



Challenges of the New Millennium

John Kenneth Galbraith, Paul M. Warburg Professor of Economics Emeritus at Harvard University, discusses the major events of the past century and takes a look at the challenges ahead, in this conversation with Asimina Caminis, Senior Editor of *Finance & Development*.

Professor Galbraith, a world-renowned economist, has had a distinguished career in U.S. and international politics. He is the author of more than 30 books, including *The Great Crash*, *The Affluent Society*, *The New Industrial State*, *The Good Society*, and, most recently, *Name-Dropping: From F.D.R. On*.

What do you consider to be the most important events of the twentieth century and the greatest challenges facing us as we enter the twenty-first century?

The twentieth century was marked by three great disasters—the two wars and the Great Depression. Speaking in the most general terms, the major lesson to be drawn from the past hundred years is of the things to be avoided. Most people, at least in the more developed world, suffered more from death and hunger in the wars than from the depression. In a world equipped with atomic weapons, war is what we must, above all, seek to avoid. This is especially a lesson for the United States, because we are particularly vulnerable to any use of atomic weapons. (One bomb in downtown New York, I note, would rob a very large number of people of their possessions and any record of what they own.) So I begin by saying that the two greatest needs we have now are peace and the avoidance of another world depression.

*In your book *The Good Society*, you speak of both the benefits of globalization and the potential conflicts between globalization and the domestic policies of nation-states. Do the*

benefits of globalization outweigh its costs?

I begin with a minor point. I'm an advisor to the *American Heritage Dictionary* on language use and I will not allow the word globalization. It is a very ugly term! That we will have closer international relationships in such areas as economics, culture, the arts, travel, and communications I strongly hope, because one of the sources of disaster in the century just past was uncontrolled nationalism, which I would like to see less of in the future. Trade, along with cultural exchange and travel, lessens that risk. If you are an international corporation doing business in various countries, you are not inclined to stir up trouble between governments as has been the case in the past—particularly before World War I, when the heavy industries were military allies of governments and exponents of nationalism. I'm a committed supporter of closer international relationships.

The trend toward greater integration of countries into the world economy has aroused certain fears—for example, that industrial countries will lose jobs to the developing world, where labor is cheaper. Are such fears justified? Do you think they will lead to a backlash?

The loss of jobs is inevitable. It is something we must live with. We should bear in mind, among other things, that this loss of jobs is to people who are also very much in need of work and for whom employment is an escape from severe poverty. There are things we can do internationally to support wage standards, and I'm in favor of that, but I'm willing to accept some transfer of employment to people who are even more in need of work. When we talk about the low wages in Thailand, we forget how much worse off are the people who do not have those wages.

As developing countries become more integrated into the world economy, how can they reduce their vulnerability to external shocks? What lessons would you draw from the recent financial crisis in East Asia?

I have a very different view of that. We should take for granted that there will be economic crises, and especially in the young countries. History offers many examples of financial insanity in newly industrializing countries—among others, the American colonies or, indeed, the United States of the nineteenth century; Britain during the eighteenth century at the time of the South Sea Bubble; the Netherlands during the Tulipomania that swept the country in the seventeenth century; and France at the time of the great speculation for gold in Louisiana, which, sadly has not yet been discovered. Future crises are likely. There are some things we can do—that the IMF can do—to alleviate the damage, but I make two points: capitalism is inherently unstable and it is especially unstable in early youth. This is inescapable.

Subsequent to the Asian crisis, Malaysia, for one, adopted capital controls, and some economists began to argue that capital controls might be justifiable under certain circumstances.

There may be certain circumstances when one sees something particularly reckless being done, but the control of the flow of capital is not a simple thing. I would make it subordinate to closer international relationships involving close cooperation and intelligent restraint. We should also be aware that there is a useful feature of financial crises. Going back to an older colleague of mine—Joseph Schumpeter, with whom I often disagreed—I would point out that a financial crisis cleans up incompetence in the banking system, in the industrial system, and, to some extent, in government. This is a serious matter in old and new countries alike, but particularly in new countries. This comes back to something I've long urged as regards the IMF, of which I'm a strong supporter. I want to see it more willing to have "hygienic action"—notice that word—as regards incompetent bankers and incompetent businessmen and a more kindly attitude toward the people who suffer innocently and whose aggregate demand the economy needs.

In The Good Society, you argue that the industrial economies should coordinate their social and economic policies. What forum do you envisage for this coordination?

I was a young editor at the time of Bretton Woods. I reacted, as did all of my generation, with great enthusiasm. I've continued to think that those years that brought the IMF and the World Bank into existence were ones of great innovation. And I want to see continued development, for example, of the World Trade Organization, laying down the common rules on international trade. I also want to see more international coordination on science and on economic policy guidance. International action through conferences and through institutions such as the IMF, the World Bank, and the WTO is an essential part of the internationalism that I urge. You notice that I use the word internationalism and not globalization.

