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"On the Income Gap Between Nations: Was Veblen the First Development Economist?"

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Abstract: Development economics is understood as a postwar phenomenon without antecedents. Yet, Veblen's contribution to development economics was once widely disseminated and acknowledged. Veblen's evolutionary economics centered on historically relative and limited truths applicable to specific cultures. Veblen's growth theory is a theory of economic development: quantitative accumulation is significant because it engenders qualitative change. Veblen's analysis of the harnessing of the economic potential centers on the ability of a society to successfully introduce scientific and technological advances, giving rise to increasing returns as the surplus is invested in industrial activities. Veblen presented oblique comments and startling insights in a non-empirical manner.

Keywords: Veblen, technology, development economics, Imperial Germany, Opportunity of Japan

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The Origins of Development Economics

In what is perhaps the most sustained exploration of the genesis of development economics, H. W. Arndt argues that it had a "prehistory" prior to its formulation as a distinct field of economics after WW II (Arndt 1987, 9-48).[1] In 1945, the United Nation's (UN) Charter mandated the promotion of the "conditions of social and economic progress." This allowed for an institutionalization of development economics at UN development centers in New York and Santiago, Chile (Toye and Toye 2004, 26, 53-60). By virtually all accounts the emergence of development economics was *sui generis* — a postwar phenomenon that was all but devoid of antecedents.

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Dissenting Positions: Other Canons?

This standard narrative, however, has been brought into question: It is possible to encounter analyses that present either Alexander Hamilton or Frederich List as development economists. But Hamilton was primarily interested in the advantages of a large national debt for the development of a financial sector and his "defense of tariffs was related fundamentally to public credit considerations and only to a lesser degree to a belief in the benefits of protection" (Vernengo 2007, 227). As to List, it is important to note that he regarded economic development to be impossible in the geographical regions that include nearly all of the "developing areas." List took the view that economic development could not occur among the peoples who lived in a tropical climate because in such regions it is not possible, he claimed, to bring forth the same level of mental and physical productivity as in "temperate" zone nations (List 1841, Part II, Ch 13). Eric Reinert maintains that the first development economist was the 17th Century Italian, Antonio Serra whose 1613 treatise anticipated the centrality of national innovation systems in the critical industrialization process (Jomo and Reinert 2005, xvii). But Serra was concerned with how a once rich region should understand its own demise — hardly the subject matter of development economics (S. Reinert 2005, 25). H. W. Arndt maintains that Marx was the first to use the term "economic development" and "to aim explicitly at a theory of economic development" (Arndt 1987, 36). But even Marxists rejected the idea that Marx understood the dynamics of developing nations.[2]

Jomo and Reinert remind us that economic development has been the dominant unifying theme in economic analysis at least since Henry VII's "Tudor Plan" of 1485, which sought English industrialization (Jomo and Reinert 2005, vii-xiii). Those who have written in this broad tradition are part of what is termed the "Other Canon" — a heterogeneous body of thought that has wrestled with the non-quantifiable but all-important aspects of economic dynamics. Jomo and Reinert distinguish between *economic development* — an issue that was central to all of the classical economists — and *development economics. Development economics* — with its emphasis on historical understanding, disequilibrium, elements of pre-capitalist modes of production, interdisciplinary forms of analysis, dualism and so on — is viewed as an important recent addition to the Other Canon.[3]

Veblen as a Development Economist

James Street argued that "[i]nstitutional development theory takes its primary roots from conceptions advanced by . . . Thorstein Veblen and his intellectual successors . . ." (Street 1987, 1863). Alexander Gerschekron, who is commonly credited with a unique view of the catching up process in "backward" nations, makes but a singular reference to Veblen while acknowledging (inadequately) his great debt to Veblen's seminal idea of the "*merits of borrowing and the penalty of taking the lead*" (Gershenkron 1965c, 8).[4]

