BY JOSEPH A. SCHUMPETER

HISTORY OF ECONOMIC ANALYSIS

TEN GREAT ECONOMISTS

ECONOMIC DOCTRINE AND METHOD

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Capitalism, Socialism and Democracy

Ruskin House

GEORGE ALLEN & UNWIN LTD

MUSEUM STREET LONDON
CONTENTS

Preface to the Second Edition ix

Preface xiii

PART I: THE MARXIAN DOCTRINE
Prologue 1
I. Marx the Prophet 3
II. Marx the Sociologist 5
III. Marx the Economist 9
IV. Marx the Teacher 21

PART II: CAN CAPITALISM SURVIVE?
Prologue 59
V. The Rate of Increase of Total Output 61
VI. Plausible Capitalism 63
VII. The Process of Creative Destruction 72
VIII. Monopolistic Practices 81
IX. Closed Season 87
X. The Vanishing Investment Opportunity 107
XI. The Civilization of Capitalism 111
XII. Crumbling Walls 121

PART III: CAN SOCIALISM WORK?
XIII. Growing Hostility 131

PART IV: THE MARXIAN DOCTRINE
Prologue 165
XV. Clearing Decks 167
XVI. The Socialist Blueprint 172
XVII. Comparison of Blueprints 187

PRINTED IN GREAT BRITAIN
BY THE COMPTON PRINTING WORKS (LONDON) LTD., N.1
Can Capitalism Survive?

Nor need one accept this conclusion in order to qualify as a socialist. One may love socialism and ardently believe in its economic, cultural and ethical superiority but nevertheless believe at the same time that capitalist society does not harbor any tendency toward self-destruction. There are in fact socialists who believe that the capitalist order is gathering strength and is entrenching itself as time goes on, so that it is chimerical to hope for its breakdown.

CHAPTER V

THE RATE OF INCREASE OF TOTAL OUTPUT

The atmosphere of hostility to capitalism which we shall have to explain presently makes it much more difficult than it otherwise would be to form a rational opinion about its economic and cultural performance. The public mind has by now so thoroughly grown out of humor with it as to make condemnation of capitalism and all its works a foregone conclusion—almost a requirement of the etiquette of discussion. Whatever his political preference, every writer or speaker hastens to conform to this code and to emphasize his critical attitude, his freedom from "complacency," his belief in the inadequacies of capitalist achievement, his aversion to capitalist and his sympathy with anti-capitalist interests. Any other attitude is voted not only foolish but anti-social and is looked upon as an indication of immoral servitude. This is of course perfectly natural. New social religions will always have that effect. Only it does not make it easier to fulfill the analyst's task: in 300 A.D. it would not have been easy to expound the achievements of ancient civilization to a fervent believer in Christianity. On the one hand, the most obvious truths are simply put out of court a limine; on the other hand, the most obvious misstatements are borne with or applauded.

A first test of economic performance is total output, the total of all the commodities and services produced in a unit of time—a year or a quarter of a year or a month. Economists try to measure variations in this quantity by means of indices derived from a number of series representing the output of individual commodities. "Strict logic is a stern master, and if one respected it, one would never construct or use any production index," for not only the material and the technique of constructing such an index, but the very concept of a total output of different commodities produced in ever-changing proportions, is a highly doubtful matter. Nevertheless, I believe that this device is sufficiently reliable to give us a general idea.

1 There is however another method of dealing with obvious though uncomfortable truths, viz., the method of sneering at its triviality. Such a sneer will serve as well as a refutation would, for the average audience is as a rule perfectly unaware of the fact that it often covers the impossibility of denial—a pretty specimen of social psychology.

2 A. F. Burns, Production Trends in the United States Since 1870, p. 262.

3 We cannot enter into this problem here. A little will, however, be said about it when we meet it again in the next chapter. For a fuller treatment see my book on Business Cycles, ch. ix.
Can Capitalism Survive?

