

A POST-KEYNESIAN/STRUCTURALIST STRATEGY
FOR ECONOMIC DEVELOPMENT

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University of Missouri-Kansas City, 2013

ABSTRACT

There are two distinct traditions that have widely different views on the fundamental problem of economic development. This dissertation makes a contribution to the tradition known as the Scarcity in the Midst of Plenty Approach, which views the problem as an inability of less developed economies to fully utilize their existing resources because of demand constraints. The result of this situation is that these economies are frequently left with an inefficient production structure, high levels of structural underemployment, and few investment inducements that can ameliorate it. In order to solve this problem, the author argues that a development strategy must be implemented that is capable of combining short term demand targeting with long term structural change. Accordingly, the thesis of this dissertation is that the combination of balanced growth, employer of last resort, and the developmental state can serve as a development strategy that can successfully combine these

two elements as well as minimize structural underemployment. Consequently, we argue that this strategy can initiate and/or sustain a development process in less developed economies.

Our results demonstrate that this is indeed the case.

APPROVAL PAGE

The faculty listed below, appointed by the Dean of the School of Graduate Studies have examined a dissertation titled “A Post-Keynesian/Structuralist Strategy for Economic Development,” presented by Devin T. Rafferty, candidate for the Doctor of Philosophy degree, and certify that in their opinion it is worthy of acceptance.

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INTRODUCTION

Despite the fact that many Latin American nations achieved independence well before the end of World War II, the subdiscipline of economic development did not emerge until the post-War era. Indeed, it was only when an array of nations from various geographical regions also achieved independence that the ‘problem’ of economic development occurred. Because the well-being of the vast majority of the globe’s inhabitants needed to be increased, this problem clearly required a solution. Naturally, how this problem itself was ultimately envisioned would determine the solution(s) formulated to solve it. Hence, specific contributions made to the emerging field implicitly reveal how the problem was viewed.

The immediate result of these events is what has become known as early development theory. Accordingly, the authors working in this area became known as the ‘pioneers’ of development due to their initial formulation and subsequent solution for this ‘problem’. Over time, the number of authors making contributions has increased- causing the intellectual content of these theories to grow both more diverse and nuanced. Consequently, the fundamental problem being examined- however the ‘problem’ itself is defined- has become more refined in scope. It is possible to identify two contrasting approaches to how this problem¹ has been conceptualized. The first is called the Scarcity Approach and the second is the Scarcity in the Midst of Plenty Approach.

¹ It is important to note that this discussion concerns how the problem of economic development is conceptualized. This is distinctly different from how a process of development can be conceptualized. In Chapter I, we will take up the issue of how to conceptualize a process of economic development.

In the Scarcity Approach, it is believed the fundamental problem facing less developed economies is that their prospects are limited by a dearth of current resources. Thus, the Scarcity Approach envisions less developed economies as supply constrained. Previous authors whose work is representative of this approach includes Harry Johnson, P.T. Bauer, Deepak Lal, Bela Balassa, and Ian Little while more modern proponents would include John Williamson, Hernando de Soto, and the official policy stances of the IMF and World Bank from the 1980s onward (Toye 1987).

Because the fundamental problem is believed to be a supply constraint, the purported solution involves acquiring additional resources from domestic and/or foreign sources to produce higher growth rates. As a result, policy recommendations typically involve increasing the savings rate of domestically-based private investors. Moreover, this framework advocates utilizing this stock of augmented resources to attract additional ones from abroad (Kregel 2004, 280-281). Briefly, we will look at these two proposals in greater depth.

With regard to domestic policy, the Scarcity Approach advocates creating a ‘free market’ to take advantage of the presumed scarcity. To be sure, orthodox neoclassical microeconomics- as well as Austrian economics- centers on the ‘economics of choice’; that is, there is unlimited wants but limited resources. From this assumed premise, scarcity is then an inherent feature of all economies and entrepreneurs must compete for resources. Given these foundations (along with other empirically questionable assumptions) a ‘free market’ Pareto optimal macroeconomic situation can be theoretically constructed if outside intervention is minimal- where the latter is needed to prevent the distortion of prices from

their market clearing parameter values. In turn, the pricing system will then function as a set of signals- which is crucial for achieving Pareto Optimality. Accordingly, if the economy can ‘find the political will’ to minimize exogenous intervention, the economy will operate at full employment and appropriately utilize its resources. Thus, the Scarcity Approach argues that the fundamental challenge less developed economies face involves the implementation of a legal institutional framework- such as the property rights systems of developed economies- to enhance the degree of scarcity and promote the neoclassical economics of choice. To do so, this paradigm recommends policies to increase the savings rate since its adherence to the Loanable Funds theory causes its proponents to believe this is a necessary condition for entrepreneurs to access additional investment funds.

With regard to international policy, the Scarcity Approach endorses the liberalized integration of less developed economies into the global economy. Indeed, as a complement to the Pareto optimal domestic market, it argues a less developed economy should liberalize its foreign sector to prevent external price distortions- which it is claimed could have two adverse effects. First, external price distortions could reallocate domestic resources in a manner that would prevent the economy from achieving Pareto optimality. Second, if external prices are distorted the economy’s productive structure may not reflect its natural endowments- which would similarly result in a failure to achieve Pareto optimality and hinder long run growth prospects. Instead, it is argued that a less developed economy should utilize Ricardian trade theory and Samuelson’s factor price equalization to achieve internal and external general equilibrium. Further, liberalization is said to allow foreign resources to be channeled more easily- loosening the supply constraint.

However, this discussion still leaves the question of where growth is to originate unanswered. This aspect of the Scarcity Approach involves two facets- a domestic source and an international source.

In terms of a domestic growth source, it is said that upon creating a free market the economy will fully employ labor and capital. Therefore, outside of an increased labor force, neither of these factors can be a growth source since they are already fully employed. This would seem to present a conundrum: if labor and capital are fully employed, how is output expansion supposed to occur? Domestically, the answer is that growth comes from technical change- which can be considered exogenous or endogenous depending upon the way time is integrated.

In terms of exogeneity, technical change is seen as outside the model's statically-based production theory. Thus, by introducing improved technology into a static framework growth is made possible. This is the infamous technical change residual that the Real Business Cycle tradition popularized.

In terms of endogenous growth, sometimes the process of improved technical change is argued to arise from human capital growth- which accelerates the pace at which technical change occurs. Because changes in human capital are said to occur within the model, technical change can occur endogenously. Thus, the contrast between these two positions is simply found in their treatment of time. Regardless, the Scarcity Approach envisions that the source of domestic growth is technical change.

On the other hand, internationally-originating growth results from the less developed economy's liberalized integration into the global economy. In other words, the external

source of growth is found in Ricardian trade theory and the application of technical change throughout this process.

At this point, we may offer an initial objection to the Scarcity Approach that does not rely on challenging its general equilibrium framework.² Instead, our critique is this: are resources actually scarce in less developed economies? Certainly not. In point of fact, the characteristic of less developed economies that initially sparked developed economies' interest involved the fact that the former possessed abundant resources (Kregel 2004, 290)! Hence, to argue that the essential problem of economic development involves supply constrained economies does not seem correct. This shows that an alternative conceptualization of the problem is warranted. Below, we will depict this conceptualization- which we label as the Scarcity in the Midst of Plenty Approach.

In this second approach, the fundamental problem facing less developed economies is argued to be an inability to fully utilize their existing resources. In turn, this situation is caused by a lack of inducements to undertake the investments necessary to organize production in a way that facilitates the realization of these resources' potential. With respect to labor, the consequence is that it is perpetually underemployed because of structural factors. Thus, in contrast to the Scarcity Approach- which insists that less developed economies lack the resources necessary for development- the Scarcity in the Midst of Plenty Approach argues that the majority of resources necessary for development are present. Instead, what prevents a development process from occurring is an inability to induce the process of combining these resources in a more efficient manner.

² However, we may note that significant internal and external consistency problems involving general equilibrium frameworks have been well documented throughout the history of economics.

This is not to deny that certain factors may be in short supply. To be sure, in certain instances this may be the case. However, the scarcity of a particular factor is not the fundamental problem. The fundamental problem is that there is no incentive to provide that factor in greater abundance. This position is distinctly different from arguing that the factor is scarce because the resource does not exist. Instead, we are arguing that the factor is scarce because there is no existing incentive to provide a larger supply of it.

This discussion harkens back to Keynes' analysis in Chapters 16 and 17 of the *General Theory* when he demonstrates how- with a given set of expectations- the supply of certain factors (capital assets) in developed economies is scarce precisely because the inducement to provide newly produced quantities of them is non-existent. Thus, the reason factors are scarce and/or underutilized is not related to any physical limitation regarding the ability to produce them- such as the 'productivity' of capital. To be sure, this is the core argument of the *General Theory* involving the marginal efficiency of capital relative to the marginal efficiency of money. In turn, this also implies that the resources necessary to create the factor are not actually scarce. Indeed, while the resources to produce these factors may exist in abundance, the factor itself is scarce and/or underutilized because there is no inducement to newly produce and/or fully employ them since it would not be profitable to do so.

Extending this analysis to less developed economies demonstrates that the fundamental problem is not that resources are scarce. Instead, the problem is that there is no inducement to fully utilize them as factors of production. Hence, identical to Keynes' analysis in the *General Theory* involving developed economies, we conclude that less

developed economies are demand constrained. In other words, because potential payoffs are low there is no inducement to undertake the investment processes necessary to transform the economy's production structure. As a result, the economy is structurally unable to fully employ its existing resources and expand the division of labor.

Here we have arrived at Adam Smith's dictum that the division of labor is limited by the extent of the market (Smith 1986, Chapter 3). Indeed, if effective demand is low, the division of labor will remain narrow and resources, especially labor, will be structurally underutilized. Hence, it is the demand constraint that causes the inability to induce/sustain the process of resource combination which prevents a less developed economy from appropriately utilizing its labor resources and expanding the division of labor. Thus, it is demand constraints that prevent less developed economies from increasing production levels (Kregel 2004).

Now, with respect to labor resources, it is tautological to argue that when they are limited in their ability to realize their full potential the result is underemployment. In other words, an economy with large levels of underemployment will never be able to realize its economic potential since labor is perpetually underutilized. Thus, we find that economic development, at its core, is about locating ways to induce investments that will minimize structural underemployment and, in doing so, maximize output.³ At the same time, one of Keynes' primary contributions in the *General Theory* was to demonstrate how an economy can move labor from lower productivity occupations (unemployment) to higher productivity

³ Throughout this essay, we use the term 'minimize' rather than 'eliminate' or 'eradicate' because it is nearly impossible to completely do away with structural underemployment. To be sure, it is still a feature that can be found in developed economies. Thus, while the objective of a development strategy should be to eliminate structural underemployment, in practice the minimization of it is likely the best one can hope for.

occupations (employment) by increasing the level of effective demand. We will pick up on this theme in Chapter I.

At this point, we may inquire as to why less developed economies lack the inducements necessary to undertake a transformation of the productive structure. In other words, why is the stock of resources underutilized? We saw above that the answer to this is that less developed economies are demand constrained. However, this does not get us very far since demand constraints come in many different shapes and sizes. Instead, we need to identify the specific characteristic that prevents less developed economies from possessing the inducements necessary to fully utilize their resources. In order to do this, we need to split less developed economies into two categories: low and lower middle income economies and upper middle income economies.

In low and lower middle income economies, the specific characteristic holding back the inducements necessary to fully utilize resources is a low income/high structural underemployment trap- which will be examined in Chapters 2 and 4. Briefly, we may state that when this trap is present there is little inducement to invest- and thereby little inducement to transform the nation's productive structure and minimize structural underemployment- because there is a low level of real income. Indeed, the low level of real income causes a relatively large quantity of individual investments considered in isolation to have negative net present values or, at a minimum, have expected returns lower than the marginal efficiency of money. Thus, little investment occurs- which perpetuates the low level of real income and the structural underemployment of resources, particularly labor.

Hence, the biggest challenge facing these economies involves how to overcome this trap and set a development process in motion.

On the other hand, in upper middle income economies the existing resources are being used more productively than they previously were. However, they are likely still not being used as productively as possible. Hence, upper middle income economies have two different agendas. First, they are concerned with how to sustain their development process. Second, relatedly, they are concerned with becoming developed economies; that is, they want to be high income economies. Consequently, upper middle income economies would benefit from the creation of additional investment inducements for three reasons- all of which would further transform the productive structure. First, additional inducements would help accelerate this process. Second, additional inducements would diversify the sources driving this process. Third, the combination of these two features would stabilize⁴ the rate of development.

The recognition by the Scarcity in the Midst of Plenty Approach that demand constraints prevent less developed economies from fully utilizing their resources reveals that a development process is, fundamentally, a process that combines short term demand targeting with long term structural change. Accordingly, this implies that any viable strategy for development must be capable of combining short term demand targeting with long term structural change.

Short term demand targeting is necessary for two reasons. First, it is needed to initiate a development process by inducing investments in strategic areas that will permit the

⁴ By stabilize we mean narrow the dispersion of the rate at which structural underemployment is being done away with.

economy to more fully utilize its resources. Second, throughout a process of long term structural change, certain ‘on the fly’ adjustments will need to be made. Thus, in order to sustain a development process, short term demand targeting will be required to realign the short term macroeconomic movements with the longer term structural goals.

At the same time, since the ultimate goal is to transform the economy’s production structure, long term structural change is necessary. To be sure, this change is what will allow the economy to more fully utilize its domestic resources. As a result, the Scarcity in the Midst of Plenty Approach envisions a development process as the process of more fully utilizing existing labor resources- with this process potentially culminating in the minimization of structural underemployment.

This dissertation seeks to make a contribution within the Scarcity in the Midst of Plenty Approach. As a premise, it argues that within this tradition there is no strategy for economic development that satisfactorily integrates short term demand targeting with long term structural change. Drawing off this recognition, the thesis of this dissertation is that balanced growth, Employer of Last Resort (ELR), and the developmental state can be synthesized to serve as a strategy that will achieve short term demand targeting concurrent with long term structural change in less developed economies. Therefore, this strategy is capable of initiating a development process. Moreover, it is capable of sustaining a development process. Finally, we argue that this synthesis will allow less developed economies to minimize structural underemployment.⁵

⁵ It is important to note that short term demand targeting and long term structural change are prerequisites for a development process. However, as we shall see in Chapter I, a development process does not guarantee the minimization of structural underemployment because there are many ways of combining short term demand targeting with long term structural change that do not accomplish this latter goal.

It should be noted that each individual theory mentioned above belongs to the Post-Keynesian/Structuralist tradition. Consequently, we argue that this particular strategy is a post-Keynesian/Structuralist strategy for economic development.⁶

⁶ Some may object to this characterization. Instead, one may argue that this synthesis should be depicted as a ‘Neglected Aspects of Post-Keynesian/Structuralist Development’ approach. To be sure, while these three theories are neglected in the development literature, the author is hesitant to label this synthesis as a ‘Neglected Aspects’ approach because giving it that label can incorrectly convey that it examines peripheral aspects of development. To be sure, these three theories are core components of a viable development strategy. Therefore, it is not examining peripheral aspects of development. Thus, the takeaway should be as follows. If it is recognized that this synthesis is not simply examining peripheral development aspects, we have no problem labeling it as a ‘Neglected Aspects’ approach. However, what must be retained is the vital implication that this synthesis can preside over a development process and minimize structural underemployment without requiring additional features.

CHAPTER I

THE PROPER OBJECTIVE OF AN ECONOMIC DEVELOPMENT STRATEGY AND SOME ISSUES OF TERMINOLOGY

Part I.A - The Proper Objective of an Economic Development Strategy

We first need to outline what a development strategy should seek to accomplish. To be sure, one cannot speak of a strategy for economic development without depicting that strategy's goal. Consequently, we first need to identify what the objective of our strategy is.

In the Introduction, we argued that the fundamental problem envisioned by the Scarcity in the Midst of Plenty Approach involves an inability to fully utilize existing resources because these economies are demand constrained owing to a lack of inducements to invest. As a result, they are left with an inefficient production structure in which labor is perpetually underemployed. Consequently, economic development should fundamentally be concerned with discovering ways through which to end structural underemployment; that is, the proper objective of a development strategy should be to minimize structural underemployment.¹ In turn, this reveals that economic development is fundamentally a process of job creation. This sentiment is echoed by Lauchlin Currie who argued that economic development's, "immediate goal is to put the vast army of unemployed to work by creating new jobs" because, "the issue...is at the heart of the underdevelopment problem" (Currie 1967, 23, 98). Now, obviously this objective will be facilitated by formulating methods of inducing investments designed to produce a more efficient production structure.

¹ The reason why the term 'minimize' is employed instead of the term 'eliminated' was discussed in Footnote 3 of the Introduction.

This highlights the importance of conceptualizing a development process. To be sure, the fundamental question posed by the Scarcity in the Midst of Plenty Approach involves how to minimize structural underemployment. Further, as we saw above, one of the ways to accomplish this is to uncover ways of inducing investments that will produce a more efficient production structure. Thus, by examining how to produce a more efficient production structure we are inherently analyzing long term structural change which, obviously, is a process that can take a significant amount of time. Therefore, how we envision this process matters a great deal. Consequently, we must define the phrase ‘a process of economic development’.

Part I.B - Conceptualizing a Process of Economic Development

Arguably one of the toughest tasks a development economist can face is conceptualizing and defining a process of economic development. This is due to the fact that one can choose to abstract from much of the world in identifying what s/he feels to be the crucial facets of what allows one to be considered ‘developed’ or ‘less developed’. This makes the entire sequence incredibly subjective, since the various phenomena identified and the weighting attributed to each of them will likely differ from one analyst to another. For this reason, the author is averse to conceptualizing a development process from a ‘microeconomic’ perspective- meaning one cannot simply use individual aspects of

economic life to demarcate whether one can be considered ‘developed’ or ‘less developed’.² There is simply too much ‘gray area’ to prevent a concrete distinction from being made.

Instead, the author would advocate a ‘macroeconomic’ approach to conceptualizing a development process since it entails the creation of a more efficient production structure. Hence, we define a development process as the process through which an economy more fully utilizes its labor resources- with the objective being the minimization of structural underemployment. Accordingly, a development process can rightfully be viewed as a process of long term structural change.

At the same time, this characterization of a development process demonstrates that its success “depends not so much on finding optimal combinations for given resources and factors of production as on calling forth and enlisting...resources and abilities that are hidden, scattered, or badly utilized...[which implies]... that the problem is ‘structural’ rather than cyclical” (Hirschman 1958, 5). Hence, Hirschman is correct when he argues that, “if backwardness is due to [an] insufficient number and speed of development tasks, then the fundamental problem of development consists in generating and energizing human action in a certain direction” (Hirschman 1958, 25). This, in turn, reveals that a process of development is not simply a process of transforming the way resources are utilized. It is also, simultaneously, a process of economic mobilization.

This allows us to reach a very important conclusion regarding the policy approach necessary to undertake a process of development, which was stated rather poignantly by

² This argument invalidates much of the theoretical approach of the Washington and post-Washington Consensus since they both identify individual aspects of the developed economies- such as the ‘correct’ institutions, methods of governance, property right arrangements, etc. - and attempt to instill them in less developed economies. In turn, this implicitly indicates that these paradigms believe the differential possession of these characteristics is what demarcates the developed and less developed economies. One cannot possibly hope to ascertain the level of an economy’s economic development simply by evaluating whether that economy has the ‘correct’ institutions, etc.

Hirschman himself: “Our foray into the theory of development has thus left us with a heightened consciousness of the importance of a theory of development *strategy*” (Hirschman 1958, 49, Italics in Original). This demonstrates that a development process results from a strategy specifically designed to transform a relatively inefficient production structure into a more efficient one. Indeed, by emphasizing the need to formulate a strategy that will mobilize labor resources towards higher productivity occupations, we have outlined the necessary conditions that must be met in order to minimize structural underemployment.

Above, we defined a development process as the process through which an economy more fully utilizes its labor resources. Further, as we argued in the Introduction, a development process is fundamentally a process in which short term demand targeting is combined with long term structural change. Accordingly, if an economy is to minimize structural underemployment, the ensuing process must utilize a strategy capable of combining both of these elements.

It should be noted that the minimization of structural underemployment is not equivalent to a development process. To be sure, we stated that a development process is a process that combines short term demand targeting with long term structural change. It is this combination that will allow an economy to more fully utilize its labor resources. However, there is no inherent guarantee that this process will minimize structural underemployment. Indeed, there are many ways to combine short term demand targeting with long term structural change that do not minimize structural underemployment. Thus, while the combination of short term demand targeting and long term structural change are needed to create a development process, it may not be enough to reach our ultimate objective.

Part I.C - Categorizing National Levels of Development

In this section, we will provide a classificatory scheme that identifies levels of economic development. In doing so, we highlight qualitative features that prevent an economy from initiating and/or sustaining a development process. The distinction between this section and Parts I.A and I.B above is as follows. The discussion above essentially answered the question ‘what is the objective of economic development and what needs to be done to achieve it?’ On the other hand, the scheme presented here answers the question ‘what are the structural features of a particular economy that prevent it from doing so?’ Hence, this scheme can correctly be viewed as a complement to the discussions in Parts I.A and I.B.

Part I.C.1 - Background Information on Our Categorization Scheme

As background information, it is important to note that this categorization scheme does not imply the presence of an automatic, linear development process. In other words, our categorization scheme is just that- a categorization scheme. Fundamentally, we are only seeking to describe macroeconomic traits. Therefore, this scheme should not be interpreted as purporting that one category will eventually lead to movement within the scheme. Hence, in no way is our scheme similar to that of Rostow (1958, 1984) or any other 'sequential' categorization scheme in which an economy will inherently transition from one stage to the next. To be sure, ascension within the scheme requires a development strategy capable of solving the problems expounded by the Scarcity in the Midst of Plenty Approach.

Part I.C.2 - The Categorization Scheme

The first category in our scheme is that of low and lower middle income economies whose primary macroeconomic trait is the presence of the low income/high structural underemployment trap.³ As we saw in the Introduction, this trap involves a small inducement to invest because real income is relatively small. Consequently, this type of economy fails to undertake the long term structural change necessary to move labor towards higher productivity occupations. Furthermore, the lack of investment institutionalizes the low level of real income- trapping the economy in a vicious circle of poverty derived from high structural underemployment. As a result, the biggest challenge facing both low and lower middle income economies involves how to overcome this trap and initiate a development process. Because market forces alone are incapable of doing this, a strategy that combines short term demand targeting with long term structural change is needed.

The next category is upper middle income economies.⁴ Unlike above, upper middle income economies are in the midst of a development process- meaning they are solving the fundamental problem posed by the Scarcity in the Midst of Plenty Approach; namely, how to minimize structural underemployment. Thus, in addition to sustaining the development process, upper middle income economies are concerned with becoming high income economies.

Nonetheless, in upper middle income economies there is no guarantee that the existing quantity of investment is sufficient to accomplish either of these goals. Hence, in order to sustain a development process, upper middle income economies also need a strategy

³ These categories follow the World Bank's own classification scheme and therefore it is possible that there may be exceptions regarding the qualitative features ascribed to economies within each category.

⁴ The combination of low income, lower middle income, and upper middle income economies corresponds to what we have been referring to as 'less developed economies'.

capable of combining additional short term demand targeting with further long term structural change. As argued in the Introduction, doing so would provide them with three benefits. First, it would accelerate the development process. Second, it would diversify the number of sources driving this process- meaning that the economy would not be reliant upon a single/few sector(s) throughout its development process. Third, the combination of these two aspects would stabilize the rate of development- meaning that the dispersion of the rate at which structural underemployment is being minimized will narrow. Further, depending upon the particular strategy employed, the economy could potentially minimize structural underemployment.

The final category is that of high income economies. This is what we referred to above as developed economies. It is important to remember that these economies are, at least in principle, still evolving. Therefore, it is possible in these economies that there is still some structural underemployment that can be eliminated. However, for our purposes here, the motivation behind this particular strategy is to transform less developed economies by minimizing structural underemployment. To be sure, it is at that point that the analysis of Keynes and post-Keynesians regarding how to further increase national income will become applicable- allowing the economy to become a high income economy (if it has not already done so).

Part I.C.3 - The Significance of this Terminology

Throughout the course of this essay, we will employ specific terms from the discussion above to argue the thesis. If the case calls for the author to refer to a specific level within the categorization scheme, the corresponding level will be employed- such as 'lower

middle income economy'. On the other hand, if the reference is being made in more general terms, it will be denoted by using, for example, the term 'less developed economy'.

CHAPTER II

A POST-KEYNESIAN/STRUCTURALIST STRATEGY FOR ECONOMIC DEVELOPMENT: THE SYNTHESIS OF BALANCED GROWTH, EMPLOYER OF LAST RESORT, AND THE DEVELOPMENTAL STATE

In the Introduction, we saw that the Scarcity in the Midst of Plenty Approach believes the fundamental problem facing less developed economies is an inability to fully utilize domestic resources. In addition, we saw that the cause of this problem is a lack of inducements to undertake the investments necessary to create a more efficient production structure via the minimization of structural underemployment. Hence, we saw that this implies development is essentially a process of job creation. Further, because the nature of the problem is structural, we saw that a development process is not as much a transformation of resource utilization as it is a mobilization of labor resources towards a specific objective. Consequently, we reached the conclusion that a strategy capable of combining short term demand targeting with long term structural change is necessary for a less developed economy to initiate/sustain a development process and potentially minimize structural underemployment.

As stated in the Introduction, the thesis of this dissertation is that balanced growth, Employer of Last Resort, and the developmental state can be synthesized to serve as an economic strategy that can achieve short term demand targeting concurrent with long term structural change in less developed economies. As a result, we argued that this strategy can initiate/sustain a development process. Moreover, we argued that it can minimize structural underemployment. In this chapter, we will provide a brief introduction to the three theories

being integrated. This will be followed by a depiction of what the integrated framework resembles. In doing so, we will support the contentions put forth above.

Part II.A - Balanced Growth

We argue that balanced growth is the quintessential policy a less developed economy can utilize to solve the fundamental problem posited by the Scarcity in the Midst of Plenty Approach. On the one hand, it solves the demand constraint problem familiar to post-Keynesians by providing the inducements to undertake investment and thereby alter the level of effective demand. Thus, its modus operandi is short term demand targeting. At the same time, because it is concerned with investment spending it provides a solution to the Structuralist problem surrounding how to begin minimizing structural underemployment. In this regard, balanced growth is simultaneously capable of long term structural change. Thus, at its core, it integrates short term demand targeting with long term structural change to initiate/sustain a development process in less developed economies. What is more is that since effective demand and capacity creation are increasing at roughly the same rate, there is a tendency towards price stability.

Balanced growth builds upon early formulations of the balanced growth concept espoused by such authors as Allyn Young, Paul Rosenstein-Rodan, and Ragnar Nurkse- all of whom were all heavily influenced by Adam Smith's dictum 'the division of labor is limited by the extent of the market' (Young 1928; Rosenstein-Rodan 1943; Nurkse 1953, Chapter I; Smith 1986, Chapter 3). Accordingly, these authors believed that less developed economies are demand constrained since, as embodied in Smith's dictum, the only way to utilize labor resources more efficiently is to increase the extent of the market- which we

know from Keynes is determined by effective demand. Thus, they each recognized that a lack of inducements to invest is what ultimately prevents less developed economies from minimizing structural underemployment. As a result, each author proceeded to formulate versions of balanced growth to overcome this.

Now, a major structural difference between less developed and developed economies is that in the former there is often little productive capacity or there is capacity that never approaches full utilization.¹ Consequently, whereas in developed economies the extent of the market can be increased by raising effective demand, in less developed economies solely increasing effective demand without also creating capacity can set off inflation (Rao 1958, 210-211). Hence, it is not enough to only increase the rate of expenditure. Instead, we must also ensure that this expenditure increases productive capacity.

This begs the question as to why there is a low inducement to invest. In other words, what is the primary obstacle preventing these economies from beginning to more fully utilize their labor resources? To answer this, we must segment less developed economies into two groups, as we did in Chapter I.

In low and lower middle income economies we saw that the low inducement to invest is attributable to the low income/high structural underemployment trap. On the other hand, we said that in upper middle income economies the number of existing investment inducements may not be sufficient to sustain a development process and/or allow it to

¹ Note that there is a difference between arguing that an economy does not possess many resources and arguing that an economy does not possess much productive capacity. In the latter, the economy may possess all the resources it needs to have a large productive capacity but if it is demand constrained- following Keynes' analysis in Chapters 16 and 17 of the *General Theory*- it will fail to realize this result. In its place, the economy will possess the resources necessary to make a large capacity possible but will fail to consistently utilize them efficiently. Indeed, this is the central insight of the Scarcity in the Midst of Plenty Approach.

become a high income economy. If this is the case, they too would benefit from the creation of additional inducements. We discuss the problems of both categories in greater depth below.

Part II.A.1 - Low and Lower Middle Income Economies and the Low Income/High Underemployment Trap

The elaboration of the low income/high structural underemployment trap arose for two reasons. First, there was a need to explain why low and lower middle income economies were just that: low and lower middle income economies. Second, it was needed to explain why these economies seemed to be permanently stuck in these categories since they rarely experienced any forward progress.² The conclusion reached was that these economies were stuck in a low income/high structural underemployment trap.

To explain, this trap is a situation in which low levels of real income result from a small domestic market. In turn, the market is small because of a low propensity to invest. Finally, the small propensity to invest is caused by a low level of real income. Hence, the accompanying structural underemployment is the result of a ‘vicious circle of poverty’ - an extremely institutionalized negative process of cumulative causation. As a consequence, the prospects for increasing the division of labor are limited and the economy is left with an inefficient production structure. Finally, the problems associated with widespread poverty, indigence, and underemployment will persist until a solution is successfully implemented. Thus, it is clear that to overcome this trap both short term demand targeting and long term

² This observation contradicts any ‘natural’ or ‘stages’ tendency towards development- such as W.W. Rostow’s theory. Further, it invalidates contributions of more ‘modern’ economists, such as Deepak Lal, who argued that development was assured by the market mechanism- assuming the state did not distort relative prices.

structural change are needed. We argue that balanced growth can combine these elements by initiating a development process.

Part II.A.2 - Upper Middle Income Economies and the Number of Inducements to Invest in a Development Process

The biggest challenge for upper middle income economies is that the number of existing investment inducements may not be sufficient to sustain the development process and allow it to become a high income economy. As a result, there may be significant problems- three of which we will briefly highlight. First, the economy's progress may be reliant upon foreign income levels- such as the case with export led growth (ELG) models. Thus, should the marginal propensity to import change within the importing economy, the upper middle income economy's progress will stall. Similarly, the health of the upper middle income economy may be dependent upon a single (or a few) sector(s). Therefore, it could be subjected to violent swings in performance should that sector(s) experience problems. Hence, creating alternative sources of development will diversify the economy's production structure and help to consistently maintain a positive trajectory. Third, being considered an upper middle income economy does not inform us as to whether Myrdal's backwashing

effects are occurring within the economy (Myrdal 1956).³ If this is the case, the economy needs a method of expanding output in the region(s) falling behind. Consequently, it is undeniable that creating additional inducements to diversify, accelerate, and stabilize⁴ the development process would be advantageous for upper middle income economies because it will sustain the development process. To do so, a policy is required that can combine short term demand targeting and long term structural change. We argue that balanced growth can serve that purpose. However, balanced growth is likely to be incapable of completely minimizing structural underemployment on its own.⁵

³ Myrdal posited that cumulative causation could cause a persistence of poverty and inequality within/among less developed economies because the migration of labor and/or capital would tend to have a positive impact on the region/economy able to attract it while the region/economy the labor and/or capital left would tend to suffer. The reason behind this is due to what Myrdal called backwashing effects which would cause the area the resources left to have a second round of further migration away from it since resources are attracted to the highest return. Consequently, capital and/or labor would not venture to the areas that need it the most- as posited by the orthodox static analysis of marginal productivity theory. Instead, the resources that were initially left behind would later be attracted to the booming areas- thereby further impoverishing the area from which they were departing. The result would be that the backwashed areas would experience a perpetuation of poverty and a permanent divergence would be created between the booming areas and the stagnating areas (Myrdal, 1956).

⁴ By stabilize we mean narrow the dispersion of the rate at which structural underemployment is being minimized.

⁵ We will discuss the reasons why this is so in Part IV.A.2.B.2.

Part II.A.3 - The Economics of Balanced Growth

Balanced growth⁶ will solve the issues that both low and lower middle income and upper middle income economies face. To do so, it will initiate an investment sequence in a range of horizontal activities whose resulting output possesses high income elasticities of demand. It is argued that the consumption derived from the increased employment that the investment sequence makes possible will be spent on the increased net output of these activities.

The rationale behind this plan starts from the premise that it makes little sense for an individual to invest on his or her own because the likelihood of a single entrepreneur receiving back the entire increased wage bill is slim. This is because the additional workers will likely purchase an array of various goods and services instead of the single one the entrepreneur produces. Therefore, that particular investment will have a negative return.

On the other hand, balanced growth believes that if many different entrepreneurs simultaneously undertake investment whose resulting output possesses high income elasticities of demand⁷ the subsequent purchase of these goods by the workers will allow the

⁶ Our version of balanced growth alters prior notions of balanced growth. In its earlier form, the focus was frequently on increasing the savings rate in order to generate the finance that would be used as investment. This implies that there was a belief among these authors, notably Young and Nurkse, that Say's Law was valid (Young, 1928; Nurkse, 1953, 8-11). In other words, they saw the causal relationship between savings and investment as the former leading to the latter- which Keynes overturned and post-Keynesians have upheld. Thus, in contrast to these earlier expositions of balanced growth, the version supported here rejects Say's Law and argues that the level of output is determined by effective demand. Consequently, we believe that the correct causality runs from changes in investment to changes in savings via changing income levels. As a result, this updated version is able to incorporate the argument that the lack of capacity and/or underutilized capacity in less developed economies is the result of demand constraints (and not a supply of savings constraint). Hence, instead of proposing to increase the savings ratio to increase investment- which Keynes showed to be a fallacy of composition through the paradox of thrift- this version of balanced growth advocates initially undertaking investment that will lead to higher degrees of purchasing power, a larger extent of the market, and a higher savings level via the employment multiplier.

⁷ By producing goods with high income elasticities of demand, balanced growth reduces the risk that increased domestic income will result in a burgeoning current account deficit and balance of payments issues. Hence,

entrepreneurs to recoup their invested funds. Consequently, these investments' returns will surpass the return offered by the marginal efficiency of money. Moreover, in the absence of private entrepreneurs willing to undertake this task, the state- in its normal role as a currency issuer- can also do so. Indeed, as we shall see in Parts II.C and II.D, the state is in an unrivalled position to implement balanced growth and- given certain characteristics of the state's governing apparatus- should do so.

The result in this latter scenario is increased employment, effective demand, capacity creation, wages, profits, and an extent of the market- which makes it possible to expand the division of labor. This provides the best opportunity for a less developed economy to initiate/sustain a development process since increases in employment, demand, and productivity growth will reinforce one another.

This shows that balanced growth will break the low income/high structural underemployment trap and initiate a development process in low and lower middle income economies. At the same time, balanced growth is capable of creating additional inducements to invest in upper middle income economies- which will accelerate the rate of development while diversifying the sources of it. In doing so, this new rate will stabilize- meaning that the dispersion of the rate at which structural underemployment is being minimized will narrow. Hence, balanced growth will allow upper middle income economies to sustain their development processes.

instead of creating a situation in which the marginal propensity to import causes a trade deficit to develop and/or expand, the fact that balanced growth is focused on producing items with high income elasticities of demand ensures that any external leakages will be minimized. The relevant consideration would be to determine whether the income elasticity of demand associated with items in the balanced growth program is greater than the marginal propensity to import.

One of the primary design benefits a balanced growth program presents involves the flexibility it offers regarding output recommendations- which would depend on the characteristics, culture, and desires of the individual economy. However, we may comment that with regard to what activities should be created and/or expanded, a three pronged approach will be the most beneficial.⁸ First, the plan should increase production in activities that will satisfy domestic consumer demand in order to guarantee that the increased net consumption is directed towards the home market. Second, measures should be taken to promote increasing returns activities.⁹ Third, frequently a portion of the increased net consumption will be for agricultural products. As a result, a segment of a balanced growth program must focus on increasing the supply of these goods.

Above we argued that balanced growth should increase the production of goods with high income elasticities of demand so that the increased employment will spur these goods' purchase. In doing so, it can set up a system of backward and forward linkages within the vertical structure of production which would subsequently induce further investment and expansion of the market. For example, in constructing, say, a beer industry, the needs of the final good can induce an upstream demand for higher quality water. This derived demand can translate into improved water purification techniques. In this regard, balanced growth can lead to phases of unbalanced growth within the vertical structure of production.¹⁰

⁸ This will be discussed in greater depth in Part IV.C.

⁹ We will define this explicitly in Chapter IV. For now, the reader should know that we are not referring to the neoclassical conception of the term.

¹⁰ Among the first development economists there was debate regarding whether balanced or unbalanced growth was more appropriate for a less developed economy. As shown above, these two methods are really more complements than substitutes- with balanced growth focusing on the horizontal expansion while unbalanced growth is associated with a vertical expansion.

This unbalanced growth process can be particularly helpful for relieving certain structural inflationary tendencies associated with bottlenecks that the economy may be prone to produce.¹¹ In our case of the beer industry, if balanced growth has produced such an increase in employment that the demand for beer has been permanently raised it will make the economy's supply of, say, hops relatively scarce. This will provide an incentive to hops' producers to invest in additional production. As a result, the bottleneck will not present future problems. Further, this mechanism can also induce a pattern of vertical integration should the producers prefer to have greater control over production- which would contribute to heightened investment once again.

What is more is that balanced growth can incite further instances of unbalanced growth through horizontal linkages even within final demand. Suppose that our beer company finds that the expansion caused by balanced growth has sparked an increase in the demand for lager-type beverages. This will induce it to invest in lager making capacity. However, it may also make the enterprise curious about its prospects regarding stout-type beers. In doing so, it would need to set up a unit dedicated to researching market potential, a unit for how to advertise the product, a unit for testing the ability to brew stout-type beers, et cetera. The point is that all of the various units depicted in this example will require investment. Thus, the initial wave of balanced growth will deliver subsequent, more isolated

¹¹ A word of caution must precede our depiction of this scenario. It should be noted- and this is incredibly important to recognize- that not all bottlenecks can be solved via unbalanced growth's linkage effects. Unbalanced growth frequently relies upon the price mechanism in order to function and history- as well as theory- has demonstrated that the price mechanism is an unreliable avenue of balancing supply with demand. Instead, depending upon the specific linkage in question, a more direct method of alleviating the bottleneck may be desirable- such as through state-led action. As a general rule, the more important it is to alleviate the bottleneck, the less unbalanced growth should be relied upon.

processes of unbalanced growth. To be sure, this will further contribute to minimizing structural underemployment.