A half-century ago, before the dead hand of neoclassical economics swept the economics profession, Veblen's contribution to development economics seems to have been more widely disseminated and acknowledged than it is today. This, at least, is the conclusion one would likely draw from essays by Morris Copeland, Douglas Dowd, Carter Goodrich, Allan Gruchy, and Myron Watkins published in *Thorstein Veblen: A Critical Appraisal* (Dowd 1958a). One of the prime characteristics of *development economics* as it has been practiced since WWII has been its emphasis on historical specificity. Veblen's evolutionary economics centered first on the "historical relativity of economic truths" as being the only "scientifically valid" concepts, which had to be limited to "specific historical periods and to a specific culture or . . . cultures" (Copeland 1958, 60). Second, economic analysis had to be embedded in a "sense of cultural perspective," thereby dispensing with the pretentions of universality of neoclassical and much of classical economics (Copeland 1958, 61). It would be difficult to locate two more prescient first principles guiding the methodology of *development economics.*[5]

Gruchy argued that Veblen's main concern was to supplement economics with a theory of growth, "which seeks to explain the long-term forces fostering or *hindering* the expansion of [a] nation's total production" (Gruchy 1958, 154 (*italics added*)). Veblen's growth theory *is* a theory of economic development because economic expansion leads to and causes institutions and mores to metamorphose: quantitative accumulation is significant and worthy of serious analysis only because it engenders qualitative change. By deduction, the absence of adequate growth can be explained by the ability of the "kept classes" to abscond with most all of the national economic surplus, thereby destroying the possibility of investment. How to confront and displace the kept classes and thereby harness the *hidden potential* in peripheral nations is clearly an overriding theme of development economics. Veblen's analysis of the harnessing of this potential centers on the ability of a society to successfully introduce scientific and technological advances, thereby giving rise to increasing returns as the surplus is invested in *industrial* activities. Increasing returns from the expanding manufacturing core spill over onto other sectors. Retarding habits of thought and behavior are subordinated to the institutionalization of constructive instrumentalist processes as long-run increasing returns, lowering production costs, proceed through a cumulative process.[6]

Among the kept classes, which would roughly accord with the agro-mineral-export- financial oligarchy (and their underlings) in a developing nation, human proclivities such as conspicuous consumption are often dominant "dynastic privileges" (Watkins 1958, 255). Among the underlying population the proclivities to (1) sustain the well-being of society, (2) excel in productive activities, and (3) use reason to build tools to solve social problems were thought to be closer to the surface. If a society can bring this *constructive animus* to the foreground and subordinate the predatory animus historically inculcated among the oligarchy, economic development can likely be achieved.

Veblen on "Underdevelopment"

Veblen's book, *Imperial Germany,* and his essays, "The Opportunity of Japan" and "Outline of a Policy for the Control of the 'Economic Penetration' of Backward Countries and of Foreign Investment," present his views on developing regions (Veblen [1915] 1954; 1934a; 1934b).[7] At best, Veblen presents oblique comments and startling insights that were never pursued in a detailed empirical manner. As such, determining Veblen's "place" in the field of development economics will likely remain a matter of dispute.

Clarence Ayres emphasized Veblen's idea that ". . . overall economic development *of any people* is conditioned by the interaction of the dynamism of technology and the inhibitory force of institutionalized tradition" (Ayres [1960] 2003, 110; Veblen [1915] 1954, 191). But, this will only be true to the degree that dominant classes are initially willing to forego an exorbitant rate of return (Veblen [1915] 1954, 192). Societies that exhibit "permissive elasticity" in their cultural/institutional structures move ahead; the "dynamism of technology is the same all societies" but "technical cultural traits" vary (Ayres [1960] 2003, 108).

