

Chapter 7

Can Capitalism Survive?

Can capitalism survive? No. I do not think it can ... its very success undermines the social institutions which protect it, and “inevitably” creates conditions in which it will not be able to live and which strongly point to socialism as the heir apparent.

Joseph A. Schumpeter (1942), *Capitalism, Socialism, and Democracy*: 61.

Perhaps the most interesting aspect of Schumpeter’s lifelong work in economics was a similarity between his work and that of Karl Marx, the most noted socialist writer in history. What makes this similarity striking is that Schumpeter’s greatest insights relate to the role of the innovative entrepreneur at the heart of capitalism. Yet, despite this insight, Schumpeter, like Marx, believed that the economic system of capitalism would eventually be replaced by socialism as a result of forces from within. In *Capitalism, Socialism, and Democracy* (CSD) Schumpeter himself states: “My final conclusion therefore does not differ, however much my argument may, from that of most socialist writers and in particular from that of all Marxists” (CSD: 61).¹⁸

There are, however, two important differences between the analysis of Schumpeter and Marx with regard to the end of capitalism. First, while Marx

18. In Thomas K. McCraw’s definitive biography of Schumpeter, *Prophet of Innovation* (2009), he argues that Schumpeter’s discussion of the socialism successfully replacing capitalism should be interpreted as, at least to some extent, sarcastic. McCraw writes: “As a whole, the organization of Schumpeter’s discussion of socialism has elements of a shell game. At first his argument seems designed to establish the viability of socialism and its likely replacement of capitalism. But there follows such a lengthy series of convoluted qualifications and assumptions as to raise doubts about his candor ... a careful reading leaves little question that his purpose has been to praise capitalism and condemn socialism. Even so, Schumpeter’s irony escaped many readers” (2009: 366–367).

personally desired socialism and believed it to be a superior economic system, Schumpeter did not, declaring: “Prognosis does not imply anything about the desirability of the course of events that one predicts. If a doctor predicts that his patient will die presently, this does not mean he desires it” (CSD: 61). Schumpeter was a firm believer in the power of private innovation and entrepreneurship and the benefits capitalism produced; ones that he believed were superior to the outcomes under socialism. Unlike Marx, Schumpeter did not *want* capitalism to be replaced by socialism, nor did he think this transition would be beneficial for the well-being of society.

Second, while both Marx and Schumpeter believed there was an inevitable transition of capitalism into socialism, they disagreed on the causes. Marx believed capitalism would produce inequalities, monopolies, and economic failures that would lead to a revolt of the “exploited” working class (the “proletariat”) against the wealthy, capitalist class (the “bourgeoisie”) that owned the means of production. In stark contrast, Schumpeter understood from his analysis of history that capitalism greatly benefitted the working class:

Queen Elizabeth owned silk stockings. The capitalist achievement does not typically consist in providing more silk stockings for queens but in bringing them within the reach of factory girls in return for steadily decreasing amounts of effort. (CSD: 67)

Schumpeter clearly dismisses Marx’s argument in an essay published in a 2008 collection of his writings, *Essays on Entrepreneurship, Innovations, Business Cycles, and the Evolution of Capitalism* (EOE):

In Marx ... it is necessary to separate the arguments ... and the answer itself. All his arguments, but in particular the one that asserts that labour will be goaded into revolution by steadily increasing misery, can be proved to be untenable. But this does not dispose of the answer itself, because it is possible to arrive at a correct result by faulty methods. (EOE: 207–208)

So while he agreed with Marx’s conclusion that capitalism *would* be replaced by socialism, he firmly disagreed with the cause of the transition. Schumpeter instead believed that capitalism would be destroyed by its very

economic *success* as it produced an intellectual class that would subsequently work to undermine the systems of private property and private contracting that underpin the economic system of capitalism. Contributing to this transition, Schumpeter also believed that entrepreneurship and innovation would become bureaucratic within big firms and carried out as a routine matter based on specialists:

We observe ... the individual leadership of the entrepreneur tends to lose in importance and to be increasingly replaced by the mechanized teamwork of specialized employees within large corporations ... [and] that the capitalist process by its very success tends to raise the economic and political position of groups that are hostile to it ... shifting of economic activity from the private to the public sphere, or, as we may also put it, toward increasing bureaucratisation of economic life. (EOE: 207–208)