In terms of an approach to the external sector,¹² it is crucial to recognize that balanced growth need not interfere with foreign trade. One of the goals of this strategy is to allow the economy's population to enjoy a larger amount of real output than previously by expanding the domestic market and complementing it with what is brought in from abroad. In his own discussion of balanced growth, Nurkse stressed that this is not import substitution- though unfortunately the two positions have become conflated over time (Nurkse 1953, 2009, 378-379). This reveals that employment in the export sector should not be minimized in order to employ workers in domestic production. Instead, domestic production should be increased while retaining the existing employment of the export sector. As Nurkse said,

...the chief point to be stressed here is that increased production for the home market need not impinge on the export sector at all. The purpose of the balanced investment policy should not be to draw labor away from export industries but to raise the productivity of people now working in subsistence agriculture and other activities for domestic consumption. (2009, 375)

Finally, a word of caution should be said about balanced growth. It is important to recognize that this program should not be taken to an extreme limit. When confronted with the benefits that balanced growth has to offer, a particular economy may be tempted to commence production in a vast array of highly specialized goods- some of which the economy may have no capabilities for producing given the technology and/or labor skill set. That is neither the rationale nor the goal of balanced growth. Again, as Nurkse said,

¹² In Part IV.D, we discuss the external considerations surrounding balanced growth in greater depth.

“The case for balanced growth is concerned with establishing a pattern of mutually supporting investments over a range of industries wide enough to overcome the frustration of isolated advance, in order precisely to create a forward momentum of growth” (2009a, 337). Thus, balanced growth is simply a conception of how to combine short term demand targeting with long term structural change in order to initiate/sustain a development process.

This analysis implies that balanced growth would be relatively more valuable for low and lower middle income economies than for upper middle income economies. While balanced growth certainly can be implemented in the latter, in low and lower middle income economies its value is heightened because these economies have yet to overcome the low income/high structural underemployment trap- which upper middle income economies have already done. Nonetheless, balanced growth can sustain the transformation already underway in upper middle income economies. This latter argument will be made more forcefully in Chapter IV.

Part II.B - Employer of Last Resort

In our discussion of balanced growth, we saw that it is capable of inducing the investments necessary for less developed economies to more fully utilize their labor resources. In this regard, it is capable of integrating short term demand targeting with long term structural change. Therefore, it can initiate/sustain a development process. Moreover, we saw that it will produce a tendency towards price stability since effective demand and capacity creation will expand at the same rate. Similarly, the linkage mechanisms associated with it offer promising opportunities to further increase investment and additionally avoid certain issues associated with structural inflation.

However, balanced growth can only produce a tendency towards price stability- it cannot guarantee it. Further, it is unlikely to minimize structural underemployment¹³ since it relies upon increased rates of private investment- which Keynes informed us can change rapidly and in large magnitude. Hence, our strategy must overcome these imperfections of balanced growth. Employer of Last Resort (ELR) can accomplish both of these objectives while providing the system with enhanced flexibility.

Part II.B.1 - The Basics of ELR

ELR was refined by Hyman Minsky who took into account Keynes' 'two fundamental flaws' of a capitalist system; namely, its inability to sustain full employment and its "arbitrary and inequitable distribution of wealth and incomes" (Keynes 1997, 372). Building upon this, Minsky added a third flaw: capitalism is an inherently unstable economic system in which booms inevitably create slumps (Minsky 2008, 2008a). As a result, he felt there was little reason to believe prices or employment would be stable for any sustained stretch.

ELR resolves these flaws by providing an economy with three primary macroeconomic benefits. First, it produces loose, full employment- and thereby minimizes structural underemployment. Second, it guarantees price stability in less developed economies through two different avenues. Third, ELR lends structural flexibility to a system that can be rather inflexible at times. Each of these benefits of ELR will be discussed after an interim is taken to present its monetary foundations.

¹³ As we noted in Footnote 6 above, we will discuss the reasons why this is so in Part IV.A.2.B.2.

Part II.B.2 - The Monetary Foundations of ELR

To provide ELR with the best chance of success, this strategy recommends that a less developed economy adhere to the modern monetary theory (MMT) school of macroeconomic thought first espoused in the works of Knapp, Innes, and Keynes (Knapp 1924; Innes 1913, 1914; Keynes, 2011). Central to the MMT framework is the assertion that a sovereign state producing its own non-convertible, fiat money can always afford to purchase any amount of real output the private sector is willing to sell it.¹⁴ Further, in this view taxes are not required to generate fiscal receipts that can be used for spending. Instead, they create a demand for the money ‘thing’ that is denominated in the state’s predetermined unit of account. Likewise, state-issued bonds are used to maintain interest rates instead of being used for funding purposes. Hence, a relatively strong state that is willing and capable of enforcing taxation policy is vital to the MMT framework.¹⁵ Finally, adhering to a flexible exchange rate will prevent any external factor from interfering with the achievement of loose, full employment (Wray 2012, Chapter 5).

However, it is important to note that ELR can nonetheless be implemented and function properly even if a less developed economy is unwilling/unable to minimize its dollarization issues. Indeed, MMT only affords an economy a heightened degree of ease with regard to financing its ELR program. In other words, MMT is not a necessary condition to possess an ELR policy- it simply facilitates the process. Hence, while dollarization

¹⁴ This leads to the realization that the state can purchase any quantity of under/unemployed labor resources- which is what ELR does.

¹⁵ To be sure, Wray has shown that the inability of states to institute or maintain their own currencies generally occurred because they each lacked the capacity to enforce widespread usage of state liabilities in market transactions (Wray, 1998, 65-67). As we shall discuss in Chapter III, this aspect of MMT is pertinent for economies that have dollarization issues. To be sure, this strategy would recommend that such conditions are done away with.

inherently carries some problems of its own, in terms of financing ELR it is not much of an obstruction. Unfortunately, a lengthier discussion on this point will have to wait until Chapter V when we will have fully elucidated the logic behind MMT, discussed the economics behind ELR, and depicted what our integrated framework resembles. For now, we simply wished to point out that while MMT assists with the financing of ELR an economy can nonetheless institute it even if it does not possess a sovereign currency.

Part II.B.3 - ELR, the Job Guarantee, and Full Employment

ELR creates a labor market that can be characterized as loose, full employment; that is, in the aggregate, labor demand is always far in excess of labor supply. As a result, it is relatively easy to move between jobs and there is little upward pressure on wages since full employment is achieved by ‘hiring off the bottom’.¹⁶

Since structural underemployment is the largest issue facing less developed economies, it follows that ELR has a major role to play throughout a development process (and beyond) since it provides a job guarantee (JG) to anyone ready, willing, and able to work at the ELR living wage set by the state.¹⁷ In economic jargon, the state takes on a perfectly elastic labor demand at a predetermined wage rate. In doing so, it ensures that labor markets are representative of loose, full employment since labor demand will always be far in excess of labor supply. Further, labor will find that it is relatively easier to find and secure a job than in the absence of this policy. To accomplish this, the state will essentially become

¹⁶ By contrast, tight, full employment is a situation in which, in the aggregate, labor demand is approximately equal to labor supply. Accordingly, it is more difficult and time consuming to move between jobs and significant upward pressure can be placed on wages. In Footnote 6 of Part V.A we show why loose, full employment is a superior macroeconomic state than tight, full employment.

¹⁷ To prevent competition for workers with the private sector over time, the ELR living wage is set lower than the prevailing private sector wage rate.

a market maker in labor by creating and maintaining a buffer stock of better trained and more productive workers (Wray 1998, Chapter 6; 1998a).

Also, it should be noted that although funding would originate from the state, project proposals, ratification, and implementation should be as decentralized as possible to meet community demands (Bhaduri 2005, Chapter 5; Wray and Tcherneva 2005). This latter point implies that there will be a need to monitor projects to ensure the funds are not simply being used to benefit local leaders. Indeed, specific methods of doing so were discussed by Wray and Tcherneva in case studies that could serve as a basic framework for auditing methods (Wray and Tcherneva 2005a, 2005b).

As a final note on the JG, by creating a buffer stock of labor the cyclical instability heavily emphasized in Minsky's analysis will be addressed. To be sure, during booms the quantity of buffer stock employment (BSE) will be drained as the private sector hires away ELR workers through the lure of higher paid labor. On the other hand, in slumps the BSE will be replenished. As a result, loose, full employment will be maintained through time (Mitchell 1998).

Part II.B.4 - ELR and Price Stability

The second primary macroeconomic benefit of ELR involves its ability to guarantee structural price stability through two different avenues. The first involves the impact that ELR can have on wage patterning during what is known as the distributive conflict. The second involves the presence of bottlenecks and how ELR can alleviate some of them. We will discuss these two sources of structural price instability and how ELR can address them below.

Part II.B.4.A - ELR and the Distributive Conflict

Evident as far back as Classical economics, the distributive conflict refers to the struggle between workers seeking higher wages and capitalists seeking higher profit margins. When workers attempt to secure higher wages, entrepreneurs frequently respond by raising their prices so as to pass on the higher labor costs. In turn, this leaves the wage share constant- forcing workers to once again attempt to gain higher wages. Clearly the result of this scenario is wage-price inflation- making it a significant source of structural price instability. We argue that ELR can circumvent this issue and guarantee price stability by having the ELR living wage serve as a reference wage for the rest of the economy. In turn, because labor is a cost factoring into almost every pricing decision, prices will remain constant. This particular price stabilization feature of ELR has four interrelated components- with the first two serving as prime evidence to support our argument while the latter two are complementary. Below we will give them each the attention they require.

First, ELR achieves price stability by applying Keynes' analysis of the wage unit in an empirical setting. At its core, this analysis reduces all heterogeneous labor to a multiple of the basic unit of unskilled labor (Wray and Tcherneva 2005). At the same time, price stability can be recognized as a constant purchasing power of the currency in terms of the wage unit. Thus, a unit of the ELR wage can effectively serve as the wage unit. Consequently, a single unit of the currency will always be worth some number of labor units (Wray and Tcherneva 2005).

Concurrently, we argue that the ELR living wage can act as a reference wage for the rest of the economy- with higher skilled labor being remunerated a multiple of the ELR

living wage. It follows that if the ELR wage remains constant, the other rates of remuneration will remain relatively constant as well. Since labor is an input into virtually all production processes, the constancy of wage rates implies that prices will also remain stable. Moreover, because the value of the currency will remain constant within an ELR policy, this wage patterning mechanism can institutionalize a constant purchasing power of the currency in relation to wage remuneration rates. In doing so, it will alleviate the inflationary pressures derived from the distributive conflict by fostering structural price stability.

Second, Mitchell's NAIBER is defined as the ratio of BSE to total employment required to stabilize inflation. This is useful for an analysis of macroeconomic wage patterning because if the buffer stock becomes too small its ability to serve as the reference wage for the economy will diminish and cost-push inflation from the private sector will occur. To counteract this, the state can always take actions to replenish the buffer stock, move the NAIBER away from a zero value, and allow it to reassert itself as the primary price stabilization feature of the economy (Mitchell 1998).

Third, there is typically a concern that ELR will cause deficits to become excessive and thereby cause inflation through various channels. However, Wray has shown that deficits can never cause inflation by impacting the so-called loanable funds market. Similarly, they cannot do so simply by printing money as in the case of the empirically-questionable Friedman version of the quantity theory of money (Wray 1998, Chapters 4 and 5). Nonetheless, in the MMT view deficits can become excessive in the sense that effective demand can outpace total productive capacity. ELR's inherent design ensures that it will not contribute to this scenario since every time a job is created in the private sector another job is

vacated in the ELR sector. Hence, there would be a reduction of ELR-related expenditure which ensures that the ELR budgetary component moves counter cyclically. Consequently, ELR can never be a source of excess effective demand and inflation (Wray 1998a).

Fourth and finally, the structure of ELR has been accused of creating the conditions for inflation to emerge because it is claimed that employers will be forced to compete with ELR for workers. Elsewhere these arguments have been disproved. Thus, here we shall simply reiterate that these critiques do not hold water because the ELR wage is set below the prevailing private sector wage. Consequently, the private sector does not have to compete with ELR for employees. If workers desire a higher wage, it will be obtainable in the private sector provided that it possesses a demand for these workers. Further, on the topic of whether ELR total compensation packages would force private employers to increase their compensation packages, it must be remembered that this will be a one-time price increase as the packages are adjusted- which is not the definition of inflation (Wray and Mitchell 2005).

Part II.B.4.B - ELR and Bottlenecks.

A second cause of structural price instability results from what Diamand labelled 'productive' and/or 'external' bottlenecks (Diamand 1978).¹⁸ Indeed, one of the primary results of having a relatively inefficient production structure is that less developed economies are frequently bottlenecked in strategically important sectors. In turn, this causes the price of the scarce, bottlenecked factor to increase- causing real wages to decline which produces a more regressive income distribution. At the same time, the industries utilizing the scarce input lower their output levels to what the input can accommodate. Consequently, less

¹⁸ Keith Griffin also discusses a similar concept in his masterpiece *Underdevelopment in Spanish America* (Griffin, 1969).

developed economies are forced to deal with the dual effects of increasing inflation and structural under/unemployment.

If the solutions to these problems are not complex, i.e. can be achieved by typically unskilled labor, ELR has a role to play in alleviating the economy's supply constraints. To be sure, ELR workers can directly increase output of the bottlenecked product, produce certain co-operant factors of production that will facilitate increasing the output of the bottlenecked product, construct output associated with linkages that will alleviate future bottlenecks, and/or construct infrastructure projects that will assist others in alleviating the bottleneck. In all four of these cases the ELR workers would reinforce structural price stability.¹⁹

Part III.B.5 - What These Two Benefits Imply for Our Development Strategy

In the Introduction, we saw that a development process involves formulating a strategy capable of combining short term demand targeting and long term structural change. Subsequently, we argued that ELR is a policy that should be included in this strategy. Thus, we need to examine how ELR simultaneously promotes short term demand management and long term structural change.

First, it provides a JG to anyone ready, willing, and able to work at the ELR living wage in order to achieve loose, full employment. This clearly has implications for both short term demand targeting and long term structural change. In terms of the former, achieving full employment will increase consumption and permanently raise effective demand. In turn,

¹⁹ We will discuss bottlenecks and the role that ELR can play in alleviating them in greater depth in Part V.A.3.B. For now, we simply wished to introduce the complications bottlenecks can present and how ELR can solve them.

this will cause the expected returns on certain investments to increase and thereby surpass the marginal efficiency of money- causing additional quantities of investment to be induced. In terms of the latter, the JG ensures that labor resources move to higher productivity occupations. Therefore, ELR can initiate/sustain a development process. Furthermore, it will allow less developed economies to minimize structural underemployment.

Second, we saw that ELR provides the economy with price stability. Like with the JG, this has implications for short term demand targeting and long term structural change. In the short term, it will increase investment since entrepreneurs will have greater confidence in their estimations regarding the expected returns of a particular investment. Moreover, it will increase real income levels and thus increase consumption. In terms of long term structural change, the increased investment that price stability induces will further transform the economy's production structure by more fully utilizing labor resources.

Part II.B.6 - ELR and Structural Flexibility

The third primary benefit of ELR involves its ability to introduce structural flexibility into a capitalist system.²⁰ In the Introduction, we stated that less developed economies have relatively inefficient production structures which makes them structurally incapable of fully employing the economy's labor resources. Therefore, a policy that increases the structural flexibility of the system while producing loose, full employment is an indispensable component of any development strategy. It is argued that ELR is the quintessential policy

²⁰ This section follows the analysis in Part II.B.5 because it focuses solely on long term structural change and therefore would not be appropriate in a section that also dealt with short term demand targeting.

that can accomplish this. Below we will discuss four ways in which it promotes structural flexibility.²¹

First, we know that development is essentially about job creation; that is, we want to minimize structural underemployment. Further, we know that the JG is able to maintain loose, full employment through time. Consequently, if other facets of a development process were to falter, ELR solves this dilemma via the JG. Thus, ELR increases the economy's structural flexibility since it allows the economy to initiate/sustain a development process while guaranteeing loose, full employment is maintained. The importance of this cannot be overstated. Therefore, ELR is a vital component of our development strategy because it can complement balanced growth while simultaneously allowing less developed economies to minimize structural underemployment.

Second, achieving full employment in the private sector requires investment in heterogeneous capital assets. In turn, the introduction of capital assets presents a structural asymmetry because such assets cannot be instantaneously adjusted to produce the output of other sectors. Therefore, any slumping sector will have a state of less than full employment (Forstater 1998). ELR fixes this because the state can always utilize it to produce new, potentially robust output, alleviate ongoing shortages, and make sure not to use production techniques in which certain types of capital are either already or on the verge of becoming supply constrained. It can perform this latter function by diverting the input composition of ELR into other areas (Forstater 1998).

Third, ELR can solve specific issues related to Myrdal's backwash effects. Indeed, ELR can counteract these tendencies by increasing both effective demand and output in these

²¹ We will discuss these four aspects of structural flexibility, as well as three additional ones, in Part V.A.4.

areas. In turn, this will raise both the employment multiplier and entrepreneurs' expectations. Thus, ELR can stabilize/reverse any backwash effects occurring in less developed economies.

Fourth, ELR creates labor flexibility by producing better trained and educated workers. Indeed, ELR prevents labor skills from deteriorating which will make labor more productive relative to a situation without ELR. Further, participants are allowed to upgrade their skills within ELR- enabling them to perform a wider array of tasks. The result of this process is that the capabilities of the economy will increase- making the economy's ongoing structural transformation more flexible (Forstater 1998; Wray 1998, Chapter 6).

Part II.C - The Developmental State

Thus far, we have argued for two rather ambitious policies; namely, those of balanced growth and ELR. However, policy decisions are not made in an apolitical vacuum. Consequently, we need to introduce political economy to discuss the type of entity that would have the capacity to implement this strategy. It is obvious that the state is the only political economic actor that can do so. Yet, not even all states would possess this capacity. Indeed, ones that are wedded to a laissez faire economic ideology would not be capable of implementing these policies. Hence, what type of state would have the capacity to implement both balanced growth and ELR? It is argued that the entity possessing this characteristic is the developmental state.

The developmental state is a state that utilizes market intervention methods to explicitly promote strategically vital sectors in order to achieve an economic transformation. At first glance, this could correctly appear to be a rather pointed definition. Indeed, its

formulation was not without careful consideration of the political science literature surrounding it. At any rate, a discussion of how this definition was formulated will allow us to isolate its essential traits. In particular, it is necessary to explain its approach to a structural transformation within a capitalist system.

In analyzing the developmental state, it helps to characterize it as a Plan Rational state in which private ownership is combined with state management of the economy (Johnson 1982, Chapter 1; Woo-Cumings 1999). It is important to note that the state does not make all decisions related to economic production. Instead, the developmental state locates methods- both direct and indirect²²- that will allow it to co-operate with the private sector in order to achieve mutually desired goals. In addition, it does not turn a blind eye to the composition of output. Instead, the developmental state actively structures a composition of output it believes will assist the economy throughout its development process. Accordingly, there is a qualitative aspect associated with production in the developmental state: it views certain economic activities as inherently more important to possess than others. Hence, methods of inciting a transformation are the prevailing concern of the economy since primary focus is given to the economy's productive structure.

Here we see the connection between the Scarcity in the Midst of Plenty Approach and the developmental state. In the former, the fundamental problem facing less developed economies involves the fact that their production structures underutilize much of their labor resources. Accordingly, the only way to remedy this is by employing a strategy that can

²² As we shall see in Part IV.B and VI.C, direct methods involve the state itself undertaking a program of change by becoming a producer while indirect methods correspond to a situation in which the state engineers a system of incentives to coax the private sector into implementing its program for change.

initiate/sustain a development process. In terms of the latter, the developmental state is the political entity capable of accomplishing this objective by utilizing its qualitative insights.

At its core, the developmental state primarily emphasizes ‘effectiveness’. In other words, because it insists on achieving an economic transformation the crucial aspect of the economy that gets evaluated is whether its policies were effective at accomplishing the intended goal(s) (Johnson 1982, Chapter 1). Therefore, the viability and continuation of the state’s legitimation depends upon whether it is able to achieve its stated goals.

Now, as mentioned above, the developmental state is a Plan Rational state in which private ownership is combined with state management of the macroeconomy. Johnson provides us with two other frameworks for configuring the relationship between ownership and management in the economy. The first of these alternative forms he labels as the ‘Market Rational’ state while the second he calls the ‘Plan Irrational’ state (Johnson 1982, Chapter 1). We will discuss each of these to better illuminate the Plan Rational state concept.

Johnson views a Market Rational state as a state that sets the ‘rules of the game’ of economic competition. In other words, it relegates itself to simply providing the regulatory framework within which capitalist competition is to occur. Importantly, this type of political economy lacks a qualitative aspect in that it does not attempt to ‘pick the winners’, place importance upon certain sectors, or predetermine which activities are to thrive. As Johnson says, a Market Rational state

...does not concern itself with substantive matters. For example, the United States government has many regulations concerning the antitrust implications of the size of firms, but it does not concern itself with what industries ought to exist and what industries are no longer needed. (1982, 19)

Hence, in Market Rational states there is no overarching national economic plan formulated by the state because the direction of the economy is left entirely in the hands of private ownership.

This second framework can be contrasted against the Plan Rational state because, as Johnson points out, “the Market Rational state usually will not even have an industrial policy (or, at any rate at least recognize it as such)” (Johnson 1982, 19). Consequently, a Market Rational state’s concern is with the ‘efficiency’- as opposed to the effectiveness- of the system. As a result, it does not concern itself with the Plan Rational state’s qualitative aspects regarding the composition of output.

The third type of political economic framework that Johnson analyzes is called a Plan Irrational state- a system similar to the former USSR. In this type of system, both the management and ownership of the economy remain under direct state supervision. In turn, this characterization is considered ‘Plan Irrational’ because it violates the capitalist system’s hallmark of private property relations- which the developmental state obviously upholds. Consequently, in Johnson’s view these types of states cannot be considered Plan Rational.

This discussion of contrasts among these three types of states demonstrates that a Plan Rational state is one in which the “dominant feature [is] precisely the setting of such substantive social and economic goals” (Johnson 1982, 19). Hence, we can properly conceive of the developmental state as a situation in which the state and some hand-picked sectors²³ engage in a mutually beneficial relationship. This can correctly be seen as a highly

²³ The argument that the developmental state promotes sectors- and not individual enterprises as in France from 1945-85- demonstrates why Loriaux is wrong in asserting that France was a developmental state (Loriaux, 1999). France had the ambition to arrange but not the capacity to execute the economic transformation because it essentially removed the driving force of capitalist economic transformations. By picking individual

politicized form of a market economy. Indeed, Schneider refers to the developmental state as ‘political capitalism’ in which “profits and investment decisions...depend...on decisions made in the state” (Schneider 1999, 278). Further, this reflects that the developmental state emphasizes rapid economic transformation and the need for state intervention to promote its realization (Schneider 1999).

Part II.D - An Overall Depiction of This Strategy

In the Introduction, we outlined two different approaches to envisioning the problem of economic development. In doing so, we saw that the Scarcity in the Midst of Plenty Approach views the fundamental problem facing less developed economies as an inability to fully utilize their domestic resources. In turn, we saw that this situation is brought on by a lack of inducements to undertake the necessary investments that will create a more efficient productive structure. Accordingly, we found that to solve this problem a development strategy must be implemented that is capable of combining short term demand targeting with long term structural change.

At the same time, we asserted the thesis that balanced growth, Employer of Last Resort, and the developmental state can be synthesized to serve as this strategy. Thus, it is capable of initiating/sustaining a development process. Moreover, we argued that this combination will allow a less developed economy to minimize structural underemployment. Subsequently, in this chapter we presented the individual components of our strategy. Now we will examine these contentions.

enterprises instead of targeting sectors, the capitalist hallmark of competition for profit was minimized. Instead, the state introduced a situation in which some enterprises simply accrued rents from the state. Thus, we would argue against the characterization of France as a developmental state during this period if Loriaux’s depiction of French policy is accurate.

In Part II.A, balanced growth was found to be capable of simultaneously inducing investments by making initially unprofitable investments when considered in isolation now profitable when considered as a program of investments as a whole. In addition, it was found to raise consumption and therefore effective demand. Consequently, it was concluded that balanced growth is capable of achieving short term demand targeting. At the same time, because balanced growth's primary mechanism involves increased levels of investment and employment, it will allow the economy to more fully utilize its labor resources. In this regard, balanced growth provides the long term structural change necessary to initiate/sustain a development process.

Subsequently, in Part II.B we demonstrated that ELR has three primary macroeconomic benefits. First, it ensures loose, full employment by instituting a JG. Second, it is able to guarantee price stability throughout the economy. As a result, we saw that ELR will increase both consumption and investment levels. Thus, it is capable of short term demand targeting. With regard to long term structural change, we found that these two benefits will also facilitate the economy's effort to more fully utilize its labor resources. Further, in doing so it provides less developed economies with an enhanced degree of economic flexibility- another long term structural benefit. Thus, we concluded that ELR is a vital component of any development strategy because it too will initiate/sustain a development process by combining short term demand targeting and long term structural change. Moreover, ELR allows an economy to minimize structural underemployment since it produces loose, full employment over time.

Finally, in Part II.C we defined the developmental state as a state that utilizes market intervention methods to explicitly promote strategically vital sectors in order to achieve an economic transformation. Thus, we characterized it as a Plan Rational form of political economy in which private ownership is combined with state management of the macroeconomy. Moreover, we saw that it accomplishes this by locating methods to induce investments that will incite a transformation embodying its qualitative insights regarding production. This clearly reveals that the developmental state is capable of combining short term demand management and long term structural change. Indeed, that is what the concept fundamentally entails! Thus, it is capable of initiating/sustaining a development process since it institutes policies that combine short term demand targeting with long term structural change.

At this point, it is apparent that each component of our strategy is capable of combining short term demand management and long term structural change. Thus, in order to support our thesis we need now only examine whether they can be synthesized. In other words, we need to identify if combining them will cause their respective transmission mechanisms to conflict with one another. If they do not, we may conclude that they can be successfully integrated. In turn, this would prove that balanced growth, ELR, and the developmental state can be synthesized to serve as an economic strategy that can achieve short term demand targeting concurrent with long term structural change in less developed economies.

In order to determine whether their transmission mechanisms conflict, we first need to determine what each theory's transmission mechanism is. The primary transmission

mechanism of balanced growth involves increasing private and public investment in order to increase employment and, in doing so, move labor resources towards higher productivity occupations. ELR's primary transmission mechanism involves an increase in public expenditure to hire labor resources that the private sector refused to hire.²⁴ In doing so, it expands public employment to achieve loose, full employment. Thus, in addition to also more fully utilizing labor resources,²⁵ ELR allows less developed economies to minimize structural underemployment. Finally, the developmental state's transmission mechanism involves locating ways to induce investments that will result in a macroeconomic transformation. In doing so, it too will also be responsible for more fully utilizing labor resources.

It is clear that each of these mechanisms do not conflict. In fact, this analysis reveals that they are highly complementary to one another since they all combine short term demand targeting with long term structural change in order to more fully utilize labor resources. As a result, we find that these three theories can be synthesized without conflict. Therefore, we conclude that balanced growth, ELR, and the developmental state can be synthesized to serve as an economic strategy that can achieve short term demand targeting concurrent with long term structural change in less developed economies. Accordingly, this strategy is capable of initiating/sustaining a development process. Furthermore, because ELR creates and

²⁴ Some may object that simultaneously instituting balanced growth and ELR could make government finance scarce. Followers of MMT know that in monetarily sovereign economies this is not the case due to the state's privileged position as the currency issuer. This will become more apparent in Chapter III. For now, we may state that there is no financial tradeoff between using funds for balanced growth or ELR in economies with a sovereign currency. Therefore, in this regard, their mechanisms do not conflict.

²⁵ Note we demonstrated ELR's JG will not compete with the private sector over workers. Therefore, ELR will not compete with balanced growth because their employment mechanisms do not conflict.

maintains loose, full employment, our strategy enables less developed economies to minimize structural underemployment.

CHAPTER III
FINANCING OUR POST-KEYNESIAN/STRUCTURALIST
STRATEGY FOR DEVELOPMENT

We demonstrated three primary points in Chapter II. First, we proved that our strategy's ability to combine short term demand targeting with long term structural change will break the low income/high structural underemployment trap in low and lower middle income economies to initiate a development process. Second, we proved that it will sustain an upper middle income economy's development process by accelerating, diversifying, and stabilizing its rate of development. Thus, in both of these instances we demonstrated that our strategy will allow less developed economies to more fully utilize their labor resources. Consequently, they will be capable of achieving output levels consistent with a more appropriate distribution of resources and, in doing so, solve the fundamental problem the Scarcity in the Midst of Plenty Approach argues they face. Third and finally, we proved that our strategy will allow less developed economies to minimize structural underemployment.

At the same time, we saw that the state will have to implement this strategy. Therefore, the topic of public finance and its connection to our strategy becomes a critical issue. Indeed, we must ascertain whether the financial capacity exists in less developed economies to administer these recommendations. In order to view the easiest way the state can finance this proposal, we must introduce a body of ideas known as modern monetary theory (MMT). Now, it is important to note that a less developed economy that fails to adhere to the core tenets of MMT can still finance our strategy. Indeed, following the ideas of MMT simply provides a less developed economy with the greatest degree of policy space

when implementing our strategy relative to other financing arrangements. As a result, in this chapter we will discuss this paradigm in the context of less developed economies. As we shall see, MMT has rather profound implications for how our strategy can be financed.

Part III.A - A Primer on Modern Monetary Theory for Less Developed Economies

With its roots found in the Chartalism and Functional Finance approaches of Knapp, Innes, Keynes, and Lerner, MMT is a macroeconomic framework encompassing monetary theory, macroeconomic accounting identities, the operational mechanics of fiscal policy, and certain aspects of post-Keynesian economic analysis. It is important to note that MMT's depiction of the operational mechanics of fiscal policy is a descriptive theory; that is, it does not make unfounded conjectures about how it believes currency operations happen in the real world. Instead, it empirically describes how currency operations in a monetarily sovereign economy actually occur- no matter how unique and unexpected these claims may appear.

The basic principle of MMT's monetary theory is the assertion that all money is a social credit/debt relationship; that is, money is nothing more than an IOU of the issuer. In other words, when a merchant sells his/her output in exchange for a sum of money, s/he actually received nothing more than a sum of IOUs in return- which is simply the social reflection of the buyer acknowledging that s/he was in the merchant's debt. In order to extinguish this 'debt', the buyer provided the merchant with credits (or 'claims') on either itself or a third party (Innes 1914). Hence, what we conceive of as money is simply a balance sheet reflection of social stature- in this instance of the buyer and merchant (Bell 2001). Reaching the conclusion that money is simply an IOU allows us to assert, as Minsky famously did, that "everyone can create money, the problem is to get it accepted" (Minsky

2008, 255). Thus, it would appear that to understand why some IOUs actively circulate while others are never accepted in payment we need to discover why these monies are accepted; that is, what determines an IOU's acceptability?¹

At the core of MMT is the assertion that taxes drives money; that is, the imposition of a tax by the state on something with an inelastic demand- such as property- causes its citizens to demand tangible units of that economy's 'money thing' (what is commonly referred to as 'currency') in order to pay the tax. Hence, taxes drives money in the sense that the imposition of a tax creates a demand for the currency which, in the absence of the tax, would typically otherwise just be a meaningless/worthless piece of paper (Wray 1998, Chapter 2, 2012, 47-58). Therefore, currency derives its value from its ability to be used to pay taxes and a unit of that currency is worth how much of the tax liability it will satisfy- as determined by the state.²

This allows us to return to why some IOUs widely circulate while others will never be accepted. The answer is that IOUs that can be used to pay taxes will be widely accepted and circulate freely while IOUs that cannot be used to pay taxes will be accepted less and circulate less frequently. This is because if the tax base is sufficiently broad and on an item for which there is an inelastic demand, a significant portion of the economy's total

¹ It should be noted that the answer to this is frequently (and mistakenly) that money is intrinsically valuable- meaning that it is made of precious metals or that it is convertible into something more valuable than the form it typically takes of generic and identical pieces of paper.

² This implies that it makes no difference if the money thing were convertible into gold, silver, other precious metals, or another unit of that otherwise worthless piece of paper. Indeed, in the vast majority of economies around the globe- in developed and less developed economies alike- if the money thing is brought to a government pay office to be converted into something else, the pay office simply gives that individual an identical, 'worthless' piece of paper which can subsequently be used to pay taxes with. The relevant point is that convertibility is not what makes an economy's population demand the currency; it is completely unrelated and extraneous to the process. All that is needed to create a demand for the currency is the imposition of a tax by the state on an item with an inelastic demand (Wray, 1998, Chapters 2 and 3).

population will be in debt to the state. In other words, each individual will owe the state some percentage of the claims they have amassed on resources over time. Accordingly, there will be a demand for IOUs that can be used to pay the tax with. It is in the levying of this tax that three core propositions of MMT become apparent. In order to fully elucidate this analytical framework we need to examine each concept in depth.

Part III.B - Three Propositions that Follow from the Taxes Drives Money View

The first proposition that follows from the taxes drives money view is that the state names the ‘money of account’ (unit of account) that the citizenry’s debt will be denominated in (Wray 1998). In the U.S. this is known as the dollar, in Mexico the unit of account is the peso, in Japan it is the yen, in the UK it is the pound, etc. It is important to recognize that this unit of account is nothing more than an abstract measure of value- the same way that a ‘foot’ is an abstract measure of length. In turn, goods and services whose prices are multiples of this abstract unit of value can be seen as reflecting their relative worth amongst one another. Because its monopoly position affords the state with the ability to name the unit of account the tax will be denominated in, the state sets in motion a process that will have far reaching implications across the entire economy.

Because the state levies a tax obligation on broad base that is going to be paid (by virtue of it being levied on something for which there is an inelastic demand), the state makes a significant portion of its citizens indebted to it. Further, if we combine the fact that the private sector needs to pay taxes in the state’s unit of account with the realization that the private sector will be continually indebted to the state, we find that private market

transactions will come to be denominated in the state's unit of account. The logic behind this latter point is as follows.

Because private actors need to discharge their debt to the state, each individual must amass IOUs denominated in the state's unit of account. Because this need is widespread, a debtor knows that a creditor will likely need IOUs denominated in the state's unit of account. Therefore, the debtor will begin denominating his/her IOUs in the state's unit of account since others- such as the creditor- will also need them denominated in the state's unit of account. This process will eventually become so frequent that the vast majority of all private transactions will be denominated in the state's unit of account (Bell 2001).

A second proposition of the taxes drives money approach is that the state names the 'money thing' (the physical item) that will discharge the debt (Wray 1998, Chapters 2 and 3). When the state levies a tax upon its citizens, it is stating that a proportion of its citizens are now in debt to it. Obviously this is not a situation these individuals will wish to be in. As a result, they will attempt to discharge their obligation to the state. But in what form can the tax be discharged? The answer is that it is up to the state to decide. In other words, by levying the tax the state creates a monopoly privilege for itself in naming what 'money thing' it will accept in payment. Hence, we conclude that the key determinant of what allows certain monies (aka IOUs) to be readily accepted more than others is to what degree that IOU can be used to pay taxes and/or can be exchanged for something that can be used to pay taxes. Hence, anyone can create money, but the key to getting it accepted is whether it can be used to pay taxes. Accordingly, we have arrived at our central assertion that taxes 'drives'

money. In addition, this demonstrates that convertibility is extraneous to the process; that is, it does not factor into whether a money will circulate and be generally accepted.

The result of these two propositions is that the state declares what unit of account its tax will be denominated in as well as what ‘money thing’ the tax will be paid in.

Consequently, it is up to the citizenry to amass a certain quantity of claims denominated in the state’s unit of account and that take the form of the ‘money thing’ the state has said will discharge the obligation to it. At this point, the preconditions for the state to become the monopoly issuer of the currency are in place.

The third proposition of the taxes drives money approach is that the state issues its own IOUs as payment to the private sector in order to transfer real private resources to the public sector (Wray 1998, Chapters 2 and 3). To be sure, this has occurred for thousands of years in many different geographical areas; in medieval times, this was done to prevent feuds between clans in a system known as weregeld (Wray 1998, Chapter 3). At some point, in each of these systems, the state realized that it could utilize its own IOUs to transfer real resources to the public sector in order to accomplish certain objectives. In modern day, this has culminated in elected officials transferring real resources to the public sector to accomplish objectives their constituencies believe to be vital to the economy- whether it be infrastructure or the accumulation of military output.³

³ It is important to note that this can sound like a story of force when indeed it is not. In a democracy, the economy's citizens elect their governmental representatives who, in turn, vote on activities that taxes and expenditure(s) will be directed towards and in what degree. As an example, in the U.S. the Democratic Party is traditionally portrayed as using the state’s ability to issue IOUs to purchase health care for the impoverished while the Republican Party is portrayed as issuing IOUs to increase the size of the military. Therefore, this is not a story of a ‘greedy’ state but one that issues IOUs for its constituents’ interests (Wray, 2012).

The valuable lesson here for our development strategy is that the state did not require taxation receipts, nor bond sales, prior to spending its IOUs. In other words, the state does not require prior receipt of IOUs to transfer real resources to the public sector. On the contrary, it simply creates the IOUs as needed. This implies that taxes do not finance federal spending. Instead, they create a demand for the state's IOUs (currency) and, in doing so, impart value upon the 'money thing(s)' denominated in the state's unit of account. Indeed, the mechanism that guarantees private acceptance of state IOUs is that the private sector needs these IOUs to pay its tax liability to the state. It should be noted that this condition is only made possible by two prior actions. First, the state imposed a tax on the private sector denominated in its unit of account. Second, it named the money thing that would be accepted as payment for the tax liability.

Let us now pull these three core propositions together. Because the private sector's tax liability was denominated in the state's unit of account, the latter ensured that the vast majority of private sector IOUs will be denominated in its unit of account. Additionally, since the state declared that the money thing accepted to discharge the private sector's tax liability is the state's IOU, the state is able to issue these IOUs without worry as to whether they will be accepted. Indeed, the tax guarantees private acceptance of them throughout time. Hence, taxes drives money.⁴ We can call an economy that meets these three conditions a monetarily sovereign economy. Further, this discussion allows us to reach empirically-based conclusions regarding the origin and nature of money. To be sure, it

⁴ This demonstrates that convertibility is unrelated as to why monies are accepted in payment- which proves disastrous for the Metallist framework.

directs us toward some important lessons for macroeconomic policy- in particular, fiscal policy.

Above, we saw that neither taxes nor bonds provide the state with the funds it spends. Indeed, we revealed that the state does not require previous funding because of its monopoly status as the currency issuer. To be sure, since it levied a tax, named the unit of account, and stated what money thing will discharge the tax liability, the state effectively put the private sector in debt to itself. Simultaneously, it made itself the only entity capable of providing the private sector with that which is needed to pay the tax. In turn, the state issues its own IOUs (the money thing needed to pay the tax) to the private sector when the latter sells some of its real resources to the state.