For the United States, individual series good and numerous enough to warrant construction of such an index of output are available since the Civil War. Choosing what is known as the Day-Persons index of total production we find that, from 1870 to 1930, the average annual rate of growth was 3.7 per cent and, in the division of manufactures alone, 4.3 per cent. Let us concentrate on the former figure and try to visualize what it means. In order to do this we must first apply a correction: since the durable equipment of industry was always increasing in relative importance, output available for consumption cannot have increased at the same rate as total production. We must allow for that. But I believe that an allowance of 1.7 per cent is ample; thus we arrive at a rate of increase in "available output" of 2 per cent (compound interest) per year.

Now suppose that the capitalist engine keeps on producing at that rate of increase for another half century starting from 1928. To this assumption there are various objections which will have to be noticed later on, but it cannot be objected to on the ground that in the decade from 1899 to 1999 capitalism had already failed to live up to that standard. For the depression that ran its course from the last quarter of 1929 to the third quarter of 1932 does not prove that a secular break has occurred in the propelling mechanism of capitalist production because depressions of such severity have repeatedly occurred—roughly once in fifty-five years—and because the effects of one of them—the one from 1873 to 1877—are taken account of in the annual average of 2 per cent. The subnormal recovery to 1935, the subnormal prosperity to 1937 and the slump after that are easily accounted for by the difficulties incident to the adaptation to a new fiscal policy, new labor legislation and a general change in the attitude of government to private enterprise all of which can, in a sense to be defined later, be distinguished from the working of the productive apparatus as such.

Since misunderstandings at this point would be especially undesirable, I wish to emphasize the fact that the last sentence does not in itself imply either an adverse criticism of the New Deal policies or the proposition—which I do believe to be true but which I do not need just now—that policies of that type are in the long run incompatible with the effective working of the system of private enterprise. All I now mean to imply is that so extensive and rapid a change of the social scene naturally affects productive performance for a time, and so much the most ardent New Dealer must and also can admit. I for one do not see how it would otherwise be possible to account for the fact that this country which had the best chance of recovering quickly was precisely the one to experience the most unsatisfactory recovery. The only somewhat similar case, that of France, supports the same inference. It follows that the course of events during the decade from 1929 to 1939 does not per se constitute a valid reason for refusing to listen to the argument in hand which, moreover, may in any case serve to illustrate the meaning of past performance.

Well, if from 1928 on available production under the conditions of the capitalist order continued to develop as it did before, i.e., at a long-run average rate of increase of 2 per cent per year, it would after fifty years, in 1978, reach an amount of roughly 2.7 (2.6916) times the 1928 figure. In order to translate this into terms of average real income per head of population, we first observe that our rate of increase in total output may be roughly equated to the rate of increase in the sum total of private money incomes available for consumption, corrected for changes in the purchasing power of the consumers' dollars. Second, we must form an idea about the increase in population we are to expect; we will choose Mr. Sloane's estimate, which gives 160 millions for 1978. Average income per head during those fifty years would therefore increase to a little more than double its 1928 amount, which was about $650, or to about $1300 of 1928 purchasing power.

Perhaps some readers feel that a proviso should be added about the distribution of the total monetary income. Until about forty years ago, many economists besides Marx believed that the capitalist process tended to change relative shares in the national total so that the obvious inference from our average might be invalidated by the rich growing richer and the poor growing poorer, at least relatively. But there is no such tendency. Whatever may be thought of the statistical measures devised for the purpose, this much is certain: that the structure of the pyramid of incomes, expressed in terms of money, has not greatly changed during the period covered by our material.

4 "Consumption" includes the acquisition of durable consumers' goods such as motor cars, refrigerators and homes. We do not distinguish between transient consumers' goods and what is sometimes referred to as "consumers' capital."

5 That is to say, average real income per head would increase at a compound interest rate of 1½ per cent. It so happens that in England, during the century preceding the First World War, real income per head of population increased at almost exactly that rate (see Lord Stamp in Wealth and Taxable Capacity). No great confidence can be placed in this coincidence. But I think it serves to show that our little calculation is not wild absurd. In Number 241 of the National Industrial Conference Board Studies, Table 1, pp. 6 and 7, we find that "per capita realized national income" adjusted by the Federal Reserve Bank of New York and the National Industrial Conference Board cost of living index, was in 1929 a little over four times the 1899 figure—a similar result, though open to still more serious doubts as to reliability.
One way of expressing our result is that, if capitalism repeated its past performance for another half century starting with 1928, this would do away with anything that according to present standards could be called poverty, even in the lowest strata of the population, pathological cases alone excepted.