In *Imperial Germany*, a technologically-based argument underlies the interpretation of Germany's rapid economic ascendance. The nation that is most advanced in the industrial arts is, apparently, either ineffective at restraining the diffusion of advanced technologies, or willing to sell the "know-how" to "borrowing nations," because necessary technologies are "readily acquired" (Veblen [1915] 1954, 37; 187; 224). This ease of acquisition is worth noting since Veblen was more aware, arguably, than any 19th Century economist of the concentrated power of industrial capital and its proprietary vested interest in the *status quo.* Veblen did not clarify the fluid mechanisms through which borrowing nations acquired state-of-the-art technology. Rather, the emphasis is on the socioeconomic impacts of borrowed technologies — Veblen argued that the recipient nation would be able to incorporate the technologies while ignoring the inhibitory institutional matrix extant in the nation wherefrom the "elements of industrial efficiency" were borrowed (Veblen [1915] 1954, 38). The main drift of the argument is that the borrowing nation's economic possibilities are greatly enhanced because this nation can extract a greater level of "technological proficiency" (with much lower social costs) from the borrowed elements than can the nation that pioneered the technology (Veblen [1915] 1954, 190-91). Borrowing nations have relatively low sunk costs in obsolete machinery, thus encouraging the adoption of a new technological path. And, in Germany's case few *rentier elements* existed, further encouraging a *strategy switch* (Veblen [1915] 1954, 193-94, 196).

Germany's "exuberant growth" — notable from the 1825-50 period onward, resulted from population growth, industrial efficiency and military force (Veblen [1915] 1954, 61). While industrial efficiency was the "prime mover" Veblen also singled-out the role of the State, particularly in terms of the synergistic impact of military spending serving to advance industrial capabilities.[8] The State also plays a central role in removing internal barriers to production and trade. But, curiously, Veblen finds no role for import substitution industrialization: Germany's "self-contained" state intervention resulted in too much national agricultural production, thereby inhibiting industrial growth (Veblen [1915] 1954, 180-81; 184). Here, and elsewhere, Veblen adopts an extreme free trade posture (Veblen [1915] 1954, 242-43; 1934a, 262). Development economists since WWII have debated this perspective, commonly arguing that free trade will "lock-in" a resource dependent production system subject to decreasing returns (Cypher and Dietz 2009, chapters 5-6). Veblen legitimately criticizes Germany's mercantilist, colonial structure. But, at the same time he fails to emphasize the crucial role of interventionist state policies — so successfully deployed in Asia since WWII — that would be necessary for a nation to rise from economic backwardness (Amsden 2001).

Resource endowments, once a favorite explanatory element of development theory, play no role in Veblen's formulation of development/growth. Resources, for Veblen, are not destiny — unlike the then prevailing views suggesting trade specialization should be based on existing resources (commonly leading to the staples trap). Likewise, racialist formulations are rejected out of hand. Germany exhibited no special advantages in "workmanship." The industrial arts of Germany were lodged in the handicraft stage of production. With the shift to manufacture/machinofacture, achieved through borrowed technology, Germany's archaic industrial system was transcended. Further, workers need *less* mastery of the industrial arts as work becomes more simplified, while productivity rises under the new production stage of the Industrial System (Veblen [1915] 1954, 188). The spread of literacy, today known as "human capital," is crucial to the growth process — as is the shift in the "higher learning" toward technological knowledge and away from more classical forms (Veblen [1915] 1954, 194-95). Further, anticipating the "endogenous growth" theorist, Veblen argues that a dearth of capital *per se*, and the inability to raise investment funds, is much less an inhibitory factor than is the lack of theoretical knowledge. Shifting away from a "capital-centric" or "deterministic" analysis, Veblen further insisted that (1) the lack of industrial experience and knowledge; and/or (2) the presence of customs or laws that inhibit the use of new forms of production were more important considerations than were the ability to raise loan capital and/or investment funds for the acquisition of capital goods (Veblen [1915] 1954, 187-88; 272). Another qualitative element, demonstrably lacking in Latin American nations but extant in Asia, was a "sentiment of solidarity" and "community will" allowing for the effective transition to the advanced industrial stage (Veblen [1915] 1954, 163-4).

In "The Opportunity of Japan," Veblen adapts many of the arguments developed in his study of Germany, but at the same time he argues that those vast areas of Africa, and Asia "racially alien to the bearers of western culture" have not acquired "a practicable working arrangement with the occidental system of mechanical efficiency" and have "no effectual comprehension of the logic . . . of western technological equipment" (Veblen 1934a, 257). Veblen proceeds to argue that Japan has been *positively* conditioned by a feudal system similar to that of Western Europe. Given this, it is unfortunate that Veblen did not take up his own evolutionary approach regarding Africa and Asia. Had he done so the historical role of colonial dominance and depredation and the endurance of feudal and semi-feudal social, cultural and economic elements might have led Veblen into a sophisticated analysis of the causes of economic backwardness. Veblen claims that Japan's rapid success in overcoming its anachronistic state had much to do with a racially hybrid population similar to that of Germany. These functional population conditions, he claimed, were absent in Africa and Asia. Yet, he presents no evidence for his effort to differentiate Japan and Germany from Africa and Asia on these grounds.

