social-democratic policy arguments.

Characteristic of the use of the Keynesian macro-framework was the familiar argument by trade unionists that increased wages would increase aggregate demand, stimulate job creation and new investment. The importance of increased consumption became the focus of what is now described as the Fordist model of development— mass consumption, it was argued, is necessary for mass production. (In Post-Keynesian variants, increased effective demand was seen as the condition for realisation of potential productivity increases imbedded in existing technology.) However, to realise these benefits, in direct contrast to the neoclassical argument, the market by itself could not suffice— state policies and macro-management were seen as critical. What marked this as social democratic

in essence was the consistent theme is that workers can gain without capital losing — i.e., the positive-sum characteristics of the Fordist model. And this is what the case for endogenous economic development has shared in its stress upon the importance of domestic demand as the foundation for the development of nationally-based industry.

During the so-called ‘Golden Age’ between the end of World War II and the early 1970’s, these theories which challenged the neoclassical wisdom enjoyed a period of grace. It was an unusual period: the United States had emerged from the war with no real capitalist competitors— the economies of Germany and Japan were basket-cases, and the industries of France, England and Italy could not compete with those of the U.S. Further, in the U.S. and elsewhere, there was considerable pent-up demand both from households and firms. Although it was widely predicted that the end of the war would bring a relapse into the Depression, in fact the conditions were ripe for a substantial increase in consumption and investment (the latter drawing upon a large pool of technological advances made in the 30s and 40s). Added to that (and supporting industrial profits) were falling terms of trade for primary product prices as the result of increased supplies. In the U.S., oligopolistic industries were able to engage in target pricing to achieve desired profit rates and could yield wage increases without fear of being uncompetitive; elsewhere, the economies of scale available from new investments made the growth of consumption as the result of wage increases a net benefit rather a challenge to profitability.

Here was the setting in which the virtuous circle of the Fordist model could flourish: output increases stimulating consumption gains and vice versa— in both developed countries and in developing countries which decided to industrialise on the basis of import-substitution rather than to rely on the fortunes of primary product exports. But, the rapid growth of productive capacity in many places in this period portended a point when capital would face a problem of over-accumulation.

Already, by the late 1950s there were signs that competitors were emerging to challenge U.S. economic hegemony.<sup>1</sup> Further, by the mid-60s, terms of trade for primary products (dominated by oil) stopped falling, soon to begin an upward movement. Increasingly, it was the companies outside the U.S. that were growing more rapidly, and by the early 70s, with falling profit rates spreading, that “Golden Age” of capitalism is generally conceded to have come to an end.

The increasing intensity of capitalist competition which now became apparent reflected the over-accumulation of capital. In this context, transnational firms reduced their production costs either by shutting down (relatively inefficient)

branch plants that had been established to serve particular national markets or by turning them into exporters as part of a global production strategy. Production for national markets and, thus, the import-substitution strategy for industrialisation now no longer was seen as credible because relative costs became the focus in the competition of capitals. In general, the virtuous circle of Fordism had been broken, and a premium was placed instead on driving down wages and other costs for capital.

This ‘new reality’ is the context in which Keynesianism was rejected. The neoclassical wisdom which identified high wages and social programmes as a source of disaster once again dominated. Neo-liberalism (supported by international financial institutions) became the weapon of choice of capital, leading to a generalised assault on social programmes, wages and working conditions in the developed world and the use of a strong state in developing countries to ensure their access to the comparative advantage of repression.

But, why were Keynesianism and the Fordist model so easily discredited? Basically, Keynesianism as transmitted was always a theory of aggregate demand but not of supply. Its premise was that the level of output is constrained by demand in the economy in question; and if that demand was forthcoming, capital would provide the supply. Since the assumption was that capital would supply the consumption and investment goods if government created the appropriate environment, the government’s role was to stimulate the economy in those cases where the interaction of individual capitals in its absence was such as to lead to low investment. Its assigned task in the theory was to create the environment for investment when the market failed.

What happened, though, as aggregate demand rose and domestic supply did *not* respond appropriately? Inflation, trade deficits. Accordingly, in the new reality, the environment that government sought to create became one which would induce investment in the local economy rather than investment *elsewhere* —its focus, thus, became to lower taxes and wages. The neoclassical and Keynesian question, in short, had remained the same: what can the state do to make capital happy to invest? What was consistent was the role envisioned for government— support capital’s requirements.

