A note on Erik Reinert's Listian-Schumpeterian development economics

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1. Introduction

The title of Erik Reinert's (2007) recent book—*How Rich Countries Got Rich ... and Why Poor Countries Stay Poor*—nicely summarises the twin problems of what has been called development economics. His answers to the problems are largely found in what may be called a Listian–Schumpeterian approach to development economics. In a simplified version of this approach, "development" (or "evolution") has always involved the attempts of fiscal states to improve the position of their national economies in the world economy. The tool for this improvement is the "increasing returns sector", i.e., the dynamical part of the economy consisting of a changing part of manufacturing as well as an increasing part of services. If a national economy contains such a sector, it can integrate in the world economy based on the principles of comparative advantage. However, if the sector is weak or does not exist in an economy, the very same principles lead to a vicious cycle of underdevelopment and poverty.

Reinert does not try to glorify the actions of the fiscal states. The policies of successful were often, at least in the past, intended to increase the tax base for hegemonic policies that included expansion by war. However, the national policies were even more often characterised by a short-termism that created serious financial troubles and very little development. Earlier states with such states were likely to be conquered by more developed countries, but presently economic trouble leads to the intervention of the World Bank and the World Trade Organisation. According to Reinert, these Washington institutions do not promote long-term development. Instead, the "Washington Consensus" has led to a destruction of the weak results of developmental efforts. Reinert (2007, 295) characterised this "a crime against of a considerable percentage of humanity" that consists in "the perhaps irreversible deindustrialization—the killing of the increasing returns sector—of the periphery". The formula for killing weak and immature industries that are still based on protection and subsidies is simple: quick liberalisation. However, the enormous waste of skills and organisational structures can only be understood on the basis of a historically oriented

theory that emphasises industrial activity as the key factor needed in the process of development.

Reinert suggests that the short-termism and lack of historical sense that characterises the "Washington Consensus" has been part and parcel of major parts of the economics discipline ever since the French physiocrats and Adam Smith. The lacking recognition of the developmental importance of the "increasing returns sector" is especially clear in the Ricardo's theory of international specialisation and in Samuelson's (1948; 1949) theory of factor price equalisation through international trade. The way these theories have been used for policy advice is an example of what Schumpeter called "the Ricardian Vice". This "Vice" is not the application of *simple* models but the application of *inadequate* models. Shortly before he died, Schumpeter (1954) argued that the practice of using inadequate models by his students at Harvard University reflected that they "lack the historical *sense*". Since they lacked the faculty (sense) of perceiving history, their models also lacked historical meaning (sense).

In contrast, the leading contributors to the development economics of the 1940s and 1950s had the historical sense. Reinert's book is designed to resurrect this sense by means of polemics against anti-historic approaches and by positive contributions. The latter includes an attempt to reconstruct "the Other Canon" that has related to the developmental strategies of fiscal states since the early start in Renaissance Italy. To reconstruct this "canon", Reinert moves back in the history of thought from early development economics via Schumpeter and List to the Enlightenment and the Renaissance. At the same time, he collects a series of case stories of "Schumpeterian Mercantilism" that can be used to promote the historical sense of theorists and policy makers. However, he does not systematically explore the huge task of developing the often very loose contributions of "the Other Canon" to a cumulatively developing toolbox of scientific analysis. The reason is probably that his aim is to promote the vision that can guide subsequent research. However, it might be relevant for researchers in the field to ponder on Schumpeter's account for the scientific process that is depicted in Figure 1 (adapted from Andersen, 2007).

2. The rise and fall of the historical sense

Schumpeter's (1989b, 328) apparently naive remedy for most economists's lack of historical sense was the production of "a large collection of industrial and locational monographs" that emphasised innovation and entrepreneurship. If economists sensed the stylised facts revealed by such "detailed historical case studies" (p. 325), they would ultimately produce models that were radically different from those that they actually developed. Here Schumpeter thought of models of business cycles and growth, but his views also applies to the development economics that emerged immediately after World War II.