Just to reinforce the point that taxes and/or bonds cannot finance government spending, we introduce a matter of temporal logic. A state that levies a tax in its unit of account and declares that its IOU is the only thing it will accept in fulfillment of that tax logically cannot have its spending funded by taxes and/or bonds. This is because upon levying the tax the private sector will not possess the money thing necessary to discharge its obligation to the state (Wray 1998). Hence, state expenditure cannot be funded by taxes/bonds. Indeed, the state has to perform a variety of acts for the private sector to know what is owed. First, the state must denominate the tax in a unit of account- which logically would not previously exist. Second, it must name the money thing that will suffice as payment for the tax liability- which is almost without exception the state's IOU. Thus, how is the private sector supposed to possess something previously not in existence? This reveals

that the state must first spend the ‘money thing’ into existence by issuing its own IOUs- which will subsequently be returned to the state in the form of tax payments.

This allows us to see that state issued money is simply the state’s IOU. Further, it is obligated to accept its IOUs in payment of taxes from the private sector. At the same time, in exchange for being forced to accept its IOUs as payment for taxes, the state gains the ability to create money that is guaranteed to be accepted. Therefore, the state can purchase any quantity of real output for sale. Hence, if monetarily sovereign, a less developed economy undoubtedly possesses the financial capacity to implement our strategy. Moreover, MMT demonstrates that the real constraint on our strategy’s ability to exact a structural transformation involves the supply of real resources- not financial ones.

The conclusions reached in our discussion of MMT will surely fascinate the reader. Admittedly, the first time someone is introduced to them confusion typically occurs since it contrasts with what they have traditionally heard. This is why, from the outset, the author stated that MMT is not a theory merely hypothesizing about how federal government fiscal operations occur. Nor is it necessarily a theory about what the government should do- though it does possess specific implications. Instead, it is a grounded theory regarding how a monetarily sovereign economy’s fiscal operations occur- it is describing reality. Whether the political conclusions to which these facts lead may disconcert the reader is not of immediate importance. What is of immediate importance is that the reader understands these are economic facts- this is how the real world operates.⁵ However, we are not finished with our discussion of MMT. It is still necessary to tie in some loose ends so that a complete

⁵ This, of course, is in complete contrast to orthodox monetary theory and its accompanying fiscal recommendations that have ignored centuries worth of historical evidence demonstrating its logical flaws.

depiction of MMT is made. Only then will the audience be able to discern how MMT affects our development strategy.

Some of the issues that remain are the following. What do taxes do? What do bonds do? Should the state purchase everything for sale? Does the creation of this system make the economy prone to hyper-inflation? We will answer these common inquiries in the order we raised them.

The answer as to what function taxes perform is a rather simple one. We saw above that taxes cannot logically finance federal government spending because the state must create and spend its own IOUs before the private sector can reflux them as tax payments. Hence, taxes play another role. Indeed, we reached the conclusion that taxes create a demand for the money thing the state has denominated in its unit of account. Thus, we can say that taxes are what bestow value upon the state's IOUs (Wray 1998, Chapter 2).

Related to the taxation inquiry is the next usual follow-up question: if the state does not require funding to spend because it simply creates IOUs, why does it issue bonds to 'borrow' money? Saying that a monetarily sovereign state 'borrows' money is incorrect because bonds are not issued to borrow money- though there are plenty of supporters that adhere to this belief. Instead, the state issues bonds for two interrelated reasons. First, it allows interest rates to be set throughout the economy.⁶ Second, by issuing bonds the state provides the private sector with an asset that yields additional state IOUs over time- known as interest. This differs from simply holding state issued IOUs- which do not earn interest.

⁶ Though the U.S. government could technically set the interest rate at each individual date along the interest rate yield curve, it oftentimes prefers to only set the overnight interest rate (the federal funds rate). However, this is a political decision and does not detract from the economic fact that it could set each interest rate along that curve.

Thus, it makes logical sense to exchange any excess state IOUs for bonds in order to earn interest. Still, why would the state do this? Though the mechanics of this can become complex and the author would refer readers elsewhere for an in depth analysis of this (such as the citations listed below), bonds are issued because by creating an asset the private sector will desire relative to state IOUs during the interim when they are not required to pay taxes, the state is able to control the quantity of a specific type of state IOU (reserves) in the financial system. In doing so, the state is able to hit its interest rate target(s) (Wray 1998, 2012). Thus, bonds are issued so the state can set interest rates throughout the economy.

Next we come to whether the state should purchase everything the private sector has for sale. There are two dimensions to this question. The first is whether the state should purchase everything the private sector is willing to sell- regardless of private expenditure decisions. The second is whether the state should purchase any excess output after the private sector has performed its expenditures. Simply put, the answer to the first question is no and the answer to the second question is yes.

If the state was to purchase everything that was for sale- regardless of private expenditure decisions- it would adversely affect the economy in many ways. For example, it could raise the potential for a revolution against the state and therefore should obviously be avoided. In addition, it would likely set off hyper-inflation. On the other hand, if the state was to purchase all the excess output after private expenditure decisions are made, the production side of GDP would equal the expenditure side. Consequently, sales receipts would confirm expectations and encourage additional production- which would increase employment, profits, etc. This should continue until the full employment level of output is

reached. Therefore, we summarize that just because the state can purchase everything for sale does not mean that it should purchase everything for sale. Instead, the state should purchase output until full employment is reached and maintained (Wray 2012, Chapter 6).

Fourth and finally, people oftentimes incorrectly believe that MMT will be inflationary because they uphold Friedman's version of the quantity theory of money- despite the fact that he made incredibly unrealistic assumptions. This concern is treated at length elsewhere- such as in the citations provided (Wray 1998, 2012). Accordingly, we will simply discuss MMT's approach to inflation concerns.

If expenditure is less than production, there is an excess supply of goods in the market- which would cause a deflationary process to begin. On the other hand, if the sum of state and private expenditure is greater than the full employment level of production, there will be excess demand for goods and services. Consequently, there would be inflationary pressure. Hence, the fiscal objective of the state should be to ensure that the level of expenditure is consistent with the full employment level of output. In doing so, demand will balance with supply and ensure a tendency towards price stability. Thus, the state's ability to create and spend its own IOUs would only be inflationary if it caused the total level of expenditure to be in excess of the full employment level of output. Because we are advocating that the state should only ensure that the full employment level of output is reached, the answer is no- MMT will not be inflationary if exercised properly.

At this time, we draw the reader's attention to a potential problem surrounding MMT in less developed economies. This is the problem of dollarization.

Part III.C - Dollarization, MMT, and Less Developed Economies

Dollarization is a situation in which an economy's citizens either voluntarily or involuntarily make another economy's currency the accepted money of their economy. We need to see what this implies for MMT in both cases. We will start with an instance involving the voluntary usage of a foreign currency which will be followed by the involuntary usage of a foreign currency.

Part III.C.1 - MMT and Voluntary Dollarization

When the citizens of an economy voluntarily begin using a foreign economy's currency as their own preferred means of payment it is likely because of two interconnected reasons. First, it can occur because they do not have confidence in the value of the domestic state issued IOUs; that is, they expect the domestic state's IOUs to become increasingly worthless over time. Consequently, they begin to utilize another economy's currency because it is believed to have a steadier value over time.⁷

Second, this can only occur if the domestic state is unwilling/unable to enforce the tax obligation on its citizenry. In other words, if the state cannot and/or is unwilling to enforce the tax it has levied upon them, the money thing (the domestic state issued IOUs) that can be used to discharge the tax will not be as valuable relative to a situation in which the tax had to be paid. Thus, fewer members of the private sector will make an effort to obtain it. As a

⁷ There are two typical sources of this type of dollarization. As we shall see in Chapter V, the first source stems from wealthy individuals who do not trust the currency's value. As a result, since they have access to FOREX markets, they begin to employ a foreign currency as their means of payment. The second population segment potentially responsible for dollarization occupies the polar opposite of the income distribution: individuals who are informally employed. This second group may decide to voluntarily dollarize because of the perceived need to possess a 'strong' global currency to complete basic transactions.

result, the demand for that money thing will decrease and it will grow increasingly worthless- which we call inflation.

When the state is unable/unwilling to enforce its tax obligations, it creates a situation akin to the state having the same authoritative power over you as your neighbor. Indeed, there is no definite reason to accept your neighbor's IOUs because of his/her lack of authoritative capacity over you. Thus, his/her IOUs would be relatively worthless. A state that is unable/unwilling to enforce its tax obligation is no different. The result will be that the state's IOUs will decline in value since what those IOUs can be redeemed for has decreased.⁸

A phenomenon similar to this occurred in the Confederate South during the American Civil War. Because the Confederate army was busy fighting a war against the Northern Union forces, there was no viable way to enforce its tax obligation on the citizenry. Consequently, the South was unable to monetize its economy with Confederate IOUs. This is one of the primary reasons it lost the war- it could not transfer real private resources to the military cause (Wray 1998, 61-67).

In the event that voluntary dollarization was to occur, it would certainly alter some of the conclusions about MMT from above. First, the state would be unable to issue its own IOUs in exchange for output the private sector was willing to sell it. Second, inflation could also occur from the state's inability to effectively enforce its tax- not just from a situation in

⁸ When some individuals dissent to the MMT approach because of the belief that state spending will lead to inflation, they oftentimes point out the cases of Weimar Germany or Zimbabwe. What they do not realize is that in both of these cases the reason for inflation was not that state spending was excessive. Rather, the state was unable/unwilling to enforce the tax obligation and therefore the state's IOUs grew increasingly worthless (which was also combined with large amounts of foreign denominated debt). It had nothing to do with government expenditure levels- though, as shown above, this can lead to inflation if taken past the full employment level of output.

which expenditure runs ahead of productive capacity. Third, it is likely that third party transactions would not be denominated in the state's unit of account nor would they utilize the state issued money thing. Consequently, the relative values of each individual's IOUs would be extremely difficult to ascertain.⁹

The solution to voluntary dollarization is an easy one. The state must be willing and able to fully enforce its tax obligation. This would ensure that the population has an inelastic demand for the state issued money thing and, in turn, the state's IOUs would not grow increasingly worthless over time.

Part III.C.2 - MMT and Involuntary Dollarization

Involuntary dollarization is one of the more interesting and perplexing phenomenon of recent times. As opposed to a situation in which the economy's citizens decide to dollarize, involuntary dollarization is when a state levies a tax obligation upon its citizenry denominated in a foreign state's unit of account. In turn, it then declares that the money thing that can be used to discharge the tax obligation is the foreign economy's currency. Hence, while the state possesses the willingness and the ability to enforce its taxation policy, it states that the thing used to discharge the tax is not a domestically produced entity! This results in an enormous loss of sovereignty and policy space. Indeed, the state is effectively giving up its political sovereignty since its ability to make war will be dependent upon procuring a foreign economy's IOUs. As a result, the money supply of the dollarizing economy becomes dependent upon the supply of the foreign economy's IOUs. Therefore, it is effectively powerless over its own money supply.

⁹ In point of fact, this is what happened in the period of U.S. history known as Wildcat banking that contained many different financial crises.

This too also alters many of the conclusions MMT analysis led to above. First, since the state cannot issue its own IOUs as payment to the private sector, it is voluntarily limiting its discretionary policy making ability. Therefore, it is voluntarily choosing to limit its policy space and ability to adapt to changing economic conditions.¹⁰ Additionally, taxes and bonds will have to finance the state's expenditures. Third, inflation could be the result of a complex intertwining of the exchange rate, domestic and foreign interest rate differentials, domestic and foreign taxation policy, and changes in the trade relations between the two economies. This is a far cry from inflation simply being the result of increased costs, excess demand, or an inability/unwillingness to enforce taxation policy like it is in monetarily sovereign economies.

It should be noted that the voluntary adoption of a foreign currency is exactly what happened when the European countries adopted the Euro. In doing so, those states effectively gave up the issuance of their own sovereign currencies- lira, drachma, etc., and instead adopted a foreign currency- the euro (Wray 2012, Chapter 5). We need not delve into the potential repercussion of involuntary dollarization since they have been witnessed in Europe from the inception of the Great Financial Crisis and persist to this day. We will only note that all involuntary dollarization arrangements should be abandoned as soon as possible since they greatly reduce domestic policy space and national sovereignty. However, it should be noted that involuntary dollarization does not eliminate the possibility of implementing our strategy- it only makes it more financially difficult to do so relative to monetarily sovereign economies.

¹⁰ As an example, it would be powerless to adopt counter-cyclical fiscal policy- the importance of which became evident during the Great Recession.

Part III.D - MMT's Lessons for Our Development Strategy

At the outset of this chapter, we saw that the relationship between public finance and our strategy is a critical one since the state will have to administer our recommendations. Thus, we needed to determine whether the financial capacity exists in less developed economies to implement these policies.

MMT conclusively demonstrates that this capacity can- and typically does- exist. Indeed, MMT reveals that if a less developed economy is monetarily sovereign, its inherent ability to create currency ensures that it can always possess the financial capacity to implement our development strategy. Accordingly, the policy recommendation that naturally follows from this analysis is that a less developed economy should always make possession of a sovereign currency the centerpiece of its monetary structure because it greatly facilitates the ease with which this strategy (as well as other development strategies) can be financed. Finally, MMT demonstrates that the pertinent constraint on the state's ability to exact our strategy's transformation involves the supply of real resources- not financial ones.

CHAPTER IV

BALANCED GROWTH

In Chapter II, our post-Keynesian/Structuralist strategy for development was presented in its ‘bare bones’ form so as to prominently feature each element. In addition, we saw that each element of this synthesis does not conflict with the others. In fact, we demonstrated that each is complementary with one another. Thus, we concluded this particular synthesis is a post-Keynesian/Structuralist strategy for development that is capable of combining short term demand targeting and long term structural change. Accordingly, we recognized that it can initiate/sustain a development process as well as minimize structural underemployment.

Nonetheless, the articulation of this strategy should not simply be limited to its skeleton form. A development process is a complex task with many moving parts that require detailed consideration. Thus, it is necessary to analyze our strategy’s individual components in greater detail.

The current chapter, Chapter IV, will present an analysis of balanced growth. Subsequently, in Chapter V, we will discuss ELR in the context of less developed economies. Following this, in Chapter VI we will discuss the developmental state and some perceived limitations of the concept. Finally, in the Conclusion we will highlight the primary benefits of this strategy.

For now, however, we will analyze balanced growth in greater depth. We intend to prove only a single theme: that it can successfully initiate/sustain a development process by combining short term demand targeting with long term structural change.

Part IV.A - Balanced Growth and Less Developed Economies

In order to analyze balanced growth in greater depth, it is necessary to once again split less developed economies into the categories of low and lower middle income economies and upper middle income economies. Creating this line of demarcation is necessary in order to identify the specific problem(s) each type of economy is likely to face. First, we will first discuss the issues associated with low and lower middle income economies.

Part IV.A.1 - Low and Lower Middle Income Economies and the Low Income/High Structural Underemployment Trap

It is important to remember that many of the pioneers of development- who were influenced by Keynes and Kalecki and therefore would be considered heterodox- were primarily concerned with two questions (Jomo 2005; Patnaik 2005). First, they attempted to explain why what are now known as low and lower middle income economies were just that: low and lower middle income economies. Second, they wanted to explain why these economies seemed to be stuck in these categories. The conclusion many of them reached- and the view endorsed here- is that they were stuck in a low income/high structural underemployment trap.

As described in Chapter II, a low income/high structural underemployment trap is a situation in which relatively low levels of real income become institutionalized because of a small domestic market and a low inducement to invest. Indeed, the problem is that there is little incentive to invest because of the low level of real income. In turn, this limits the size of the domestic market and causes real incomes to remain relatively low- which reproduces the small propensity to invest. Consequently, the economy is perpetually identified by high

levels of structural underemployment and a small degree of purchasing power. Hence, because the market remains small through time the division of labor remains limited. The result of this trap is an economy with a relatively inefficient production structure that perpetually leaves labor underemployed. In other words, the root cause of the fundamental problem in the Scarcity in the Midst of Plenty Approach is the low income/high structural underemployment trap.

Accordingly, we found that the key to breaking this trap involves combining short term demand targeting with long term structural change. In other words, we need to simultaneously increase effective demand and the rate of capacity creation. Further, it is preferable to do so in a stable fashion. This last key- a stable expansion- may require an explanation as to why it is preferable. Thus, we must digress for a moment.

The most obvious reason for preferring a stable expansion is that it inherently prevents a stop/go expansion- which begs the question why this latter scenario is undesirable. The primary economic reason is because a stop/go expansion can make entrepreneurs unsure as to whether an expansion will continue. Consequently, stop/go processes can upset expectations and make entrepreneurs hesitant about investing. Hence, even if an expansion was genuine in the sense that entrepreneurs were willing to invest, stop/go scenarios may instead cause them to err on the side of caution and hold their wealth in liquid forms. Accordingly, this would cause even a 'genuine' expansion's foundation to turn into a self-fulfilling prophecy of collapse. In turn, this could initiate a process of negative cumulative causation- which would cause the economy to return to a low income/high structural underemployment!

There is also an important socio-political reason why a stable expansion is to be desired. If an expansion is undertaken in an unstable fashion many of the structural deficiencies of less developed economies can cause socio-economic problems. One example would be the onset of high rates of sectoral inflation- such as via an increased demand for food. In turn, this could spark a wage-price spiral and social unrest. Hence, we desire stability because it allows social institutions to evolve as the economic and political activities of the economy change.¹

Part IV.A.1.A - Balanced Growth and Breaking the Low Income/High Structural Underemployment Trap in Low and Lower Middle Income Economies

In Chapter II, it was argued that balanced growth breaks the low income/high structural underemployment trap by simultaneously undertaking an investment sequence in a range of horizontal activities whose resulting output possesses high income elasticities of demand.² Upon doing so, the increased output will be purchased by the higher level of wage earner consumption made possible by the increased employment that was brought on by the investment.³

¹ This analysis would appear to have some important implications for contemporary economic development theory. In particular, it implies that the neoclassically-based Washington and post-Washington Consensus- which emphasize themes such as ‘getting institutions right’ and ‘getting property rights right’- have their priorities misplaced. Instead, the analysis here demonstrates that economic change precedes institutional change- not vice versa.

² By producing goods with high income elasticities of demand, balanced growth reduces the risk that increased domestic income will result in a burgeoning current account deficit and balance of payments crisis. As opposed to a situation in which the marginal propensity to import allows a trade deficit to develop and/or expand, the fact that the items will have high income elasticities of demand assures that the increased income level will be spent domestically. Therefore, any external leakages will be minimized. In order to ascertain the likelihood of this occurring, the relevant consideration would be to determine whether the income elasticity of demand for the items associated with balanced growth is greater than the marginal propensity to import.

³ Because balanced growth increases productivity while simultaneously inciting higher consumption, it manages to increase these two elements *pari passu*- meaning that the macroeconomy’s expansion will be stable and balanced.

We saw that the logic behind this scenario starts from the premise that it makes little sense for an individual in an economy faced with the low income/high structural underemployment trap to invest on his or her own initiative because the likelihood of receiving back at least the whole of the increased wage bill is slim. Indeed, the addition to employment will likely purchase an array of differing commodities- not just the one the investing entrepreneur produces. Therefore, a particular investment will have a negative return or, at a minimum, have an expected return less than the marginal efficiency of money.

On the other hand, balanced growth states that if many entrepreneurs simultaneously undertake investment in horizontal activities whose resulting output possesses high income elasticities of demand, the subsequent workers' purchases will allow the entrepreneurs to recoup their funds. This is how low and lower middle income economies can break the low income/high structural underemployment trap. Further, in the absence of willing private entrepreneurs to undertake this task, the state- especially if it is monetarily sovereign- is uniquely positioned to implement this on its own.

It is in balanced growth that we have located a mechanism allowing us to increase both effective demand and the rate of capacity creation in a stable manner. Consequently, this mechanism will enable low and lower middle income economies to begin transforming their production structures and expand the division of labor. In doing so, they will more fully utilize their labor resources. This is the way to overcome the low income/high structural underemployment trap.

Now, before we can formally explicate the logic underlying balanced growth, we must first define the term 'increasing returns' because it will be used extensively throughout

the remainder of this essay. Thus, before proceeding to formally define balanced growth, we must first inform the reader what this term entails.

Part IV.A.1.A.1 - The definition of increasing returns

Unless otherwise specified, throughout this essay the term increasing returns is not used in the neoclassical sense. In this latter framework, it is argued that some firms will be able to increase output by a factor greater than the proportional increase of their inputs- given that an all-encompassing production function exhibiting constant technology is a valid assumption. Additionally, in the neoclassical sense of the term, it is purported that increasing returns will eventually cease because diseconomies of scale will outweigh economies of scale. This can be disputed for a variety of reasons but ultimately a critique of this concept stems from the assumed validity of a production function- which we would argue is non-existent. Thus, this entire analytical apparatus is a conceptual framework without empirical foundation.

Instead, we will define increasing returns as falling unit costs as the volume of output increases (E. Reinert 2007, 103-104). In doing so, we use the term in a way that is derived from Adam Smith's dictum 'the division of labor is limited by the extent of the market' (Smith 1986, Chapter 3). To be sure, this idea was built upon by Young, Rosenstein-Rodan, and Nurkse- who all used it to demonstrate how an enlarging macroeconomy will induce an

individual enterprise to invest in better technology⁴ and expand the division of labor (Young 1928; Rosenstein-Rodan 1943; Nurkse 1953, Chapter 1). In this sense, it is precisely because of technological change induced by an expanding market that increases in productivity and prospective profitability are brought about. In turn, we argue that this is the process that will ultimately allow an expansion of the division of labor to occur and enterprises to realize increasing returns.

It is important to recognize that it is the combination of two interrelated mechanisms that allow enterprises to realize the benefits of increasing returns. First, the increased investment in better technology allows the market and the division of labor to expand- resulting in higher productivity. This makes it possible for the enterprise to create increasing returns if it increases its supply flow since it will be done at lower unit costs. In doing so, the potential is created to realize higher profits should the output be sold. Second, there is also a higher real income level brought on by the increased employment that results from the initial investment. Accordingly, this additional income can be spent on that enterprise's output. Thus, when the unit cost reductions are combined with increased real consumption, the enterprise is afforded the ability to realize higher profit totals- which are brought on by

⁴ The idea that an expanding macroeconomy can induce enterprises to upgrade their technological capabilities complements Lazonick's work rather well. Indeed, in his 1991 masterpiece *Business Organization and the Myth of the Market Economy*, Lazonick shattered the neoclassical theory of competition by arguing that when an enterprise alters its technology it thereby alters its cost structures, pricing system, and the non-price attributes of what it produces (such as the income elasticity of demand for its products). In turn, this allows the enterprise to decide whether it wishes to adopt an innovative strategy (large fixed investment costs dedicated to R&D to develop new products) or an adaptive strategy (requires low fixed and factor costs to gain market share). The important difference between the two strategies is that the former will have a distinct competitive advantage over the latter if it is successful at converting its high fixed investment costs into low unit costs since it will become a market leader and thus be able to form the incumbent conception of control (Lazonick, 1991, 95-101; Fligstein, 2001, Chapter 2). In order to achieve this success, the innovative enterprise requires a large volume of sales in order to have its high fixed costs translate into low unit costs. This is exactly what the expanding macroeconomy that balanced growth makes possible will accomplish. As a result, less developed economies will be more likely to possess enterprises that are capable of pursuing an innovative strategy while the enterprises themselves will benefit from the ability to realize increasing returns.

induced investment in better technology. In turn, the higher profits will induce entrepreneurs to increase investment once again- which will have the impact of moving additional labor resources towards higher productivity occupations. Hence, this is why increasing returns are essential throughout a development process: it allows the process of minimizing structural underemployment to be strengthened and sustained.

It is vital to appreciate that the combination of these two factors is what allows the enterprise to realize increased profits. On the supply side, increasing returns are created through a process of technological upgrading- which allows unit costs to decrease. On the demand side, what allows the enterprise to realize the benefits of increasing returns is the fact that there are higher real income and employment levels brought on by the investment necessary to expand the division of labor. To be sure, in the absence of this latter mechanism involving external economies it would be impossible to benefit from increasing returns since the increased output would simply go unsold. Therefore, this second mechanism is vital to realizing increasing returns.

It must be appreciated how different this conception of increasing returns is from its neoclassical usage. First, the neoclassical conception holds technology constant; in our depiction we discussed changes in the level of technology. Second, in our presentation the increase in the division of labor is directly caused by increases in technology. This is different from the neoclassical position which, given their assumptions, states that the division of labor will somehow naturally expand during production. Third, there is no a priori reason in our analysis regarding the enterprise's ability to maintain increasing returns over time. This is in stark contrast to the neoclassical analysis which posits that a variety of

factors will ultimately create long run diseconomies of scale that outweigh the economies of scale. Fourth, the neoclassical conception is a partial equilibrium analysis; that is, it abstracts from changes in the rest of the economy and how they will have an impact on the individual firm's decisions. In contrast, we are able to incorporate how changes in the economy will affect the enterprise's production decisions because our analysis is dynamic in nature. Fifth, in our depiction increasing returns can only be realized through the simultaneous creation of external economies. In the neoclassical analysis, the realization of increasing returns is independent of such economies. Finally, the results of our analysis are not derived from any neoclassical-type aggregate production function- which is without empirical support yet the neoclassical microeconomic tradition nonetheless adheres to.

Part IV.A.1.A.2 - The social marginal efficiency of capital and the formal definition of balanced growth

Having defined increasing returns, we can now formally define balanced growth. In order to do so, we need to return to Keynes' private marginal efficiency of capital⁵ analysis and introduce the concept of the social marginal efficiency of capital. Similar to Fisher's concept of rate of return over cost, Keynes defined the (private) marginal efficiency of capital as the

rate of discount which would make the present value of the series of annuities given by the returns expected from the capital asset during its life just equal to its supply price. This gives us the marginal efficiencies of particular types of capital assets. The greatest of these marginal efficiencies can then be regarded as the marginal efficiency of capital in general. (Kregel 1988; Keynes 1997, 135-6)

⁵ While in the *General Theory* Keynes referred to this concept simply as the marginal efficiency of capital, for reasons that will subsequently become clearer we are labelling it as the 'private' marginal efficiency of capital.

In low and lower middle income economies, the private marginal efficiency of capital for both specific capital assets and in general will be relatively low because “the series of annuities given by the returns expected from the capital asset” will not be very large- for two reasons. First, the purchasing power of individuals is relatively limited due to low levels of real income. Second, any increased consumption resulting from increased employment will likely not be wholly spent on a single enterprise’s increased output. As a result, the private marginal efficiency of capital for both specific capital assets and in general is not likely to surpass the marginal efficiency of money. Therefore, single-handedly enlarging the market would be unprofitable if undertaken alone. Although Keynes called it the marginal efficiency of capital, here we will refer to this concept as the ‘private’ marginal efficiency of capital because it is only concerned with a single entrepreneur and his/her investment decisions.

On the other hand, we saw that balanced growth envisions a multitude of investments that occur simultaneously. Accordingly, when the increased real income resulting from the increased net employment is diversified amongst additional consumption expenditure, the increased net output will all be sold. In doing so, this mechanism guarantees to make investment projects that are unprofitable when considered individually now profitable when considered as a component of an investment program.

It should be recognized that this change in profitability is the result of spillover effects that occur from the diversification of additional consumption expenditures. Further, these spillover effects can be identified as external economies. Indeed, this captures how an individual investment by a single enterprise in balanced growth will ultimately increase the

extent of the market and spur the creation of economies that are external to other enterprise(s) and their investment decisions (Nurkse 1953, 14-15). It is precisely because these external economies enlarge the total size of the market that previously unprofitable investments are now made profitable. In addition, it follows that in doing so the economy will be transforming its production structure by more fully utilizing its labor resources. This is how to break the low income/high structural underemployment trap as well as create and realize increasing returns throughout a development process.

We propose that it is the presence of this specific external economy that gives rise to what we call the social marginal efficiency of capital. Moreover, this external economy is what creates a difference between the social marginal efficiency of capital and the private marginal efficiency of capital. Thus, we may now introduce our social marginal efficiency of capital concept and utilize it to formally define balanced growth.

We define the social marginal efficiency of capital as a type of external economy in which the employment multiplier derived from an individual investment raises the private marginal efficiencies of other investments. It should be noted that the more scarce capital assets are, the stronger this force will be. Indeed, as the economy expands the magnitude of the divergence between the social marginal efficiency of capital and the private marginal efficiency of capital will dissipate. Finally, we may note that the social marginal efficiency of capital differs from the private marginal efficiency of capital because the former does not look at an individual investment in isolation- which the latter does. Instead, the social marginal efficiency of capital analyzes a group of temporally-related investments and how an

individual investment's expected returns can be influenced by another investment project's undertaking.

This concept permits us to formally define balanced growth. It is a program in which an array of simultaneous investments produce a social marginal efficiency of capital that raises the private marginal efficiencies of each investment constituting the program. In doing so, it affords the investing enterprises with the opportunity to realize increasing returns.

It should be pointed out that the smaller the extent of an economy's market owing to the low income/high structural underemployment trap, the larger the divergence will be between the social marginal efficiency of capital and the various private marginal efficiencies. This is because there will be fewer pre-existing options for workers to spend their increased incomes on. Hence, if the only option is to spend the increased income on the output associated with balanced growth, it is more likely that this policy will succeed at breaking the low income/high structural underemployment trap. Further, this implies that as an economy expands, the strength of balanced growth's complementary consumption expenditure dissipates. This means that as the economy grows larger, a balanced growth program must also grow larger in order to guarantee that the complementary nature of the consumption linkages occurs.⁶

⁶ When we say 'larger in size' regarding a balanced growth program, there are two ways to interpret this. The first is to take it as meaning that the program will encompass an increasing amount of enterprises. In the second interpretation, it can be taken to mean that the quantity of investment itself will become larger and larger. Though both interpretations can ultimately prove productive for accomplishing a large scale balanced growth program, extreme caution needs to be exercised when undertaking such an event. This is because such a plan can quickly become too difficult to manage and thereby creates a convoluted mess of economic activity. After all, when learning something new, it is better to do a little correctly than a lot incorrectly.

Part IV.A.1.A.3 - Balanced growth as an economic transformation of low and lower middle income economies

In Part IV.A.1, we saw that breaking the low income/high structural underemployment trap requires a strategy capable of combining short term demand targeting and long term structural change. Thus, we needed a way to simultaneously increase both effective demand and the rate of capacity creation. Further, we saw that it is preferable to do this in a stable macroeconomic environment. Indeed, we saw that this will allow low and lower middle income economies to transform their production structures by more fully utilizing their labor resources. At the same time, we demonstrated that balanced growth will accomplish these three objectives. Let us look closer and see how.

First, balanced growth will initially increase effective demand via increased investment rates. In addition, it will subsequently increase two different components of consumption. First, it will increase the consumption of the employees required to operate the physical investment. In turn, this is likely to spur additional increases of both investment and wage earner consumption via the employment multiplier. Second, it will increase the consumption of capitalists- though this may improve to a negligible degree.

Second, balanced growth will increase the rate of capacity creation because, after all, it is concerned with investment spending.⁷ In turn, this allows the division of labor to expand and productivity to increase since the extent of the market will have grown. Hence, increases in effective demand will translate into increased real income levels since the rate of capacity

⁷ We may note that the increased rate of capacity creation will make Rao's critique of the multiplier non-applicable. As mentioned in Chapter II, the Rao critique was that the employment multiplier may be non-existent or negligible in less developed economies because of the typical lack of capacity (Rao, 1958, 210-211). Hence, in his scenario, any increased effective demand would only serve to increase prices and thereby keep real income levels constant instead of increasing them as typically expected.

creation will increase. In addition, because we are only creating capacity in certain horizontal activities, we have not minimized the economy's ability to generate vertical linkage effects. Thus, the economy will retain this innovative dynamic. Further, as discussed in Part II.A, this linkage process is particularly helpful when confronting the structural inflation caused by bottlenecks.

As a bonus, the combination of increased effective demand and capacity creation will allow certain enterprises both within and outside the balanced growth program to realize increasing returns.⁸ To be sure, in Part IV.A.1.A.1 we saw that increasing returns involves two processes- a supply aspect and a demand aspect. On the supply side, we saw that the potential to realize the benefits of increasing returns is brought on by an expanding economy that induces an enterprise to invest in technological upgrading. In turn, this process of technological upgrading is what allows the enterprise to expand output at lower unit costs. However, this only creates increasing returns- it does not guarantee that the enterprise will realize the benefits of doing so and therefore we also needed to analyze the demand side. On the demand side, we saw that the higher net income and employment levels resulting from the initial investment can allow the enterprise to realize increasing returns.

It should be obvious how balanced growth ensures this process will occur. The initial mechanism of balanced growth involves increased investment- which subsequently affects both supply and demand. On the supply side, the investment undertaken will be associated with technological upgrading. In turn, this will cause the division of labor to expand and

⁸ It can be argued that balanced growth will also induce enterprises not associated with the program to increase investment and thereby afford them with the possibility of realizing increasing returns should their resulting output possess high income elasticities of demand. In this regard, balanced growth can create increasing returns for enterprises not associated with the program which will additionally strengthen and sustain the development process. We will pick up on this idea in Part IV.A.2.B.

therefore the enterprise will be able to expand output at lower unit costs- giving it the potential to benefit from increasing returns.

On the demand side, balanced growth's simultaneous investment strategy causes increased employment which leads to increased consumption. Moreover, this increased consumption will be diversified amongst an array of goods- implying that a multitude of enterprises will have their sales receipts increase. Thus, the increased output that enterprises produce under this plan will be sold and the enterprises themselves will be capable of realizing increasing returns and higher profit levels.⁹ In turn, the higher profits will induce additional quantities of investment- which will strengthen and sustain the development process itself. Consequently, by allowing low and lower middle income economies' enterprises to realize increasing returns, balanced growth ensures that a development process will be initiated and sustained.

Third, there are three ways by which balanced growth can ensure that the economy will expand in a stable fashion. First, the expansion will be stable because upon deciding to undertake balanced growth, the coordinating entity of the program- most likely the state- should let enterprises know about it. In doing so, the system will have an enhanced degree of predictability that will stabilize what could otherwise be a potentially volatile expectational state. Indeed, entrepreneurial expectations will be increasingly vindicated as the investment projects prove profitable.

Further adding to a stable expansion is that the growth of national expenditure will largely be driven by increased consumption. We know that this brings greater stability

⁹ The factor determining the net increase of sales receipts and thus the ability to realize increasing returns will be that item's income elasticity of demand.

because this type of expenditure is the most stable of effective demand's components. What is more is that since these are low and lower middle income economies, a sizeable portion of this consumption will be spent on food- indicating which sector(s) must be expanded.

A third feature contributing to stability is that there will be a relatively constant price level. Indeed, this is because the growth in supply will approximately be equal to the growth of demand. Further reinforcing this tendency is that increasing the extent of the market will also increase the division of labor and productivity.

What this all adds up to is that by utilizing short term demand targeting, low and lower middle income economies will break the low income/high structural underemployment trap. In doing so, they will overcome the single largest economic obstacle preventing them from embarking on a development process. Simultaneously, when overcoming this obstacle they will initiate long term structural macroeconomic change and begin solving the fundamental problem the Scarcity in the Midst of Plenty Approach argues they face; namely, how to minimize structural underemployment. Accordingly, as they begin a development process they will start to achieve production levels consistent with a more appropriate distribution of labor resources which will set them on the road to becoming upper middle income economies.

Part IV.A.1.A.4 - The logistics of initiating balanced growth in low and lower middle income economies

Balanced growth will have to be instigated by the state. This is because an economy mired in a low income/high structural underemployment trap will be unable to spontaneously induce entrepreneurs into undertaking an investment program large enough to overcome the trap. To be sure, this is because frequently the investment projects- when taken in isolation-

will have negative net present values or, at a minimum, have expected returns that are less than the marginal efficiency of money. Accordingly, the state will have to implement balanced growth.

Though this will be discussed more in Part IV.B and was touched on in Chapter II, we can identify two categories of measures the state can use to implement balanced growth- direct and indirect methods.¹⁰ Direct methods involves the state undertaking production on its own through nationalized enterprises while indirect methods refer to ways the state can intervene in the market to coax private enterprises to undertake production.

In terms of direct methods for implementing balanced growth, the state can undertake production in the desired areas by setting up SOEs, hiring the workers, and producing the output itself. However, while this method may prove invaluable- notably to fill in gaps where the private sector is non-existent and/or unwilling to undertake additional production- for political and economic reasons the state should not over-utilize this route.

Instead, there are plenty of indirect measures the state can use to initiate balanced growth. From among them, the more obvious ways would include tax policy, administered (and potentially differential) interest and exchange rates, strategic subsidy allocation, and the engineering of an incentive structure designed to promote product innovation. Again, however, we will discuss this issue in greater depth in Part IV.B.

¹⁰ Note that in Chapter III we saw the financial capacity to utilize these methods is a non-issue for monetarily sovereign economies. In other words, if the state is monetarily sovereign there is no financial constraint on its ability to implement this program. Instead, the appropriate constraint involves the supply of real resources.

Part IV.A.2 - Upper Middle Income Economies and Balanced Growth

In Part IV.A.1.A.3 above, we saw that balanced growth will allow low and lower middle income economies to overcome the low income/high structural underemployment trap while setting them on the path to becoming upper middle income economies. Here, in Part IV.A.2, we will analyze the relationship between balanced growth and upper middle income economies. It may be worth pausing to remind the reader that this type of economy is already in the midst of a development process. Therefore, this implies that the economy has begun a structural transformation. Accordingly, it has two concerns. First, it wishes to sustain (and strengthen) this process. Second, it wants to become a high income economy.

As discussed in Part II.A.2, the biggest problem facing upper middle income economies is that the quantity of existing inducements to invest may not be sufficient to sustain its development process. Indeed, we saw that there may still be significant structural problems- such as foreign dependency, domestic sectoral asymmetry, or internal backwashing. To be sure, in each of these cases we saw that the economy needs a way to sustain and/or accelerate its development process while diversifying its production structure. Moreover, success at doing so would stabilize the rate of development since the dispersion of the rate at which structural underemployment is being minimized will narrow. It is obvious that the creation of additional inducements would benefit an upper middle income economy since it would accomplish these objectives. Here we intend to prove that balanced growth can serve that purpose; namely, that it will sustain a development process by accelerating, diversifying, and stabilizing the rate of development.

Part IV.A.2.A - The Political Aspect of Introducing Balanced Growth in an Upper Middle Income Economy

We must start with the political feasibility of implementing balanced growth in an upper middle income economy. To be sure, it may be difficult to introduce policies that place an emphasis on areas that, up to that point, may not have been associated with the driving force of the development process. Thus, to facilitate this process it would help if balanced growth was characterized as a complement to the method(s) that had been driving the economy's transformation. Further, stressing that it will allow the economy to accelerate, diversify, and stabilize its development process will cause it to be received more congenially.