While clearly saying Marx’s theory was “open to serious objections” he agreed with Marx that there was a tendency toward “industrial combination” and “the emergence of largest-scale concerns”, “cartels”, “trusts”, and “big business” (EOE: 197). In Schumpeter’s view, this resulted in an erosion of the function and status of the entrepreneur in society:

Innovation is, in this case, not any more embodied *typically* in new firms, but goes on, within the big units now existing, largely independently of individual persons ... as a matter of course on the advice of specialists ... Progress becomes “automated”, increasingly impersonal and decreasingly a matter of leadership and individual initiative. (EOE: 70–71)

In Schumpeter’s view, the continual flow of product innovation becomes something people take for granted, and these innovations become entrenched in the routine operation of large firms. Progress is no longer so visibly attributed to innovative entrepreneurial individuals. The sizeable political and social class of small merchant entrepreneurs and their employees who directly felt vested in the economic system of capitalism and property ownership are replaced by emotionally unattached employees, managers, or shareholders of large bureaucratic firms. Thus, the entrepreneur falls from being on top of the pyramid of

society. In the process, individuals lose sight of capitalism as the true historical source of their prosperity and of its long-run benefits. They instead focus on using expanded government control to alleviate short-run economic concerns and social shortcomings as they see them, without realizing the harmful long-run secondary effects.

While Schumpeter believes the automation of the entrepreneur's role, as well as what he viewed as the "rationalizing" of the human mind, play a role in the downfall of capitalism, it is the lack of intellectual and political supporters to protect the institutions of private property and contracting that play the major role. To better understand this part of his argument requires understanding the defining features of capitalism according to Schumpeter:

A society is called capitalist if it entrusts its economic process to the guidance of the private businessman. This may be said to imply, first, private ownership of nonpersonal means of production, such as land, mines, industrial plant and equipment; and, second, production for private account, *i.e.*, production by private initiative for private profit. (EOE: 189).¹⁹

Afforded a leisurely life away from the business sector, the intellectual class of academics, journalists, and bureaucrats turn on the very institutions that underpin the economic system that brought this luxury—private ownership and free markets. In this manner, Schumpeter says Marx "greatly overrated the bourgeoisie's ... will to resist gradual changes that are contrary to its interest ... its scheme of life" (EOE: 208). Rather than Marx's view of the workers turning on the bourgeoisie supporters of capitalism, in Schumpeter's view the bourgeoisie themselves turn on capitalism.

Far from being a transition that might occur in the distant future, Schumpeter worried this transition to socialism was already underway: "Capitalism is ... in so obvious a process of transformation into something else, that is not the fact, but only the interpretation of this fact, about which it is possible to disagree" (EOE: 71). He provides examples of

19. Schumpeter also stressed that "the institution of bank credit is so essential to the functioning of the capitalist system that, though not strictly implied in its definition, it should be added to the other two criteria" of private ownership and private production for private profit as defining characteristics of the capitalist system (EOE: 189).

how far the process of transformation has advanced already... Government control of the capital and labour markets, of price policies and, by means of taxation, of income redistribution is already established and needs only to be complemented systematically by government initiative in indicating the general lines of production (housing programs, foreign investment) in order to transform, even without extensive nationalization of industries, regulated, or fettered, capitalism into a guided capitalism that might, with almost equal justice, be called socialism. Thus, the prediction of whether the capitalist order will survive is, in part, a matter of terminology. (EOE: 209)

Schumpeter's view that the transition away from capitalism was underway with a growing influence of government was largely consistent with, and informed by, the current events at the time of his writing with the major expansion in the size and role of the US federal government during the New Deal programs that followed the Great Depression, and the economic controls imposed during World War II. He saw these same trends occurring in his home country of Austria, and other western countries. Schumpeter saw a coming government budgetary crisis (of the "tax state" as he called it) resulting from "expansion of the sphere of social sympathy" (ESC: 131) as "the will of the people demands higher and higher public expenditures" (ESC: 116) to finance social transfer programs on top of the debt accumulated from World War II.