It was history-related theories that quickly became the trade mark of much of development economics. Actually, all the producers of what Paul Krugman (1994) has called the "high development theory" of the 1940s and 1950s had the historical sense. The reason is not least that many of them—like Hans Singer, Albert O. Hirschman, Paul Rosenstein-Rodan, Gunnar Myrdal, François

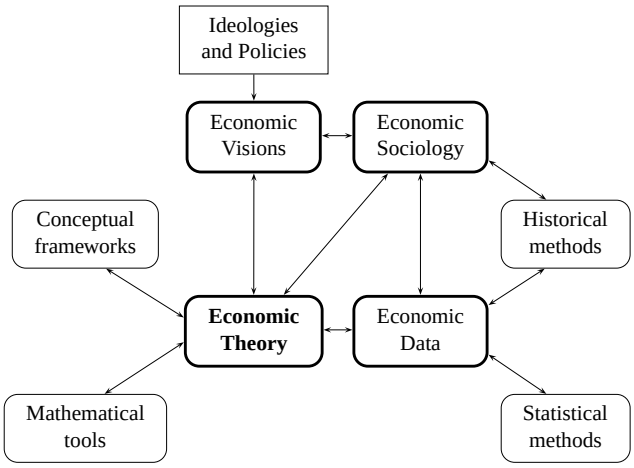

Figure 1: The scientific process according to Schumpeter (1954, Part I; 1989c). The process includes the competitive scientific endeavours within a community of researchers. The competition means that individual contributions based on fixed ideologies and policies provide analytical tools that are potentially useful for members of the community with different opinions.

Perroux, Paul Streeten, and Alexander Gerschenkron—were brought up with the long-term economic problems of Continental Europe and often combined a background in Neoclassical Economics with one in the German Historical School.

Let us take Singer as example. He had studied at the University of Bonn with both Schumpeter and the leading historical economist Spiethoff before studying with Keynes in Cambridge and gained experience as a development consultant. This mixed background helped Singer (1950) to produce the theory of the declining terms of trade and factor prices of underdeveloped countries specialising in standard commodities. The historical consequence is an unequal distribution of the gains of trade and the—very difficult—solution is to change the specialisation of poor countries. However, his mixed background as well as his emphasis on the complexity of the problems of underdevelopment mean that he cannot be categorised as member of Neoclassical Economics or the Historical School or Keynesian Economics or some type of Schumpeterian Economics. Thus his work shows surprisingly little direct influence of Schumpeter and Keynes (Toye, 2006). Furthermore, Singer emphasised the need of transcending even his own views—as did Hirschman (Rodwin and Schön, 1994) and Myrdal (Steeeten, 1998).

The praiseworthy pluralism—some would say eclecticism—of the founding fathers did not promote development economics as a discipline. Their pupils needed simplification and lacked the historical sense. This meant that the field of development economics tended to disintegrate because of a lack of a common core; and this disintegration was promoted by the lack of success stories from the prime regions of interest (Latin America and Sub-Saharan Africa) and by the shrinkage of the funding of development research.

Hirschman (1981) wrote an essay on "The Rise and Fall of Development Economics" with a complex argument. In contrast, Krugman (1994) gave a simple explanation and suggested the opposite movement: "The Fall and Rise of Development Economics". His explanation of the fall is the lack of disciplined modelling and a new rise presupposes clear foundations of development economics by means of formalised reconstructions of some of the results of the founding fathers. Then it will become clear to which extent the more complex explanations are needed and to which extent the simpler accounts by textbook economics are sufficient.