## **The Failure of Social Democracy**

There should be no surprise, then, that capital abandoned the tool of Keynesian theory for one more suited to its needs under the new conditions. *But, how do we explain the failure of social democracy to find an alternative?* After all, social democracy has always presented itself as proceeding from a logic in which

the needs and potentialities of human beings take priority over the needs of capital. Even limited measures such as the exclusion of medical and educational services from the market, the provision of income maintenance programmes and social services, and the advocacy of everyone's right to a decent and well-paying job suggest an implicit conception of wealth as the satisfaction of human needs— rather than one of capitalist wealth.

In fact, the failure of Keynesianism as theory was really the failure of an ideology— social democracy. Within the Keynesian structure, there was always an alternative. The basic Keynesian equations in themselves say nothing about the structure of the economy: they don't distinguish between burying money and government investment, between activity which leads to the expansion of capitalist enterprises and activity which leads to the expansion of state enterprises. Although for Keynes the appropriate engine for growth was the capitalist one, a policy of expanding a state productive sector (i.e., its expanded reproduction) was always a theoretical option in order to drive the economy.

If the capitalist sector is the only sector identified for accumulation, however, then in theory and practice the implication is self-evident: a 'capital-strike' (the contracted reproduction of capital) is a crisis for the economy. All other things equal, a government cannot encroach upon capital without negative-sum results. This has always been the wisdom of conservative economists.

Yet, it is essential to understand that the conclusions of the neoclassical economists are embedded in their assumptions— and particularly relevant here is the assumption that all other things are equal. Consider two simple examples.<sup>2</sup> Rent control: the conservative economist will tell us that if you do introduce rent controls (at an effective level), the supply of rental housing will dry up and a housing shortage will emerge. Mineral Royalties: the conservative economist will tell us that if you do attempt to tax resource rents (notoriously difficult to estimate), investment and production in these sectors will decline, generating unemployment, etc. Both those propositions can be easily demonstrated— and they can also easily be demonstrated to be entirely fallacious with respect to the necessary conclusion.

Assumed constant in both cases is the character and level of government activity. Clearly, rent controls may reduce private rental construction— but if the government simultaneously engages in the development of social housing programmes (e.g., the fostering of co-operatives and other forms of non-profit housing), there is no necessary emergence of a housing shortage. Similarly, taxing resource revenues may dry up private investment in mineral exploration but a government corporation established for exploration and production in this sector

can counteract the effects of a capital strike. Obviously, all other things are not *necessarily* equal. Why should all other things be equal if a social democratic government rejects the logic of capital?

Thus, we need to be aware of the limits of the conservative economist's logic. However, that does not at all mean that these arguments can be *ignored*! Because what the conservative economist does quite well is indicate what *capital* will do in response to particular measures. It is an economics of capital. And, nothing is more naive than to assume that you can undertake certain measures of economic policy *without* a response from capital; nothing is more certain to backfire if you introduce measures that serve people's needs without anticipating in advance capital's response.<sup>3</sup> Those who do not respect the conservative economist's logic, which is the logic of capital, and incorporate it into their strategy are doomed to constant surprises and disappointments.

Understanding the responses of capital means that a capital-strike can be an opportunity rather than a crisis. If you reject dependence upon capital, the logic of capital can be revealed clearly as contrary to the needs and interests of people. *When capital goes on strike, there are two choices: give in or move in.* Unfortunately, social democracy in practice has demonstrated that it is limited by the same things that limit Keynesianism in theory —the givens of the structure and distribution of ownership and the priority of self-interest by the owners. As the result, when capital has gone on strike, its response has been to give in.

Thus, rather than maintaining its focus on human needs and challenging the logic of capital, social democracy has proceeded to enforce that logic. The result was the discrediting of Keynesianism and the ideological disarming of people who had looked upon it as an alternative to the neoclassical wisdom. The only alternative to barbarism on offer became barbarism with a human face. With this acquiescence to the logic of capital, its hold over people was reinforced; and the political result was the popular conclusion either that it really doesn't matter *who* you elect or that the real solution is to be found in a government *unequivocally* committed to the logic of capital.

So it was that the new wisdom became TINA—there is no alternative. No alternative to neo-liberalism, which is simply neoclassical economics enforced by finance capital and imperialist power. Yet, as occurred after the 'Golden Age', concrete conditions have a way of undermining accepted truths —and nowhere has this been truer than in less developed countries. The fallacy of assuming that every country could become the Promised Land by surrendering completely to capital became clear; and, as the evidence of the failures of the external orientation imposed by generalised neo-liberalism has accumulated, interest in an internal



solution, the endogenous model of development, has grown again— especially in Latin America. Yet, how credible is such an option in the current conjuncture where intense capitalist competition continues and the power of international capital in fact (if not ideology) has not declined?