What role do you see for the IMF and the World Bank in the twenty-first century?

I see essentially a continuation and extension of their present roles. When we have a crisis, there needs to be an infusion of capital and there needs to be guidance on the matter of recovery, both of which are essential functions of the IMF. (I repeat, I don't want to see that preventing the cleansing effect of crises, which I have already emphasized.) And I want to see the World Bank continue to support capital flows to the poor countries—a most important function. The international financial markets do not sufficiently help the poorest countries, and that's where the World Bank is needed. One of the great achievements of the last century was the end of colonialism. But the end of colonialism did not bring the end of poverty, nor did it ensure in all cases adequate government.

Do you believe that democracy is essential to development and economic growth?

As a matter of religion, I support democratic government, but I also am aware that democratic government can be a guise for poor government or non-government. We have to look beyond democracy and ask also for competence. I emphasize that. I have previously argued that, looking around the world today, one sees that good, honest government is the greatest requirement for economic development—as was recognized in Europe and the United States in the last century. One of the greatest barriers to economic development is the government that does not serve its people and is protected by a commitment to sovereignty. We need to recognize—through the United Nations, not through individual countries—that there are times when sovereignty protects grave suffering.

Do you believe the European Economic and Monetary Union is a step toward closer coordination of policies by individual nation-states?

I support the EMU—it is a step in the right direction. I would point out that it is more wonderful in conversation than in reality, and I would like to see the reality increase beyond the common currency. But, having said that, I think it is one of the important developments of our time.

You have cited income inequality and urban poverty as two of the biggest problems that we face. What role should economic policy play in addressing these problems?

Monetary policy is not unimportant, but in the United States we tend to put too much faith in it. We dream that everything can be resolved by the Federal Reserve System. That's too optimistic. Getting back to the main point, inequality and urban poverty are indeed the two great problems of the developed countries and especially of the United States. I make no secret of my support of a strongly progressive income tax, stopping well short of the idea, not serious, that we need high marginal rates so that the rich will work harder to sustain their after-tax income. And I have long felt, as have many others, that a rich country such as the United States can guarantee everybody a minimum income. Some will not work, but leisure is said to be good in the affluent community—leisure is even said to be good for a Harvard professor. I'm not as appalled as most conservatives if we help the poor and some of them, as the saying goes, "abuse the system." Let us always have in mind in the fortunate countries that nothing, absolutely nothing, so denies the liberty of the individual as an absence of money.

Isn't there a danger that some wealth will flee to tax havens? And what about the so-called investment effect of higher taxes?

There will always be tax evasion. But we do make escape from the income tax system to the tax havens a matter for criticism and contempt, and let us continue doing that. We need even more to examine how the money that goes to the tax havens was, in fact, made. People who make money honestly generally pay taxes and this must be legally assured. I don't worry, for the moment, about the investment effect of this. The pursuit of income is not damaged by the fact that some of it goes to taxes; it may be enhanced. The contrary view is advanced by those who don't want to pay taxes. We must recognize that some of our most ingenious and committed literature is on the dangers of taxing the affluent. In that connection, we must have an increasing recognition of the relationship of income to corporate structure. Very large incomes are established by the top corporate executives who are in the wonderful position of appointing the board of directors that sets their income. We should hardly be surprised if that income is very generous.

Do you think the nature of the corporation will change in the twenty-first century?

No, but we should be more aware of the nature of the corporate structure than we are.

As an admirer of the economist Simon Kuznets, do you agree with his theory that economic growth in developing countries will necessarily be accompanied by greater income inequality, at least initially?

I'm quite sure Simon Kuznets, who was my very close friend and neighbor, was right. In a peasant economy or a

simple farming economy, as we've had in the past, there was a greater equality, often a greater equality in poverty, than there was as development increased and an increasing number of people escaped the poverty. I grew up in a farming community in Canada where there was a broad equality in income. But when people left the farm and went into business or the professions or other endeavors, income inequality increased—the result of expanded opportunity.

You have said that the GNP and the GDP are inadequate as measures of a country's welfare; what would be a more accurate measure?

There's much more. As I have said on previous occasions, Florence in its great days was a town with a very low gross domestic product. Shakespeare came from a country with a very low GDP. And Darwin, who did more to change our thinking about human existence and prospects than anyone else, was also from a much poorer country. Many of the great achievements of humankind have had very little to do with income. This is something we should always have in mind as we contemplate our educational system. I've long been a supporter of education in economics, but, for the sake of my conscience, I've also been a supporter of education in the arts. I might say that, as a personal matter, on the whole I've had more enjoyment writing about art than about economics. I worked on one of the well-known books on Indian painting and have also found my greatest life enjoyment in writing novels.

You've written more than thirty books. Are you working on a book now?