Reinert has an additional explanation for the decline of development economics and the conditions for its revival. According to him, the problem is that the intellectual climate of the Cold War implied that "reality-based economics—the historical schools of Europe and the institutional school in the United States—were crowded out and virtually disappeared" (Reinert, 2007, 34); and it was replaced by "the canonical sequence of Smith, Ricardo, Marx, etc. [that] still constitutes the skeleton for most teaching and scholarly discussion" (p. 300). The solution is to bring "the Other Canon" of "Reality Economics" back to economics (p. 33). Thereby Reinert seems to support Hodgson's (2001) attempt of to bring "history" back to economics, but it should be emphasised that the predominant static institutionalism is part of the problem while it is only dynamic and evolutionary institutionalism that might provide a solution to the crisis of development economics. Furthermore, Krugman's remedy should not be forgotten.

3. Schumpeter or List: the choice of a label

The difficulties of development economics are to some extent similar to the difficulties of innovation systems studies. The literature on national systems of innovation (Lundvall, 2007) tends to be too systemic, too structuralist, and too institutionalist. Although this tendency might have been necessary to get such studies started, there is a serious need of adding a more historical approach emphasising the creation and recreation of national systems of innovation.

Schumpeterian: One strategy for reaching this historical activism is to perform the difficult intellectual task of combining theories of entrepreneur-driven development with the more or less systemic theories (Radosevic, 2007). This strategy might be called Schumpeterian, a label that covers much more than Joseph Schumpeter (1934).

Listian: An apparently different strategy is to study the creation and recreation of innovation systems as reflecting state actions for national development. This strategy is followed by Reinert (2007) and Chang (2007b; 2007a). Although such authors might be characterised as techno-mercantilists or techno-protectionists, these policy-oriented labels bring more heat than light since the approach is not tightly bound to any particular policy. It is more fruitful to characterise the approach as Listian, although Reinert's notion of the "Other Canon" emphasised that the label is not constrained to Friedrich List (1885).

Listian–Schumpeterian: However, the Listian label is not really sufficient to cover the efforts of Reinert and Chang since the inspiration from the tradition to which List belongs has also led to studies characterised by static institutionalism. Therefore, their approach that tries to capture the history of, and present possibilities for, the creation of dynamic industrial capabilities by relatively weak states might better be characterised as Listian–Schumpeterian Development Economics.

Schumpeterian as covering Listian: When considering the scale and scope of both Schumpeter's work and the subsequent neo-Schumpeterian, or post-Schumpeterian, literature, it might even be possible to simply talk about their contributions as promoting a jump forward of Schumpeterian Development Economics.

4. Bringing Schumpeter to development economics

At the meeting of the American Economic Association that took place a few days before Schumpeter's death early in 1950, he discussed development economics with Hans Singer (1989). Schumpeter had earlier told his former student that the problems of underdevelopment were purely political and not the topic of economic theory. However, now that he saw Singer's (1950) preliminary results, he wished him luck with the endeavour. Nevertheless, the early Singer did not think it possible to apply Schumpeter's (1934) *Theory of Economic Development*. Instead, Singer (1953, 19–20) used this book to define development economics both negatively and positively (relating to the 1952 version of Wallich, 1958):

1. Singer emphasises that while the agents of economic development in Schumpeter's theory are innovating and pioneering private entrepreneurs, government is the most likely agency of economic development in many underdeveloped countries.

2. While Schumpeter assumes changes in production functions due to new products or processes, Singer emphasises that economic development through the introduction and adaptation of products and methods.

3. The generating force of Schumpeter's economic development is found in the supply side of the market while Singer's generating force in the desire for increased consumption.