Veblen's absence of critical, historically-based understanding of the "pronouncedly backward peoples" continues in his essay on the "Control of Economic Penetration" (1934b). Imagining a new world order after WWI, Veblen maintains that "[b]y grace of fortune" a benevolent Trustee or Protectorate status will now befall much of the world's impoverished regions (Veblen 1934b, 368). His prescription is to submerge national distinctions among vast regions, urging that they become "wards" under the "guardianship" of something analogous perhaps to the League of Nations (Veblen 1934b, 370). Veblen envisioned a situation where the League, as "the responsible keeper of their fortunes" would rule out heedless exploitation of their natural resources. Foreign investors were to manage on their own, without the ability to exert imperial pressures from their home states. At best, temporary leases would be extended to foreign firms, while the League would orchestrate the nationalization of the necessary infrastructure to a "moderate, retarded" level of "effectual industrial penetration" (Veblen 1934b, 372, 374).

Conclusion

Based on the foregoing analysis, it is reasonable to attribute to Veblen an early perception of major concepts that would become integral building-blocks in development economics after WWII. Veblen originally ranged over several seminal areas, anticipating the centrality of what would become known as National Systems of Innovation and Independent Technological Capabilities and Capacities. Veblen's insight into the centrality of technology was not either "capital- centric" or "deterministic," as is commonly charged. Rather, Veblen's stress on learning, know-how and the numerous intangible elements relating to human capacities anticipates the crux of the endogenous New Growth Theory that draws-out the significance of research, development and technological spill-over effects.

But, Veblen failed to apply his arguments beyond the two successfully borrowing nations in his analysis of the process of catching-up.[9] Given his general astuteness, his sometimes off-hand, sometimes romantic and patronizing observations regarding the "backward" regions of the world were jarringly out of step with his scathing critiques of prevailing orthodoxies. From a "Veblenian" perspective, he suffered all the defects of his virtues because of his (provincial) Eurocentric training and perspective.

His insistence on the efficacy of free trade policy is difficult to fathom given the successful application of List's infant industry industrial policy in Germany's catch-up phase. Nowhere does Veblen take up the issue of the asymmetric competitive forces of British industrialism which, in the absence of countervailing interventionist state policies to incubate industrial capacity, would have left Germany (and the United States) as simple commodity producers. Since Veblen is credited with the creation of the concept of path dependence it is surprising to see the failure of the application of this concept in *Imperial Germany* — where the absence of state intervention in the area of international trade vs. the internal market would have locked Germany into an *adverse* path combining handicraft production with agrarian pursuits (Hodgson 2003, 128-9).

Another area where Veblen appears to have failed to disenthrall himself of prevailing neoclassical orthodoxy relates to the assumption that technology is to be easily transferred, normally through market forces. In fact, technologies have been jealously guarded throughout history by both nations and the monopolistic giant firms Veblen analyzed so thoroughly. In addition, through legal institutions such as patents and property rights, crucial components of "know-how" (the capacity to duplicate technology) and "know-why" (the capacity to *create* technology) are controlled, closely-held or otherwise rendered unobtainable. Veblen's powerful ideas pertaining to the developmental prospects arising from borrowing is diminished by his acritical suppositions regarding these limits and barriers that any borrowing nation must confront.