### **The Possibility of Endogenous Development**

Removing the strait-jacket placed upon economic development by neo-liberalism will not be an easy matter. A true focus upon endogenous development can not simply be an orientation to the limited markets which characterised previous import-substitution efforts (even with a superficial regional integration which permits various forms of sub-imperialism to develop); rather, it calls for incorporating the mass of the population which has been excluded from their share of the achievements of modern civilisation. In short, real endogenous development means making real the preferential option for the poor. And, that means making enemies— enemies domestically (both those who monopolise the land and the wealth as well as those who are content with the status quo) and enemies externally.

Any country that would challenge neo-liberalism by seriously attempting to foster endogenous development will face the assorted weapons of international capital —foremost among them the IMF, the World Bank, finance capital and imperialist power (including in forms such as the U.S. National Endowment for Democracy and other faces of subversion). These are, of course, formidable foes. Since no government by itself can hope to succeed in this struggle against such external and internal enemies, the central question will be whether the government is willing to mobilise its people on behalf of the policies that meet the needs of people. Here, the essential matter is the extent to which the government has freed itself from the ideological domination of capital.

This unshackling implies more than simply a return to the old idea of import-substitute-industrialisation —even if accompanied this time by the massive land reform that would create the potential for a much larger home market. New models of Keynesianism —even dressed up as the Fordist positive-sum solution— will not move those whose active support will be necessary to strengthen the resolve of a government which will find itself constantly pressured by capital to sue for peace. Theories which continue to be rooted in existing patterns of ownership, in the dominating principle of self-interest and in the belief that (outside of a few exceptions) the market knows best cannot support a successful challenge to the logic of capital —because they are an organic part of that logic. The central

flaw in social democratic proposals for endogenous development is that they break neither ideologically nor politically with dependence upon capital. If a model of endogenous development is to be successful, it must base itself upon a theory which places the goal of human development first. More than the consumption stressed by neoclassicals and Keynesians alike, it must focus on investment in (and the development of) human capacities. This means not only the investments in human beings that come from the direction of expenditures and human activity to the critical areas of education and health but also from the real development of human potential which occurs as the result of human activity —i.e., the revolutionary practice that Marx described, that simultaneous changing of circumstances and human activity or self-change (*c.f.*, Lebowitz, 2003: Ch. 10). In contrast to a populism which merely promises new consumption, this alternative model focuses upon new production —the transformation of people through their own activity, the building of human capacities.

A development theory which begins from the recognition of human beings as productive forces points in quite a different direction to that of the economics of capital. Where are the measures in traditional theory for the self-confidence in people that is created through the conscious development of cooperation and democratic problem-solving in communities and workplaces? Where is the focus upon the potential efficiency gains of unleashing these human productive forces, whose creativity and tacit knowledge cannot be produced by directives from capital? By stimulating the solidarity that comes from a focus upon the interests of the community rather than self-interest, a model based upon this supply-side theory rooted in human development will allow a government to move further with the support of the community. Within such a framework, the growth of non-capitalist sectors oriented to meeting peoples' needs are not merely a defence against a capital strike; rather, they emerge as an organic development. The needs of human beings rather than the needs of capital, in short, here become the engine that drives the economy.

Endogenous development is possible— but only if a government is prepared to break ideologically and politically with capital, only if it is prepared to make social movements actors in the realisation of an economic theory based upon the concept of human capacities. In the absence of such a rupture, economically, the government will constantly find it necessary to stress the importance of providing incentives to private capital; and, politically, its central fear will be that of the 'capital-strike'. The policies of such a government inevitably will disappoint and demobilise all those looking for an alternative to neo-liberalism; and, once again, its immediate product will be the conclusion that there is no alternative.

## Notas

<sup>1</sup> This was very apparent to me as an economic analyst in the electrical products industry in the U.S. Increasingly, the trade journals were filled with fears about emerging European competitors and about the need to stress 'Buy American' policies when it came to contract awards by the local, state and federal governments.

<sup>2</sup> These examples come from the 1972-5 period when the New Democratic Party (Canada's social-democratic party) governed British Columbia, Canada.

<sup>3</sup> This, unfortunately, was the experience in British Columbia in 1972-5.

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