Singer's ways of formulating the difference between Schumpeterian theory and the problems of development economics were unfortunate because they ignored the necessary mix between private and governmental entrepreneurship, the innovation characteristics of the much of the introduction of technologies from abroad, and the need of a relative independence of the supply side in order to serve the ultimate goal of increased consumption. The linkage theory of Hirschman (1958) was also made ineffective by translating it from its original Schumpeter-like perspective of facilitating interdependent entrepreneurship to a matter of maximising linkages in the sense of input–output tables of

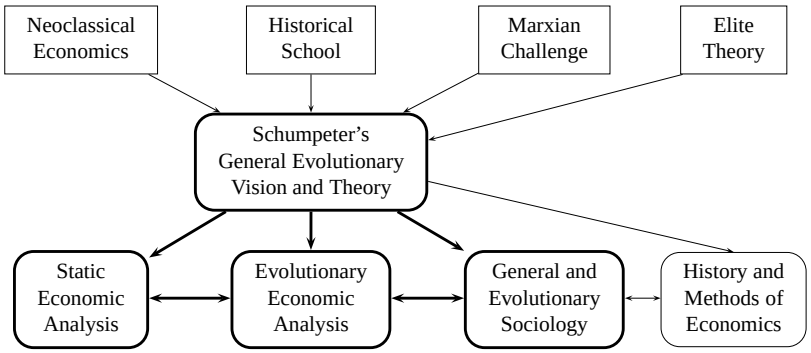

Figure 2: Schumpeter's evolutionary pivot as well as the main sources and components of his analytical work.

developed countries. Such shifts away from a Schumpeterian world created an enormous confusion in the development economics community (1975).

On this background, one of the recipes for a resurrection of development economics seems to be an increased—and carefully thought out—dose of Schumpeterian perspectives. This also seems to have been the conclusion of later Singer, who about Schumpeter's book stated stated that "I realise now more clearly than in earlier years how deeply relevant many of its [TED's] themes are to the development of poor countries and the problems of underdeveloped countries." He especially pointed at three themes that had originally been de-emphasised but that "now seem to me the key to the problems of development in poor countries" (Singer, 1997, 131):

1. Schumpeter brought out "the great importance of technology, innovation, access to innovation and ability and the means of linking innovation with the production process in the form of new products or new processes or the development of new markets."

2. In Schumpeter, the "emphasis placed on the fact that development represents a disruption of familiar and traditional processes of stationary circulation, arousing resistances and hurting established interests."

3. Schumpeter tried to depict the self-transformation of the economic system by entrepreneurial initiative and Singer relates this to notions of "self-reliance, self-sustaining growth, dependency, backwash effects and all that!"

The great thing about Reinert's (2007) contribution is that it serves to bring attention to these three Schumpeterian themes of development economics while at the same time keeping his emphasis on the state and its promotion of a wealth-creating sector characterised by increasing returns. The similarity between the approaches of Reinert and Schumpeter is obvious from Figure 2 (adapted from Andersen, 2007).

Although Reinert emphasises the inspiration from the Historical School and other types of history-friendly social science, he acknowledges the Marxian

Challenge. Furthermore, he puts much emphasis on what is presently called Elite Theory to promote an activist and creative image of human behaviour while at the same time including the role of routine behaviour and vested interests.

However, Reinert seems to have replaced Neoclassical Economics by Industrial Policy. As we shall see in the next section, policy issues have a place in the Schumpeterian account for the scientific process. With respect to Neoclassical Economics, the difference is largely a matter of style. Actually, Schumpeter (1942, Part II) used the same style in *Capitalism, Socialism and Democracy*. However, I guess that he in more scholarly works would, for instance, have praised the factor price equalisation theorem of his student and friend Paul Samuelson—and then use it as limiting case that beautifully serves as the starting point for summarising main mechanisms the often radically different realities.

Schumpeter's design of his theory of capitalist economic evolution might to some extent be seen as following Krugman's (1994) recipe for overcoming "the fall of development economics". He tried to overcome the weaknesses of the Historical School by developing a relatively simple model by means of the formal tools available for him. These were not least the tools provided by Léon Walras and the rest of Neoclassical Economics (Figure 2). However, he reinterpreted these tools in the light of the stylised vision of economic history wanted to implement, a vision that to some extent was based on the facts collected by the Historical School. For instance, he did not apply Reinert's strategy of rejecting equilibrium analysis. Instead, he reinterpreted general economic equilibrium as reflecting a lock-in to a certain stage of growth and development. It is in this setting that the Schumpeterian entrepreneur enters the model.