Part IV.A.2.B - The Mechanics of Balanced Growth in Upper Middle Income Economies

In upper middle income economies, the transmission mechanism of balanced growth works identically to the way it does in low and lower middle income economies. Indeed, it expands the domestic market by simultaneously undertaking an array of complementary investments in horizontal activities whose resulting output all possess high income elasticities of demand. In doing so, it produces a social marginal efficiency of capital that raises each private marginal efficiency of capital. In turn, this leads to the realization of increasing returns for enterprises both within and outside of the program.

However, because upper middle income economies are structurally different from low and lower middle income economies, we must make two caveats. First, if the upper middle income economy's prior expansion is in consumer's goods, balanced growth should not replace this but rather complement it. In this context, such a program would focus on creating additional consumer's goods- instead of substitutes for what already exists. Doing

so prevents crowding out the original expansion. Indeed, if this is accomplished it would accelerate the initial expansion.

Similarly, the design of the balanced growth program should make sure that the inputs required for it are not predominantly the same as those required for the expansion currently underway. Failure to do so could set off inflation in the beginning and intermediate stages of production. In turn, this would have the impact of pushing up final output prices and sparking an inflationary spiral. Now, the linkage effects associated with unbalanced growth could counteract this tendency. However, balanced growth is most likely to succeed if this situation was avoided altogether. Thus, care should be taken when designing balanced growth to ensure that its inputs are mostly different from those fueling the previous expansion.

Having mentioned these caveats, we can now argue the thesis of this section. As stated in Part IV.A.2, we intend to argue that balanced growth will sustain a development process by accelerating, diversifying, and stabilizing an upper middle income economy's rate of development. Below we will demonstrate that such a plan introduces at least three different mechanisms. The first involves considering balanced growth in isolation. The latter two take into account the interaction between balanced growth and the mechanism previously responsible for the economy's expansion.

First, it is easy to see that balanced growth will establish previously non-existent activities. Thus, it will obviously increase the development rate of certain sectors. In doing so, it will accelerate the economy's development process relative to a scenario without it. Moreover, it will diversify the sources of development.

Second, if the mechanism previously driving the expansion flounders, balanced growth will allow the economy to keep up its rate of development. Thus, by having balanced growth in place, the economy will continue to develop even if its main engine(s) falters. Indeed, since there would be at least two mechanisms capable of driving a development process, one can compensate for the other's lackluster performance. In this regard, balanced growth will sustain a development process. In this scenario, the economy's structure will be afforded two major benefits. First, the sources of employment growth will become increasingly diversified. Second, should the previous source falter, balanced growth will stabilize the economy's rate of development. Thus, balanced growth will diversify the sources of structural underemployment minimization and thereby stabilize the overall rate of development.

Third, balanced growth and the previous source of expansion can reinforce one another. In doing so, the force that each emits for a development process will become institutionalized. Note that this is distinct from simply making the economy more flexible through simple diversification- as it is also different from the first case involving an acceleration of the economy's development relative to a situation without balanced growth.

Instead, what we are proposing here is that if there are (at least) two sources of employment growth, they can feed off one another and evolve into a self-reinforcing mechanism. This is because when balanced growth is implemented, it raises the social marginal efficiency of capital for the whole economy. In doing so, it expands the overall market by increasing both effective demand and capacity creation. This we have already demonstrated is the foundation of its logic. Thus, it is apparent that balanced growth will

create external economies for enterprises outside the balanced growth program as aggregate real income and consumption increases. Consequently, these external economies will induce additional investment from enterprises not associated with balanced growth. In doing so, it will allow enterprises both within and outside the balanced growth program to realize increasing returns- which will induce further additions to investment and employment. Thus, we find that implementing balanced growth will increase employment in sectors not even associated with the program! In turn, these workers will increase consumption and induce investment in other areas, etc. Therefore, balanced growth will reinforce and accelerate development outside the program itself while also diversifying the sources of employment growth- which will stabilize the national rate of development.

In this third case, balanced growth will do more than sustain a development process. It will also strengthen it by creating a self-reinforcing mechanism involving each development pole that will institutionalize the growth rates of investment, employment, and consumption. It is important to appreciate how powerful this mechanism can be since it will improve an upper middle income economies' ability to sustain a development process.

Our analysis of these three effects allows us to conclude that balanced growth will sustain a development process by accelerating, diversifying, and stabilizing the rate of development of an upper middle income economy. First, we saw that it will accelerate the economy's development process since it will create previously non-existent activities. In addition, this will diversify its sources of employment growth. Second, balanced growth will create additional engines of development which will also diversify the sources of employment growth and, in doing so, stabilize the rate of development should one engine(s)

experience lackluster performance. Third, balanced growth will accelerate the development of sectors not associated with the program which will subsequently do the same for even more sectors- as well as positively feedback on the sectors associated with balanced growth. This will also have the impact of accelerating the overall development rate while diversifying the sources of employment growth. Hence, the dispersion of the rate at which structural underemployment is being minimized will narrow- meaning that the rate of development will stabilize around its new accelerated rate. It is undeniable that these three mechanisms will sustain (and strengthen) a development process.

Part IV.A.2.B.1 - Implementing balanced growth in an upper middle income economy

It was already stated in Part IV.A.1.A.4 that the state will need to implement balanced growth in low and lower middle income economies because of the need to overcome the low income/high structural underemployment trap. On the other hand, in upper middle income economies this trap has already been overcome. Indeed, here balanced growth is being utilized to sustain a development process by accelerating, diversifying, and stabilizing the rate of development.

Nonetheless, state involvement will undoubtedly be necessary to coordinate and manage the program here as well. Accordingly, the state will be required to utilize both direct and indirect policy tools to implement it. However, we may note in passing that low and lower middle income economies are more likely to require direct methods of implementation while upper middle income economies are more likely to be capable of relying on indirect measures for implementing balanced growth. This is an issue we will pick up on again in Parts IV.B.3 and IV.B.4.

Part IV.A.2.B.2 - Upper middle income economies, balanced growth, and a process of economic development

In Chapter I, we defined a development process as the process through which an economy more fully utilizes its labor resources- with the objective being the minimization of structural underemployment. Further, in Part I.C.2 we saw that an upper middle income economy is one in the midst of a development process- meaning that it has overcome the low income/high structural underemployment trap and is moving its labor resources to higher productivity occupations. Thus, it has two main priorities. First, it wants to sustain its development process. Second, it wants to become a high income economy. At the same time, we saw that there is no guarantee the existing quantity of investment is sufficient to achieve either of these goals. Hence, we argued that to overcome this obstacle upper middle income economies need to implement a development strategy capable of combining short term demand targeting with long term structural change.

Above, we saw above that balanced growth will sustain and strengthen an upper middle income economy's development process by accelerating, diversifying, and stabilizing its rate of development. In order to do so, it will combine short term demand targeting with long term structural change. Therefore, it will allow upper middle income economies to achieve the first primary goal; namely, it will allow them to sustain a development process. However, we did not analyze whether it will allow these economies to achieve the second goal of becoming a high income economy.

It is possible that balanced growth will be unable accomplish this second goal- for a variety of reasons. First, we know that the propensity to consume decreases as income increases. In turn, this implies that investment will have to grow larger over time to fill the

gap between consumption and output if this is to occur. In the *General Theory*, Keynes demonstrated that there is no reason to believe the actual quantity of investment will be equal to that which is required- though he was looking at issues of cyclical unemployment. Second, even if the necessary quantity of private investment did occur, we know that this type of expenditure is volatile meaning that there is no guarantee a development process will persist. Third, investment takes the physical form of heterogeneous capital- which cannot be instantaneously altered. Thus, as consumption patterns change slumping sectors will not be capable of transforming themselves into ones facing greater demand- which could result in structural under/unemployment and a failure to become a high income economy. Fourth, because of its reliance upon private investment, it is possible that balanced growth will not minimize structural underemployment. Accordingly, it would make it that much more difficult for an upper middle income economy to become a high income economy.¹¹ Thus, while balanced growth will sustain a development process, it may be unable to complete the transformation of upper middle income economies into high income economies. Accordingly, we find that to ameliorate these shortcomings another policy must be included in our strategy that can complement balanced growth. In Chapter II, we saw that this policy is ELR.

Part IV.B - Methods of Implementing Balanced Growth

In Part IV.A.1 above, we argued that the low income/high structural under-employment trap prevents low and lower middle income economies from having a high

¹¹ Theoretically, balanced growth plans of an increasingly large size could continuously be undertaken which would solve all of these issues. However, this scenario would involve a large amount of plans that would be growing in size over a long time. As such, it is possible that a relatively large policy error would occur at some point.

investment rate. In other words, the presence of a relatively low real income level causes the expected return on many individual investments to fall short of the marginal efficiency of money. Accordingly, we argued that the way to break this trap is by simultaneously inducing a multitude of investments- producing a social marginal efficiency of capital that raises the private marginal efficiency of capital of each individual investment. In addition, we saw that this will allow enterprises both inside and outside the program to realize increasing returns. Thus, we concluded that these actions would allow low and lower middle income economies to initiate a development process.

Subsequently, in Part IV.A.2, we saw that in upper middle income economies there is no guarantee the existing quantity of investment is sufficient to sustain its development process and/or allow it to become a high income economy. As a result, we stated that there may be significant structural problems associated with the economy's development process- such as foreign dependency, domestic structural asymmetry, or internal backwashing. Therefore, to sustain its development process, an upper middle income economy needs a way to diversify its sources of employment growth while accelerating this rate. In turn, we said that this structural diversification would stabilize the rate at which structural underemployment was being minimized by narrowing the dispersion of these rates. Thus, we argued that instituting balanced growth would allow these economies to achieve the goal of sustaining its development process. However, we also saw that it is possible balanced growth would be unable to transform upper middle income economies into high income economies. Therefore, we stated that our strategy would need an additional policy that is capable of complementing balanced growth.

Moreover, we concluded that the progenitor of balanced growth would have to be the state due to the inability of a single entrepreneur to organize and undertake such a large program. However, the implementation of this process was largely omitted despite its obvious importance. Here we take up this essential issue.

As discussed briefly elsewhere, there are both direct and indirect methods of implementing balanced growth. In the former, the state directly undertakes the program while in the latter it engineers a system of incentives to coax the private sector into undertaking the program. Here we will examine each avenue's costs and benefits while describing these scenarios in greater detail. This will be followed by an analysis involving the likely composition necessary for each type of less developed economy.

Part IV.B.1 - Direct Methods of Implementing Balanced Growth

In a role the developmental state literature refers to as demiurge- meaning 'public worker'² - the state takes on the role of producer in areas the economy lacks sufficient private production of. In effect, we are discussing the premiere of state owned enterprises (SOEs).¹² When acting as a demiurge, Peter Evans argues that the state is driven by an assumption regarding the "limitations of private capital...[by asserting]...that private capital is incapable of successfully sustaining the developmentally necessary gamut of commodity production" (Evans 1995, 13). Taking into account this rationale allows us to observe why less developed economies may choose to act as a demiurge as well as see its connection to balanced growth.

¹² Even the Washington Consensus agrees the state should take on this role for infrastructure.

In low and lower income economies marred by the low income/high structural underemployment trap, the state would rightfully be suspicious of private capital's ability to suddenly undertake a development process. Because of these reservations, the state may wish to sidestep the private sector and undertake direct actions to break this trap. In doing so, it would act as a demiurge. Further, if it is monetarily sovereign, we know from MMT that its fiscal arsenal includes the ability to purchase any amount of real output for sale. Because of this, it would be capable of directly undertaking balanced growth and, in doing so, initiate a development process.

This scenario obviously would involve increased levels of state investment. Indeed, when acting as a demiurge the state would directly determine the level and composition of output, the quantity of inputs and who the suppliers will be, how labor will be hired, and how to market these goods- among other things. It would also require higher levels of state consumption- which would stabilize the expansion since a greater percentage of the economy would be consumption based.

In upper middle income economies, similar events can transpire. Should the state believe that the economy's current development process is unsustainable, not rapid enough, or sufficiently diversified, it can directly implement balanced growth. Thus, in deciding to act as a demiurge, it too would increase both its investment and consumption levels.

It may be objected that there are severe drawbacks to having the state directly involved in balanced growth. Indeed, it may be argued that it is not acceptable to have the state acting as a totality in balanced growth- though admittedly that would be an extreme example. The likely reasoning behind this critique would be that SOEs can promote rent-

seeking which- though fiscally sustainable as shown by MMT- could result in providing financial support to non-competitive firms.

To counter this critique, we must recognize the fact that virtually all enterprises- public and private alike- attempt some form of rent-seeking throughout their lifetime. Indeed, we support the argument that there are two types of rent-seeking: good and bad.¹³ Good rent-seeking involves scenarios that bring stability to the market and does not affect the dynamism of the enterprise(s). In the economic sociology literature of heterodox microeconomics, this phenomenon is called market governance (Fligstein 2001). Conversely, bad rent-seeking is when enterprises are more concerned with maintaining tight-knit relations with one another and/or the state than with achieving competitiveness.

This point demonstrates that rent-seeking cannot simply be labeled as ‘bad’. Instead, what matters is whether the enterprise’s relations with each other and/or the state take on a higher priority than the competitive drive associated with capitalism. Hence, a scenario in which balanced growth’s SOEs attempt to engage in ‘bad’ rent-seeking is no likelier to develop than in the private sector since the latter also frequently attempts to pursue ‘bad’ rent-seeking. Nonetheless, it was worth mentioning this point to highlight that we are cognizant of the fact that SOEs can potentially pursue ‘bad’ rent-seeking behavior.

A concluding thought on this topic is that while efforts should be made to ensure SOEs do not pursue ‘bad’ rent-seeking behavior, the claim that SOEs cause the state to lose money is not strictly true- since monetarily sovereign states can always issue more IOUs. Instead, it would appear that the relevant consideration regarding direct implementation of

¹³ Orthodox economists are the party solely responsible for promoting the belief that rent-seeking behavior is always bad.

balanced growth is whether the additional IOUs are propping up inefficient enterprises or if they are contributing to a dynamic expansion of the economy. Regardless, the financial implication of MMT is that a monetarily sovereign state can afford either agenda.

Part IV.B.2 - Indirect Methods of Implementing Balanced Growth: Channeling Finance Directly and Indirectly

Our list of indirect methods for implementing balanced growth is meant to be descriptive and by no means can be exhaustive. Indeed, one of the best lessons of development processes involves the ability of the state to engineer atypical indirect initiation methods; that is, ways to start a development process that were not easily discernible or readily apparent (Woo-Cumings 1999). Nonetheless, some of the more obvious indirect methods by which the state can instigate balanced growth will be discussed below. It should be noted that these methods are applicable to both low and lower middle income economies and upper middle income economies alike. Finally, when questioning where the financing for these methods is to originate, it must be remembered that money is no object to a monetarily sovereign state; it can always produce more state IOUs if the situation requires it. Hence, questioning where the financing for this will originate is of little importance. Instead, how the state goes about channeling these funds to the private sector is what is of utmost importance.

The first indirect method involves the federal government's taxation policy. Indeed, one realization MMT leads to is that much of a typical economy's taxation policy is unnecessary. In other words, because a monetarily sovereign economy does not require taxation receipts to finance its expenditures, there is little rationale for taxes that discourage

employment, output, and consumption- such as payroll taxes and the like.¹⁴ Hence, the state could induce private enterprises to undertake balanced growth by reorienting its tax code. As an example, it could provide tax credits for undertaking investment that adds to the economy's productive capabilities. Additionally, it could tax financial products- such as a corporate capital gains tax for non-financial enterprises- to discourage non-financial enterprises from effectively running their treasuries like financial institutions.¹⁵ Another example would involve the lowering and/or removal of taxes on employers for increasing their employment level. In fact, the government could give credits for doing this. Finally, the government could minimize and/or lower sales taxes to promote consumption.

With regard to interest rates and credit, official policy should keep the former low- even zero- for a variety of reasons. From among the more prominent ones is Keynes' infamous Chapter 24 policy proposal in the *General Theory* involving the euthanasia of the rentier- meaning that simply investing in financial products to expand wealth should no longer be an option. Instead, enterprises would have to undertake productive investments if they wished to 'have money breed more money'. Moreover, by having low rates of interest, certain investments that were not previously profitable now will be- the essential goal of balanced growth. Indeed, low interest rates will permit enterprises to have relatively low financing costs which will encourage more investment than would be forthcoming at higher rates of interest.

¹⁴ Instead, we may recall that the only taxation required to monetize an economy is that a tax be levied on a large base and on an item for which there is an inelastic demand- such as property.

¹⁵ This scenario is becoming increasingly important as the process of financialization becomes more prominent in the global economy. See Krippner (2005) for more on this.

As an aside, it should be noted that it is imperative to maintain this policy over time and therefore to not attempt to stop inflation by increasing interest rates. Indeed, from the analysis presented thus far, we have seen that inflation arises from only three sources: excessive spending relative to capacity, increased costs, or the government's inability and/or unwillingness to enforce its taxation policies. Hence, instead of utilizing monetary policy via interest rate hikes to solve an inflationary problem, policymakers should go straight to the source.

At the same time, a bank-based financial system should be used to selectively allocate cheap credit towards specific activities and enterprises associated with balanced growth. Indeed, this can foster long term relationships in which enterprises and banks effectively form partnerships for a certain duration. Similar to what occurred in Northeast Asia, this would provide enterprises with a means to enlarge production and employment (Woo-Cumings 1999; Wade 2003). History has demonstrated that this can be an important source of enterprise growth and could play an integral part in initiating balanced growth.

Another way of indirectly implementing balanced growth via credit allocation can involve specific credit guarantees. In other words, should a specific enterprise(s) accomplish some predetermined set of goals, it could be awarded future lines of credit for a specific duration (Amsden 2004). Having this advantage relative to its competitors would allow it to increase production and engage in product diversification in the hope of securing monopoly profits- both of which require increased investment and employment.

Similarly, subsidies and grants can be used to instigate balanced growth since they can be directed towards both specific enterprises and/or entire sectors. In doing so, a subsidy

could be awarded to the enterprise that accomplishes a mandated goal- whether it be quality targets, production targets, or another criteria (Wade 1990). The introduction of subsidy/grant criteria deserves more attention.

One of the defining characteristics of successful economic transformations relative to unsuccessful ones involves the way in which subsidies and grants are awarded. In unsuccessful ones, frequently the subsidy was awarded to an enterprise regardless of whether it accomplished the mandated goal(s). In turn, this encouraged bad rent-seeking behavior since the enterprise was awarded the subsidy regardless of its performance (Loriaux 1999).

By contrast, in successful cases the state typically declared a certain objective and the enterprise that was able to accomplish it was awarded the subsidy (Wade 1990). Further, receipt of the subsidy could be made temporary so that the enterprise accomplishing the initial objective cannot become complacent. Instead, the state could mandate that the subsidy will be given to the enterprise that is successful at accomplishing the objective contingent on the enterprise's ability to accomplish further, more complex tasks. In the event that the enterprise fails at this latter objective(s), the subsidy would expire and the other enterprises would be eligible to receive it.

This subsidy/grant structure provides enterprises with increased funding while the economy is afforded an inherent mechanism that causes innovative progress. Thus, the dynamic aspect of competition is preserved while bad rent-seeking behavior is appropriately discouraged. Hence, a targeted, well-designed program of subsidies and grants can provide the necessary incentive to commence balanced growth.

The next method of indirectly implementing balanced growth involves rationing funds. It is important to note that in a monetarily sovereign economy rationing funds is not necessary if the contract is denominated in domestic currency since there is no financial tradeoff between funding Enterprise A or Enterprise B. If the state so desired, it could provide funding to both these entities. It only need limit funding of certain enterprises for other reasons- such as related to performance- but it is important to recognize that those are not financially-related issues.

Foreign exchange (FOREX) is an entirely different matter since the state cannot create the IOUs of another state. Frequently- even within the heterodox development literature- it is believed that FOREX receipts are required to ensure that all labor resources are fully employed. This is mistaken since one of the central insights of MMT is that a monetarily sovereign economy can purchase anything for sale in the domestic currency- which would obviously include labor resources. Hence, a monetarily sovereign state can always afford to fully employ labor- regardless of the FOREX position of the economy. Thus, once MMT is introduced, the belief that an economy must acquire FOREX to increase employment essentially becomes a non-issue. Instead, the accumulation of FOREX is important because it involves the economy's ability to acquire imports and what this implies about its development prospects.

We start our analysis of rationing FOREX by arguing that if an import purchase denominated in the less developed economy's currency was large enough to induce a foreign supplier to export its output- regardless of the 'strength' of the less developed economy's currency- the exporter could potentially purchase a foreign exchange derivative package to

hedge its position in the transaction. Doing so would prevent the supplier from losing par value because of the currency's 'weak' position in the FOREX market. Thus, through MMT we see that even imports may not require FOREX if the order is large enough. Indeed, as Lenin is rumored¹⁶ to have said "the capitalists will sell us the rope with which we will hang them" meaning that if a business deal was large enough, the inherent structure of capitalism is such that it will entice entrepreneurs to explore all possible options to make a sale feasible- regardless of exchange rate movements and the strength of the currency. Naturally, it would be easier to convince the foreign supplier to do this if the state was the purchaser.

However, for smaller import orders FOREX will be required. Hence, how can balanced growth be implemented if the demands for FOREX turn out to be larger than the supply? There are three possible answers to this predicament. First, the state can ration FOREX to priority activities and thereby provide the appropriate enterprises with the resources they need. A simple criteria could involve how that particular enterprise and/or sector figures into the overall program. Second, the state could supplement the first scenario by acting as a liaison between the domestic private sector's FOREX demands and the foreign suppliers. If state is monetarily sovereign, the fact that it is capable of issuing currency would help in this regard. Third, the state could undertake a variety of measures discussed within the following citations to ensure that its exports are competitive globally. In turn, this would allow it to earn the additional FOREX required to cover the increased import bill (E. Reinert 2007; Bresser-Pereira 2008; Wade 1990; Shafaeddin 2012).

¹⁶ The author employs the term 'rumored' here because Lenin never actually put this quotation in writing. Instead, it is believed that he said it at one point during his rule of the USSR- though this is also debatable. Regardless, the author includes this suspected quotation because it aptly characterizes the point he is attempting to make.

Fifth, one of the driving forces of capitalism is the enterprise's incentive to secure monopoly profits. It is what makes businesses engineer intricate products sometimes only previously seen in science fiction stories. A less developed economy attempting to indirectly implement balanced growth can take advantage of this. By utilizing innovation incentive structures, the state can provide enterprises with an impetus to expand production in the hopes of securing monopoly profits. At the same time, the products and processes associated with their production can serve the larger social objective of instigating balanced growth. This is a policy that Reinert discusses at length (E. Reinert 2007).

As an example, that state could construct an innovation incentive structure regarding targeted, temporary monopoly rights for intellectual property. In such a scheme, the state would possess many different avenues through which it could concoct opportunities for enterprises to temporarily accrue monopoly profits. For example, the state could inform enterprises in that sector of a specific objective it desires to achieve. Subsequently, it would then mandate that the enterprise managing to accomplish it will be awarded a temporary patent for a certain period of time. In doing so, it would be providing the enterprise with monopoly profits. However, the state would proceed to inform the victorious enterprise that it must subsequently achieve some additional goal(s) to retain the patent. If it fails to achieve this latter goal, the intellectual property inroads that have been made would be provided to the rest of the enterprises in that sector. Thus, the next goal could be set, ad infinitum. Obviously, subsidies and/or grants could be an integral complement of such a program.

Finally, the state can institute discretionary external policy to allow domestic production the necessary time to begin and expand its activities. Now, it should be noted that

we are not advocating infant protection as much as we are discussing infant creation (Nurkse 1953, Chapter 2). Moreover, these policies could be temporary and/or be said to be temporary so that bad rent-seeking is not afforded an opportunity to become common.¹⁷ Because these measures could be temporary and/or be believed to be temporary, enterprises will be forced to become and remain competitive.

In the next two sections, we will evaluate the composition of direct and indirect methods for implementing balanced growth that will likely be necessary to ensure the program's success.

Part IV.B.3 - The Likely Composition of Direct and Indirect Methods Necessary for Implementing Balanced Growth in Low and Lower Middle Income Economies

Because low and lower middle income economies face the low income/high structural underemployment trap, they are likely to require the state to act as a demiurge and directly implement balanced growth. Indeed, in these economies the state may have to play a large role in relatively important facets of the program. Nonetheless, because there are enterprises already in existence the state should attempt to utilize some indirect methods of instigating balanced growth. Therefore, we surmise that while indirect methods may play a role, it is likely that the state will have to rely on direct methods- at least initially.

¹⁷ This is not to deny that discriminatory trade measures may be necessary after the economy has developed. This is not what we are arguing. What we are simply stating is that in order to ensure domestic production becomes viable it may be necessary to at least temporarily institute these measures.

Part IV.B.4 - The Likely Composition of Direct and Indirect Methods Necessary for Implementing Balanced Growth in Upper Middle Income Economies

In upper middle income economies, the enterprises in existence are likely to be more experienced and dynamic than those in low and lower middle income economies. Thus, they will be capable of meeting additional challenges without outside assistance. Because the production structure is both more efficient and flexible, it is unlikely that the state will have to directly implement the majority of balanced growth. Hence, while it may occasionally have to act as a demiurge, we would argue that indirect methods can be the preferred method of implementation.

At the same time, we should not write off the possibility of direct state action in these economies. We can simply expect it to be less frequent due to the presence of certain enterprises that can be induced to perform the necessary tasks.

In concluding, indirect methods should be the dominant way that balanced growth is instigated in upper middle income economies. In doing so, much of the competitive dynamism accompanying private market competition will be preserved since the state will utilize the profit motive to transform the economy. Therefore, we surmise that in these economies, indirect methods of implementing balanced growth should play the dominant role while the state may infrequently have to utilize direct methods.

Part IV.B.5 - The All-Important Case of Agriculture: Direct or Indirect Methods?

This topic has not been addressed yet because it will be discussed heavily in Part IV.C. However, we can state that upon implementing balanced growth a portion of the increased consumption demand will likely be for agricultural products- more so in low and

lower middle income economies than in upper middle income economies. In turn, as Kalecki argued, if the supply of food does not accommodate the increased demand there will be food inflation- which can spread rapidly throughout the economy and threaten development efforts (Kalecki 1976). Consequently, it is essential that a concerted effort to increase the supply of food should be made- which is an integral part of any balanced growth program. Thus, in seeking to accomplish this objective, what should the proper mix of direct and indirect methods be?

While some may argue forcefully for indirect methods, the importance of increasing the supply of food cannot be understated. It clearly has a vital connection to balanced growth- in addition to every human being's right to eat. Because of its importance, it would not be undesirable for the state to employ direct methods to increase the supply of food.

In terms of efficiency, it is true that state involvement could be relatively inefficient- in an economic sense. But this is limited to the economic sense of the term. The moral imperative to feed human beings is unconcerned with economic inefficiency. Harkening back to our discussion of the developmental state in Part II.C, here we are more concerned with effectiveness than efficiency. Thus, we would only discourage the state from undertaking direct agricultural production if it could be definitively shown that the private sector will reliably provide more individuals with larger supplies of food. Therefore, it is perfectly admissible for the state to directly increase the supply of agricultural goods at any stage in a development process. However, in reality, the composition of direct and indirect methods for increasing the supply of food will differ from economy to economy.

Part IV.C - The Types of Activities Balanced Growth Should Seek to Create

Despite the fact that the state is necessary to implement balanced growth, its internal considerations should not determine what the program will create and/or expand. Indeed, if this was the case the legitimacy of the state could be placed into jeopardy. Instead, the state should utilize a relatively broad criteria to explore the needs and benefits that can be created by this program. A suggestion for this criteria is the topic of this section.

First, balanced growth should increase production in activities that will satisfy domestic consumer demand in order to guarantee that the increased net consumption is directed towards the home market. Should the increased consumption fail to occur because the program leaves domestic consumer demand unsatisfied, balanced growth will be doomed to fail from the beginning. The relevant consideration here would be the products' income elasticities of demand.

Second, activities should be promoted that afford enterprises with the potential to realize increasing returns since they allow enterprises to earn increased profits. In turn, increased profits induce entrepreneurs to increase investment and thereby move additional labor resources towards higher productivity occupations. Indeed, increasing returns will sustain and strengthen a development process- further promoting its success. In Part IV.A.1.A.3 above, we saw that two factors in balanced growth can lead to the realization of increasing returns. First, the simultaneous increase of investment will cause enterprises to invest in technological upgrading- which makes expanding the division of labor possible. In turn, productivity increases and unit costs fall as output increases. This is where increasing returns are created. At the same time, the realization of increasing returns depends on

whether the increased consumption resulting from higher employment levels is spent on these enterprises' output- which we know is determined by the activity's income elasticity of demand.

This shows that the ability to realize increasing returns hinges on two variables. First, the creation of increasing returns depends on how well an activity lends itself to technological upgrading. Thus, in order to analyze whether an activity will be capable of realizing increasing returns we have to determine which activities lend themselves well to technological upgrading. Second, we must analyze which activities are characterized by high income elasticities of demand. Because we defined the realization of increasing returns as a process involving both a cost aspect (lowered unit costs from technologically-related productivity increases) and a demand aspect (high income elasticities of demand causing increased net consumption), we need to look at both sides of this phenomenon to see which sectors are most likely to possess these activities. However, first we must introduce a distinction between Schumpeterian and Malthusian activities that will have implications for our analysis of increasing returns.

Obviously the technological upgrading associated with the cost side of increasing returns can only be made possible if there are technological innovations. In turn, these innovations are the result of a complex process in which synergies¹⁸ are created.¹⁹ Thus, the more an activity exhibits the potential for synergies to occur, the more likely it is that technological innovations will be produced.

¹⁸ A synergy is when two or more things simultaneously operate together to produce a result not otherwise attainable.

¹⁹ This process will be discussed in greater depth in Chapter VI.

Activities that lend themselves well to synergistic creation can be classified under the heading of Schumpeterian activities (E. Reinert 2007). Thus, the more an activity facilitates and produces synergies, the more likely it is that that particular activity (and those associated with it) will create increasing returns since these activities easily promote technological innovations via synergy creation. Thus, these activities lend themselves well to the creation and production of a type of output that enterprises can invest in when seeking to technologically upgrade. The result is that certain activities are more Schumpeterian than others. Hence, they are more likely to create increasing returns.

In contrast, activities that do not lend themselves well to synergistic creations can be classified under the heading of Malthusian activities. In turn, these activities are unlikely to be associated with the creation and production of technological innovations. Consequently, they will be unlikely to create increasing returns (E. Reinert 2007).²⁰ Having introduced Schumpeterian and Malthusian activities, we can return to our analysis of determining which sector(s) is likely to promote the realization of increasing returns. We do so by initially examining the cost aspect of increasing returns which will be followed by an analysis of its demand aspect.

On the cost side, the most prominent factor figuring into whether a sector can create increasing returns is whether it predominantly has Schumpeterian or Malthusian activities. In other words, what matters is if that sector's dominant production activities lend themselves well to synergistic creations. If they do not, then the sector will find it is unable to produce

²⁰ This distinction's merit is revealed when answering the question as to why American agriculture can experience increasing returns despite agriculture being a primary activity- which is typically thought of as Malthusian in nature. The answer is that the creation of synergies and its subsequent application to American agriculture has allowed that sector to garner increasing returns- which is unlike many less developed economies.

technological innovations. In turn, this would mean that enterprises are either forced to import higher levels of technology- which could introduce additional complications- or they will be unable to create increasing returns. Thus, we find that, on the cost side, the ability to create increasing returns depends upon whether a sector can easily create synergies; that is, if it predominantly has Schumpeterian activities.

The ability to create synergies in manufacturing and services is well established in the literature. On the other hand, these same effects- though still applicable to agriculture via improvements in chemistry and botany- are believed to be less easily created in agriculture (E. Reinert 2007). Hence, if the cost side of increasing returns is dependent upon the ability to create technological innovation, it would appear that the manufacturing and service sectors are essential for an economy to possess. However, agriculture is not to be entirely ruled out, depending upon the economy and its institutions.

Moving to the demand aspect of increasing returns, we must identify differences in income elasticities of demand among sectors as well as between less developed economies and high income economies. Accordingly, this will have implications for the ability to realize increasing returns- especially for strategies promoting production for the domestic market versus production for the foreign sector.

In terms of agricultural production for the home market's consumption, there is good reason to believe that the income elasticity of demand in less developed nations will not be as inelastic as it would be in high income economies. This is because typically we can expect there to be a segment of the population that wishes to consume more food than it is currently doing. Therefore, in the face of higher real incomes, agricultural consumption will expand

(Kalecki 1976). This would certainly be able to provide the demand component associated with the realization of increasing returns. However, this will become more unlikely as the economy progresses towards becoming a high income economy. Indeed, with sufficient increases in agricultural consumption we would expect the demand for food to become as inelastic as it is in high income economies. Nonetheless, since in the immediate future we can expect the income elasticity of demand for agricultural products to be relatively elastic, this is an initially feasible avenue of realizing increasing returns. Indeed, it could figure prominently in low and lower middle income economies because of the initial low level of agricultural consumption.

On the other hand, domestic demand for manufacturing and services are both likely to be characterized by relatively elastic income elasticities of demand, no matter what the income level (Prebisch 1984, 177-178; Toye and Toye 2003). Thus, they are safer bets over time regarding whether they will be able to domestically promote the realization of increasing returns. In doing so, they would sustain (and strengthen) a process of development.

With regard to the external sector, the Prebisch-Singer Hypothesis tells us that producing agricultural goods for high income economies will surely face an inelastic demand (Prebisch 1984, 177-178; Toye and Toye 2003). Thus, the less developed economy would not be able to realize increasing returns. On the other hand, more potential for employment growth likely exists for exporting agriculture to other less developed economies since their income elasticities of demand will be relatively more elastic. However, the low level of real income in other less developed economies will be a major hindrance to utilizing this avenue.

Further, we would expect that as less developed economies' income levels rise, their income elasticity of demand for agricultural goods will become inelastic- as it is high income economies.

In the case of exporting manufactures and services to high income economies, we would expect the income elasticity of demand to be relatively elastic. Additionally, we would expect this to be true in the case of exporting to other less developed economies (Prebisch 1984, 178-179). Thus, we find that exporting manufactures and services can allow less developed economies to realize increasing returns. However, relying on the external sector to produce employment growth introduces a range of potential complications- such as changing foreign income levels, changing foreign demand patterns and compositions, etc.

This discussion reveals that a less developed economy's balanced growth program should focus on satisfying domestic consumer demand in the manufacturing and service sectors. We reached this conclusion because both of these sectors have an affiliation with Schumpeterian activities while simultaneously possessing high income elasticities of demand. Thus, this ensures the best opportunity for the balanced growth program to succeed while also creating increasing returns- which will sustain and strengthen the initial successes of both the program and the development process itself. However, as we saw in Part IV.B.5, agricultural expansion plays a vital role in any balanced growth program.

The third and final aspect of our criteria involves the fact that a significant portion of the increased net consumption will be for agricultural products- at least initially.

Consequently, a concerted effort should be made to increase the economy's marketable

surplus- a term we have not previously defined. Following Nurkse, the marketable surplus is the

surplus of farm products [which] determines the volume of non-farm employment, including employment in manufacturing and other activities. It reflects simply the farm sector's demand for non-agricultural commodities. This is the concept that is relevant to the balanced growth principle. (Nurkse 2009a, 337)

In order to ensure a stable expansion of the economy under balanced growth, it is necessary to increase the marketable surplus for two reasons. First, it is needed to prevent the higher real income levels of those who were already employed from setting off food inflation once their agricultural demand increases. Second, it is needed to prevent the same scenario from occurring in the context of higher employment levels (Kalecki 1976). Further, because access to food is a social concern fundamentally more important than profit, this is an area the state should be directly involved in to ensure the marketable surplus grows over time.

We can now summarize our criteria for designing a balanced growth program. First, it is important to ensure that the increased output will satisfy domestic consumer demand so that the program's increased consumption occurs. Second, balanced growth should focus on promoting the production of manufactures and services in order to allow increasing returns to be realized- which will sustain and strengthen both the program and the development process. Third, against this backdrop, the economy must ensure that its marketable surplus increases. Success in this endeavor will prevent food inflation from occurring which can have disastrous impacts on an economy in the midst of a development process. It is argued

that by using this criteria for balanced growth, a less developed economy will institute the conditions necessary for a sustained, robust development process.

Part IV.D - External Constraints to Balanced Growth

At this point, certain external constraints to balanced growth need to be taken into consideration. Specifically, the impact that such a program can have on the current and capital account must be analyzed so that any pre-existing limitations can be identified before they cause complications. As shown below, while such external constraints do exist, they can ultimately be compensated for by combining a well-designed balanced growth program with discretionary management of the current and capital account where necessary.

Part IV.D.1 - The Impact of Balanced Growth on the Current Account

The biggest challenge to the success of a balanced growth program involving the current account surrounds the issue of whether or not such a policy will lead to a large increase of imports over exports as domestic income expands. If such a scenario was to transpire it could be highly detrimental to our development strategy because, in the absence of corrective measures, the persistent trade deficits would eventually lead to a balance of payments crisis. Thus, it is necessary to see if such a scenario can be prevented and/or overcome by policies that will ensure this is not the case. We find there are at least three such policies that can accomplish this.

First, such a scenario can be avoided by designing an appropriate balanced growth program. As noted in Part IV.C, balanced growth should be designed so as to increase production in areas that will satisfy domestic consumer demand to guarantee that the

increased net consumption is directed towards the home market. As noted in Footnote 7 of Chapter II and Footnote 2 of this chapter, the relevant consideration is whether the income elasticity of demand associated items in the balanced growth program is greater than the marginal propensity to import. If it is, import growth resulting from balanced growth will be kept to a minimum. As a result, there would be little chance that balanced growth would contribute to persistent trade deficits and a balance of payments crisis. Further, this is consistent with Nurkse's vision for how the external sector should be approached when formulating a balanced growth program, as we highlighted in his quote at the end of Part II.A.3.

Second, should this route fail, policies can be implemented to correct the external imbalance. On the export side, the strategic promotion of certain sectors that the economy already possesses as well as ones that it wants to develop in the future would achieve two interrelated goals.²¹ In the near term, it would ensure that the economy came to acquire the FOREX needed to finance the increased import bill. As a consequence, in the medium and longer terms, the accumulation of FOREX would prevent the emergence of a balance of payments crisis. On the import side, the state could utilize a combination of tariffs and quotas where appropriate to prevent the excessive growth of imports over exports and thereby retain balance of payments equilibrium.