Schumpeter also foresaw the growing influence of large-scale business firms in the political process, in attempts to use the power of government to "fight the threatening attack" posed by creative destruction; they, in the process, "can and will fight progress itself" (CSD: 96). "Taking industry as a whole, there is always an innovating sphere warring with an 'old' sphere, which sometimes tries to secure prohibition of the new ways of doing things" (BC1: 106–108). Government, shaped by the social structure, becomes a "handle, as it were, which social powers can grip in order to change this structure" (ESC: 108), and "the state ... enlarges ... deep into the flesh of the private economy" (ESC: 110–111). Schumpeter had serious concerns that high levels of taxation associated with the expansion of government size were already eroding the incentives to innovate and produce: "almost all countries have shot way beyond the mark in this or that case of indirect taxation and have burdened some articles to such an extent that the fiscal interest of the state itself has been hurt" (ESC: 113).

This gradual transition toward more and more government control and economic intervention in Schumpeter's view is aided by democracy and the march of "democratic socialism". According to Schumpeter, "democratic methods have become an element of the moral credo of the average American ... I do expect a slow progress in regulation, which will only cease when there is nothing unregulated left" (ESC: 313). It will consist of "extending the democratic method, that is to say the sphere of 'politics', to all economic affairs" (CSD: 299). "In any case, that democracy will not mean increased personal freedom" (CSD: 302).

It is clear that Schumpeter viewed a movement away from capitalism and toward socialism as resulting in less personal freedom, as well as lower levels of economic prosperity, in the long run. This is not surprising as Schumpeter is widely known for his writings illustrating the benefits and essential role of private-sector entrepreneurship in the capitalist, free-market system. Schumpeter noted this transition was "not by economic necessity" and would result in a "sacrifice of economic welfare, into an order of things which it will be merely matter of taste and terminology to call Socialism or not" (EOE: 72). Thus, while Schumpeter, like Marx, believed that the economic system of capitalism had built-in features that would lead to its demise and replacement with socialism, the two authors had not only different rationales but also different prognoses for the impact it would have on the well-being of the individuals in society.

Schumpeter's careful study of economic history, his practical knowledge from his time working in government, and his experience from living in different countries gave him an impressive understanding of how Western, capitalist societies would likely evolve in the decades after his writing. His writings foreshadowed the growing ability of special-interest groups to control the political process, the rise of large firms using the power of government to protect their interests from competitive pressures, the increased bureaucratization of innovation through large-firm concentration, the rise of the regulatory state with extensive controls on private business, and the growing levels of fiscal debt and taxation. As with the movement toward socialism, however, he felt the net result of these changes were harmful to freedom and prosperity.

Schumpeter's concern, which has manifested itself to a large extent, was that in intellectual circles eventually capitalism would be on "trial in front of judges who have the death sentence ready in their pockets ... the condemnation

of capitalism and all of its works is a foregone conclusion—virtually a requirement of the etiquette of discussion ... Any other position is held as not only crazy, but as anti-social” and this bias would prevent people from understanding the true economic and cultural accomplishments of capitalism.²⁰

While a transition to socialism to the full extent Schumpeter described has yet to manifest itself, there is no question that government intervention and influence over the economy in Western countries has continued to grow rapidly, and that public and intellectual attitudes toward political platforms based on some variant of “democratic socialism” seem to have become more positive (and views about capitalism more negative), particularly in academic circles and institutions of higher education. In this light, Schumpeter’s writings are best viewed as a warning about where these countries are at now and could be headed if this trend continues as people lose sight of what generated the progress they now enjoy. As Schumpeter noted, “any pro-capitalist argument must rest on long-run considerations” (CSD: 144–145).

20. The evidence that this intellectual turn has started to unfold is best witnessed by Schumpeter’s biographer noted Harvard scholar and Pulitzer-Prize-winning author, Thomas McCraw, in his statement that this argument is one that “many people who have spent time in universities will quickly recognize, regardless of their politics”. These quotations are taken from page 641 of Thomas K. McCraw’s *Prophet of Innovation* (2009), which is based on a translation of pages 161–162 of Schumpeter’s (1948) article, Capitalism and the Intellectuals, in the *German Journal for European Thought*.