The interests of ordinary economic agents are in many ways locked to the existing circular flow of economic life while the profit expectations of the entrepreneur is connected to the troublesome period of transformation of the circular flow. When the basic resistance has been overcome by the pioneering entrepreneur, the bandwagon of imitators and bankers turn to expectation-based behaviour, and finally ordinary economic agents are forced to follow the lead. This process leads to a picture of economic evolution, or economic development, as taking the form of innovative revolutions punctuated by quasi-equilibrium episodes.

This story presupposes a heterogeneity of economic agents that has been abstracted away by both Classical Economics and Neoclassical Economics. Therefore, it was crucial for Schumpeter to apply to his evolutionary economics the elusive Elite Theory that ranges from Nietzsche to Sombart and Pareto. Here he found a dichotomy between routine behaviour and creative behaviour as well as ideas of human motivation that explained extraordinary effort of an apparently risk-seeking type.

Schumpeter also used Elite Theory as a way of breeding life into Marxian vision of the self-transformation of economic and social life—a vision whose implementation had largely been strangled by Marx's dependence on the tools of Ricardian Economics. Although it can be argued that the Schumpeterian vision was similarly strangled by its dependence of the tools of Walrasian Economics, his dependence on Elite Theory helps us to recognise clearly his attempts to

change the available analytical tools.

5. Reinert and Schumpeter on the history of economics

After the English manufacturing industry had emerged as the world leader, the English state could largely drop the protectionism that had promoted this position and enjoy the benefits of free trade as well as the theories that supported it. In contrast, laggards like Germany and the USA developed the industrial policies of the mercantilist tradition; and some of their economists, like List (1885), refined the related theories like the "infant industry argument" for "educational" protectionism in relation to manufacturing industry and made polemics against British Classical Economics.

However, Reinert demonstrates convincingly that that this type of thinking had deep roots and that it existed long enough to influence the emergence of development economics in the 1940s and 1950s. An early peak performance was provided by the Italian economist Antonio Serra, that in some respects is clearer than later contributions by, e.g., List and Myrdal. Actually, Serra presented in the early seventeenth century a pioneering account for systemic economic underdevelopment and development based on the dismal economic performance of his native Naples and the success story of Venice (Reinert, 1999, 291–294).

There are many more contributions to "the Other Canon", and Reinert (2007, 10) has bought most of them for his extensive research library as they have become available—partly by the selling-out from the unique Baker Library of Harvard University that he explored while studying at Harvard Business School. Thereby, he may be said to have made the same type of study that Schumpeter had performed in the Baker Library when producing his monumental *History of Economic Analysis*. There is, however, a major difference between Schumpeter's and Reinert's study of the history of economics.

Reinert (2007, 4) is trained in the case study method that is intensively applied at Harvard Business School (and explicitly introduced as a way of exploiting the methodology of the German Historical School). He seems interested in providing a collection of case studies of mercantilist policy and the related theorising ranging from Italian Renaissance to the Bismarckian policies of the late nineteenth century.

In contrast, Schumpeter's *History* focussed on the analytical progress of theoretical economics and only used policy debates to provide information on the background for theoretical work. Although he is one of the few leading economists who took mercantilism seriously and considered it a major contributor to the emergence of the science of economics (together with a broadly conceived scholasticism), he did not make a dichotomy similar to Reinert's "standard economics" and "reality economics".

Instead Schumpeter distinguished between (1) the economics serving the study of the functioning and administration of a largely *given* economic system and (2) the economics that focussed on the mechanisms of irreversible *transformation* of economic systems. While the former activity had to some extent developed into a science that cumulatively improves theoretical tools, the latter has hardly showed any analytical progress since Antonio Serra and simi-

lar early contributors from the European Continent (which Schumpeter praises highly). Since he produced a history of the cumulative improvement of tools of economic analysis, he has surprisingly little to tell about later developments of "the Other Canon" of transformation economics.