Nor is this all. Whatever else our index may do or may not do, it certainly does not overstate the actual rate of increase. It does not take account of the commodity, Voluntary Leisure. New commodities escape or are inadequately represented by an index which must rest largely on basic commodities and intermediate products. For the same reason improvements in quality almost completely fail to assert themselves although they constitute, in many lines, the core of the progress achieved—there is no way of expressing adequately the difference between a motorcar of 1940 and a motorcar of 1900 or the extent to which the price of motorcars per unit of utility has fallen. It would be more nearly possible to estimate the rate at which given quantities of raw materials or semi-finished products are made to go further than they used to—a steel ingot or a ton of coal, though they may be unchanged in physical quality, represent a multiple of their economic efficiency sixty years ago. But little has been done along this line. I have no idea about what would happen to our index if there were a method for correcting it for these and similar factors. It is certain, however, that its percentage rate of change would be increased and that we have here a reserve that should make the estimate adopted proof against the effects of any conceivable downward revision. Moreover, even if we had the means of measuring the change in the technological efficiency of industrial products, this measure would still fail to convey an adequate idea of what it means for the dignity or intensity or pleasantness of human life—for all that the economists of an earlier generation subsumed under the heading of Satisfaction of Wants. And this, after all, is for us the relevant consideration, the true "output" of capitalist production, the reason why we are interested in the index of production and the pounds and galing that enter into it and would hardly be worth while in themselves.

But let us keep to our 2 per cent. There is one more point that is important for a correct appraisal of that figure. I have stated above that, broadly speaking, relative shares in national income have remained substantially constant over the last hundred years. This, however, is true only if we measure them in money. Measured in real terms, relative shares have substantially changed in favor of the lower income groups. This follows from the fact that the capitalist engine is first and last an engine of mass production which unavoidably means also production for the masses, whereas, climbing upward in the scale of individual incomes, we find that an increasing proportion is being spent on personal services and on handmade commodities, the prices of which are largely a function of wage rates.

Verification is easy. There are no doubt some things available to the modern workman that Louis XIV himself would have been delighted to have yet was unable to have—modern dentistry for instance. On the whole, however, a budget on that level had little that really mattered to gain from capitalist achievement. Even speed of traveling may be assumed to have been a minor consideration for so very dignified a gentleman. Electric lighting is no great boon to anyone who has money enough to buy a sufficient number of candles and to pay servants to attend to them. It is the cheap cloth, the cheap cotton and rayon fabric, boots, motorcars and so on that are the typical achievements of capitalist production, and not as a rule improvements that would mean much to the rich man. 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.

The same fact stands out still better if we glance at those long waves in economic activity, analysis of which reveals the nature and mechanism of the capitalist process better than anything else. Each of them consists of an "industrial revolution" and the absorption of its effects. For instance, we are able to observe statistically and historically—the phenomenon is so clear that even our scanty information suffices to establish it—the rise of such a long wave toward the end of the 1780's, its culmination around 1800, its downward sweep and then a sort of recovery ending at the beginning of the 1840's. This was the Industrial Revolution dear to the heart of textbook writers. Upon its heels, however, came another such revolution producing another long wave that rose in the forties, culminated just before 1857 and ebbed away to 1897, to be followed in turn by the
These revolutions periodically reshape the existing structure of industry by introducing new methods of production—the mechanized factory, the electrified factory, chemical synthesis and the like; new commodities, such as railroad service, motorcars, electrical appliances; new forms of organization—the merger movement; new sources of supply—La Plata wool, American cotton, Katanga copper; new trade routes and markets to sell in and so on. This process of industrial change provides the ground swell that gives the general tone to business: while these things are being initiated we have brisk expenditure and predominating "prosperity"—interrupted, no doubt, by the negative phases of the shorter cycles that are superimposed on that ground swell—and while those things are being completed and their results pour forth we have elimination of antiquated elements of the industrial structure and predominating "depression." Thus there are prolonged periods of rising and of falling prices, interest rates, employment and so on, which phenomena constitute parts of the mechanism of this process of recurrent rejuvenation of the productive apparatus.