Inevitably. The tentative title is *The Economics of Innocent Fraud*. It is a somber account of all of the things we believe, in economics and politics, that have no relation to the truth. I begin by pointing out the way we have renamed the system—because capitalism had an unfortunate memory involving Marx on the one hand, and Rockefeller and Carnegie on the other, we've moved to a bland, meaningless reference to the market system. It doesn't say anything but is quite harmless. And I also deal, among many other things, with the fraud that is called work. Work is very good if you are poor, but if you are rich, leisure becomes important. The more you enjoy your employment, the more pay you get. This is the line of discussion on which I'm now engaged. It is something to which I've devoted a certain part of my life—the joy of annoying people.

So-called labor market rigidities—minimum wage, job protection, social security taxes—are often blamed for Europe's high unemployment rates, while flexible labor markets are credited with high rates of job creation in the United States. Is this trade-off inevitable?

You have to know what you're trading. If you're asking what produces the maximum rate of growth and if that is the total objective of life, perhaps there is too much rigidity in

the European social system. If you're asking what gives a contented and happy life and if that is your objective, you're likely to come out with a very different answer. I'm very willing to sacrifice some entrepreneurial freedom in return for a more civilized existence, and I don't think, parenthetically, that the trade-off is very great. I think we can have a substantially higher minimum wage in the United States without doing any serious damage to economic growth—more likely, none at all. And I also feel, as I said earlier, that we can give a basic income to the poor without doing any damage. It may even be that the flow of aggregate income, to use an old Keynesian term, will be more secure as a result. The poor will always spend their money; the rich may not.

Is the trade-off between inflation and full employment inevitable?

I have never minimized the role of inflation and I never felt that we would have as good employment as now and as favorable a rate of growth as now with as little inflation. That trade-off between growth, worker income, and inflation seems, indeed, to have receded in modern times. I certainly hope that is the case. We now have a very good rate of production and a very low rate of inflation—something, as I say, that I didn't foresee and that very few economists foresaw. When something is good, let us live with it.

Given the much-publicized failure of command economies and central planning, many economists now advocate scaling back the role of the state in economic activity and giving free rein to markets. What do you see as the appropriate role for the state to play in the economy? What sorts of things can and should be left to markets?

I do not see much of a parallel between what happened in the former Soviet Union and what is needed in the United States. People in the Soviet Union discovered—as indeed did the Chinese—that, beyond a certain level of economic development, you bring into existence more people than you can keep quiet. People want to have a share in their government, want freedom of expression and the other liberties associated with well-being. That was what brought the end in the Soviet Union. The notion that you could have any system that kept Americans quiet is fantastic. I'm not worried about the role of government. I regard that as a purely practical matter. There are some things—education, health care, minimum income, social security—where government is absolutely essential. There are other matters where the government rightly surrenders the production of goods and services to private enterprise. The problem is not one—I emphasize this very strongly—to be decided by ideology. It is not one to be decided by general rules. It is to be decided in the particular case.

In some countries, services once provided by the public sector have been or are being privatized.

I would not be for the privatization, say, of education. We should strive to improve the very large institution that

already exists in this area, rather than making such a massive change as putting our schools under private control. On the other hand, I'm not going to quarrel with anybody who wants to send his or her children to private universities. I'm the product of two public universities, but I also accept the existence of Harvard University. Again, this is an area where we should not be controlled by formulas, by ideology, but by what is best in the practical case.

Another trend we are now seeing worldwide is that of decentralization, as central governments devolve some of their power and responsibilities to local authorities.

I think there's often merit in having decisions made close to home.

Are boom-and-bust cycles an inevitable feature of our economic system or are there measures that can be taken to smooth or eliminate them?

The inevitability of the business cycle, as it used to be called, I take for granted. We've had this for several hundred years and the basic fact that is important for the IMF, as I said earlier, is that good times bring into existence, first, incompetent business executives; second, wrongful government policies in many cases; and, third, speculators. Working together, they ensure the eventual bust, and this is part of the system. The more we understand it, the more people will protect themselves, but this has been going on for several hundred years and I see no great change. I think we are a little more sensible than we once were. Some time after the South Sea Bubble, there was a wonderful company created to drain the Red Sea and recover the treasure that had been lost there by the Israelites. That sort of company probably wouldn't have much success now, although intelligence in these matters comes very, very slowly. But there is the salutary cleansing process, and I can't but think that there are circumstances now that one day will require that process. As one example, does anyone imagine that we have enough financial intelligence to manage the vast number of mutual funds that now exist?

The 1980s were known as the decade of the debt crisis, the 1990s as the decade of internationalism. What will the distinguishing mark of the twenty-first century be?

I don't attribute those words to either decade. Both have been part of a much longer process and can't be identified with any particular ten years. As to the future, I hope to see improvement in the poorest countries and reasonable stability in the fortunate countries, and, as I said earlier, I'm a strong advocate of closer international association. I don't want people to retreat behind nationalism—and certainly not behind a nationalism that is all embracing. **F&D**