Third, the combination of a low interest policy and a discretionary approach to the capital account would prevent an inflow of foreign capital seeking to make the financing of

²¹ In order to promote its exports the economy should first determine whether its exchange rate is appreciated as a result of the Dutch disease. If this turns out to be the case, it must make the appropriate corrections in order to ensure that its market exchange rate is equivalent to the rate that would enable its exports to be globally competitive. The work of Bresser-Pereira is highly instructive in this area (Bresser-Pereira, 2008, 2011).

additional import growth easier, like what happened in Mexico throughout the early 1990s (Kregel 1998). Now, it should be noted that this policy, unlike the two discussed above, cannot directly prevent the possibility that balanced growth will lead to excessive import growth and an external imbalance. However, what it can do is ensure that should an external imbalance occur, the problem will not be exacerbated by foreign lending.

Part IV.D.2 - The Impact of Balanced Growth on the Capital Account

To complete our examination of external constraints to balanced growth, we also need to analyze the connection between the capital account and our strategy. Specifically, we need to look at how balanced growth's own success could be undermined by excessive foreign lending if measures are not undertaken to counter it.

A rising domestic real income level caused by a successful balanced growth program will cause the demand for additional investment funds to rise. At the same time, the continued success of the economy will make foreign lenders more anxious to supply capital to this process. When taken together, these two factors could cause import growth to exceed export growth and thus allow an external imbalance to develop. Further, this process could appreciate the exchange rate as the combination of a persistent trade deficit and growth through foreign savings comes to a head- which would subsequently make it more difficult for domestically-based exporters to remain globally competitive and correct the trade imbalance (Bresser-Pereira 2011, 494-495). The end result is that a balance of payments crisis would likely occur which would segue into years of stagnation as the foreign debt burden strained economic activity.

To solve this problem, it is imperative to remember that this is a capital account issue since the original source of the issue stems from the ability of foreign lenders to supply additional capital throughout the expansion. Hence, the solution is to employ a discretionary approach to the capital account by strategically using capital controls and similar measures to limit the size of inflows. To be sure, a less developed economy should never have an unregulated, liberalized capital account for exactly these reasons. Instead, by managing its capital account, the economy will prevent both a trade gap from emerging and the appreciation of the exchange rate. Further, this latter feature will allow exporters to be globally competitive which reduces the likelihood that a balance of payments crisis will occur (Bresser-Pereira 2011, 494-495).

Part IV.E - Balanced Growth, Increasing Returns, and Employment Effects

At this point, it may be necessary to address a certain issue regarding the promotion of increasing returns. Specifically, it may be objected that promoting increasing returns will cause increased technological unemployment. To dispel this critique, we must distinguish the difference between how promoting increasing returns will affect employment at current production levels relative to how employment will be affected at increased production levels.

In Part IV.A.1.A.3, we saw that the realization of increasing returns consists of two processes. First, we saw that increasing returns causes unit costs to fall as output expands. In addition, we demonstrated that this phenomenon is created by investment in higher technology- which is induced by an expanding market. Second, we saw that in order to realize increasing returns, enterprises must produce products with high income elasticities of demand. If this is the case, it will experience increased sales receipts. In addition, we saw

that the increased net consumption leading to increased sales receipts is the result of external economies created by increased employment. Thus, increased employment is what leads to the realization of increasing returns.

This revelation is integral to dismissing any arguments claiming that the promotion of increasing returns will cause technological unemployment. Indeed, as we shall see, technological unemployment is the result of the incentive mechanism inherent to a capitalist economy- not the result of promoting increasing returns in balanced growth. In fact, balanced growth will mitigate this tendency by virtue of its impact on the profit motive.

Part IV.E.1 - Increasing Returns, Technological Unemployment, and Varying Output Levels

We start by analyzing the effects of increasing returns on employment when output levels expand- the exact events that will occur with balanced growth. In this instance, it should come as no surprise that employment levels will increase. This is due to the fact that as enterprises add to their productive capacity they will require additional workers to operate the physical equipment. Further, as these additional workers consume their new-found incomes, other enterprises will be induced to invest in additional machinery which will further increase employment. Therefore, we find the claim that technological unemployment will result from balanced growth's promotion of increasing returns as theoretically unfounded.

Next, we explore the effects of increasing returns on employment when enterprises decide to keep production at their current output levels.²² In other words, in this scenario

²² In Part IV.C above, we saw that balanced growth will increase the marketable surplus. Therefore, we need not analyze the impact of increasing returns on employment in the context of constant agricultural output.

enterprises decide to invest in technological upgrading yet produce the same quantity of output. In this case, the impact of increasing returns on employment is less obvious so we must examine it methodically. We shall see that technological unemployment can result. However, it would also be irrational for the enterprise not to expand its level of output. Therefore, this case will be highly unlikely in practice and thus we conclude that technological unemployment will occur only if the entrepreneur were to insist on producing the same level of output- in spite of obvious signals that the entrepreneur should expand production. In addition, we will also present a solution to this potential, though unlikely, issue of balanced growth leading to increased technological unemployment.

There are two choices an entrepreneur will face as balanced growth expands the economy. First, an enterprise can decide to produce the same amount of output as before even after investing in technological upgrading. Second, there is the more likely situation in which the mechanisms associated with balanced growth induce that enterprise to increase its output levels.

In the first case, the capital/labor ratio of the enterprise will increase. As a result, the enterprise will require fewer workers to produce the same amount of output. Here technological unemployment can develop. However, there is no reason to suppose that this is directly caused by balanced growth. Indeed, it is always in the interest of the entrepreneur to attempt to lower his/her labor costs- regardless of whether it is associated with balanced growth. Thus, one cannot blame technological unemployment on such a program alone; instead, one would have to blame the incentive mechanism of the capitalist system itself.

Fortunately, there is little reason to expect an entrepreneur to invest in technological upgrading if s/he had aspirations of producing the same amount of output. Instead, the enterprise will likely decide to increase its output levels because it is the perfectly rational thing to do. Let us see why.

During balanced growth, other enterprises will be expanding their investment and employment levels- something well established by now. Accordingly, the increased employment will result in higher real income and consumption levels. It therefore makes rational economic sense for an entrepreneur to increase their output levels for two reasons- both of which are related to higher profit margins. First, because the social marginal efficiency of capital has increased relative to the private marginal efficiency of capital, there is an incentive to invest in technological upgrading since doing so allows the enterprise to spread its costs over a larger quantity of output. In turn, this allows the firm to reduce its unit costs. At the same time, it simultaneously is adding employment- despite increasing the capital/labor ratio! Second, because real income and consumption is increasing, there is now a greater demand for the enterprise's products. Therefore, it will be able to sell more units.

The combination of lower unit costs and increased demand will clearly result in greater profits relative to a situation in which the enterprise decided to keep its output levels constant. Thus, it would be economically irrational not to expand output in the face of competition during an expansion. Instead, it makes more sense to invest in technological upgrading and subsequently expand output- which we have already demonstrated will increase employment and profits. Hence, we have arrived at nothing more than the rationale behind balanced growth and the reasons for its success!

Importantly, we have also shown that balanced growth cannot lead to increased technological unemployment. Instead, technological unemployment is caused by the incentive structure of a capitalist economic system. In fact, as shown above, balanced growth is likely to counteract this incentive since it adds employment while simultaneously providing enterprises with increased profits. Ergo, we conclude that balanced growth will not promote technological unemployment despite its ability to create increasing returns- save for an incredibly implausible exception in which enterprises act irrationally. Nonetheless, we can discuss two viable solutions to this remote problem.

First, MMT reveals that a monetarily sovereign state could act as a market maker and agree to directly purchase additional output of the enterprise. In doing so, it would be guaranteeing that the number of units employing the new capital/output ratio will increase despite the fact that this ratio has gone up.²³ Thus, it is revealed that the key to solving this unlikely problem involves encouraging the enterprise to increase its level of output- even if it initially desired to upgrade its technology but still produce the same level of output. This is one solution to the issue.

Second, a policy could be implemented- such as ELR- that will prevent workers from being subjected to outright technological unemployment. Instead, this policy would provide them with an opportunity to maintain and acquire skills while also earning an income. Though this is not preferable to the first solution, it is certainly better than outright technological unemployment. However, it should be remembered that, in reality, this problem is highly unlikely to come to fruition.

²³ This could also be done by exporting additional output levels. Here, as in the case of government involvement, output levels would obviously increase as the number of units employing this ratio increases. However, it is easier for the government to guarantee a market for the additional output relative to exporting it.

Part IV.F - Balanced Growth and the Structure of Modern Production

When discussing the implementation of balanced growth, it is necessary to account for the ever-evolving structure of modern production. Indeed, in contemporary times, the dominant structure of production has changed. While popular sentiment and imagination about ‘the business enterprise’ may still conjure up images of large-scale factory plants, aggressive R&D by single enterprises, standardized products for all markets, and large scale assembly lines, the global structure of production has drastically shifted. Indeed, the above depiction of production is not relevant to a globalized economy- has not been for thirty years. Below we will depict the structure of production from past eras, contrast it against the structure of modern production, and discuss how this transition impacts balanced growth.

Part IV.F.1 - Fordist versus Flexible Production

In order to characterize the structure of modern production, we begin by contrasting the two main structures of production that existed in the 20th century. The first can be called Fordism- which occurred from the beginning of the 20th century until the mid-1970s. At that point, Flexible production began sprouting up and eventually came to dominate- as it still does to present day (Madrick 1995).

Fordism typically has been used to denote non-farm, relatively large-scale output by a single enterprise and the secondary production of goods and services derived from these industries. Indeed, especially with regard to industrialization, this is what is typically thought of when utilizing the term ‘production’. Thus, Fordism refers to huge production facilities whose advantage is related to economies of scale that are derived from unit cost reductions arising from the relatively large output flow the enterprise(s) could sell (Madrick 1995). In

doing so, this structure required large initial outlays, an emphasis on advertising across a range of demographics, and a dedication to internal research and development to produce innovations. Further, the Fordist model consists of making a homogeneous product intended to satisfy all potential markets. It was in this type of system that a single enterprise was able to possess and control many stages of production in a given market (Madrack 1995).

This was the type of production structure employed by the United States when it became the world superpower. Indeed, at the time it was unrivalled in its production capabilities because Fordism was the easiest and most practical way to realize increasing returns. However, around the mid-1970s this production structure had become virtually obsolete. It was at this time that the global production structure became radically altered- mostly as the Asian economies grew stronger through their innovative approaches to ‘flexibly’ structuring production (Madrack 1995).

In place of Fordism came the Flexible production structure. In this latter arrangement, increasing returns were secured via a production structure composed of many different, diversified, and smaller production facilities that could make a variety of different outputs- many of which were complements or substitutes for one another. Thus, the production structure became more complex as enterprises became increasingly specialized and customizable. At this point, enterprises now competed for particularized segments within each market. This implied that it was no longer sufficient to produce a homogenous, standardized product on a large scale (Madrack 1995). In a word, the production structure had become more ‘flexible’.

The result was a new era of production that emerged in which an enterprise's primary advantage was derived from unit costs reductions that could occur at small and medium scale output levels. This was made possible by two features. First, it resulted from the accommodating and complementary nature of differing stages of production. Second, it resulted from the specific level that each enterprise occupied and competed at within this hierarchy (Madrick 1995). The result is that a modern production structure should no longer be thought of as a few dominant enterprises but instead as a collection of small and medium sized enterprises- possibly all owned by a parent company- that perform specific tasks within the various stages of production.

A direct implication of this analysis would seem to be that a less developed economy's best opportunity to ensure future growth of employment and output requires the creation of a Flexible production structure. In other words, it would appear that less developed economies should attempt to create a production structure characterized by function-oriented enterprises that produce specifically customizable outputs within the hierarchy of production. We will examine this concept in the context of a balanced growth program below.

Part IV.F.2 - Fordist Production, Flexible Production, and Production for the Domestic Market versus Production for the Foreign Market

This discussion of Fordist versus Flexible production structures has specific implications for the preferred configuration of enterprises in balanced growth; that is, should enterprises be encouraged to solely evolve within a Flexible production structure? As we will see, it turns out that the preferred structuring of enterprises in our program depends upon

the role they will play; that is, whether they will be producing for the domestic market or for the external market. This we will take up in the following two sections.

*Part IV.F.2.A - Production for the Domestic Market
and its Preferred Structure*

Here we intend to identify whether throughout a development process it is more essential to have a Flexible production structure or a domestic market that is both expanding and self-sustainable. Admittedly, combining the two would be optimal. However, here they must be analyzed in isolation of one another in order to ascertain which is more imperative to possess.

As we have seen, balanced growth lays stress upon expanding the size of the domestic market. Indeed, it is the domestic possession of these industries that allows the workers who produce one product to domestically consume a variety of different outputs. In doing so, it guarantees that profit margins are met and/or expanded- which has the impact of further guaranteeing increases in effective demand, the rate of capacity creation, and employment levels. Hence, we would argue that it is more important to have a self-sustainable expansion of the domestic market. Therefore, it is acceptable if the enterprises in balanced growth have a Fordist production structure- though a Flexible one would certainly be preferable.

A central result of this is that if there is a tradeoff between the ability to implement balanced growth and the need to construct a Flexible production structure, the former must take precedence. This is not to say that they are mutually incompatible. In fact, reality is quite the opposite and it is encouraged that the economy head in this direction. However,

what we are stating is that if there is a trade-off, the economy should conduct a balanced growth program with Fordist type industries rather than forgo the development process.

A potential factor complicating this conclusion would involve foreign producers who can offer a superior product by utilizing Flexible production methods. Now, in designing an ‘optimal’ balanced growth program, we seek to create domestic activities that can be complemented by the foreign sector. In other words, we will be aiming to create a partnership with the foreign sector- as opposed to substitutes like in ISI. Nonetheless, a less developed economy will face foreign competition throughout a development process for at least the following two reasons.

First, upon undertaking balanced growth, the domestic economy will expand as employment and real income increases. Thus, even if the state is able to ‘perfectly’²⁴ engineer an expansion that complements the foreign sector, when foreign enterprises observe this expansion they will attempt to sell their products in that market. As a result, even if the state was able to perfectly engineer an initial situation of complementarity, its success in doing so will likely generate increased competition between foreign and domestic producers. This is the first way in which foreign competition may come to impact balanced growth.

Second, in reality, an economy is unable to accomplish complete complementarity of its domestic market with the foreign sector. In certain cases, there will undoubtedly be overlap between what is produced domestically and what is offered in the foreign sector.²⁵

²⁴ By ‘perfectly’ we mean that there is perfect complementarity between the expansion of domestic and foreign production.

²⁵ Given our criteria from Part IV.C which stated that balanced growth should produce output that will satisfy domestic consumer demand, there is likely to be commonalities between what is already imported and what people want to produce domestically- as highlighted by Nurkse’s international demonstration effect (Nurkse, 1953, Chapter 3).

Therefore, we need a course of action involving how to deal with foreign competition in the domestic market. In turn, this will have specific implications for our preferred production structure. How we can deal with this issue is simple.

We would argue that the creation of an enlarged domestic market should always be the central priority of a development strategy. Without that, a process of economic development cannot stand on its own because it will be perpetually subjected to foreign pressures. Hence, to achieve economic security throughout a development process, if the existence of foreign producers offering a superior product threatens the ability of the less developed economy to expand its domestic market the solution is to keep those foreign producers from interfering.²⁶ In order to do so, a less developed economy should employ the appropriate protectionist measures- whether that requires utilizing quotas, tariffs, etc. It is only after the domestic market has been expanded and production has become sufficiently 'malleable' that these restrictions can be lifted and the process of infant creation could be over. The important point is that a domestic market must be expanded- regardless of what the dominant structure of international production resembles.

Now, despite what this initial scenario could require, the less developed economy could subsequently attempt to segment enterprises into a Flexible production structure. In fact, it can be argued that by initially dedicating itself to expanding the domestic market, the economy will have ample duration to adopt and experiment with a Flexible production structure. Thus, it may ultimately manage to construct one that is incredibly dynamic and flexible.

²⁶ This analysis is obviously similar to the discussion in Part IV.D.1.

Further, because balanced growth involves the creation/expansion of a range of different activities, there is no reason to suspect that these enterprises cannot be subdivided into simpler, function-oriented tasks more consistent with a Flexible production structure. In this regard, balanced growth would be responsible for not only expanding the domestic market but also providing the economy with a Flexible production structure- which it would benefit from well into the future.

Part IV.F.2.B - Production for the Foreign Market and its Preferred Structure

Production for foreign markets can be quite a complicated and rigorous development task since now the less developed economy will be competing against many other economies- which have had time to develop, augment, and experiment with the Flexible production structure. Hence, the less developed economy's enterprises will have to be globally competitive. As we saw in Part IV.F.1, the only way to do this is to adopt a Flexible production structure. We are aware this could involve tackling a steep learning curve, providing direct and indirect support to these enterprises, setting clear expectations and objectives, and identifying synergies as they present themselves (E. Reinert 2007; Shafaeddin 2012; Lazonick 1991; Wade 1990; Bresser-Pereira 2008).

However, as argued in Part IV.F.2.A above, the central priority of a development strategy should be to expand the less developed economy's domestic market because it provides economic control throughout a development process. The converse of this is that the success of a less developed economy should not be contingent upon success in the external sector. Thus, while a less developed economy's production structure necessarily must be Flexible to produce for export, if it is initially inefficient it will not mark the end of a

development process if the domestic market is both expanding and sustainable. Indeed, that is what balanced growth promises to deliver to less developed economies: security and control during a process of economic development.

Part IV.G - Summary

We have necessarily covered quite a lot of ground in this chapter. First, we demonstrated how balanced growth will allow low and lower middle income economies to overcome the low income/high structural underemployment trap. At the same time, we saw how it will assist upper middle income economies in their efforts to sustain (and strengthen) their development processes because it can accelerate, diversify, and stabilize the rate of development. Second, we described how balanced growth can be implemented by highlighting both various direct and indirect avenues. Third, we set forth some basic criteria that should be followed when designing a balanced growth program. Fourth, specific issues involving certain external constraints to balanced growth were analyzed and solutions to these problems were put forth. In doing so, we demonstrated how the combination of a well-designed balanced growth program and a discretionary approach to the capital account can avert these dilemmas. Fifth, the effect that balanced growth's promotion of increasing returns will have on technological unemployment was highlighted and revealed to be a non-issue. Sixth and finally, we discussed balanced growth in relation to the structure of modern production.

CHAPTER V

EMPLOYER OF LAST RESORT IN LESS DEVELOPED ECONOMIES

Introduction: Why the Need for Employer of Last Resort?

In Chapter IV, we saw that balanced growth will allow low and lower middle income economies to break the low income/high structural underemployment trap and initiate a development process. At the same time, we also saw that balanced growth will allow upper middle income economies to sustain (and strengthen) their development processes. However, we also said that it may be unable to transform them into high income economies. Furthermore, we stated that balanced growth may not minimize structural underemployment. As a result, balanced growth needs to be complemented by another development policy. We argue that ELR meets this requirement since it is capable of achieving and maintaining loose, full employment. Hence, ELR is, fundamentally, a development policy.

At the same time, the Scarcity in the Midst of Plenty Approach contains two important insights regarding a development process in less developed economies. The first involves the relation between price instability and the production structure. The second deals with the fact that development requires long term structural flexibility while current conditions are frequently rigid. We need to explore both of these insights further.

In terms of price instability, we saw in the Introduction that the reason less developed economies' resources are prevented from realizing their potential is a lack of inducements to undertake long term structural change. The result is a structural underemployment of labor resources. It is important to recognize how price instability perpetuates this.

Though their work focused on high income economies, both Fisher and Keynes clearly elaborated the link between price changes and the inducement to invest. Indeed, Fisher's 1933 article "A Debt Deflation Theory of Great Depressions" provides an analysis of how changes in the price level can induce, as well as reinforce, changes in the level of investment through the impact they can have on expectations- a position Keynes shared in both his *General Theory* and *Treatise on Money*¹ (Fisher 1933; Keynes 1997 2011). Thus, if one of the problems facing less developed economies is a lack of investment, and if investment is negatively affected by price instability, it would seem of paramount interest to achieve price stability. Indeed, it will afford entrepreneurs a greater ability to calculate the private marginal efficiency of capital. In turn, this confidence will induce greater quantities of investment which will facilitate the transformation of less developed economies' productive structures through the better utilization of labor resources. Hence, it is imperative to achieve price stability. As a result, we must determine the structural cause(s) of price instability.²

A first source of structural price instability results from the distributional conflict involving the struggle for higher wages relative to maintaining profit margins. Indeed, this conflict finds its conceptual origin in the Classical economists' distribution models. When workers attempt to secure higher wages, the typical response of entrepreneurs is to raise prices so as to pass on the higher labor costs. This subsequently keeps the wage share constant- making workers once again struggle for higher wages. It is obvious the result of

¹ This connection was fully developed subsequently by Minsky in his Financial Instability Hypothesis.

² While there may be temporary reasons for price instability, these are short term in nature and can be fixed relatively quickly. In contrast, structural causes of price instability are fundamental issues that need to be resolved or else the long term structural change a development process entails will continually be subjected to these forces.

this process is wage-price inflation and it can be a significant source of structural price instability. Therefore, a policy that can dampen these pressures would have the impact of creating structural price stability since labor is a cost factoring into almost every pricing decision. We argue that ELR can perform this function by having the ELR living wage serve as a reference wage for the economy.

A second cause of structural price instability results from what Diamand labeled ‘productive’ and/or ‘external’ bottlenecks (Diamand 1978).³ Essentially, the argument is that when the price of a scarce, bottlenecked factor increases it subsequently reduces real wages and creates a more regressive income distribution. In turn, this lowers overall consumption levels since the purchasing power of wage earners has dwindled. Meanwhile, simultaneously, the industries utilizing the scarce input lower their production levels to that corresponding with what the scarce input can accommodate. The result is that less developed economies are likely to suffer the dual effects of increasing inflation with heightened unemployment- what is known as stagflation. Thus, what incentive is there to undertake the investment necessary to transform the productive structure when the prices of inputs are consistently changing and customers have diminished purchasing power?

To complicate the issue, the typical solution undertaken involves choking off demand via restrictive fiscal and monetary policies. Accordingly, this deflates the economy and causes further unemployment. Thus, when workers attempt to recover their purchasing power and demand action be taken to re-inflate the economy, the cycle of inflation with

³ We noted in Chapter II that Keith Griffin discusses a similar concept in his masterpiece *Underdevelopment in Spanish America* (Griffin, 1969).

unemployment begins anew. Instead, the correct solution must deal with the actual problem-which involves directly alleviating the bottleneck.⁴

As we saw in Chapter II, the unbalanced growth mechanisms induced by balanced growth can remedy some of these structural bottlenecks. However, there is no guarantee that this mechanism will solve all of them. What is more is that since balanced growth relies upon the profit motive, certain bottlenecks will not be alleviated if it is not profitable to do so. Consequently, it is necessary for our strategy to be capable of dealing with these limitations of the private sector. It is argued ELR can perform this function.

A second insight of the Scarcity in the Midst of Plenty Approach involves addressing the fact that development requires long term structural flexibility while current conditions are typically rigid. To be sure, in a development process the production structure must necessarily be altered. It is essential to recognize that we are discussing a substantial macroeconomic transformation. Consequently, any policy that introduces a heightened degree of flexibility to this process is welcome. Indeed, by increasing the degree of flexibility the economy is afforded greater leeway throughout a development process while still minimizing structural underemployment. It is argued that ELR can accomplish this while simultaneously complementing balanced growth.

To summarize, in this Introduction we have stated that ELR can accomplish four different objectives. First, it produces and maintains loose, full employment. Thus, it allows less developed economies to minimize structural underemployment. Second, it guarantees structural price stability by having the ELR living wage act as the reference wage for the rest

⁴ This conclusion stands in contrast to the neoclassical theory upon which both the Washington and post-Washington Consensus are based which posits the price mechanism will eventually solve these issues.

of the economy. Third, it alleviates certain bottlenecks that the private sector cannot. In doing so, it corrects two major sources of structural price instability. Fourth, it was argued that ELR will increase the structural flexibility of the economy while simultaneously complementing balanced growth.

The structure of this chapter is as follows. In Part V.A, we will discuss some of the individual components of ELR- such as financing this policy in both monetarily sovereign and non-monetarily sovereign economies, the Job Guarantee (JG), its price stability aspect, and its introduction of heightened structural flexibility. In doing so, we will support the arguments put forward above. Subsequently, in Part V.B we will examine the logistics of structuring and implementing ELR in less developed economies.

Part V.A - The Individual Components of Employer of Last Resort

To refresh the reader's mind, ELR is an employment policy in which the state possesses a perfectly elastic demand for labor at a predetermined living wage. In doing so, its inherent design produces loose, full employment⁵ and price stability. Because hiring labor necessarily has an expenditure aspect, we should first discuss how the state will finance this policy.

⁵ It should be noted that loose, full employment is a superior economic state than tight, full employment. Indeed, loose, full employment is a situation in which aggregate labor demand is far in excess of aggregate labor supply. Consequently, there is slack in the labor market which prevents upward pressure on wages- which could cause cost-push inflation and a rise in unemployment. By virtue of the perfectly elastic labor demand associated with ELR, it is obvious that this policy will result in loose, full employment. By contrast, tight, full employment can be characterized as a situation in which aggregate labor demand is approximately equal to aggregate labor supply. Because in this latter case there is no slack in the labor market, it is more likely that there will be upward pressure on wages and cost-push inflation will result- culminating in a failure to maintain full employment. Further, tight, full employment is likely to arise from conditions in which private investment constitutes a relatively large share of total expenditure. Because private investment levels are volatile, we must recognize that the achievement of tight, full employment is likely to be temporary in nature because of the mechanisms by which it is reached. For these reasons, we conclude loose, full employment is superior to tight, full employment.

Part V.A.1 - Financing an ELR Policy in an Economy with a Sovereign Currency

As shown in Chapter III, to monetize an economy the state must impose a tax on an item for which a large base has an inelastic demand- such as property. In turn, this creates a demand for the state's IOU- commonly called currency- and thereby bestows value upon it. In addition, we argued that this process will result in the vast majority of third party debts being denominated in the state's unit of account. Moreover, we saw this process permits the state to issue its own IOUs as payment to the private sector for the latter's real resources. Consequently, the state is able to pursue public objectives while the private sector comes to possess the item necessary to discharge its tax obligation. Thus, we concluded that a monetarily sovereign state possesses the ability to purchase any amount of real private resources that are for sale- provided they are denominated in the domestic currency.

A second economic tautology (following the one from the dissertation's Introduction) is that unemployment signals the private sector did not wish to employ all the labor resources that were for sale. If it had, there would not be unemployment. At the same time, because a state with a sovereign currency can purchase any amount of real resources, it can always purchase the labor resources of the individuals the private sector chose not to. Clearly this situation is economically superior to a situation in which some labor resources are left idle/underemployed since the latter situation fails to make the maximum contribution towards output because it is inefficient. Therefore, we conclude that the state's purchase of otherwise unemployed/underemployed labor is necessary if the economy is to operate relatively more efficiently by minimizing structural underemployment.

It is important to recognize that the financing costs of this in an economy practicing MMT is essentially a non-issue since the state can always create IOUs to fully employ its labor resources. Therefore, an economy with a sovereign currency should not approach ELR with a predetermined budget; the cost of realizing loose, full employment is simply an ex post accounting statistic in a monetarily sovereign economy.⁶ However, as mentioned in Chapter II, this arrangement only facilitates the administration of an ELR program. Indeed, an economy with dollarization issues is still perfectly capable of administering an ELR policy- as we shall see below.

Part V.A.1.A - Financing ELR in Dollarized Economies

As stated in Chapter III, there are two ways an economy can dollarize: voluntarily and involuntarily. We will first examine how voluntary dollarization affects ELR's financing which will be followed by the same analysis in the context of involuntary dollarization. We may note that voluntary dollarization involves issues of ELR worker remuneration while involuntary dollarization deals with issues surrounding the cost of ELR to the state and how it may appropriately finance the program.

To the extent that voluntary dollarization has occurred- meaning the economy's citizens have adopted a foreign currency as the preferred means of payment- it is unlikely to affect the financing of ELR. This is because voluntary dollarization likely originates from one of two population segments.

⁶ A possible objection to ELR could argue that this approach runs the risk of creating leeway for fraud and potential waste. Methods of countering this will be analyzed in Part V.B when we discuss how ELR should be structured.

The first involves individuals who do not trust the sovereign currency's value and have access to FOREX markets. If this is the case, they can willfully choose to utilize a foreign currency as the preferred means of settling transactions. However, these individuals are likely to be relatively wealthy with fairly secure private sector employment- not the type of individuals ELR would typically hire. Thus, it makes no difference from a remuneration perspective if these individuals refuse to accept the state's IOU (sovereign currency) as payment for ELR employment since they are unlikely to be employed by ELR.

A second segment promoting voluntary dollarization involves individuals in the informal sector who require a 'strong' currency to complete transactions because of these currencies' popularity. We can expect these individuals to be fairly impoverished and without regular, formal, or full time employment. It turns out that ELR can help to minimize this source of voluntary dollarization. Assuming these individuals desire secure, formal, full time employment they will partake in ELR- meaning they will be remunerated in official currency. In turn, this makes it much more likely they will begin to utilize the state's IOU in the vast majority of their transactions. Thus, as they join ELR they will cease utilizing other currencies as the preferred means of payment- which solves the voluntary dollarization problem.

Further, let us suppose that the two population segments listed above (wealthy and/or impoverished individuals) are not the source of voluntary dollarization. If this is the case, we still know that the state can enforce the usage of official currency through the imposition and collection of taxes. As a result, the voluntary dollarization issue would subside and, for our purposes here, not affect the financing of ELR.

Somewhat surprisingly, an economy that has involuntarily dollarized is also perfectly capable of administering an ELR policy despite the fact that the state will initially have to acquire the foreign currency that will be used to remunerate the ELR workers. Indeed, if the increase in fiscal expenditure is a manageable sum and there is a strong likelihood that ELR workers will purchase domestically produced output (so as to prevent a widening trade gap⁷) there is no a priori reason why an economy with a non-sovereign monetary regime could not implement ELR.

As it turns out, many estimates of the total cost of an ELR policy put it at around 1% of GDP- and these estimates are likely biased upwards (Fullwiler 2005). If this is correct, surely this cost is manageable in relation to the benefits the program itself will provide. Further, it should be remembered that the cost of ELR is countercyclical in that when private activity slows, the cost of ELR will increase. Conversely, when private activity picks up, ELR can produce budgetary surpluses- thereby accumulating the funds necessary to operate it in the future (Fullwiler 2005; Mitchell and Wray 2004).

This evidence supports the argument that even an involuntarily dollarized economy can successfully implement and administer an ELR policy over time. Hence, as we stated in Part II.B.2, despite the fact that the possession of a sovereign currency certainly makes financing ELR easier, there is no reason why this employment policy cannot be incorporated into non-monetarily sovereign economies. Instead, the crucial point is this: even in

⁷ We saw in Part IV.C that one of the goals of our balanced growth program is to produce output that will satisfy domestic consumer demand. In doing so, it will ensure that ELR worker purchases tend to be centered on domestically produced output which will lessen the likelihood that ELR will contribute to a widening trade gap. Again, the relevant consideration is whether the income elasticity of demand for the newly produced domestic goods and services is greater than the marginal propensity to import. Additionally, if the marginal propensity to import turned out to be greater, the state could also undertake actions designed to mitigate the effects of the increased import bill, as we discussed in Part IV.D.1.

dollarized economies it is entirely possible to have an ELR policy and therefore there is no valid financial macroeconomic reason why a JG cannot be offered to every individual- regardless of the currency regime.

Part V.A.1.B - In-Kind Payments and Financing ELR

A second way in which the ability to remunerate ELR workers could be compromised involves the widespread usage of in-kind payments. In many rural and impoverished areas of less developed economies numerous informal occupations are likely to have their payments made in-kind. However, similar to the second case of voluntary dollarization above, we would expect ELR to solve this problem. Assuming these workers desire secure, full time, formal employment, they will undertake ELR employment and receive payment in the form of state IOUs. Accordingly, informal in-kind payments will occur less frequently.⁸ Therefore, we conclude that informal in-kind payments do not represent a hindrance on the ability to finance ELR.

Part V.A.2 - ELR and the Job Guarantee

In the Introduction and Chapter I, we saw that the Scarcity in the Midst of Plenty Approach views development as fundamentally about job creation because this process seeks to minimize structural underemployment to produce a more appropriate distribution and usage of resources. Because ELR promises to produce loose, full employment, it follows that ELR will allow a less developed economy to minimize structural underemployment.

⁸ As we will discuss below, there may initially be a need to remunerate ELR workers with a combination of monetary reimbursement and in-kind payments due to the impact a large spike in formal employment can have on the exchange rate. The difference is that in this latter scenario we are discussing in-kind payments associated with formal employment while above we were discussing in-kind payments in the informal sector. Moreover, the in-kind payments associated with ELR remuneration will be phased out over time while with informal employment there is no such guarantee (Wray 2012, 227-230).

Therefore, it is an essential component of our development strategy. In this section, we will perform two tasks. First, we will discuss the economics of the JG in order to fully elucidate its logic. Second, we will discuss specific benefits that result from it.

Part V.A.2.A - The Economics behind the Job Guarantee

ELR facilitates a development process by utilizing the JG to mobilize labor resources towards higher productivity employment. In order to do so, the state must possess a perfectly elastic demand for the labor resources the formal private sector refused to hire.⁹ Indeed, we can characterize ELR as a form of countercyclical fiscal policy involving a direct labor component since it hires more people in a downturn than in an expansion. Thus, by offering full-time, secure, formal employment, the state is able to create and maintain loose, full employment and thereby minimize structural underemployment. At the same time, it facilitates the procurement of individual and socially meaningful objectives.

In Chapter IV, we saw that balanced growth can initiate/sustain a development process. However, we also recognized that there is no guarantee it will allow less developed economies to minimize structural underemployment. This is one of the primary reasons why ELR is included in our strategy- it solves balanced growth's shortcoming by guaranteeing that less developed economies will minimize structural underemployment. Thus, in addition to our strategy's ability to combine short term demand targeting with long term structural

⁹ This reveals that ELR 'hires off the bottom' of the labor pool by providing work to the typically low-skilled, low-educated workers that are frequently unaffected by the trickle down impact of private investment-led growth. In addition, these individuals are usually the first ones fired and the last ones hired. Thus, in order to minimize this source of economic inefficiency it is necessary to engage in a direct job creation process like that associated with ELR.

change to initiate/sustain a development process, it is also capable of minimizing structural underemployment itself.

It is vital to grasp the importance of the JG. In the Scarcity in the Midst of Plenty Approach, the fundamental problem facing less developed economies involves a lack of inducements to transform the productive structure- which results in an inability to fully utilize domestic labor resources. The JG bypasses this structural issue and directly mobilizes labor resources towards higher productivity occupations. Thus, if the biggest problem facing less developed economies involves the combination of structural underemployment and an inability to mobilize these resources, it is obvious that ELR's emphasis on direct job creation solves this issue.¹⁰

In exchange for the labor performed in ELR, the state will remunerate workers with a predetermined 'living wage' set by the state. The actual level of the wage should be such that it provides ELR workers with a standard of living substantially above subsistence. Further, since ELR acts as a buffer stock for labor by hiring more in a slump and less in a boom, the ELR living wage will be the effective buying and selling price for a unit of the buffer stock. Seen this way, the ELR living wage will set a wage floor and, in effect, become the de facto minimum wage throughout the economy.

Now, we should note that the ELR living wage should not be set at a level that will force the private sector to compete with ELR for labor resources over time. The objective of ELR is to complement the private sector's hiring decisions- not substitute for them. Thus, caution needs to be exercised when setting the ELR living wage to ensure that it does not

¹⁰ It should be noted that in Chapter II we demonstrated ELR can be used in concert with other policies- such as balanced growth.

cause an exodus of workers from the private sector. However, to the extent that private compensation packages did not previously provide a sufficient standard of living, it is permissible if the standard set by ELR's living wage forces a one-time increase in these employers' rates of remuneration. Moreover, the ELR living wage should be altered as needed to keep up with adjustments in the cost of living.

At this juncture, we need to discuss a caveat involving the initial compositional form of the ELR living wage. Indeed, there are potential macroeconomic impacts that certain compositions can cause.

Part V.A.2.A.1 - The compositional form of the ELR living wage in less developed economies

In less developed economies, the compositional form of the ELR living wage can potentially have major macroeconomic consequences. Indeed, if the ELR living wage is initially composed entirely of monetary reimbursement it will be providing a large mass of previously underemployed individuals with large spikes in monetary income. In turn, this could rapidly increase the demand for imports, place downward pressure on the exchange rate,¹¹ and spark pass through inflation (Wray 2012, 227-230).

To counteract this, at least initially the monetary portion of the ELR living wage could be set at a level comparable to that prevailing in the informal sector while additional remuneration would be delivered in-kind. Indeed, this could be done by delivering such items as food, clothing, housing, and access to certain types of care and services (Wray 2012,

¹¹ It could be argued that the simultaneous implementation of balanced growth could mitigate this scenario because, as outlined in Part IV.C, this program should produce output that will satisfy domestic consumer demand. Therefore, there would be increased domestic demand instead of increased import demand depending upon whether the income elasticity of demand associated with the balanced growth program is greater than the marginal propensity to import.

228-230). It should be kept in mind that this would only be initially necessary. Over time, the in-kind component of the ELR living wage would be phased out as the economy became accustomed to having higher employment and monetary income. To be sure, as the structural characteristics of the economy changed, explicit concern for the potential exchange rate impact of ELR could wane.

Part V.A.2.B - The Benefits of a Job Guarantee

A correctly instituted ELR policy simultaneously provides many benefits at both the macro and microeconomic levels. In this section, we will discuss these benefits. First, we will delineate the macroeconomic benefits of ELR. This will be followed by a discussion of the microeconomic benefits.

Part V.A.2.B.1 - The macroeconomic benefits of a job guarantee

First, ELR will end poverty in that particular economy. The importance of this cannot be overemphasized. The ultimate objective of economic development is to increase the well-being of all of the world's inhabitants. Thus, because ELR provides a JG, no individual will ever have to be subjected to poverty again. This is an incredibly significant realization since nearly half of the global population lives on less than \$2.50 per day.

Second, throughout this essay we have argued that development is fundamentally a process of job creation in which labor resources are mobilized towards higher productivity occupations. To be sure, we argued that the objective of economic development should be the minimization of structural underemployment. It is clear from the analysis above that ELR will achieve and maintain loose, full employment. Hence, the second macroeconomic

benefit is that ELR will allow an economy to minimize structural underemployment- the very objective of this strategy!