Now these results each time consist in an avalanche of consumers' goods that permanently deepens and widens the stream of real income although in the first instance they spell disturbance, losses and unemployment. And if we look at those avalanches of consumers' goods we again find that each of them consists in articles of mass consumption and increases the purchasing power of the wage dollar more than that of any other dollar—in other words, that the capitalist process, not by coincidence but by virtue of its mechanism, progressively raises the standard of life of the masses. It does so through a sequence of vicissitudes, the severity of which is proportional to the speed of the advance. But it does so effectively. One problem after another of the supply of commodities to the masses has been successfully solved by being brought within the reach of the methods of capitalist production. The most important one of those that remain, housing, is approaching solution by means of the pre-fabricated house.

And still this is not all. Appraisal of an economic order would be incomplete—and incidentally un-Marxian—if it stopped at the output which the corresponding economic conveyor hands to the various groups of society and left out of account all those things that the conveyor does not serve directly but for which it provides the means

9 These are the "long waves" which, in business cycle literature, are primarily associated with the name of N. D. Kondratieff.

10 This of course also applies to agricultural commodities, the cheap mass production of which was entirely the work of large-scale capitalist enterprise (railroads, shipping, agricultural machinery, fertilizers).

As well as the political volition, and all those cultural achievements that are induced by the mentality it generates. Deferring consideration of the latter (Chapter XI), we shall now turn to some aspects of the former.

The technique and atmosphere of the struggle for social legislation obscures the otherwise obvious facts that, on the one hand, part of this legislation presupposes previous capitalist success (in other words, wealth which had previously to be created by capitalist enterprise) and that, on the other hand, much of what social legislation develops and generalizes had been previously initiated by the action of the capitalist stratum itself. Both facts must of course be added to the sum total of capitalist performance. Now if the system had another run such as it had in the sixty years preceding 1928 and really reached the $1300 per head of population, it is easy to see that all the desiderata that have so far been espoused by any social reformers—practically without exception, including even the greater part of the cranks—either would be fulfilled automatically or could be fulfilled without significant interference with the capitalist process. Ample provision for the unemployed in particular would then be not only a tolerable but a light burden. Irresponsibility in creating unemployment and in financing the support of the unemployed might of course at any time create insoluble problems. But managed with ordinary prudence, an average annual expenditure of 16 billions on an average number of 16 million unemployed including dependents (10 per cent of the population) would not in itself be a serious matter with an available national income of the order of magnitude of 200 billion dollars (purchasing power of 1928).

May I call the reader's attention to the reason why unemployment which everyone agrees must be one of the most important issues in any discussion of capitalism—with some critics so much so that they base their indictment exclusively on this element of the case—will play a comparatively small role in my argument? I do not think that unemployment is among those evils which, like poverty, capitalist evolution could ever eliminate of itself. I also do not think that there is any tendency for the unemployment percentage to increase in the long run. The only series covering a respectable time interval—roughly the sixty years preceding the First World War—gives the English trade-union percentage of unemployed members. It is a typically cyclical series and displays no trend (or a horizontal one). Since this is theoretically understandable—there is no theoretical reason to call the evidence in question—those two propositions seem established for
the prewar time to 1913 inclusive. In the postwar time and in most countries unemployment was mostly at an abnormally high level even before 1930. But this and still more the unemployment during the thirties can be accounted for on grounds that have nothing to do with a long-run tendency of unemployment percentages to increase from causes inherent in the capitalist mechanism itself. I have mentioned above those industrial revolutions which are so characteristic of the capitalist process. Supernormal unemployment is one of the features of the periods of adaptation that follow upon the "prosperity phase" of each of them. We observe it in the 1820's and 1870's, and the period after 1920 is simply another of those periods. So far the phenomenon is essentially temporary in the sense that nothing can be inferred about it for the future. But there were a number of other factors which tended to intensify it—war effects, dislocations of foreign trade, wage policies, certain institutional changes that swelled the statistical figure, in England and Germany fiscal policies (also important in the United States since 1935) and so on. Some of these are no doubt symptoms of an "atmosphere" in which capitalism will work with decreasing efficiency. That however is another matter which will engage our attention later on.