Schumpeter's readers should not consider the gradual disappearance of "the Other Canon" from the exposition of *History* as based on a value judgement. He obviously considered the problems of transformation—or development or evolution—as by far the most important ones, and he emphasised the very limited range of the results of Neoclassical Economics. However, what had basically been obtained by Gustav von Schmoller and his followers in the Historical School was also rather pedestrian from the viewpoint of a born theorist: the hugely increased quantity and quality of economically and politically relevant data. What had *not* been obtained—even by Sombart, Spiethoff, and Max Weber—was cumulatively improvable theoretical tools.

Werner Sombart (1902) tried to combine Marx's evolutionary "logic" with historical fact in the two large volumes on *Modern Capitalism*, of which the latter volume was called *Theorie der kapitalistischen Entwicklung*. Sombart's book presented an idiosyncratic mix of theoretical sketches and historical facts that, according to Schumpeter (1954, 816–817n), "even out-Schmollered Schmoller". Although this book "shocked professional historians by its often unsubstantial brilliance ... it was in a sense a peak achievement of the historical school, and highly stimulating even in its errors".

Sombart's idiosyncratic book seems to have provided one of the challenges for the early Schumpeter (1912): he wanted to create a systematic theory of capitalist economic evolution, a theory that was intended to be cumulatively improvable (and to some extent extensible to evolutionary sociology and evolutionary political science). Although these goals have only recently been fulfilled and only in a partial way (see, e.g., Hanusch and Pyka, 2007), Schumpeter spent a lifetime on the project and much interesting material—even on "Schumpeterian Mercantilism"—can be found scattered in his works.

6. Reinert's "Schumpeterian Mercantilism"

Reinert's starting point for entering development economics is to a large extent the study of the history of industrially oriented trade policy and the related trade theory. This study has an emphasis on the theory of practice of what has been called "mercantilism". Ever since Adam Smith, mercantilism has been ridiculed by most leading economists as the alchemy of the balance of payments. However, Reinert follows the lead of Schumpeter by trying to rescue the insights of the economists of the mercantilist traditions and reducing Smith to the role a somewhat dubious system-builder.

This is partly done by demonstrating that "[p]romoting new knowledge was a fundamental driving force for the economic policies of the Renaissance—and later of all *realökonomisch* mercantilism, cameralism and Colbertism" (Reinert, 1999, 276). He characterises this aspect of the state's promotion of economic growth as "Schumpeterian" mercantilism. It is obvious that this "dynamic and knowledge-producing rent-seeking—or Schumpeterian Mercantilism—had in

many cases degenerated into static rent-seeking. (p. 301). However, it seems clear that the mercantilist tradition—from the Italian city states of the Renaissance and onwards—focussed on the causes of the relative economic strength of the European states. The key cause for the increase in knowledge, skills and competitiveness was the creation of a strong and developing manufacturing sector.

According to most mercantilists, the manufacturing sector was not only supposed to create exports and substitute imports. It also served as an engine of growth through its internal development and its influence on the productivity of the sectors of agriculture and transport: "For centuries manufacturing was synonymous with the combination of technological change, increasing returns and imperfect competition" (Reinert, 2007, 6). Furthermore, the direct military relevance of parts of the manufacturing sector was obvious to everyone and the indirect consequence of underdevelopment was normally submission under a more developed country.

Reinert (p. 77) emphasises one of the consequences of submission: "Colonies were regions where ... synergetic interaction was not intended to take place ... The prohibition of manufacturing industries—whether explicit or de facto—is the key element in any colonial and neo-colonial policy." Since Ricardo's theory of international specialisation told that manufacturing does not matter, it served to make this policy morally defensible. However, it was definitely not used if it prescribed England to deindustrialise in important areas.