A third, less grandiose, macroeconomic benefit is that there will be an increasingly consumption-based composition of effective demand. Therefore, the economy's development process will be relatively stable. In addition, with the composition of effective demand weighted more heavily towards consumption, enterprises are more likely to be in a 'hedge' position- at least for a longer duration of time (Minsky 2008). As a result, investment expectations will become more bullish since wage-earners will be increasing their consumption purchases. In this sense, ELR will increase the inducement to invest- allowing the economy's productive structure to be more rapidly transformed. Thus, ELR will provide benefits to more than just its workforce.

Fourth, this consumption-based composition of effective demand can stabilize employment and expectations during a downturn. In such an event, employers will be bearish and therefore attempt to trim their labor forces- which will cause effective demand to fall, excess supplies to rise, prices to fall, and a further round of employment cuts. However, with ELR in place, consumption will not fall as much as it would otherwise. In turn, this allows some of the excess supply to be sold which can provide an incentive not to minimize employment further. Consequently, private sector employment will remain higher and the slump will not be as severe as otherwise (Wray 2012, 223).

Fifth, ELR will lead to an increased rate of capacity creation. To be sure, ELR workers could be used to create certain needed infrastructure- such as transport methods and sanitation disposal systems. In turn, this would allow geographically-related bottlenecks to

be alleviated. Further, these infrastructure projects could spur private linkages- which would have the impact of accelerating the rate of development (Wray 2012, 229).

Sixth, ELR will increase worker productivity. As we will see below in our presentation of microeconomic benefits, ELR workers will have access to various training programs in order to maintain and/or upgrade their current skills sets. In doing so, ELR will be responsible for creating a better trained and more productive labor force (Wray 2012, 223). Further, because ELR can provide specialized skills to a number of individuals, the division of labor can expand- making non-ELR workers more productive as well. In addition, if the state provided intermediate and/or higher technology capital for ELR it would serve two purposes. First, it would allow the economy to immediately improve its productivity and expand its output levels. Second, it would allow typically low-skilled labor to become better trained- making it more likely that these individuals would eventually be able to secure full-time, private sector employment (Wray 2012, 223).

Seventh, ELR will create a situation in which previously underemployed individuals will secure full time employment- thereby allowing them to realize a higher level of productivity (Wray 2012, 223). Though this is similar to the sixth benefit above, it must be recognized that it is distinctly different. Above, we were discussing increases in productivity that can result from ELR while here we are discussing immediate increases in productivity simply by joining ELR.

Eighth, rural ELR workers can be used to increase the marketable surplus- which we saw in Chapter IV is vital throughout a development process. Hence, a JG can ensure that

food inflation does not disrupt our economic strategy. More fundamentally, expanding the supply of food should be part of any program attempting to alleviate poverty.

It should be noted that the common theme uniting these various macroeconomic benefits is that they all involve a transformation of the economy's productive structure towards a more appropriate distribution of labor resources. Indeed, whether we were discussing the effects of reducing poverty, minimizing structural underemployment, or increasing effective demand, stability, capacity creation, productivity, or the marketable surplus, we were fundamentally analyzing processes involving the direct mobilization of labor resources towards higher productivity occupations. Thus, it is obvious that ELR is an indispensable development policy and should be included in any strategy seeking to initiate/sustain a development process by minimizing structural underemployment.

Part V.A.2.B.2 - The microeconomic benefits of a job guarantee

In addition to the macroeconomic benefits depicted above, there are some invaluable microeconomic benefits a JG can offer. In this section, we will explore them.

Similar to the first macroeconomic benefit, ELR will allow any individual to permanently escape the grip of poverty. Again, this cannot be understated. By providing each individual with the opportunity to gain full-time, formal employment, the state will recognize each individual's right to a job. In doing so, s/he will be afforded the opportunity to lead a fruitful life instead of one that is hemmed in by poverty. The socio-economic benefits associated with this are virtually infinite.

Second, ELR allows those who are less skilled to acquire on the job training- making it easier to acquire private sector employment. Further, individuals can participate in training

programs to gain the skill sets they need to attain private sector employment (Wray 2012, 223). Participation in such programs allows individuals access to basic, yet ultimately acquired skills such as literacy, disease prevention, sanitation lessons, etc. It would also allow those already possessing these and other particular skills to maintain them through usage on the job in their respective fields.

Third, ELR has extremely important individual socio-economic effects because it allows participants an opportunity to engage in meaningful employment (Wray and Tcherneva 2005). In turn, this enables individuals to perform tasks that they can take pride in. Indeed, this position is reflected in a 2005 study performed by Wray and Tcherneva involving the ‘Jefes de Jogar’ program in Argentina in which they found that program participants said that they felt ‘respected’ (Wray and Tcherneva 2005a).

Following the logic above, we find a fourth microeconomic benefit to be that ELR can serve as a method for instituting specific socio-economic goals- whether it involves the empowerment of a particular group, broad social issues, or ecological concerns. To be sure, if there is a specific socio-economic outcome that is desired, ELR can be designed to promote its achievement. Thus, we conclude that ELR can be a powerful force for societal change (Wray 2012, 223).

Fifth, because ELR participants will have a better socio-economic existence relative to a situation without ELR, activities typically associated with underemployment will occur less frequently. Indeed, social vices such as alcohol abuse, crime, vagrancy, etc. will not be as prevalent (Wray 2012, 223).

It can be noted that the theme running throughout this section is that ELR has readily identifiable socio-economic benefits for individuals directly and indirectly associated with ELR. A better skilled and fully employed labor force can transform the economy's socio-economic characteristics in ways that cannot truly be captured by purely economic modeling. Hence, we see that ELR's individual socio-economic effects are not simply confined to the program itself. Indeed, it has significant societal spillover effects that can transform the non-economic characteristics of the economy- in addition to the microeconomic benefits it provides program participants with.

Part V.A.3 - ELR and Price Stability

In the Introduction to this Chapter, we saw the Scarcity in the Midst of Plenty Approach contains an important insight regarding the relationship between an economy's productive structure and price instability. Indeed, we saw that price instability causes entrepreneurs to be hesitant about investing which, in turn, prevents the economy from undertaking the long term structural change necessary to minimize structural underemployment. Further, we saw that in less developed economies there are two primary causes of structural price instability: the distributive conflict and bottlenecks. In this section, we will show how ELR can ameliorate these issues and guarantee long term structural price stability. First, we will examine the distributive conflict. This will segue to an analysis of bottlenecks and how ELR can also remedy this source of structural price instability. Finally, we will identify an inherent feature of ELR that will additionally contribute to structural price stability.

It should be mentioned that there will not be a separate section dedicated to the benefits of price stability- as there was for a JG in Part V.A.2.B above. This is done for two reasons. First, the benefits of price stability- especially throughout a development process- are well established. Second, in both the Introduction to this Chapter and in the paragraph above, it has already been sufficiently emphasized that the primary benefit derived from structural price stability involves the ability to conduct long term structural change.

Part V.A.3.A - The Distributive Conflict, ELR, and Price Stability

One of the fundamental contributions of Classical economics involves the recognition that there is a distributive conflict between workers wanting higher wages and capitalists wanting increased profits. If workers are able to realize wage increases, the capitalists will raise their prices so that the higher labor costs are passed on and profit margins are retained. The result is that wage earners' purchasing power is unchanged- causing them to subsequently negotiate once again for higher wages. It is obvious this conflict can result in a wage-price spiral. Thus, we find that the distributive conflict can be a significant source of structural price instability.

The above highlights that the distributive conflict can prevent a less developed economy from transforming its productive structure since price instability deters entrepreneurs from undertaking investment. Hence, if there was a policy that could dampen these pressures it would exert structural price stability throughout the economy. ELR can perform this function by having the ELR living wage serve as a reference wage for the economy.

ELR puts into motion Keynes' analysis of the wage unit. At its core, Keynes' wage unit reduces all heterogeneous labor to some elementary unit of unskilled labor. To be sure, more highly skilled labor represents a multiple of this unskilled labor unit. Accordingly, more skilled labor- which embodies more labor units relative to unskilled labor- is remunerated at a higher rate than the simple, unskilled labor unit. This is why wages in a capitalist economic system are not identical- labor is heterogeneous and therefore its remuneration is as well.

Now, let us recognize that the remuneration rate given to the elementary unskilled labor unit can be called the wage unit since the latter can purchase a single unit of unskilled labor. It follows that more highly skilled labor can be purchased for a multiple of this wage unit.

Concurrently, we should note that price stability can be conceived of as the constant purchasing power of the currency in terms of the wage unit. In other words, price stability can be directly measured by how many units of currency it takes to purchase a wage unit over a given time period (Wray and Tcherneva 2005). Thus, if it continually takes more units of currency to purchase a wage unit over a given time period the currency is weakening- which is called inflation. On the other hand, if it continually takes fewer units of currency to purchase a wage unit over a given time period the value of the currency is improving- otherwise known as deflation. Finally, if the same number of currency units will purchase a wage unit over time the economy is experiencing price stability.

In order to see how this theoretical exercise can be applied in the real world to ameliorate the distributive conflict, let us substitute one unit of the ELR living wage as an

empirical approximation for Keynes' wage unit. In doing so, we would conceive of price stability as the amount of ELR labor that one unit of the currency could purchase. Hence, as long as the ELR living wage remains constant, one unit of the currency will consistently be able to purchase a certain quantity of ELR labor (Wray and Tcherneva 2005).¹²

At the same time, because skilled labor is remunerated a multiple of unskilled labor, the ELR living wage can serve as a reference point during the wage bargains between capitalists and workers. Thus, because the ELR living wage will remain constant over time the remuneration rates of more skilled labor will as well. In turn, since labor is a cost factoring into almost every pricing decision there will be a structural tendency towards price stability. Moreover, because the value of the currency will remain constant within an ELR policy, this wage patterning mechanism can institutionalize a constant purchasing power of the currency in relation to wage remuneration rates. In doing so, it will alleviate the inflationary pressures derived from the distributive conflict by fostering structural price stability.

Further, Mitchell turned this concept into a dynamic analysis when he created the NAIBER- defined as the ratio of Buffer Stock Employment (BSE) to total employment required to stabilize prices (Mitchell 1998). In this analysis, Mitchell demonstrated that if the BSE became too small, its ability to serve as the reference wage for the economy could diminish and the distributive conflict's cost-push inflation could result. In order to avert this scenario, the state can take preventive actions to replenish the buffer stock. In doing so, it

¹² As noted above, the ELR living wage should be adjusted periodically to keep up with cost of living adjustments. However, this would not result in wage inflation since these would be one time increases whereas inflation involves a consistent erosion of the currency's purchasing power.

would move NAIBER away from its relatively low value and cause the ELR living wage to reassert itself as the reference wage of the economy (Mitchell 1998).

Part V.A.3.B - Bottlenecks, ELR, and Price Stability

As we saw in this Chapter's Introduction, the second cause of structural price instability involves the presence of bottlenecks. To be sure, we noted Diamand argued bottlenecks represent an imposing obstacle to price stability that is unique to less developed economies. Further, he analyzed how bottlenecks are typically dealt with- policymakers choose to deflate the economy via demand reductions rather than solve the source of the problem which is, of course, the bottleneck. Thus the widespread existence of bottlenecks perpetually causes less developed economies to experience stagflation (Diamand 1978). Accordingly, if there was a way to alleviate some of these bottlenecks it would remove a significant source of structural price instability. ELR can accomplish this through four different avenues.

First, ELR workers can produce increased quantities of the bottlenecked product. In doing so, they will directly alleviate the structural conditions contributing to price instability by expanding the product's output while keeping its price constant- the exact opposite of stagflation.

Second, ELR workers can produce the bottlenecked product's basic/intermediate factors and/or the co-operant factors associated with production of that good. With regard to the latter, Forstater argues there is

the possibility that for some types of capital equipment in short supply at higher levels of economic activity, [the] government could choose to help avoid heightened rigidity by increasing productive capacity in that line of production through public

sector production. This could entail direct production of the goods in short supply or the production of the goods required to produce those goods. (Forstater 1998, 560)

It should be clear that Forstater's analysis similarly applies to the production of basic/intermediate factors associated with the bottlenecked product. Whichever the case, in both instances the ELR workers would indirectly be alleviating the bottleneck.

Now, the majority of ELR workers will likely be low skilled workers. Therefore, when attempting to directly and/or indirectly alleviate bottlenecks it would be preferable if ELR's focus was on the production of non-technologically sophisticated output; that is, the production processes were relatively simple. Nonetheless, the basic point is that ELR workers can be used to augment the supply of the bottlenecked product.

Third, ELR workers could also construct output associated with linkage effects. In other words, they could be utilized to expand production into logically connected activities to alleviate potential sources of future bottlenecks. As an example, ELR workers could produce output associated with linkages in balanced growth that the private sector has not undertaken.

Fourth, as mentioned above, ELR workers could construct infrastructure projects which would facilitate productive connections and linkages that did not previously exist (Wray 2012, 229). In doing so, the risk that the economy will run into bottleneck constraints in the future will be greatly reduced.

While this reveals that ELR cannot guarantee all bottlenecks will be alleviated, it does show that it can play a significant role in minimizing some of them. In doing so, it will overcome one of the primary reasons there is frequently structural price instability. In turn,

this phenomenon would be less likely to act as a deterrent to investment and on the economy's ability to exact a long term structural transformation.

Part V.A.3.C - An Additional Mechanism Ensuring Structural Price Stability: ELR's Countercyclical Budget

Though not mentioned in the Introduction to this Chapter, there is an inherent feature of ELR that will additionally contribute to structural price stability. This mechanism hinges on the fact that ELR's expenditure stance will consistently move counter cyclically at the full employment level- ensuring effective demand will be neither deficient nor excessive.

As noted in Chapter III, in the MMT approach deficits can cause inflation if total expenditure is greater than the full employment level of output. To prevent this, ELR also ensures that effective demand will consistently be at the full employment level of output. This is because every time a job is created in the private sector there will be a simultaneous loss of an ELR job. Accordingly, there will be a reduction of public expenditure associated with ELR while there will be a concomitant increase of private expenditure resulting from the increased private employment. Hence, the inherent hiring mechanism of ELR is such that it ensures supply and demand will balance at the full employment level of output through time. Thus, the economy is afforded with an additional tendency towards structural price stability since ELR's budget moves counter-cyclically (Wray 1998a).

Part V.A.4 - The Economics of ELR's Enhanced Structural Flexibility

As we have seen, a development process involves long term structural change away from a production structure that is initially quite rigid. Therefore, any policy introducing additional economic flexibility is vital since potential obstacles will be magnified less

intensely. ELR can allow a less developed economy to realize increased flexibility while complementing the larger force driving a development process- which in our strategy is balanced growth. Indeed, there are at least seven distinct ways ELR will lead to enhanced flexibility. Each will be discussed below.

First, we have seen that a development process is essentially a process of long term structural change focused on mobilizing labor resources via job creation. Because this is necessarily a relatively long process in which certain localized failures are likely to be encountered, it is vital that the process itself be sufficiently flexible to ensure that resources will continue to be mobilized in the face of obstacles. It is clear that ELR adds a heightened degree of flexibility since it can maintain loose, full employment. As a result, should the primary force driving the economy's development process encounter difficulties, ELR's capability to maintain loose, full employment guarantees that long term structural change will continue to occur. Hence, ELR can complement the program(s) initiating the larger structural change and, in doing so, introduce greater flexibility throughout the process.

This clearly applies to the relation between ELR and balanced growth. If for some reason balanced growth was to encounter obstacles, ELR could pick up its slack by sustaining long term structural change. On the other hand, if balanced growth operated the way it is expected to, ELR simply ensures that the economy will minimize structural underemployment. Hence, not only are the policies complementary but the relation between the two also increases structural flexibility.

Second, ELR can alleviate certain complications involving the introduction of capital assets. Indeed, the introduction of such items makes the economy structurally asymmetric

since they are heterogeneous and cannot be instantaneously adjusted. Therefore, subsequently attempting to exact a structural transformation can result in structural under/unemployment. ELR solves this issue by employing any of these affected workers. Therefore, greater leeway is permitted in terms of how far and at what pace the transformation can proceed at. This is distinctly different from the first way ELR increases flexibility depicted above. There we were examining how ELR can stabilize the pace of change while here we are analyzing how ELR can accelerate the pace of change. Nonetheless, in both cases ELR will introduce greater economic flexibility.

Third, ELR can solve specific issues related to Myrdal's backwash effects.¹³ Indeed, ELR can counteract these tendencies by stabilizing and subsequently expanding output in backwashed areas potentially being left out of a development process. Through the JG, ELR will stabilize and increase both effective demand and output in these areas- which will raise the employment multiplier and make expectational states more bullish. Further, the skills acquired through ELR will produce a better trained labor force- making it more attractive for entrepreneurs to invest in these areas. Thus, ELR can reverse backwash effects by bringing flexibility to both these areas and the economy.

¹³ To refresh the reader's mind, Myrdal posited that cumulative causation could cause a persistence of inequality within/among less developed economies because the migration of labor and/or capital would tend to have a positive impact on the region/economy able to attract it while the region/economy the labor and/or capital left would tend to suffer. The reason behind this is due to what Myrdal called backwashing effects which would cause the area the resources left to have a second round of further migration since resources are attracted to the highest return. Consequently, capital and/or labor would not venture to the areas that need it the most- as believed to do so in the orthodox static analysis of marginal productivity theory. Instead, Myrdal posited that the resources initially left behind would later be attracted to the booming areas- thereby further impoverishing the area from which they were departing. The result would be that the backwashed areas would experience a perpetuation of poverty and a permanent divergence would be created between the booming areas and the stagnating areas (Myrdal, 1956).

It should be recognized that the phenomena associated with ELR in one backwashed area can induce spread effects.¹⁴ To be sure, the stabilization of one backwashed area can stimulate growth in another backwashed area(s), such as through increased demand for its output or via diffusion of knowledge. If one follows this logic, it can be seen that ELR will lead to the creation of additional development poles. Thus, it provides the less developed economy with increased flexibility should one development pole decelerate.

Fourth, ELR introduces additional external economies. Because there will be an increased number of wage earners under ELR, an increased level of consumption will be made possible. This will raise the social marginal efficiency of capital and therefore entrepreneurs will be more bullish in their investment expectations. As a result, enterprises will undertake additional investment which will facilitate the mobilization of additional labor resources- which will expand the economy's productive capabilities. Thus, since the economy's capabilities will have expanded, the productive structure itself will be more flexible.

Fifth, ELR workers can be used to increase the marketable surplus. Because accomplishing this objective is an integral component of any development strategy, an opportunity to enlarge this surplus is essential since it will prevent food inflation. Thus, because this singular issue has the potential to impact the entire economy, it follows that its alleviation avoids a situation in which the economic structure would become almost unbearably rigid. Therefore, ELR's ability to increase the marketable surplus inherently brings greater flexibility to the economy.

¹⁴ Myrdal defined spread effects as a type of positive externality where, as it is used here, the stabilization of a backwashed area can subsequently spur new development processes.

Sixth, a better skilled labor force that can accomplish a greater variety and difficulty of tasks inherently creates a production structure that is more flexible. At the same time, we saw ELR produces a better skilled labor force by allowing workers to maintain their current skills while acquiring additional ones (Wray 2012, 223). In terms of maintaining their current skills sets, ELR prevents the deterioration of labor skills which makes the labor force more productive relative to a situation without ELR. Further, by allowing participants to upgrade their skill sets, ELR produces a labor force capable of performing a wider array of more difficult tasks. The result of this process is that aggregate productivity and the capabilities of the economy will increase. It is hard to argue this would not enhance economic flexibility.

Seventh, as noted above, ELR workers can be used to alleviate specific bottlenecks in the economy. Because this was discussed previously, there is no need to elaborate the logic behind this point once again. Instead, we can simply note that by solving certain bottlenecks the economy will be capable of accomplishing more than it had been previously and therefore ELR will have made this structure more flexible.

Part V.B- Structuring ELR in Less Developed Economies

In Part V.A above, the strictly theoretical aspects of ELR were analyzed. In doing so, we demonstrated that it is an essential component of any development strategy due to the benefits it provides a less developed economy with. However, ELR is not simply a theoretical apparatus and no mention was made above regarding the logistics required to implement it. Thus, in this section we will examine how ELR should be structured in less developed economies. First, we will analyze the way ELR's cost should be approached and

calculated by the state. Next, we will put forward a simple criteria all ELR projects should meet. Finally, we will make a proposal for how ELR should be structured.

Before beginning, for the sake of terminology we must distinguish between an ELR policy and an ELR project. An ELR policy is a macroeconomic program instituted by the state. On the other hand, an ELR project is the vehicle through which the ELR policy is delivered and its benefits are realized. Viewed this way, each ELR project is a branch of the ELR policy. In turn, while funding for an ELR policy will ultimately originate from the state, the individual ELR project proposals, administration, and management will be more localized.

Part V.B.1 - The Financing of an ELR Policy

Because a monetarily sovereign state can purchase any amount of real resources that are for sale in its currency, it is the only entity for which a positive balance on the ledger at some point in time is never a concern. Indeed, MMT reveals that a monetarily sovereign state can run deficits continually without any concern to its own solvency- and should do so until the full employment level of output is reached. Thus, since a state with a sovereign currency is the only entity for which solvency is a non-issue, the funding for ELR will ultimately originate from it. Further, as we saw in Part V.A.1.A above, as long as the cost of ELR is a manageable sum (and estimations of this cost tell us that it is) it is entirely possible to implement this policy in economies without sovereign currency regimes. Hence, as noted in that section, there is no valid financial macroeconomic reason as to why an ELR policy cannot be implemented.

Now, as pointed out in Part V.A.1, it is important to realize that the portion of the state's budget allotted to an ELR policy will necessarily be an ex post accounting statistic. To be sure, it is impossible to predetermine what the cost of providing a JG to every under/unemployed worker will be since it will depend on the state of private sector activity and individual self-selection. For example, if the private sector is in a boom it will be hiring more employees and the ELR stock of workers will be drained. Consequently, the cost of ELR would decrease and its budget would constitute a smaller overall component of state expenditure. On the other hand, if the economy was in a slump the private sector would be reducing employment and the size of the ELR buffer stock would increase. Accordingly, the cost of ELR would increase and its contribution to state expenditure would be larger. Thus, it is impossible to accurately calculate how much an ELR will cost prior to offering a JG.

The important takeaway point is that the size of the ELR policy's budget should not be predetermined. In other words, a less developed economy should not take a budgetary stance consisting of the thought process 'well, we're going to allocate \$2 billion per annum to an ELR policy because that's what we have'. That logic would remove the very dynamic that makes ELR a great policy tool. Instead, what a less developed economy should say is 'ok, since past estimates of ELR's total cost demonstrate that it is well within our financial capacity to administer it, we are going to go ahead and offer a JG to all individuals that desire one'. Accordingly, the size of the budget component attributable to ELR will be however many JGs are accepted by individuals multiplied by the cost of the ELR living wage- plus some additional costs for materials, overhead, etc.

Viewed this way, ELR-type programs that have been previously implemented have put the cart before the horse; that is, they were primarily concerned with total cost and not with the quantity of employment that could be created. Instead, as revealed above, the proper way of doing it would be exactly the reverse- determine the quantity of employment that desires a full time ELR job and then realize ex post what the budgetary cost of doing so was.

Hence, while the financing for ELR projects will ultimately originate from the state, it will essentially be a blank check whose actual cost is realized ex post. This obviously puts an enormous emphasis on administration and auditing of individual projects for a variety of reasons. First, it must be ensured that the funds are being used for what they are supposed to be used for- to fully employ workers. Second, it must be identified whether the quantity of funds being requested is an amount consistent with the quantity of work being performed. In other words, there is a need to evaluate whether the project leaders are requesting excessive funds relative to what the project is accomplishing and then retaining the rest as ‘kickbacks’. Third, the design of an ELR policy must ensure that funds are not being disbursed to project managers who unfairly mistreat workers and abuse their position (Wray 2012, 230-232). Thus, we find it is imperative to structure ELR in such a way that the positive attributes of the program are readily obtainable for the individual and economy while any negative externalities are minimized.¹⁵

¹⁵ It should be noted that the self-selecting process of an ELR policy will inherently minimize certain sources of corruption and bribery because only the individuals themselves can decide whether to take an ELR job (Bhaduri, 2005, 60). In addition, the existence of ELR will provide workers with an alternative to unfair treatment by private employers- forcing the latter to better observe legal labor standards and fair treatment (Bhaduri, 2005, 60).

Part V.B.2 - A Simple Criteria for Constructing ELR Projects in Less Developed Economies

As discussed by Bhaduri, three things are crucial for the design success of an ELR policy. First, ELR should be seen as a demiurge-type effort of the state designed to undertake socially meaningful and necessary economic projects that will contribute to the development of the economy. It should not be seen or portrayed as a simple income handout from the state to the under/unemployed because, frankly, that is not what ELR is.

Second, projects should be identified that will contribute directly to either increased capacity or output. The ultimate goal should be supply augmentation- something we have seen is necessary to overcome the fundamental problem identified by the Scarcity in the Midst of Plenty Approach.

Third, if private interests will directly benefit from the ELR project they must contribute funding towards the program- such as to cover some and/or all administrative costs (Bhaduri 2005, Chapter 5). In this regard, it will force private enterprises to have some 'skin in the game' and possess an interest in realizing the project's success (Wray and Tcherneva 2005).

This criteria reveals that while the funding for ELR will originate with the state the majority of decisions in an ELR policy will be decentralized. Indeed, this allows localized demands to be met (Bhaduri 2005, Chapter 5; Wray and Tcherneva 2005). In turn, this means local politics will factor heavily into the substance of ELR projects and their management. Consequently, it is essential to structure ELR in a way that will ensure each project gets carried out as efficiently and effectively as possible.

Part V.B.3 - The Process of Proposing ELR Projects in Less Developed Economies

Project proposals should be made at the local, community level and could be made by many different interested parties: the ELR workers, non-ELR related individuals, local business leaders,¹⁶ and both the federal and local governments. Done this way, the proposal phase will facilitate an open discussion of what the ELR participants' collective desires are and what they realistically expect the ELR program to enable them to accomplish. In designing this structure of ELR, it is the author's intention that neither state nor private business interests will be able to decree that ELR workers must perform actions told to them by a higher authority- which will become more evident when the project approval stage is discussed.

At the same time, by allowing local businesses¹⁷ and/or the state to propose projects it permits these actors to demonstrate how ELR can play a valuable social role and contribute to the economy's output. To be sure, this would cause local businesses and government officials to become familiar with the capabilities and needs of ELR workers- which would serve two purposes. First, it allows businesses to communicate which necessary skills the ELR workers must acquire to obtain private sector employment- which, after all, is the ultimate goal of ELR. Second, it would establish a relationship between ELR workers, private sector enterprises, and the state.

¹⁶ Some may object that it is not wise to have private business interests involved in project proposals because they may have ulterior motives and be operating purely with profit-making schemes in mind. To this, the author would reply that it should be remembered this is only the project proposal stage, not the project approval and ratification stage.

¹⁷ To the extent that business interests are involved in project proposals, there should be a fee associated with making a proposal and another, subsequent fee if that project is selected. The logic for this fee is derived from the fact that if the project will directly benefit the enterprise it should have to pay a 'retainer' fee for the services of ELR workers. It can be noted that these sums do not have to be substantial; in fact, they have to be just enough to make the enterprise put some 'skin in the game' (Wray and Tcherneva, 2005).

Upon gauging ELR workers' capabilities, these actors could better ascertain how ELR can be utilized to achieve certain social outcomes that do not exist because they did not initially appear to be viable- assuming the ELR workers themselves decide these outcomes are something they wish to achieve.¹⁸ In this regard, ELR would act as a complement to both the private sector and other public agencies. As a result, a working relationship could become established among these parties.

Finally, with regard to the state making project proposals, this would allow the various levels of government to articulate what it feels are important economic goals while simultaneously lending credibility to the ELR workers' future tasks. In order to do so, it would be necessary for government officials to attend meetings at the local level as well as make their presentations to the ELR workers and community leaders.

Part V.B.4 - The Approval Process of ELR Projects in Less Developed Economies

As opposed to the process involving ELR project proposals, the ratification and approval of ELR projects should be determined by only the ELR workers themselves. The rationale for this arises out of the fact that they will be the ones actually performing the labor. Further, if ELR projects are to truly be socially meaningful to the workers themselves (as we have said they should be) then only they should be able to approve or veto whether a project is approved (Wray 2012, 235-236).¹⁹

¹⁸ Again, it must be remembered that this is the proposal stage and not the ratification stage. Ultimately, only the ELR workers themselves will determine what their labor will produce. The discussion above is simply to demonstrate the interconnections that can be forged among different parties by allowing certain groups to participate in project proposals.

¹⁹ Note that this does not mean only one ELR project will be approved and undertaken at a time. In contrast, many different projects can be selected, implemented, and ordered in terms of when they will be undertaken.

The important point is that ultimately the vote for approving ELR projects must be made by a majority of ELR workers. Indeed, this ensures that the interests of ELR workers are represented by making ELR a participatory democracy (Wray and Tcherneva 2005). In doing so, it will empower these workers by making them a valuable component of the production structure.

To the extent that additional ELR workers enter the program after the ratification of a project has occurred, these individuals will unfortunately not be able to partake in the decision making process since that period will have elapsed. Instead, s/he may be allowed to begin work on projects currently in progress. Subsequently, when these projects have been completed and new proposal/ratification sessions occur, s/he will then be able to submit and vote on ELR project proposals.

Part V.B.5 - ELR Project Administration and Management in Less Developed Economies

The administration and management of ELR projects should be done at the local level by a combination of non-profit organizations- such as NGOs and/or religious organizations- and government-appointed ELR managers from the local/regional ELR office. The non-profit organizations would be primarily responsible for both the day-to-day administration and the primary auditing of the ELR projects. On the other hand, the government managers would primarily be responsible for the long term logistical operations of ELR projects- such as ensuring that the projects themselves have sufficient means to accomplish the tasks.

It is acknowledged that governmentally-selected individuals could present a problem in terms of managing the program- such as through wasteful expenditure and possibly worker abuse. However, there are methods of preventing this. To begin, the entire process must be

kept as transparent as possible at every level- from proposal to ratification to implementation to management of the project. Furthermore, independent and random secondary audits should be conducted by organizations outside the local ELR district. It should be noted that this secondary audit would be in addition to the primary audit the local non-profit NGOs and community leaders would conduct.²⁰

Admittedly, this is not a perfect, foolproof scheme that can minimize all forms of corruption and waste. However, what this framework does do is provide a fairly good starting point that can be amended as experience and need dictates.

Part V.C - Summary

In this Chapter, we have seen that ELR can accomplish a variety of tasks in less developed economies. First, we saw that it will create and maintain loose, full employment. Consequently, our strategy will combine short term demand targeting with long term structural change to allow less developed economies to initiate/sustain a development process and minimize structural underemployment.

Further, we saw that ELR will positively impact a development process in two broad ways. First, it will guarantee structural price stability through its effects on the distributive conflict and bottlenecks. Second, it will increase the structural flexibility of the economy. To be sure, both of these mechanisms will facilitate a development process. Moreover, we saw that ELR will complement balanced growth- thereby assuring us that these two aspects

²⁰ In point of fact, the outside, secondary auditors could be ELR managers from other districts whose own district's ELR funding is contingent upon the integrity of the audit. One can only imagine the ridicule, community shame, and threat an auditor would face should they be tempted to risk losing their own community's funding by engaging in fraudulent behavior. In addition, when arranging for which audits are to be done by whom there should be random, non-repetitive assignments so that there is no familiarity and quid pro quo mentality that can emerge between managers and the auditors.

of our strategy will not conflict. Finally, we examined the logistics of implementing ELR and proposed a possible structure for this policy.

CHAPTER VI

THE DEVELOPMENTAL STATE AND POST-KEYNESIAN/ STRUCTURALIST ECONOMICS

In Chapters 4 and 5, the strictly economic aspects of our strategy were discussed. Indeed, in Chapter IV we saw that balanced growth will allow less developed economies to initiate/sustain a development process while in Chapter V we saw that ELR will allow less developed economies to minimize structural underemployment. However, in Chapter II we acknowledged that the state must be willing to implement this strategy. Thus, at this time it is necessary to remove oneself from the theoretical laboratory and recognize that economic decisions inherently have a political aspect; that is, they do not occur in a political vacuum. Accordingly, it is necessary to examine what type of state apparatus is required for the mechanisms contained within these policies to be set in motion. As argued in Chapter II, the answer is the developmental state.

The structure of this chapter is as follows. In Part VI.A, we will discuss the relationship between the state and economic development. In doing so, the importance of having an entity capable of implementing this strategy will be revealed. In Part VI.B, the author will build upon the discussion of the developmental state in Chapter II to facilitate the reader's understanding of its more intimate features. Next, in Part VI.C, the connection between the developmental state and our strategy will explicitly be made. Finally, in Part VI.D we will discuss some perceived limitations of the developmental state concept.

Part VI.A - The State and Economic Development: Why Does It Matter?

In the Scarcity in the Midst of Plenty Approach, economic development is viewed as a process of transforming the way an economy's labor resources are utilized. Indeed, in Chapter I we characterized a process of development as a process of more fully utilizing a nation's labor resources. Accordingly, this implies that the composition of output utilizing these resources will also be changing throughout a development process. Acknowledging this means that a development process encompasses an economy's attempt to incorporate and expand into new activities; that is, it will be trying to conquer the new production techniques associated with the changing composition of output.

As a corollary, from the time of the Renaissance it has been known to economists that comprise what Reinert has labeled 'The Other Canon' that not all economic activities are equal- meaning that certain activities (Schumpeterian activities²¹) offer an economy better prospects for sustaining and strengthening a development process relative to others (Malthusian activities) (E. Reinert 2007). In other words, some activities offer a greater opportunity than others to take advantage of synergies, increasing returns, the ability to create new knowledge, positive processes of cumulative causation, and product innovations in order to raise the standard of living. This recognition necessarily introduces a qualitative aspect into the dynamics of economic development. Indeed, it implies that the possession of these activities provides an economy with a viable opportunity to advance economically

²¹ Though we will discuss it further below in this Chapter, Schumpeterian and Malthusian activities were introduced in Part IV.C.

while their absence limits the ability to advance- and could actually make the situation worse (E. Reinert 2007).²²

It is argued that the state matters in economic development because it is the only entity and/or mechanism that can ensure an economy comes to possess the types of activities that will allow it to economically advance. It is important to note that we are not advocating the state directly undertake all of the various production decisions that go into what comprises an economy. Instead, what we are arguing is that the state is the only entity that can ensure the economy's productive capabilities embody the types of activities that are integral for a development process to transpire. In turn, this can be contrasted against a situation in which the economy's various individuals undertake production in any sort of activity- regardless of its implications for an economy's ability to advance.

As an empirical example of this logic, history has demonstrated that it is vital for an economy to possess manufacturing capabilities even if its initial endowments would have Ricardian trade theory recommend agricultural specialization and resource extraction- such as in the case of Revolutionary America. Thus, were it not for Alexander Hamilton- the first U.S. Secretary of the Treasury who stressed the importance of industrialization- one can only wonder where the U.S. would currently be positioned in the global hierarchy (E. Reinert 2007, 23-25, 81-82, 241-246; Fletcher 2009, 132-134). The point is this: in the absence of Hamilton acting on behalf of the state, there was no method of ensuring the U.S. would

²² To this point, save for the brief depiction of Schumpeterian activities in Part IV.C, we have primarily focused on the financial relationships. However, by focusing on these variables we have largely glossed over an analysis regarding which types of activities are vital for economic advancement. Hence, what has been lacking from this analysis thus far is the recognition that certain activities are more valuable for an economy to possess than others. In other words, while it is essential to discover the monetary forces that allow production to proceed at differing levels, it is just as important to analyze which types of activities will enable an economy to sustain its success. This is the direction to which we turn in this chapter.

possess a sector history has demonstrated to be essential for development (E. Reinert 2007). In fact, this is something not even the fabled- yet fundamentally flawed- neoclassical price mechanism can ensure.

If the argument is true that certain activities (Schumpeterian) are superior to others (Malthusian), this proposition has incredibly important implications for the role of the state in a development process. Indeed, if certain activities inherently possess a differential potential to sustain development over time, the argument that there is a major role for the state to play in development is justified since it is not sufficient to blindly hope these activities will come to fruition through the price mechanism.²³ Hence, when we say that the state is needed to ensure the possession of these activities because there is no other mechanism guaranteeing their emergence, we literally mean that there is no other economic mechanism.²⁴

It should be obvious that the framework advocated here contrasts heavily with the orthodox Ricardian-Samuelson tradition. This is because the latter analysis adheres to the

²³ If an economy were to follow the orthodoxy's logic on this qualitative point, it would not arrive at a conclusion resembling that reached above. This is due to the fact that in the orthodox tradition, all economic production is qualitatively identical. In other words, it makes no difference if you specialize in manufacturing or agriculture because Samuelson's factor-price equalization will eventually make each individual's returns within each factor identical. Hence, despite empirical reality and the common sense perspective that different types of production result in different quantities of remuneration both across and within different factors, the orthodox neoclassical analysis would argue that there is no role for the state in promoting certain activities since it does not make a difference what the economy specializes in as long as it is exercising its comparative advantage.

²⁴ It is granted that state involvement can lead to the creation of 'corrupt' and/or 'predatory' states in which certain powerful actors within the government utilize the economic transformation to benefit themselves and not the majority of the economy. While acknowledging the potential for this, it can be countered that this has happened rather infrequently in history when considering the numerous development strategies that have been undertaken. Further, taking the position that development plans should solely empower the private sector because of state corruption can be countered with an identical charge: because the private sector is solely focused on profits, why is there any reason to believe that empowering it will result in development? One need only to look at the track record of the Washington Consensus in the 1990s, especially in Russia and Eastern Europe- where the virtual abolition of the public sector was substituted for reliance upon private enterprise- to dispel any notion that the private sector is inherently better suited to achieve development. Instead, it must be recognized that while 'predation' can exist in both the private and public sectors, there is no a priori reason to assume that one will be inherently more predisposed to its incubation than the other.

belief that capitalism is a barter economy (E. Reinert 2007, 120-127). As a result, this tradition cannot identify qualitative aspects of production because such realizations can only be made by analyzing production itself- which the orthodox models have effectively omitted because of their barter starting point. Thus, if the orthodox logic is followed, one ends up with positions like that of Michael Boskin- economic adviser to U.S. President George H.W. Bush- who famously argued that it does not matter whether an economy specializes in producing computer chips or potato chips. Indeed, this conclusion can only be reached by adhering to the belief that an economy should specialize in the production of whatever factors it inherently possesses in abundance and is relatively better at producing than other economies.²⁵

Now, reality is that in the last five hundred years no economy has become a high income economy without thorough state intervention designed to ensure national possession of Schumpeterian activities (E. Reinert 2007, 119). Consequently, we see that the state is vital in a development process because it is the only entity capable of ensuring the economy's transformation ventures into Schumpeterian activities. In order to reinforce this point, we will compare this situation to its polar opposite: the 'free market'.