At the same time, Veblen's influence on the pioneering work of Harold Innis was, by all accounts, formative (Baragar 1996; Innis 1962a, 17-26). As Albert Hirschman acknowledged, Innis was the source of one of the most important and useful sets of concepts that development economics deploys — forward, backward and horizontal linkage effects (Innis 1962b, 242-251). All of the above, points to the conclusion that Veblen was an important forerunner and forbearer of development economics. As such, it is unfortunate but not unanticipated to find that Veblen's significant work in this area has largely been, and continues to be either (1) underappreciated, (2) misunderstood, or (3) ignored. Veblen certainly contributed to this state of affairs through his insistence on a form of baroque-to-impenetrable expression that efficiently marginalized his startlingly innovative ideas and concepts crucial to understanding the development process.

Notes

1. Dominant in this period were the views of proponents of "reactive nationalism" particularly those of Sun Yat-sen whose ideas for Chinese development were composed in 1918 and M. G. Rande an Indian proponent of Fredrich List whose publications on Indian development commenced in 1892 (Arndt 1987, 16-19). British colonial administrators, particularly D. F. Lugard in his 1929 treatise on Britain's "dual mandate" regarding the stabilization of imperial control through limited programs of native participation, nutrition and education, propounded a new model of legitimation (Arndt 1987, 28; Cypher and Dietz 2009, 206-7). Other contributing factors helping to raise awareness of the need for a separate development economics would include influential work conducted by specialists at the League of Nations and the International Labor Organization during the Interwar period that brought to the foreground critical empirical analyses demonstrating the extent of the variance of nutritional,

educational and medical care levels between the industrialized nations and those of the underdeveloped regions (Arndt 1987, 33-35). Finally, Russia's revolution brought to light contending views on development along with the more rigorously presented economic perspectives of Preobrazhensky and Bukharin whose 1920s debate over the need for balanced vs. discontinuous growth helped set the course of industrialization for decades to come (Erlich 1960; Gerschenkron 1965a; 1965b).

2. Turner notes that Marx's concept of the 'Asiatic Mode of Production' has failed to be applied to developing regions and is "riddled with theoretical problems" (Turner 1983, 35).
3. Institutional economics is considered, from this perspective, to be integral to the Other Canon; yet institutional economics appears to play only an anecdotal role in the emerging work written from this perspective (Jomo and Reinert 2005; E. Reinert 2008).
4. Indeed, Veblen's importance is commonly linked to Gershenkron's work. Thus references can be found in development literature to the "Veblen-Gershenkron effect" of catch-up, or to those that argue that the ideas of cumulative growth and catching up can be traced to Veblen and Gershenkron (Findlay 1978; Targetti and Fofi 1997, 29).
5. These principles were adopted by Veblen from the German Historical School. I am grateful to Geoffrey Schneider for this point.
6. Institutional forces and factors, under the control of the kept classes, certainly can derail this process, since profit not progress is the moving force of the industrial system. The shortest route to quick profits may lead to monopolistic "sabotage" or "derangement" of technological progress. Veblen's ideas of technological impacts under conditions of U.S. monopoly capitalism in the late nineteenth and early twentieth century are not the focus of this article.
7. Veblen's ideas regarding "economic development" and/or "economic growth" are scattered about in numerous additional writings. No concise statement on the issue of development, apparently, was ever made. Because of his primary focus on Germany and Japan, dependency writers would likely argue, as did Andre Gunder Frank, that any analysis of a nation that had not been either colonized, indirectly controlled and underdeveloped by foreign powers or had been a "white settler" immigrant nation such as Australia was irrelevant for development studies (Frank 1969,4). Germany and Japan avoided colonization and later became colonizers. Nonetheless, a denial of the legitimacy of these case studies would only serve to limit understanding of development.
8. Nonetheless, a sub-optimal infrastructure was generated due to the institutional dominance of militarism—railroads and roads were built for strategic purposes and shipping technologies were distorted to serve naval ends (Veblen [1915,] 1954 214).
9. Carter Goodrich's "The Case of the Poor Countries" attempts to extend Veblen's analysis of Germany and Japan to a broad range of developing or formerly colonial regions (Goodrich 1958, 265-281). The results are suggestive, but largely inconclusive. In the same volume Douglas Dowd extends Veblen's concepts regarding Japan to the developmental debate concerning accelerated industrialization in the USSR from the 1920s to the 1950s (Dowd 1958b, 283-301).

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