A major task for Reinert is to collect the tools that promote the analysis of the described phenomena. With respect to the elements of this toolbox he to some extent agrees with, for instance, John Mathews (2005), whose list of classics includes the economic historian Gerschenkron (latecomer industrial dynamics), the political economist Akamatsu (the flying geese patterns of industry transfer from country to country), and not least Hirschman and other development economists (increasing returns, forward and backward linkages, etc.). However, although Reinert obviously likes a mixed analytical toolbox, he also wants to create some coherence. Here Schumpeter's work and the post-Schumpeterian literature are major sources of inspiration.

7. Towards a Schumpeterian analysis of "mercantilism"

If Schumpeter had been confronted with the label "Schumpeterian Mercantilism" and if he had been able to overcome his rejection of both terms as being imprecise, then he might have said that "[w]e are [here] dealing with a particular range of problems and our schema [Schumpeter's basic model] has been devised to serve it" (Schumpeter, 1939, 235). In the Schumpeterian model of economic evolution, the state can either act as entrepreneur or as provider of some of the parameters ["data"] for entrepreneurial action. Thus he does not need to a separate category of "statecraft—mercantilist or other". It is already included, but it is included at a highly abstract level.

A more concrete analysis might be developed by taking the starting point in Schumpeter's (Schumpeter (1991a)) "The Crisis of the Tax State" and other

of his papers on economic sociology (like Schumpeter, Schumpeter (1991c)). However, such an effort is definitely not a simple one. Schumpeter's sociological papers were written for the occasion and we need to reconstruct their basic logic. For instance, the tax state is described as "parasitic" and it only gradually becomes understandable why the relationship between the state and the economy also be a symbiotic one of the type described by Reinert. Here we are, however, helped by scattered and historically oriented remarks.

Schumpeter (1939, 234) criticism of the concept of mercantilism is summarised in the following remark: "we have constructed a historical entity called Mercantilism and endowed it with a set of consistent principles", but this historical entity does not "embody any set of definite economic aims or principles." Although no unified mercantilist set of policies existed, it is clear that, especially in Germany, "the prince and his bureaucracy became for centuries the dominant factor in economic life" (Schumpeter, 1939, 234).

In the German situation, it can be said that it was "the state rather then the entrepreneur which initiated modern industry" (p. 235). Apart from the many cases in which the state "directly filled the entrepreneurial function, ... it *conditioned* enterprise by reshaping the institutional framework ... and by fostering it in various ways, some of which in fact come within what we usually understand by mercantilist policy."

In France, Colbertism meant that the "bourgeoisie was scientifically exploited and protected—like game in a well-ordered park—in such a way as to ... serve the splendor of the prince, the court, and the army". Since "a maximum of surplus [was] being sucked up to finance the great center of expenditure" (p. 235), the "scientific" promotion of exploitable manufacturing capabilities was subject to strong limitations.

However, the state functioned differently during the last of Schumpeter's Kondratieff waves—"The Neo-Mercantilist Kondratieff"—which he dates from 1897. Here we see the problematic nature of the aggressive, colonising, and war-preparing "Neo-Mercantilism" of the European states of his youth (Schumpeter, 1991c, 199–208). However, we also find the less aggressive strategy for industrial development of the relatively underdeveloped Austrian-Hungarian Empire, which was designed by the Koerber government in the beginning of the twentieth century. I have found no evidence that Schumpeter followed his teacher Böhm-Bawerk, who had been a member of the Koerber government, in rejecting this strategy that was never fully implemented (Gerschenkron, 1977).

Schumpeter would probably largely have classified the relatively concrete treatment of mercantilist statecraft as "economic sociology". However, although he made significant contributions to this field (Schumpeter, 1991b), he never treated the problems of underdevelopment and state-promoted industrial evolution systematically. Presently, Reinert's (2007) book seems to be the closest approximation to what Schumpeter might have written as a follow-up of Antonio Serra's analysis—of we ignore much of the book's policy-oriented polemics and put its scientific polemics in a more guarded format.

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