Part VI.A.1 - A Discourse: Why the 'Free Market' Has Never Led to Economic Advancement

In order to discern why the state is a necessary actor throughout a development process, we need to compare a situation of active state involvement with its polar opposite:

²⁵ It could be pointed out that in order to reach such results, one also needs to posit many unrealistic assumptions such as the prior existence of full employment, that there are no externalities, factors can move easily between industries, there are no scale economies, and that both economies are already producing both goods that are to be traded (Fletcher, 2009; U. Patnaik, 2005).

one in which the state plays no role whatsoever. Thus, we will analyze what a process of development would resemble under a 'free market' regime. By comparing these two outcomes, we will better be able to identify why the state is an integral player in a development process.

It can be stated as fact that the free market has never existed and, in fact, cannot exist. To believe in the 'free market' is to believe in a myth- similar to the legend of Santa Claus. In reality, the free market cannot exist because the assumptions required to posit the existence of a harmonious, self-adjusting market economy are entirely implausible. To support this contention we will provide three examples.

First, in order for the free market to function each firm's cost structure must be identical- something that clearly does not exist. Second, in the real world, resources are being used today to engage in production tomorrow. Accordingly, that makes all economies planned economies- something that is incompatible with the notion of the 'free market'. Third, in the field of economic sociology there is a substantial literature surrounding the concept of market governance which is, roughly, various inter-enterprise attempts to bring stability, control, and a lack of competition to markets. In doing so, it is solely the private sector that is responsible for violating the preconditions necessary for a free market (Fligstein 1996, 2001; Granovetter 1985).²⁶

Since the free market cannot exist, it follows that free market economic theories cannot cause economic development. Thus, we find that our argument regarding the state as an essential actor in a development process as the only one with merit.

²⁶ This is a powerful critique of the free market concept because it counters the typical argument made by orthodox economists claiming that the only reason a free market fails to exist is due to state interference.

To be fair, even the Washington Consensus and its descendants have some role for the state. Unfortunately, over the years, attempts to refine orthodox development theory has resulted in a contraction of the role for the state while traditionally non-economic factors- such as geography and disease- have been inserted into the analysis. To be sure, geography and disease are factors that likely matter in development. However, the inclusion of non-economic factors sidesteps the larger problem- which is that the fundamental model itself is flawed due to its barter premise (E. Reinert 2007). As a result of the failure to address this issue, orthodox proponents are continually forced to include additional factors they argue the state should get 'right'- such as property rights, institutions, governance, competitiveness, innovations, entrepreneurship, education, climate, and disease (E. Reinert 2007, Chapter 6). Consequently, the orthodox development paradigm contains four major shortcomings- which is why it does not adequately capture the need for state intervention throughout a development process.

First, it is unable to describe the essential nature of a capitalist system because it views capitalism as a barter-based system instead of a production-based system. As a result, it defines economics as the 'allocation of scarce resources amongst competing ends' (a barter definition) instead of the more pertinent definition of economics as the 'social provisioning process' (a production definition). This latter characterization is superior because it necessarily entails an analysis of production.

Second, orthodox development theory is unable to explain how and/or why some economic activities are superior to others because of the barter premise upon which it is based. Indeed, it is literally incapable of analyzing qualitative differences among production

activities because of adherence to its 'Equality Assumption' - something we will explore in a moment. Therefore, orthodox theory fails to explain why Schumpeterian activities offer benefits that Malthusian activities cannot.

Third, the failure to recognize that the fundamental problem is the model itself causes orthodox development theory to be unable to explain the historical importance of the state in development. Indeed, in their analysis there is little mention of the state's role in targeting specific activities or how the state has consistently been involved in channeling finance to these sectors throughout a development process.

Fourth, orthodox theory fails to accurately and objectively analyze historical and contemporary events of economic development. Indeed, with regard to analyzing differential performance among less developed economies, the only explanation typically provided for the lack of uniformity is due to reasons classified as 'outside factors' (E. Reinert 2007, Chapter 6). Moreover, what commonly happens is that orthodox theory attempts to incorporate these 'outside factors' as explanatory variables into the fundamentally flawed framework, as noted four paragraphs above.

Let us summarize the two themes running throughout this chapter thus far. First, post-Keynesian/Structuralist economics views certain activities (Schumpeterian) as qualitatively superior to others (Malthusian). Therefore, we argued it is necessary to ensure a development process is centered upon procuring these activities. Second, we argued that state involvement in this endeavor is essential since there is no other mechanism in existence that will ensure a less developed economy comes to possess Schumpeterian activities. To

support this argument, we compared our position to that of free market economists- and found ours to be the only one with merit.

Next, we saw that orthodox development theory does have some role for the state- albeit less than what we would support. To be sure, orthodox development theory believes the state's role in economic development should be minimal because it incorrectly views all production as qualitatively identical. Thus, we stated that this feature of orthodox theory results from adherence to what Reinert has labeled as the 'Equality Assumption' - which follows from orthodox development theory's barter-based view of capitalism. Hence, in order to contrast these two differing views of the state, in the next section we will discuss the Equality Assumption. This will allow us to demonstrate why the orthodox paradigm fails to capture the essential features of a development process and thus why the state is thought to be a relatively unimportant actor. This will segue to our presentation of Schumpeterian and Malthusian activities.

Part VI.A.1.A- The Equality Assumption of Orthodox Development Economics

As discussed in Chapter II, the developmental state is concerned with understanding qualitative aspects of production in order to formulate what activities an economy should specialize in. Accordingly, this involves rejecting the 'Equality Assumption' that is made in orthodox development theory.

At its core, the Equality Assumption is the belief that all economic activities are qualitatively identical. In other words, the prospects facing cattle ranchers are believed to be identical to the prospects facing semi-conductor manufacturers. Thus, there is no major role for the state to play in a development process because it is believed that any activity has an

equal probability of leading to success. Hence, there is no need for an entity- such as the state- to favor the development of one sector over another.

By contrast, the position argued here is that the activities an economy specializes in matters a great deal- an economy of farmers will not be capable of achieving the income level that an economy of computer engineers can. Thus, we believe that the state must play a vital role in ensuring the procurement and emergence of activities that are superior to others since there is no other entity/mechanism that can/has perform(ed) this action.

The ‘Equality Assumption’ has its foundations in neoclassical production theory which posits a representative firm. In turn, the representative firm is used as a clever proxy for claiming that all enterprises in all sectors of all economies throughout time have had similar cost structures. In other words, an agricultural ‘firm’ during the Stone Age is said to have had the same cost structure as a software engineering company in modern-day Silicon Valley (E. Reinert 2007). Thus, by maintaining this assumption, orthodox development theory is unable to incorporate the dynamic elements necessary to explain why differences exist among less developed economies’ performance- such as the effects that increasing returns, synergies, and the state have had upon an economy’s productive capabilities (E. Reinert 2007).

The reason this assumption exists is because neoclassical economics views capitalism as a barter economy. Thus, when it comes to analyzing production there is not much depth the framework can access since it has already premised the analysis in terms of equal exchange. Indeed, if the Equality Assumption is dropped in favor of the admission that certain forms of production are superior to others, market exchange could occur on unequal

terms- which violates the premise of capitalism as a barter economy. Thus, it is the capitalism-as-barter foundation of neoclassical theory that prevents the orthodox development paradigm from analyzing the very mechanisms that empirical events have demonstrated to be essential throughout a development process. Moreover, this is why its role for the state is inadequate: If it does not matter which activities an economy specializes in, there is no need for the state to guide the economic transformation.

Obviously we disagree with this logic. Instead, we follow the developmental state in recognizing that some activities are more important to possess than others and therefore the development of sectors containing these activities becomes national priority. Indeed, this is why Chalmers Johnson characterizes the developmental state as a state that “has as its dominant feature precisely the setting of such substantive social and economic goals” (Johnson 1982, 19). Hence, we can properly conceive of the developmental state as a situation in which the state and some hand-picked sectors co-opt each other in a mutually beneficial relationship. This is why the developmental state is a form of ‘political capitalism’: the state actively involves itself in deciding which sectors are strategically vital for development.

We have proceeded to this point without formally describing Schumpeterian and Malthusian activities. Indeed, we justified state intervention on the grounds that certain activities are more important for an economy to possess than others. However, we have not actually explained what it is that makes these activities inherently superior to others. Thus, in the following section, Part VI.B, we will take up this task by defining Schumpeterian and Malthusian activities. Further, we will analyze which sectors are likely to contain these

activities. Finally, we will demonstrate the connection between Schumpeterian activities and the developmental state.

Part VI.B- Schumpeterian Activities, the Developmental State, and Post-Keynesian/Structuralist Economics

In Part VI.A we argued that in order for a development process to be sustained and strengthened, it is essential for the state to foster the emergence of Schumpeterian activities. Indeed, we argued that Schumpeterian activities offer less developed economies benefits that Malthusian activities cannot. Further, we stated that specializing in Malthusian activities will inherently prevent an economy from achieving progress- no matter how stringently its plans are adhered to (E. Reinert 2007).

In this section, we will depict what we mean by Schumpeterian and Malthusian activities. In addition, we will highlight which sectors are likely to possess these activities. Third, we will describe the connection between Schumpeterian activities and the developmental state. Finally, we will explore what the implications of our findings are for orthodox development theory.

Part VI.B.1- The Origin of Schumpeterian Activities

Schumpeterian activities are increasing returns activities that allow enterprises to realize higher profits. Thus, they are vital to a development process because they induce entrepreneurs to increase investment- allowing the economy to sustain its development process. To be sure, Schumpeterian activities are activities characterized by falling unit costs resulting from investments in higher technology that were induced by an economic expansion. As we have seen in Chapter IV, upon undertaking such investment two

mechanisms will be set in motion. First, technological upgrading allows the division of labor to expand and productivity to increase. This is what creates increasing returns and allows unit costs to fall as output expands. Second, there will be increased sales receipts resulting from the external economies that the investment creates. This is what ultimately allows higher profits to be realized. Thus, the combination of these two mechanisms is what makes it possible for an enterprise to realize the benefits of increasing returns (E. Reinert 2007, pgs. 103-04).

Essentially, the emphasis placed on Schumpeterian activities simply involves recognizing that a key to promoting development lies in Adam Smith's dictum that the division of labor is limited by the extent of the market. Indeed, it is Schumpeterian activities that will enable a less developed economy to mobilize its labor resources towards higher productivity occupations since they can continually expand the market and thus increase the division of labor. Hence, to initiate/sustain a development process the key is to identify which activities will lead to the realization of increasing returns.

In order to ascertain this information, we need to individually examine both of the mechanisms involved in this process. Thus, we will now inspect the two components of increasing returns- starting with the supply side's technologically related cost reductions that will occur as output expands. A demand side analysis will follow this which involves the increased sales receipts that will result from the external economies the initial investment creates. It can be noted that this overall analysis is identical to that in Part IV.A.1.A.1- though the supply aspect will go into much greater theoretical depth.

Part VI.B.1.A- The Supply Aspects of Schumpeterian Activities

In order to discuss how technologically related cost reductions make it possible to realize increasing returns, it is important to recognize that a capital asset is merely the physical embodiment of technology. In turn, technology, at its core, is a collection of knowledge- nothing more than abstract conceptions regarding how an objective can be accomplished (Veblen 1908).

Simultaneously, it is also important to note that a capital asset derives its value from the ability to provide its owner with quasi-rents over time. In turn, the origin of quasi-rents is found in the demand for the output of that capital asset. At the same time, the ability to produce the output of that capital asset is only made possible by the technology physically embodied in the capital asset. Hence, while capital assets are valuable because of their ability to provide owners with quasi-rents, they can only produce quasi-rents if the technology physically embodied in them is capable of producing a type of output for which there is a relatively large demand (Veblen 1908; Keynes 1997).²⁷ This allows us to explicate the relationship between technology and effective demand- which flows naturally from the propositions above.

The driving force in capitalism, which is a monetary production economy, is profit.²⁸ Accordingly, the objective of the entrepreneur is to acquire legal claims to quasi-rents. At the same time, the existence of quasi-rents is only made possible by creating capital assets that are capable of producing a type of output for which there is and/or will be a demand.

²⁷ This demonstrates that specific types of technology (or specific collections of knowledge) are an essential prerequisite for the emergence of quasi-rents.

²⁸ This was acknowledged by thinkers as intellectually diverse as Marx, Keynes, Schumpeter, and Veblen.

Thus, there is an inherent incentive to create these capital assets. In turn, the capital assets themselves can only be produced through the creation of synergies²⁹ - which are specific combinations of technology. Hence, it is the creation of specific combinations of technology that are to be physically embodied in capital assets that allows profit- and thereby capitalism- to exist. Moreover, this implies that there are two separate inducements to create new capital assets- both of which are related to securing increased profits.

First, there is an incentive to discover methods of lowering unit costs. In other words, given the demand for a type of output already in existence, there is an incentive to generate synergies that will result in the ability to create capital assets capable of producing that output at lower unit costs. In turn, this would permit an enterprise to increase the difference between sales receipts and unit costs- thereby increasing profits. This we can label as capital asset product innovation. It is a way of making the goods that currently exist at lower unit costs. This is where increasing returns are created and why investments in higher technology are undertaken. However, it is important to note that the benefits of this process can only be realized on the demand side.

Second, there is an incentive to create new consumption goods that can generate additional quasi-rents. To be sure, the quasi-rents derived from these goods originates from the expected demand for them upon market inception. It should be noted that this incentive is completely separate from any reduction in unit costs potentially associated with these

²⁹ A synergy is when two or more things are functioning together to produce a result not independently obtainable.

products. This we may call consumer product innovation.³⁰ It is a way of increasing the number of types of products in existence. Further, as with capital asset product innovation, in the case of consumer product innovation there will be an increased demand for capital assets that can produce these goods.³¹ Accordingly, the demand for these additional capital assets will warrant the creation of additional synergies.

This analysis allows us to see why capitalism is such a dynamic, productive³² type of economic system: though the origin of knowledge is found in Veblen's idle curiosity and instinct of workmanship, capitalism's output growth results from the ability to induce synergy creation in order to attain quasi-rents and profit (Veblen 1898). Indeed, if expected quasi-rents are such to make the private marginal efficiency of capital greater than the marginal efficiency of money, existing synergies will be utilized and new ones will be created to produce additional quantities of capital assets. In order to do so, additional employment will be required and therefore national income will increase. As a result, less developed economies are provided with a route to become high income economies as their structural underemployment is eliminated. Hence, while Veblen's explanation tells us why knowledge exists, it is the explanation of Keynes and Schumpeter regarding the role of profit and innovation in capitalism that informs us how that knowledge can be used to induce changes in employment and output.

³⁰ Consumer product innovation also factors into the demand side of increasing returns since the income elasticity of demand for these goods will largely determine whether they will be sold and thereby whether they will lead to the realization of increasing returns and higher profits.

³¹ Upon introducing consumer product innovation, there will also be an incentive to engage in capital asset product innovation to produce these new consumers' goods at lower unit costs.

³² Here we are using the term 'productive' to designate increasing output levels.

This vitally important discussion ties in well with our concern for the supply side of increasing returns- specifically how technologically related cost reductions can occur as output expands. Indeed, it is now clear how increasing returns, technology, synergies, innovation, and effective demand come together in an economic expansion.

As Keynes said, it is effective demand that determines the level of output. To be sure, without a level of effective demand sufficient to justify them, none of the supply processes depicted above will occur. However, given sufficient current and future levels of effective demand, enterprises have an incentive to undertake actions that will result in synergies, innovation, and increasing returns. Thus, on the supply side, we find that Schumpeterian activities involve the utilization of certain types of technology to create synergies and capital asset product innovations in order to lower unit costs. In turn, this process leads to the creation of increasing returns and the potential for higher profits. On the other hand, Malthusian activities are incapable of engaging in these supply side processes because they do not lend themselves well to the creation of synergies, innovations, or increasing returns.

However, the production of goods in Schumpeterian activities does not necessarily guarantee the benefits of increasing returns, such as increased profits, will be realized. In order to determine how this can occur, we need to explore the demand side of Schumpeterian activities.

Part VI.B.1.B- The Demand Aspects of Schumpeterian Activities

In Part VI.B.1 we defined Schumpeterian activities as increasing returns activities in which falling unit costs result from investments in higher technology which were induced by

an economic expansion. Moreover, in Part VI.B.1.A we examined the supply side of this definition. In doing so, we identified how falling unit costs are made possible through an ability to utilize technology to create synergies and capital asset product innovations that will lead to increasing returns. At the same time, we also saw that this does not guarantee the benefits of increasing returns, such as higher profits, will be realized. In order to determine how this can occur we need to examine the demand side of Schumpeterian activities.

The demand component of our definition of Schumpeterian activities involves investments that are induced by an economic expansion.³³ In addition, we said that this investment will set in motion a process in which increased sales receipts will result from external economies that are created by the initial investments themselves. It is this mechanism that will allow the benefits of increasing returns, such as increased profits, to be realized. Thus, in order to see how this can happen, we need to identify how external economies can be created from certain investments as well as what factor(s) determines the size of the sales receipts resulting from these external economies.

As we saw in Part IV.A.1.A.2, the employment multiplier resulting from one investment creates external economies that will raise the private marginal efficiency of capital of other, unrelated investments. Indeed, we saw that this is the relationship between the social marginal efficiency of capital and the private marginal efficiency of capital. Essentially, the argument is that upon undertaking an investment, the entrepreneur will require additional workers to operate the equipment. In turn, these workers will be

³³ Some may object to this characterization of Schumpeterian activities by arguing that Reinert, who invented the Schumpeterian-Malthusian distinction, did not define Schumpeterian activities in this way. To this, the author would counter that if one examines Reinert's work closely there is certainly a demand component involved in his discussion of Schumpeterian activities.

remunerated for their efforts- which will obviously result in a net addition to real income. Upon receiving these incomes, the additional workers will consume an array of different goods. This will cause the quasi-rents of the capital assets capable of producing these goods to increase- which will raise their private marginal efficiencies. If these private marginal efficiencies surpass the marginal efficiency of money, additional investment will be induced.

In describing this scenario, we defined the diversified increased net consumption as a type of external economy. To be sure, we labeled this particular external economy as the social marginal efficiency of capital. At the same time, this shows how external economies are created from certain investments. Moreover, this is how investments in technological upgrading (and thereby unit cost reductions) are induced by an economic expansion- the first part to the demand side of Schumpeterian activities.

Unfortunately, this does not fully inform us as to how increasing returns are realized. In order to do that, we need to analyze which factor(s) will determine the size of the additional sales receipts resulting from the diversified increased net consumption. We find that the factor with the greatest influence in this process is each item's income elasticity of demand.

It is here that we arrive at an item Nurkse placed great emphasis on. Indeed, the key to realizing increasing returns depends on that product's income elasticity of demand (Nurkse 1953, Chapters 1 and 2). If the income elasticity of demand for a particular product is high, then a noticeable portion of the diversified increased net consumption will be for that good(s). Consequently, that enterprise's sales receipts will increase. On the other hand, if that good's income elasticity of demand is low, there will be an insignificant portion of the

diversified increased net consumption directed towards its purchase. Accordingly, that enterprise's sales receipts will remain relatively constant.

Therefore, on the demand side, we conclude that Schumpeterian activities are activities that produce products with high income elasticities of demand. By contrast, Malthusian activities are activities that produce products with low income elasticities of demand. Further, it is only with the combination of investment in technological upgrading (allowing unit costs to be reduced) and higher sales receipts (caused by an elastic income elasticity of demand) that an enterprise is able to realize increasing returns and the benefits derived from it. Thus, we find that a prerequisite for a sustained development process is the ability to produce goods that have (or will have) high income elasticities of demand and whose production processes are amenable to synergy creation.

Part VI.B.1.C- A Summary of Schumpeterian and Malthusian Activities

To summarize, we find that Schumpeterian activities are characterized by an ability to utilize technology to create synergies and product innovations. Further, they are activities that produce output with high income elasticities of demand. It is important to recognize that it is the combination of these two features that allows us to define Schumpeterian activities as increasing returns activities that allow enterprises to realize higher profits.

By contrast, Malthusian activities are relatively poor at utilizing technology to create synergies and product innovations. Further, they are activities that produce output with low income elasticities of demand. Consequently, Malthusian activities are incapable of creating increasing returns.

Therefore, we conclude that certain activities inherently possess greater benefits for an economy than others. Indeed, the possession of Schumpeterian activities sustains a development process since they induce entrepreneurs to increase investment- which allows the economy to mobilize additional labor resources towards higher productivity occupations. Moreover, this demonstrates that our rejection of the Equality Assumption is valid since we have shown that certain activities are superior to others. Thus, as emphasized in Part VI.A, our argument that there is a major role for the state to play in a development process is validated. To be sure, one of the state's primary tasks it to ensure that the economy comes to possess Schumpeterian activities while shying away from the growth of Malthusian activities.

Part VI.B.2- Schumpeterian Activities, Malthusian Activities, the Sectors Likely to Possess Them, and the Growth of Wages

Above we demonstrated that Schumpeterian activities are more likely to lead to the realization of increasing returns than Malthusian activities. Indeed, we saw the reasoning behind this argument is twofold. First, the nature of the technology physically embodied within Schumpeterian activities lends itself well to the creation of synergies. As a result, these types of activities are able to utilize technology to create capital asset product innovations that can lower unit costs. This is what creates increasing returns. Second, Schumpeterian activities produce goods with high income elasticities of demand- virtually guaranteeing that such goods will be sold. This is what allows increasing returns to be realized. Thus, it is the combination of lowered unit costs and high income elasticities of demand that allows enterprises to reap the benefits of increasing returns- which simultaneously allows an economy to sustain its development process.

Moreover, we concluded that our argument advocating state involvement in a development process was justified. To be sure, we said that throughout a development process the state should concern itself with ensuring that the economy comes to possess Schumpeterian activities while discouraging the growth of Malthusian activities. In order to do this, we need to ascertain which sectors are likely to possess such activities.

This is an exercise already performed in Part IV.C. Our reasoning there, as here, led us to state that we can expect Schumpeterian activities to be found in the manufacturing and service sectors. Indeed, the reason for the high probability of these sectors possessing Schumpeterian activities is because they both simultaneously lend themselves well to synergy creation while producing goods with high income elasticities of demand (E. Reinert 2007; Prebisch 1984, 177-178; Toye and Toye 2003). Therefore, we concluded that manufacturing and services have a higher probability for allowing enterprises to realize increasing returns over time relative to agriculture.

This allows us to highlight the relationship between Schumpeterian activities and wage patterning. Because the capital asset product innovations associated with Schumpeterian activities require skilled labor to operate them, there is upward pressure placed on wages (E. Reinert 2007, 130). This mechanism can be very influential on the rest of the economy's wage patterning.

As skilled workers begin to experience higher wages in Schumpeterian activities, other enterprises can raise their output prices since there is increased disposable income. Thus, as output prices increase, workers whose productivity has not increased at all to this

point can attempt to increase their wages.³⁴ If they are successful, lesser-skilled workers will also secure higher wages (E. Reinert 2007, 130). The result of this process is that the macroeconomic process of wage patterning will have upward pressure placed on it as both income and effective demand increases. This is why, according to Reinert, it is better to have an inefficient manufacturing sector than none at all: the net effect is to raise wages across the economy (E. Reinert 2007, 163-164).

This is not to discredit the importance of agriculture in a process of economic development. Indeed, increasing the marketable surplus is a vitally important undertaking—as Nurkse demonstrated (Nurkse 2009a, 337). What we are arguing is that a development process cannot utilize agriculture as its engine. Instead, this process must be initiated via manufacturing and services so that upward pressure is placed on wages which will eventually translate into an increased marketable surplus and higher agricultural incomes (E. Reinert 2007, 136).

This revelation is incredibly important to our development strategy. If the goal of development is to raise an economy's standard of living, it is vital to possess Schumpeterian activities since they can raise wages across virtually all sectors. In addition, we know that state involvement is essential for the emergence of these activities. Thus, we need to determine what type of state would be able to foster the emergence of Schumpeterian activities. As we argued in Chapter II, the answer is the developmental state.

³⁴ Obviously the structural price stabilization feature of ELR would mitigate this tendency.

Part VI.B.3- Schumpeterian Activities and the Developmental State

We saw in Chapter II that the developmental state is a state that utilizes market intervention methods to explicitly promote strategically vital economic sectors in order to achieve an economic transformation. At the same time, we argued above that the developmental state is the key to ensuring that Schumpeterian activities get promoted. Clearly this concept places a large emphasis upon the state's ability to mobilize labor resources towards specific development objectives. Thus, to prove our argument we must make two connections. First, we must show how Schumpeterian activities and strategically vital sectors are connected. Second, we must depict how the developmental state promotes them to achieve an economic transformation.

Part VI.B.3.A- Schumpeterian Activities and Strategically Vital Sectors

The connection between Schumpeterian activities and strategically vital sectors is relatively easy to demonstrate. In Part VI.B.1 we defined Schumpeterian activities as increasing returns activities. At the same time, we saw that Schumpeterian activities are superior to Malthusian activities because they are capable of initiating/sustaining a development process. Further, they will increase wages across the economy. Thus, since these activities (and the sectors that contain them) are superior to Malthusian activities (and the sectors containing them) we can state that when formulating a development strategy, the sectors with Schumpeterian activities are strategically vital to possess since they offer benefits that other activities cannot.

Part VI.B.3.B- Schumpeterian Activities and the Developmental State as Political Capitalism

Above, we saw how Schumpeterian activities are related to strategically vital sectors- something the developmental state places great emphasis on. Thus, in order to show how the developmental state represents the key to ensuring Schumpeterian activities emerge, the second connection we must make involves how the developmental state actually promotes them and, in doing so, initiates/sustains a development process.

In Chapter II, we saw that the developmental state can be described as a Plan Rational state in which private ownership is combined with state management of the macroeconomy (Johnson 1982, Chapter 1; Woo-Cumings 1999). In addition, we mentioned that this implies the state does not make all production-related decisions. Instead, it creates methods- both direct and indirect- that allow it to cooperate with the private sector to achieve mutually desired goals.³⁵ To be sure, a Plan Rational state actively structures a composition of output it believes will assist the economy throughout a development process.

Moreover, this characterization of the developmental state as a Plan Rational state reveals that it is primarily concerned with effectiveness. Indeed, because it insists on performing an economic transformation, the aspect of its strategy that gets the most attention is whether its policies allow the economy to accomplish the intended goals. In turn, the state's legitimation depends upon whether it is able to achieve its goals (Johnson 1982, Chapter 1).

This depiction led Schneider to correctly characterize the developmental state as a form of 'political capitalism' in which "profits and investment decisions...depend...on

³⁵ It should be noted that the direct and indirect methods that empirical examples of the developmental state have employed are roughly identical to those discussed in Part IV.B.

decisions made in the state” (Schneider 1999, 278). Accordingly, this shows that the developmental state emphasizes market intervention in order to promote an economic transformation. Further, this implies that the policies designed to execute the transformation are the primary concern of the economy; that is, the direct focus is on the economy’s productive structure.

Nonetheless, this presentation of the developmental state has been mostly descriptive. Indeed, it has not explained how the developmental state promotes Schumpeterian activities. We must address this issue now. We find that the developmental state promotes Schumpeterian activities in three related ways. First, it targets the sectors likely to possess these activities. Second, it takes on four separate roles to promote the development of these sectors. Third, the state actively develops a structure of financial arrangements that allows for high rates of investment and a rapid macroeconomic transformation.

Part VI.B.3.B.1 - The developmental state and sectoral choices

Because the developmental state recognizes that certain sectors are more important to possess than others, it actively involves itself in their development. To be sure, its primary economic goal is to begin production and achieve success in the sectors it deems to be superior to others. This is why the developmental state is a form of ‘political capitalism’- state leadership is actively involved in the promotion of sectors that are more strategically vital to its success than others. As a result, it constructs an incentive system- using many of the methods outlined in Part IV.B- that is designed to facilitate this process.

It is important to recognize that in order to accomplish its economic transformation the developmental state picks sectors that it will promote. Critically, what it does not do is

pick specific enterprises. To emphasize this distinction, we need to examine why picking specific enterprises (instead of picking sectors) typically will not work. Thus, we highlight the case of France from 1945-1985 in which the state targeted specific enterprises.³⁶ As we shall see, France had the ambition to execute an economic transformation. However, it did not have the capacity to achieve it since it targeted specific enterprises. In doing so, it removed the very mechanism that serves as the driving force of a transformation.

By targeting specific enterprises, France effectively minimized the capitalist system's hallmark of competition for profits. Instead, the economic climate was reduced to one in which enterprises continually managed to accrue rents from the state. In essence, enterprises managed to coax the state into permitting them to protect themselves. As a result, there was no incentive to invest in technology upgrading or pursue R&D since the established relationship with the state guaranteed it would perpetually possess a market share. Consequently, competition within the marketplace evolved into competition within the state for protection. Save for exceptional circumstances, we would not consider an attempt at performing an economic transformation in the manner that France did as likely to prove successful.

This is very different from the 'pure' developmental state. To be sure, the developmental state utilizes an assortment of measures to facilitate the development of an entire sector. However, it simultaneously promotes competition within that sector. Thus, it

³⁶ As mentioned in Chapter II, this is why Loriaux is wrong in asserting that France was a developmental state during this period- assuming that his characterization of French economic policy is accurate (Loriaux, 1999). The developmental state targets sectors to promote. On the other hand, from 1945-1985 France targeted specific enterprises. Thus, France was not a developmental state during this time period.

ensures that some number of enterprises will emerge victorious- and, in doing so, accomplishes national goals.

This discussion informs us that the developmental state targets specific sectors it believes are essential throughout a development process. However, it still does not tell us much about how the developmental state facilitates the emergence of the sectors it has targeted. In order to depict this, we need to examine four separate roles the developmental state takes on in order to possess sectors containing Schumpeterian activities.

Part VI.B.3.B.2 - Roles the developmental state takes on to promote sectors containing Schumpeterian activities

In a landmark work, Peter Evans discusses four roles the developmental state takes on in order to facilitate the creation of sectors possessing Schumpeterian activities (Evans 1995, Chapter 1). As we shall see, the common element among them is that they are all essential functions that need to be fulfilled in order to achieve an economic transformation.

The first role a developmental state takes on to promote economic development is called ‘custodian’. In the role of custodian, the state evaluates the economy’s regulatory framework and “identifies regulatory efforts that privilege policing over promotion” (Evans 1995, 13). Thus, when acting as a custodian, the developmental state critiques the regulatory framework it currently possesses to ascertain how these rules impact the promotion of certain goals it has for the economy. If it finds the current policies are likely to hinder this process, they will be reformed and/or minimized. On the other hand, the policies will remain in place and/or be expanded upon if they facilitate a development process. The next role corresponds to what in Chapter IV we called ‘direct’ methods of implementing balanced growth while the subsequent two roles will correspond to our ‘indirect’ methods.

The second role the developmental state takes on is ‘demiurge’ - which we saw in Chapter IV approximately translates to ‘public worker’. In turn, this reveals that a demiurge is skeptical of private capital’s ability to promote development. To be sure, this role involves acknowledging the “limitations of private capital... [by asserting]...that private capital is incapable of successfully sustaining the developmentally necessary gamut of commodity production” (Evans 1995, 13). It should not come as a shock that states act as a demiurge since “all states play the role of producer and deliver certain types of goods...at the very least, states assume this role in relation to infrastructural goods assumed to have a collective or public character” (Evans 1995, 13). Thus, because of its suspicion pertaining to private capital, “the state becomes a 'demiurge' by establishing enterprises that compete in markets for normal ‘private’ goods” (Evans 1995, 13).

It can be noted that the demiurge’s skepticism regarding private capital can be linked to our position that the state is a necessary actor throughout a development process because certain economic activities are more important to possess than others. Indeed, the role of demiurge acknowledges this sentiment since it is not willing to ‘roll the dice’ and hope that private capital develops these activities. Thus, if the developmental state finds that it cannot coax the private sector into pursuing these activities, it becomes compelled to directly facilitate their emergence.

The third role the developmental state can take on is called a ‘midwife’. As with demiurge, a midwife is doubtful of private capital’s ability to achieve an economic transformation. However, there is a major difference regarding how the problem is solved. As opposed to a demiurge, a midwife “tries to assist in the emergence of new entrepreneurial

groups or to induce existing groups to venture into more challenging kinds of production” (Evans 1995, 13). In doing so, the developmental state attempts a “variety of techniques... [such as]...erecting a ‘greenhouse’ of tariffs to protect infant sectors from external competition... [or by]...providing subsidies and incentives” (Evans 1995, 14). Further, it conveys that “a particular sector... [is]...considered important” (Evans 1995, 14).

The fourth and final role the developmental state assumes is called ‘husbandry’. Throughout a development process, there inherently will be obstacles that will challenge certain sectors to adapt.³⁷ This is the scenario from which husbandry originates. In order to assist these sectors in their adaptation, the state begins “cajoling and assisting private entrepreneurial groups in [the] hopes of meeting these challenges” (Evans 1995, 14).

It should be noted that the role of midwife is likely to play a larger role at the beginning of a development process while the role of husbandry will factor more prominently throughout the process since the former involves attempts to initiate economic activity while the latter is concerned with sustaining that activity. Moreover, husbandry can “take a variety of forms... [and]...overlap with [the role] of midwifery” (Evans 1995, 14).

Part VI.B.3.B.3 - Structuring finance in the developmental state

In the preceding two sections comprising Part VI.B.3, we saw that the developmental state takes on four specific roles in order to promote the emergence of specific sectors that contain Schumpeterian activities. The final component of this discussion involves an

³⁷ One such challenge would involve the need for enterprises to cease pursuing what Lazonick calls ‘adaptive’ strategies and instead encourage them to develop an ‘innovative’ strategy (Lazonick, 1991, 95-101). To facilitate this process, the developmental state can employ subsidy schemes (to make adaptive firms competitive both internally and externally), utilize tariffs (to accomplish this only domestically), and by investing in infrastructure and education (Shafaeddin, 2012, 64).

analysis of the financial structure that will facilitate a pattern of investment that permits a rapid transformation.

Throughout this essay, we have defined the developmental state as a state that utilizes market intervention methods to explicitly promote strategically vital economic sectors in order to achieve an economic transformation. Thus, it should come as no surprise that finance is one of the primary areas the state intervenes in since the rate of investment is inherently linked to the financial structure. Because the developmental state demands a large degree of latitude in order to exercise its discretion in these matters, it should (and typically does) promote a financial structure that is predominantly bank based. By doing so, it provides itself with the ability to indirectly control the pace and terms on which credit is extended to enterprises while fostering long term relationships between enterprises and financial institutions.³⁸ Indeed, Woo-Cumings notes that with this type of financial arrangement,

the state can exert influence over the economy's investment pattern and guide sectoral mobility, because in such a structure, firms rely on bank credit for raising finance beyond retained earnings and respond quickly to the state's policy, as expressed in interest rate and other financial policies. (Woo-Cumings 1999, 11)

Hence, it is state's ability to channel the supply of credit to the activities it deems valuable that allows it to produce a rate of investment that will transform the economy relatively rapidly.

In order for this type of financial system to function properly, two prerequisites must be met. First, the economy's capital account must be at least partially closed and managed

³⁸ It should be noted that this type of financial structure can easily incorporate the indirect methods of implementing balanced growth that were discussed in Part IV.B.2.

through discretionary policy.³⁹ Indeed, by taking a discretionary approach to a partially closed capital account the developmental state is able to maintain a separation between international and domestic financial flows. In turn, this allows it to more easily control the sectoral allocation and terms on which credit is extended- making it that much easier to ensure the flow of investment into Schumpeterian activities (Wade 2003, xxvii).

Second, the creation of a bank based financial structure in which the pace and terms of credit is selectively allocated can introduce a degree of ‘bad rent seeking’ behavior. To be sure, if enterprises know that they can secure financing at below market rates, there is an inherent incentive to become highly leveraged, avoid debt and equity markets, and grow until they are too big to fail (Woo-Cumings 1999, 12). Accordingly, if actual earnings fall short of expected earnings, repayment will be unlikely and banks that had extended credit will be saddled with a large quantity of non-performing loans. In turn, this would produce a situation in which banks are reluctant to extend any further lending- which would cause the pace of investment to weaken, the economy to slow down (and likely reverse course), and necessitate state bailout packages.

There are a number of solutions to this ‘bad rent seeking’ behavior that the developmental state could adopt. First, the state could demand adherence to strict origination standards and punish banks that fail to adhere to this mandate. Doing so would have the impact of ensuring that only deserving enterprises would gain access to additional lines of credit. Second, the state could place restrictions on leverage ratios. It is true that this could weaken the pace of investment, but it has the advantage of minimizing the risk that

³⁹ One can correctly view this as similar to our analysis in Chapter IV involving external considerations surrounding balanced growth.

insolvency will become an issue during a transformation. Third, the state could mandate that if an enterprise wished to exceed the leverage ratio restrictions placed upon it the funds (or matching funds) must be raised on debt and/or equity markets. This would have the effect of allowing banking interests to avoid ‘capture’ by the borrowing enterprises- which Loriaux notes was an important contributing factor in the demise of the French developmental state (Loriaux 1999, 261). Fourth, the state could directly minimize the creation of too big to fail enterprises in two different ways. To be sure, it could take an enterprise that was too big to fail, nationalize it, break it into separate units, and decide which units it wished to sell and which it wished to retain. Likewise, it could simply allow the enterprise to fail because doing so would send a clear signal to other businesses with similar intentions that that type of behavior would not be tolerated.

Throughout Part VI.B.3, we have argued that the developmental state is the key to facilitating the emergence of Schumpeterian activities. Thus, in order to prove this we had to highlight two relationships. First, we showed how Schumpeterian activities and strategically vital sectors are related to one another. Second, we discussed how the developmental state fosters the creation of these sectors. In doing so, we demonstrated that the developmental state is crucial for cultivating Schumpeterian activities- which we know are vital to sustaining a development process. In turn, this may beg the question where, if at all, developmental states exist(ed). We will answer that query below.

Part VI.B.4 - The Developmental State: Where has it Existed? Where does it Exist?

In *How Rich Countries Got Rich and Why Poor Countries Stay Poor*, Reinert makes an invaluable contribution by showing that in the last “five hundred years this [a nation

making significant economic advancement] has not happened anywhere without heavy market intervention” (E. Reinert 2007, 119). This is an incredibly important historical fact that we must explore to determine where the developmental state exists(ed).

Throughout his book, Reinert makes the case that Ricardian trade theory is fundamentally flawed. As a result, the Ricardian policy recommendation to specialize in production utilizing an economy’s inherently abundant factors is also incorrect (E. Reinert 2007). Instead, he argues that what activities an economy specializes in fundamentally matters because certain activities can be classified as Schumpeterian. Further, as mentioned above, he demonstrates that in the last five hundred years, economies have only progressed by coming to possess these types of activities in abundance (E. Reinert 2007, 119). In other words, if an economy does not possess Schumpeterian activities, it can never economically advance. Consequently, this implies that state intervention is not sufficient to ensure economic success. Indeed, it reveals that the state must also promote strategically vital sectors throughout its interventions.

In some of the work that has been done by Erik Reinert, Ian Fletcher, Sophus Reinert, Jomo K.S., Robert Wade, Meredith Woo-Cumings, Mark Beeson, and Ha-Joon Chang, there is an ongoing theme that every significant development process is attributable to state intervention that promoted sectors possessing Schumpeterian activities (E. Reinert 2005, 2007; Fletcher 2009; S. Reinert 2005; KS Jomo and E. Reinert 2005; Wade 1990, 1998, 2005; Woo-Cumings 1999; Beeson 2009; Chang 2009). This clearly informs us as to where the developmental state exists(ed). To be sure, it tells us that developmental states existed in Japan, South Korea, and Taiwan (Johnson 1982; Wade 1990; Kohli; 1999). Further, the

economically developed city-states during the European Renaissance were all developmental states (E. Reinert 2005, 2007; S. Reinert 2005). Additionally, the past economic success of England, France, Germany, and Australia are all attributable to the fact that they were developmental states (Fletcher 2009; E. Reinert 2007). Moreover, Chang tells us that this was the case in the small, rich European economies during the early stages of capitalism- as well as more recently in the Scandinavian countries (Chang 2009, 2010). Next, Fletcher informs us that the economic success of the U.S. was only made possible by the existence of a developmental state from the time of its inception until the neo-liberal era began with the election of the Reagan administration (Fletcher 2009). Finally, China is widely said to be a developmental state- though some argue its communist foundations invalidate this argument despite the fact that it has utilized capitalist markets to achieve growth.

Part VI.B.5 - A Discourse Involving the Plan Rational State's Roles in
an Economic Transformation: Some Lessons Concerning
the Causality of Institution Creation and
Economic Development

The entire discussion in this section has important implications for the contemporary development discourse and the emphasis within it heaped upon 'getting the institutions right'. In point of fact, the developmental state concept tells us quite a lot about how an economy should attempt to acquire the 'right' institutions.

Current practice within orthodox development theory is to emphasize the need to create institutions synonymous with a capitalist mode of production. In other words, it is argued that if a less developed economy creates the institutions present in the advanced capitalist economies it will subsequently become a high income economy. As a result of this logic, many less developed economies set out on a path of 'institution creation' that they are

told will allow them to escape the presence of poverty- assuming they do it properly. We argue that this recommendation is flawed in two different ways. First, it is internally inconsistent. Second, its causality is incorrect. We will present our critique in that order.

First, frequently accompanying the recommendation to ‘get the institutions right’ is the recommendation that the size of the state should be shrunk by privatizing SOE’s and lowering taxation rates. The reasoning behind this latter recommendation is that state involvement causes prices to deviate from their ‘true’ market clearing values. Consequently, it is said that the state inhibits the ability of prices to act as signals- which is a necessity for the neoclassical model to function properly. To be sure, if prices fail to act as signals, markets will not clear properly and general equilibrium is unattainable. As a result, the state is told to take on a laissez faire approach to permit the market’s ‘natural forces’ to reach a Pareto optimal equilibrium.

This latter position, in light of the emphasis placed upon creating institutions, is rather problematic. On the one hand, the state is supposed to be actively involved in building institutions- which is an enormous undertaking that requires large amounts of time, effort, and resources. On the other hand, in direct contrast, the state is told to remain in the shadows and allow market forces to determine the appropriate equilibrium outcomes. Thus, as pointed out by Reinert, the policy recommendations provided to the state are of a 'Jekyll and Hyde' character. On the one hand, the state is to play a large role in creating institutions- yet it is simultaneously supposed to be a passive actor (E. Reinert 2007, 221-223). Naturally, it is extremely hard to reconcile how the state is supposed to be actively involved in the economy while simultaneously remaining passive in the economy. This enormous

contradiction- resulting from its own theoretical assumptions- renders orthodox development theory internally inconsistent on this ‘institution building’ point.

Second, on a deeper theoretical plane, orthodox theory is incorrect when positing that the causality runs from institution creation to economic development. We can use the developmental state to demonstrate why.

A development process is a process of change; it is the mobilization of resources and the creation of new ways of doing things. This implies that, throughout this process, production relations will be changing. Hence, the institutions associated with the previous production relations will no longer have as much relevance and/or social significance as they once did. This allows us to see that the causality actually runs from the creation of activities associated with a development process to the creation of appropriate institutions- the exact opposite of orthodox theory.

The developmental state can be used as a prime example to support this argument. First, we define an institution as a consistent pattern of human thought or experience. Thus, when discussing institutions, we are really discussing the symbolic relation physical objects take on in the minds of individuals. For example, in the case of private property, we are analyzing how individuals orient themselves daily to buy and sell things in order to change their stock of assets.

When the developmental state acts as a custodian, demiurge, midwife, or husband, it is creating an incentive structure for individuals to undertake higher levels of production. Thus, to increase production the individuals controlling the enterprise will need to acquire

additional quantities of the factors necessary to raise their output levels. Hence, the enterprise will need private property regulations clarifying what it is they own.

This simple example demonstrates that the initial act of creating an incentive structure to increase production gave birth to the need for private property- not vice versa. Thus, in this example causality ran from increased economic activity to institution creation.

Consequently, to say that simply implementing private property will lead to economic progress when there is no prior need for private property is putting the cart before the horse.

Therefore, orthodox theory is mistaken in its causality when it purports that creating ‘the right institutions’ will lead to development. Instead, the correct causality involves encouraging individuals to undertake the ‘right’ activities- at which point the ‘right’ institutions will emerge. Accordingly, this shows that institutions are only important within a certain context. In this example, private property was only important insofar as the economic system was capitalist (E. Reinert 2007, 2007a). Indeed, this leads to Chang’s point that “once we accept the ‘constitutive’ role of institutions, we begin to understand that the causality could run the other direction- from economic development to institutional changes” (Chang 2007, 27).

Part VI.C - The Developmental State and its Connection to our Post-Keynesian/Structuralist Strategy for Economic Development

To a large degree, post-Keynesian economics focuses on the determination of financial variables and how they can be adjusted to instigate/sustain a specific level of economy activity. However, what is somewhat lacking from that analysis is the insight that not all economic activities are qualitatively identical- meaning that certain activities possess a greater ability to sustain and strengthen the factors contributing to an economy’s

development process. Thus, while knowledge of how to adjust financial variables is vitally important, its *raison d'être* is to provide policy information that can be utilized to expand real output in sectors possessing Schumpeterian activities. Therefore, we find that an economy's development potential is determined by its ability to have its financial variables guarantee that it will specialize in sectors possessing Schumpeterian activities.

Here we have arrived at the essential connection between the earlier components of our post-Keynesian/Structuralist development strategy and the developmental state. To be sure, balanced growth identified how financial variables' can be altered to induce increased investment rates in strategically vital sectors. At the same time, the developmental state explains both why these sectors are vital for development as well as how this process can realistically be achieved. Moreover, both seek to create increasing returns throughout a development process by recommending the creation and/or expansion of production in the manufacturing and service sectors- which we know will subsequently sustain and strengthen the development process itself. In turn, this strengthening of the development process raises the likelihood that the economy's long term structural change will allow it to become a high income economy. Further, we saw that balanced growth will require a combination of direct and indirect methods to implement it- something the developmental state's four roles and its favored financial structure makes it perfectly capable of doing. Thus, a less developed economy should follow this logic and attempt to implement a balanced growth program consisting of increased production in both manufactures and services- with the appropriate combination depending upon the structural needs of the economy itself.

However, we also saw that this combination may not be able to minimize structural underemployment and/or transform it into a high income economy. In turn, we argued that this combination may have to be complemented by a third policy. It is here that we see the connection between the developmental state and ELR. To be sure, executing a long term structural transformation is the developmental state's top economic priority. At the same time, we saw in the Introduction and Chapter I that the type of transformation a less developed economy requires involves the mobilization of labor resources towards higher productivity occupations through the minimization of structural underemployment. Thus, if the developmental state wishes to solve this fundamental economic problem as well as possible, it must conduct a transformation that will achieve this objective. Therefore, it must adopt an ELR policy since this will allow the economy to maintain loose, full employment. In doing so, it will enable the economy to minimize structural underemployment at which point the analysis of Keynes and post-Keynesians surrounding how to further increase national income will become applicable- allowing the economy to become a high income economy (if it has not already done so).

It is only with the implementation of these two policies by the developmental state that a less developed economy will be capable of combining the short term demand targeting and long term structural change necessary to initiate/sustain a development process that will minimize structural underemployment. Thus, our post-Keynesian/Structuralist development strategy clearly solves the fundamental problem envisioned by the Scarcity in the Midst of Plenty Approach; namely, how to fully utilize labor resources.

Part VI.D - Perceived Limitations of the Developmental State Concept

Typically, when discussion of the developmental state occurs there are two primary objections raised. The first primary objection summarizes a subset of two interrelated methodology issues. First, it is doubted whether the developmental state is an abstract concept that can be generalized across time and space. This objection occurs because the term ‘developmental state’ was originally a theoretical construct created by Chalmers Johnson to describe events in Northeast Asia during the post-War era. Consequently, we need to examine whether the ‘developmental state’ can exist as an abstract concept. In turn, this concern leads to question whether the reasons for creating a developmental state must be similar to those that existed in Northeast Asia. Thus, we need to examine whether a developmental state can emerge out of a situation different from those in Northeast Asia.

The second primary methodological objection concerning the developmental state involves whether a state can be created that is unselfish and nationally oriented. Within this second objection, the subset of concerns takes three separate forms. First, it is typically doubted that a developmental state can simply come about. Further, if it is conceded that it can be created this leads to the argument that there is no guarantee it will consistently act in the national interest. In other words, it is believed that this entity will choose to undertake narrow, self-interested policies benefitting only itself instead of the economy. If true, this can potentially be a serious issue. Finally, from the combination of these two propositions it is argued that there is no mechanism in place to counteract any tendencies the economy may have towards acting in its own self-interest. In other words, if the state decides to ‘only help itself’, it is said that there may not be a mechanism that can counteract this scenario.

Consequently, it is claimed that the population will be continually deprived of welfare while the state enriches itself through the exploitation of its population.

In this section, we will examine these arguments in detail. Additionally, while these concerns are appreciated, we ultimately find that they are unwarranted. We begin by examining whether the developmental state is an abstract concept.

Part VI.D.1 - The Origin of the 'Developmental State'

In order to determine whether the 'developmental state' can exist as an abstract concept that can be generalized across space and time, we need to examine the origin of the term itself. The 'developmental state' term was first used to describe the political economic structuring of Japan, South Korea, and Taiwan from 1925-1980- though obviously the specific dates will differ depending upon which economy is being analyzed. To be sure, it was a period in which these states heavily intervened in strategically vital sectors. As a result, the 'developmental state' term was created to depict these states' attempts to promote growth during this era. Thus, rather than relying upon 'the market' to dictate what these economies would specialize in and produce, they designed an incentive scheme to achieve their economic targets.

Because state intervention was utilized to promote development, the neoclassical, orthodox development paradigm lacked an explanation for how this was achieved. As fate would have it, Chalmers Johnson subsequently coined the phrase 'developmental state' in order to capture what he perceived to be the essence of Japan's economic transformation. In doing so, he created an alternative paradigm that was grounded in applied economics: it was not a theory of how capitalism was 'supposed' to function if laissez faire was followed.

Instead, it was a theory that demonstrated how an economy can pragmatically create certain outcomes by intervening in the economy.

This brief historical discussion of the developmental state raises specific methodological points that must be explored. First, is the ‘developmental state’ only a historical description of a few states at a specific historical time or can it be an abstract concept generalized across time and space? Second, assuming it can be a generalized concept, do the reasons behind its creation have to be the same? Below, we will argue that the developmental state can serve as an abstract concept and that it is not necessary for the reasons to be identical to those in Northeast Asia.

Part VI.D.1.A - Can the Developmental State be Generalized across Time and Space?

Throughout this essay, we defined the developmental state as a state that utilizes market intervention methods to explicitly promote strategically vital economic sectors in order to achieve an economic transformation. However, if we had defined it more strictly as “a state that derives political legitimacy from its record in economic development, which it tries to achieve mainly by means of selective industrial policy” and the usage of an autonomous, embedded meritocratic bureaucracy⁴⁰ in Northeast Asia from approximately

⁴⁰ The idea of a meritocratic bureaucracy possessing embedded autonomy came about from Peter Evans’ landmark work *Embedded Autonomy: States and Industrial Transformation*, in which he argued that states that can engage in economic transformations possess a bureaucracy characterized by a “highly selective meritocratic recruitment and long term career rewards [which] create[s] commitment and a sense of corporate coherence...[that] gives these apparatuses a certain kind of ‘autonomy’” (Evans, 1995, 12). However, he argues that possessing an autonomous bureaucracy is not enough to conduct an economic transformation. He also argued that the bureaucracy must be embedded into the society it seeks to transform. In his opinion, this is how the developmental state gains the capacity to execute the transformation. On the point of embeddedness, Evans means a group of individuals who are “not...insulated from society... [but instead] embedded in a concrete set of social ties that binds the state to society and provides institutionalized channels for the continual negotiation and re-negotiation of goals and policies” (Evans, 1995, 12). On the other hand, we would argue that while this could be helpful for development, it is not a necessary condition to create a developmental state.

1925-1980’, we would conclude that the developmental state is not a generalizable concept (Chang 2010, 82). Indeed, this latter definition would define it as something that occurred during a specific time and in a specific space.

This contrast in potential definitions highlights Chang’s point that

if we see it [the developmental state] in this kind of narrow way, there is no point in discussing any developmental success (or indeed failure) cases – or for that matter any historical experience. All experiences happen at a particular time and in a particular space, whose conditions cannot be exactly replicated in other contexts. (Chang, 2010, 82)

Thus, while strict definitions of the developmental state are “logically consistent and perhaps theoretically defensible” it is an “approach [that is] overly ‘fundamentalist’” because if “we go down to the last details, all experiences – individual, regional, and national – are unique, making exact replication impossible” (Chang 2010, 82).

On the other hand, if we omit certain details of the Northeast Asian example, while retaining its fundamental theme, we can define the developmental state more loosely. Indeed, that is how we arrived at our definition of it as a state that utilizes market intervention methods to explicitly promote strategically vital economic sectors to achieve an economic transformation. In doing so, we preserved its essential insight regarding how less developed economies should realistically approach a process of development- the goal of our strategy. Therefore, we find that the developmental state can be thought of as an abstract concept.

The creator of the developmental state paradigm, Chalmers Johnson, agreed with this point. In fact, when deciding whether the developmental state could be an abstract concept he said to Walter Goldfrank- who reviewed his book and pondered the same question- that

“...yes, [it can be generalized], but only if an economy is similarly committed” to an economic transformation (Johnson 1999, 41). To be sure, he felt that the concept of the developmental state “actually exists in time and space in East Asia and also exists as an abstract generalization about the essence of the East Asian examples. It is both particular and generalizable” (Johnson cited in Woo-Cumings 1999, 10). Therefore, while the developmental state initially referred to past events in a specific place, it can simultaneously serve as a theoretical concept summarizing the theme underlying those events.

Part VI.D.1.B - Is It Necessary for a Nation State to have the Same Reasons as the Northeast Asian States to Create a Developmental State?

Above, we saw that the developmental state can exist as a generalized concept. Therefore, we revealed that the first argument of the first primary methodological objection to the developmental state is unwarranted. However, that discussion did not clarify whether the reasons underlying the creation of a developmental state need to be identical to the ones in Northeast Asia. Below we will demonstrate that the reasons need not be the same by utilizing some empirical examples from Northeast Asia itself.

First, however, we need to distinguish between the reasons for creating a developmental state and the motivation for creating it. A reason(s) is something utilized to justify specific actions undertaken to achieve a desired end- which can differ from case to case. For example, a reason given to justify increased fiscal expenditure could be that the state wanted to lower unemployment. However, this does not inform us as to why the state believed that achieving that end (lowered unemployment) was necessary. In order to ascertain that, we need to examine the state’s motivations -something more fundamental to

its political economic orientation.⁴¹ As we shall see, we find that the motivation underlying the creation of all developmental states is necessarily the same- the state wishes to survive. Thus, following our demonstration that the reasons behind creating a developmental state need not be the same, we will analyze the fundamental motivation behind the creation of all developmental states.

Part VI.D.1.B.1 - Differing reasons behind Northeast Asia's developmental states.

We can shed light onto whether the reasons for creating a developmental state need to be identical to those in Northeast Asia by examining the rationale behind each's industrialization plan. As it turns out, the evolution of each plan reveals that the reasons for creating a developmental state do not need to be the same.

In South Korea, the primary reason for creating a developmental state was to achieve a transition away from being a predatory state- a result of its Japanese colonial legacy- to a nationalist, pro-industry state. When Major General Park Chung Hee ascended to power in 1961, the major economic issues were unemployment and the balance of payments since foreign aid had been waning since the conclusion of the Korean War. Park settled upon ISI to deal with these issues in the first Five Year Plan (Adelman 1999, 2007). However, when domestic demand growth produced mixed results, Park shied away from import substituting producer inputs and shifted towards the export of labor intensive consumer goods. This transition managed to accomplish the original goals of lower unemployment and improving the balance of payments (Adelman 1999).

⁴¹ In this example, the state's motivation would clearly be that it feels it can accomplish some larger objective by lowering unemployment.

The discussion above highlights that the reason behind South Korea's nationalist development perspective grew out of its desire to simultaneously lower unemployment and achieve aid-independence. This is very different from Taiwan- another developmental state- whose reasons for creating it were derived from security concerns related to communism. Therefore, we conclude that the specific reasons behind the creation of a developmental state need not be identical.

However, this does not inform us as to what the motivation was behind the creation of either of these developmental states. For example, why did South Korea believe that lowering unemployment and correcting the balance of payments was necessary? Why did Taiwan feel that it had to rapidly industrialize to protect itself from communism? As we shall see below, there is a single motivation that can explain why all developmental states are created.

Part VI.D.1.B.2 - The motivation for creating developmental states.

The ultimate goal of every state is to reproduce itself. In other words, it needs to acquire power so as not to lose it. In the past, making war and ensuring internal order was typically sufficient to guarantee state reproduction (Evans and Rueschemeyer 1985; Evans 1995). However, due to a confluence of many factors, the state is now believed to be responsible for conducting economic transformations and ensuring basic levels of human welfare (Evans 1995, Chapter 1). Thus, now the state must achieve higher levels of economic advancement in order to reproduce itself. Accordingly, we find that the motivation to create all developmental states stems from the need to conduct an economic transformation so that the state can acquire the power necessary to reproduce itself. Hence,

while the specific reasons for its creation will differ from case to case, the motivation is the same: the state wants to survive. Further, it should be noted that this motivation will be made stronger if the economic transformation facilitates the state's other needs regarding making war and ensuring internal order (Doner et al. 2005).

Part VI.D.2 - The Proactive Creation of the Developmental State, its Potential Benevolence, and the Need for its Regulation

As mentioned in Part VI.D, the second broad methodological objection to the developmental state involves critiquing the belief that it can be proactively created. Related to this, assuming the developmental state can be created, is whether a benevolent economy state will emerge from the process. This perspective subsequently raises three specific concerns.

First, it rejects the belief that a developmental state can be proactively created. Second, it argues that there is no guarantee a developmental state will act in the interests of society- assuming it manages to be created. In other words, this perspective believes that the developmental state could take on a narrow, self-interested policy stance; that is, it could become a predatory state. Third, this perspective argues that there is no regulatory mechanism capable of countering the tendency towards becoming a predatory state. We will discuss each of these objections in that order. As with the first primary methodological objection above, we find that these concerns are unwarranted.

Part VI.D.2.A - Can the Developmental State be Proactively Created?

A typical critique of the developmental state involves whether it can be proactively created. In other words, can the developmental state be engineered or does its creation require an amalgamation of political economic circumstances that come together to form the ‘perfect storm’? We argue that while a ‘perfect storm’ can obviously lead to the developmental state’s creation, it can also be proactively engineered. To support this argument, we utilize both theoretical reasoning as well as empirical examples from the Northeast Asian experiences.

Part VI.D.2.A.1 - Theoretical support for the ability to proactively create a developmental state

Above, we stated our position that the developmental state can be proactively engineered. Initially working against this position is Onis’ argument which posits that there are certain key elements of a developmental state that are difficult to balance correctly over time. Among these elements, Onis lists two- which are “the single minded adherence to growth and competitiveness at the expense of other objectives...[and]...the equally unique and unusual degree of public-private cooperation” (Onis 1991, 120). Thus, Onis believes that it is rather “difficult to engineer an equilibrium” between state autonomy and “‘public-private cooperation’ and to sustain it over time... [because]...the knife edge equilibrium can easily be disturbed...” (Onis 1991, 122). Thus, to support our argument that the developmental state can be proactively engineered, we must demonstrate that it is possible for it to come to fruition in a political world marked by competing vested interests.

Somewhat ironically, Onis provides the key to this counterargument. For him, the central insight [of the developmental state] is that the degree of government-business cooperation and consensus on national goals...is not purely the product of a given cultural environment but has largely been engineered by the state elites themselves through the creation of a special set of institutions. (Onis 1991, 116)

In other words, the creation of the developmental state was not caused by a specific situation producing a 'perfect storm' of factors. On the contrary, the developmental state simply resulted from a willingness of leaders to alter the course of events in that economy.

Moreover, Robert Wade- an expert on South Korea's developmental state- argues that this, "...did not require sophisticated calculations and [a] highly skilled bureaucracy" (Wade 2005, 100).

This brief analysis reveals that a developmental state can be proactively created. To be sure, it can also arise from a 'perfect storm' of factors- which would be a welcome development. However, the more instructive lesson is that a developmental state can also arise simply from a desire to alter the course of events. Indeed, this is what happened in Northeast Asia!

Part VI.D.2.A.2 - Empirical support for the ability to proactively create a developmental state

The theoretical depiction above regarding how a developmental state can be proactively engineered is, more or less, exactly what transpired in South Korea. Adelman⁴² argues that the turning point in South Korea was the ascension of Major General Park Chung Hee in 1961 because it almost immediately went from a 'soft state' to an 'activist hard state'

⁴² Irma Adelman is one of the top authorities on South Korea's developmental state because she served as an advisor during the Second Five Year Plan.

(Adelman 1999). In doing so, a campaign was implemented to minimize corruption: conglomerate managers were jailed, some government employees were fired, and the remaining ones were forced to undergo retraining. Subsequently, the conglomerate managers were released contingent on the promise that they put national interests ahead of profit. Moreover, specific government employees were frequently rotated to prevent what is now called ‘crony capitalism’ (Adelman 2007).

This reveals that South Korea’s developmental state was not the product of a ‘perfect storm’ of factors. Instead, the essential mechanism for its creation was Park’s ascension and his willingness to alter the course of events by affording the governing bodies a higher degree of political independence.

This combination of theoretical reasoning and empirical evidence demonstrates that a developmental state can be proactively created. In other words, it is not necessary for a ‘perfect storm’ of factors to come together to bring a developmental state to fruition. Indeed, it can also be created by individuals in positions of power who are willing to alter the course of history. Additionally, we will demonstrate below that this sentiment will typically be present in modern states because of specific functions that it must fulfill in order to reproduce itself.

Part VI.D.2.B - Governing the Developmental State, the Interests of Society, and Predatory States

Given that a developmental state can be proactively created, when advocating for its emergence there is typically a concern that it will fail to consistently act in the national interest. To be sure, dissenters object that there is no guarantee it will employ policies designed to benefit the economy. Instead, it is argued that the state will pursue a narrow,

self-interested agenda benefitting only itself. In other words, it will become a predatory state.

This critique of the developmental state is potentially very serious. If it is true, it implies two things. First, it means that our strategy suffers from a serious shortcoming. More importantly, it implies that the state can always decide to exploit its population for its own benefit. In order to address this topic, we need to be extremely clear about what is being argued.

At the heart of this critique is the argument that ‘sometimes the state can decide to act in its own interests and disregard the impact it has upon the individuals it intends to govern’. Now, it is admitted that this issue can potentially be raised as a valid critique of the developmental state. However, we need to examine whether this charge solely has merit with regard to the developmental state concept. In other words, does this critique only apply to the developmental state?

To dismiss the developmental state on the grounds that it can become predatory is not a critique of the developmental state per se. To be sure, it is not even a critique of ‘the state’ in general- but more on that in a moment.⁴³ In other words, in terms of analyzing ‘the state’, this objection is equally applicable to any type of state in any type of political economic system. To levy this claim on only the developmental state paradigm is misleading- the critique is just as applicable to Plan Irrational and Market Rational systems.

Therefore, we conclude that this concern does not reveal a shortcoming of the developmental state concept. Instead, it is a revelation involving mankind’s inability to

⁴³ As we will see below, it is not even a critique of the state as much as it is a critique of mankind’s inability to effectively govern himself.

successfully govern himself from the time s/he began walking upright. This failure only becomes readily apparent in the developmental state concept because it affords the state with a relatively high degree of latitude in its activities. The belief that predatory governance is more likely to occur in a Plan Rational system is simply unfounded. Indeed, one only needs to look at the role that 'predatory governance' played in the demise of the U.S.S.R and the ongoing role it is playing in the demise of the U.S. to see that it can occur in any type of political economic system.

What is more is that a similar critique could be levied against the private sector in a capitalist economy. As Veblen noted more than a hundred years ago, in a system driven by profit motives there is no assurance that the owners/managers of an enterprise will act in the national interest. Instead, they can simply choose to enrich themselves at the expense of the population. This is Veblen's infamous 'sabotage' concept (Veblen 2006).

Our counterarguments to the critique that some individuals may attempt to pursue self-interested gain at the expense of others reveals that this is not a critique of the developmental state- or even 'the state' for that matter. Instead, it reflects a failure of mankind to successfully govern himself. To argue that this will only arise from the developmental state demonstrates a lack of intellectual rigor.

Therefore, we conclude that while this critique of the developmental state does hold water we cannot simply characterize this concept as without relevance for economic development. On the contrary, what it reveals is that there is a need to discover ways of guaranteeing state and societal accountability- a topic far larger than the developmental state

paradigm. Unfortunately, this is a dilemma that political philosophers have pondered for at least the last four thousand years. The author is not claiming to have solved this riddle.

Instead, what should be recognized is that a development strategy's political aspects will be impacted by a host of factors- some known and some unknown. Moreover, these systems are marked by an eternal struggle for power. Accordingly, it is impossible to determine a priori whether the empowerment of the state will result in the creation of a developmental state or a predatory state. However, what we have argued is that less developed economies should attempt to construct developmental states because it is the only path that has ever delivered economic advancement (E. Reinert 2007, 119).⁴⁴

Finally, it could be argued that creating a developmental state makes it less likely that issues related to poor governance will arise. This is because the developmental state's legitimation is derived from its ability to accomplish development objectives. Therefore, the developmental state risks losing its legitimacy if it attempts to engage in predatory activities. In turn, this would make it more difficult to accomplish its ultimate objective of state reproduction.

In conclusion, we find that critiquing the developmental state paradigm on the grounds that it will lead to the rise of a predatory state is intellectually confused. While it is true that a developmental state could subsequently become a predatory state, this is not a

⁴⁴ It should be noted that throughout this essay, the author has- like every other paradigm that has existed- made certain implicit assumptions. In this instance, we are employing certain implicit assumptions about the nature of the state, its motivations, its components, and its constituents- and this is acknowledged. In addition, we recognize that these implicit assumptions may not always hold true- though we would argue that they are not that far-fetched. Furthermore, simply acknowledging these assumptions allows one to be cognizant of how reality may differ from theoretical prediction. Therefore, we would argue that this strategy is methodologically superior to the orthodox economic theory of the state- which also employs many implicit assumptions. However, in this latter tradition the implicit assumptions are never discussed because they are believed to be universal truths- no matter how unrealistic some of them may be.

charge against the developmental state per se. Instead, it could be levied as a charge against the concept of ‘the state’ in general- regardless of whether the political economic system is Plan Rational, Market Rational, or Plan Irrational. Moreover, arguing that some individuals will attempt to enrich themselves by exploiting others- the core of this objection- is equally applicable to both the public and private sectors. Further, we saw that a developmental state is less likely to engage in predatory behavior since doing so risks losing its legitimation- and its survival. Indeed, we will see below that there is an important function a modern economy state must fulfill in order to guarantee its reproduction. Moreover, this function is incompatible with predatory behavior- meaning that if a state wants to survive, it will not be capable of whole-heartedly exploiting its population.

Part VI.D.2.C - A Phenomenon Contributing to State Accountability and the ‘Governing of the Governors’

As mentioned throughout Part VI.D, the ultimate objective of the state is to reproduce itself. As a result, there are certain functions a state must perform in order to acquire the power that will allow it to reproduce itself. Previously, the state typically acquired power by making war and ensuring internal order (Evans and Rueschemeyer 1985; Evans 1995). However, more recently, the state is required to perform two additional functions to guarantee its survival. First, it is increasingly responsible for instituting and presiding over economic transformations (Evans 1995, Chapter 1). Second, it is required to provide the population with a minimum standard of living (Evans 1995, Chapter 1).

The net effect of these two additional functions is that the state must now concern itself with how the economy is operating. In other words, this process involves the state “becoming implicated in the process of capital accumulation” (Evans 1995, 6). Therefore,

the state's ability to reproduce itself has also become contingent upon presiding over a successful economic transformation. Hence, the state must increasingly act in the national interest since failure to do so would jeopardize its ability to maintain power over time. To be sure, failing to undertake a necessary transformation would place the very survival of the state in limbo.

These propositions allow us to draw some interesting conclusions. First, it demonstrates that there is an inherent incentive facing each economy to transform itself into a developmental state. Second, this appears to be a mechanism that will ensure the state acts benevolently towards society. Indeed, at a minimum, it promotes actions that are national in scope- instead of narrow and predatory. In other words, this is a way to 'govern the governors'. The converse of this statement is that there is increasingly an incentive not to become a predatory state. Therefore, we would speculate that the duration of time a predatory state can effectively remain in power is likely to decline- although its ability to make war and ensure internal order factors heavily into the longevity of its existence.

Part VI.E - Summary

This chapter has covered quite a lot of topics. First, we demonstrated that the state is a necessary actor throughout a development process because certain activities are qualitatively superior to others. Further, we saw the state is necessary in this process because there is no other entity/mechanism capable of ensuring the economy comes to possess these superior activities. In turn, we saw the reason orthodox development theory fails to recognize this is because it upholds the Equality Assumption- meaning it views all economic activities as qualitatively equal.

Second, we explored our assertion regarding whether certain economic activities are qualitatively superior to others is justified. In doing so, we analyzed the supply and demand aspects of both Schumpeterian and Malthusian activities- and found there is in fact a qualitative difference between the two. To be sure, we concluded that Schumpeterian activities will initiate/sustain a development process while Malthusian activities will not. Thus, we argued that the state's role throughout a development process should be to promote the emergence of Schumpeterian activities while discouraging the growth of Malthusian activities. Moreover, we saw that Schumpeterian activities are likely to be found in the manufacturing and service sectors- in addition to being a source of wage growth for the whole economy.

Third, we saw that the developmental state promotes the emergence of Schumpeterian activities by targeting the development of specific sectors- and not enterprises- that possess them. However, at the same time it encourages competition within that sector. Further, in order to promote these sectors it takes on four roles- custodian, demiurge, midwife, and husband. In turn, we saw that some of these roles correspond to what we called direct and indirect methods of implementing balanced growth in Chapter IV.

Fourth, we analyzed the connection between the earlier two elements of our strategy and the developmental state. Indeed, we saw that this is where post-Keynesian economics intersects Structuralist economics since the former mostly tells us what factors determine financial variables while the latter primarily tells us which activities the financial variables should be engineered to promote. Moreover, we highlighted the complementarities between each economic element of our strategy and the developmental state.

In terms of balanced growth, we saw that it identifies how increased investment can be induced in strategically vital sectors by adjusting financial variables. Correspondingly, we saw the developmental state explains both why these sectors matter as well as how their promotion can realistically be accomplished. Further, we saw that balanced growth and the developmental state both seek to create increasing returns throughout a development process by promoting the creation/expansion of manufactures and services- which sustains and strengthens the process of long term structural change.

However, we also saw that this combination cannot guarantee a less developed economy will minimize structural underemployment and/or become a high income economy. To be sure, we said balanced growth would need to be complemented by ELR. Hence, we saw that this is the connection between ELR and the developmental state. Indeed, since a less developed economy's transformation necessarily involves mobilizing labor resources towards higher productivity occupations, it follows that the minimization of structural underemployment represents the pinnacle of this transformation. In turn, if the developmental state- whose top priority is achieving a successful transformation- wishes to solve its fundamental economic problem as well as possible, it is necessary to conduct a transformation that will minimize structural underemployment. Therefore, in addition to balanced growth, the developmental state must implement an ELR policy since it will create and maintain loose, full employment. Thus, we saw that this is the connection between the Scarcity in the Midst of Plenty Approach and our post-Keynesian/Structuralist strategy for development: the latter will allow a less developed economy to initiate and sustain a development process that will ultimately minimize structural underemployment. To be sure,

it is at that point that the analysis of Keynes and post-Keynesians regarding how to further increase national income will become applicable- allowing the economy to become a high income economy (if it has not already done so).

Finally, we discussed five perceived limitations of the developmental state concept. In doing so, we analyzed whether it is even an abstract concept, whether the reasons and/or motivations to create it have to be identical from case to case, if it can be proactively created, whether it will evolve into a predatory state, and what mechanisms- if any- exist to guarantee state accountability. We found that the five objections regarding the way our strategy employs the developmental state concept are unwarranted.

CONCLUSION

THE PRIMARY BENEFITS RESULTING FROM OUR POST- KEYNESIAN/STRUCTURALIST STRATEGY FOR DEVELOPMENT

In the Introduction, we argued that balanced growth, Employer of Last Resort, and the developmental state can be synthesized to serve as an economic strategy that will achieve short term demand targeting concurrent with long term structural change in less developed economies. At the same time, we argued that this strategy will allow a less developed economy to initiate/sustain a development process. Further, we argued that this strategy will allow a less developed economy to minimize structural underemployment.

We will conclude this dissertation by discussing the two primary benefits that our strategy will provide less developed economies with. First, we will review our results from Part II.D where we demonstrated that our strategy is capable of simultaneously presiding over short term demand targeting and long term structural change. Thus, we concluded that our strategy is able to initiate/sustain a development process. Second, we will review the finding that our strategy is capable of minimizing structural underemployment.

Part VII.A - Short Term Demand Targeting, Long Term Structural Change, and the Components of Our Strategy

We have seen that the Scarcity in the Midst of Plenty Approach believes the fundamental problem facing less developed economies is a lack of inducements to undertake/sustain the investment necessary to mobilize labor resources towards higher productivity occupations. In other words, less developed economies are demand constrained. Moreover, we saw that in low and lower middle income economies the reason for the lack of these inducements is the presence of the low income/high structural underemployment trap

while in upper middle income economies the quantity of inducements that exists may not be sufficient to sustain a development process. Thus, we concluded that to solve these issues, a less developed economy needs to implement a strategy capable of combining short term demand targeting with long term structural change. In this section, we will examine whether our strategy is capable of accomplishing this. Since this issue was already dealt with in Part II.D, we will simply summarize our findings from there.

In Part II.D, we decided that in order to determine whether our strategy was capable of simultaneously achieving short term demand targeting and long term structural change, the individual elements of the strategy needed to be examined.

With regard to balanced growth, we saw that its emphasis on simultaneously inducing a multitude of investments will ultimately raise consumption levels. The combination of increased investment and consumption will obviously have the effect of increasing effective demand. Therefore, whatever sectors are selected to participate in this program will clearly be those selected for short term demand targeting. At the same time, because balanced growth's investment expenditure will be responsible for more fully utilizing the economy's labor resources, it will also be responsible for conducting long term structural change.

Next, we examined ELR and saw that by providing the economy with a JG and structural price stability, it will increase consumption and investment. Therefore, it is a policy capable of short term demand targeting. Regarding ELR's contribution to long term structural change, we saw that the JG and price stability will be joined by a third benefit- an increased degree of structural flexibility. To be sure, these three features of an ELR will all facilitate the economy's effort to utilize its labor resources more efficiently. Thus, we concluded that ELR was also capable of achieving long term structural change.

Finally, we saw that the developmental state utilizes market intervention methods to explicitly promote strategically vital economic sectors in order to achieve an economic transformation. Because of the emphasis placed upon conducting an economic transformation, the very nature of the concept is concerned with long term structural change. Further, it clearly involves short term demand targeting since it emphasizes the explicit promotion and targeting of strategically vital sectors.

This analysis caused us to conclude that the individual components of our strategy were capable of combining short term demand targeting with long term structural change. To be sure, at this point we argued that the only thing left to be seen was whether all three concepts could be synthesized. If they could, then our thesis would be valid. As a result, we examined the transmission mechanisms of the individual components and found that none of them conflict. Therefore, we were justified in arguing that balanced growth, Employer of Last Resort, and the developmental state could be synthesized to serve as an economic strategy that will achieve short term demand targeting concurrent with long term structural change in less developed economies. Hence, our strategy is capable of initiating/sustaining a process of economic development.

Part VII.B - Our Post-Keynesian/Structuralist Development Strategy and the Minimization of Structural Underemployment

In Chapter I, we stated that the objective of a development strategy should be the minimization of structural underemployment. At the same time, we noted that there are plenty of ways to combine short term demand targeting with long term structural change that will not do this. Thus, despite the fact that our particular strategy is capable of successfully initiating/sustaining a development process- by virtue of its ability to uniquely combine short

term demand targeting with longer term structural change- we still need to examine whether it is capable of minimizing structural underemployment.

We find that ELR is the component of our strategy that will allow an economy to do this. To be sure, we noted in Chapter V that the JG aspect of an ELR policy will result in the achievement of loose, full employment. Thus, if the objective of economic development is the minimization of structural underemployment, ELR will allow an economy to achieve this outcome. Accordingly, while we find that our overall strategy allows a less developed economy to initiate/sustain a development process by combining short term demand targeting with long term structural change, it is ELR that guarantees it will minimize structural underemployment.

Part VII.C - A Summary of Our Findings

Though brief, this chapter has demonstrated that our strategy will provide a less developed economy with two primary benefits. First, our strategy guarantees that a less developed economy will be able to initiate/sustain a development process by virtue of the fact that it can uniquely combine short term demand targeting with long term structural change. Second, we demonstrated that our strategy will enable a less developed economy to minimize structural underemployment.

It is recognized that this argument potentially contains flaws of its own. However, if this strategy can serve as the starting point for a robust, intellectually honest discussion of economic development, it will hopefully mark the beginning of the end for poverty as we know it today.

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