But whether lasting or temporary, getting worse or not, unemployment undoubtedly is and always has been a scourge. In the next part of this book we shall have to list its possible elimination among the claims of the socialist order to superiority. Nevertheless, I hold that the real tragedy is not unemployment per se, but unemployment plus the impossibility of providing adequately for the unemployed without impairing the conditions of further economic development: for obviously the suffering and degradation—the destruction of human values—which we associate with unemployment, though not the waste of productive resources, would be largely eliminated and unemployment would lose practically all its terror if the private life of the unemployed were not seriously affected by their unemployment. The indictment stands that in the past—say, roughly, to the end of the nineteenth century—the capitalist order was not only unwilling but also quite incapable of guaranteeing this. But since it will be able to do so if it keeps up its past performance for another half century this indictment would in that case enter the limbo filled by the sorry specters of child labor and sixteen-hour working days and five persons living in one room which it is quite proper to emphasize when we are talking about the past social costs of capitalist achievement but which are not necessarily relevant to the balance of alternatives for the future. Our own time is somewhere between the disabilities of earlier stages in capitalist evolution and the abilities of the system in full maturity. In this country at least, the better part of the task could even now be accomplished without undue strain on the system. The
CHAPTER VI

PLAUSIBLE CAPITALISM

The argument of the preceding chapter seems to be exposed to a reply that is as damaging as it is obvious. The average rate of increase in total available production that obtained during the sixty years preceding 1928 has been projected into the future. So far as this was merely a device in order to illustrate the significance of past development, there was nothing in this procedure that could have shocked the statistical conscience. But as soon as I implied that the following fifty years might actually display a similar average rate of increase, I apparently did commit a statistical crime; it is, of course, clear that a historical record of production over any given period does not in itself justify any extrapolation at all, let alone an extrapolation over half a century. It is therefore necessary to emphasize again that my extrapolation is not intended to forecast the actual behavior of output in the future. Beyond illustrating the meaning of past performance, it is merely intended to give us a quantitative idea of what the capitalist engine might conceivably accomplish if, for another half century, it repeated its past performance—which is a very different matter. The question whether it can be expected to do so will be answered quite independently of the extrapolation itself. For this purpose we have now to embark upon a long and difficult investigation.

Before we can discuss the chance of capitalism repeating its past performance we must evidently try to find out in what sense the observed rate of increase in output really measures that past performance. No doubt, the period that furnished our data was one of comparatively unfettered capitalism. But this fact does not in itself provide a sufficient link between the performance and the capitalist engine. In order to believe that this was more than coincidence we must satisfy ourselves first, that there is an understandable relation between the capitalist order and the observed rate of increase in output; second, that, given such a relation, the rate of increase was actually due to it and not to the comprehensive compound represented by the output series, idiosyncrasies of individual items will to some extent cancel each other.

1 This proposition holds, on general principles, for any historical time series, since the very concept of historical sequence implies the occurrence of irreversible changes in the economic structure which must be expected to affect the law of any given economic quantity. Theoretical justification and, as a rule, statistical treatment are therefore necessary for even the most modest extrapolations. It may however be urged that our case is somewhat favored by the fact that within the comprehensive compound represented by the output series, idiosyncrasies of individual items will to some extent cancel each other.

Plausible Capitalism

particularly favorable conditions which had nothing to do with capitalism.

These two problems must be solved before the problem of a "repetition of performance" can arise at all. The third point then reduces to the question whether there is any reason why the capitalist engine should, during the next forty years, fail to go on working as it did in the past.

We shall deal with these three points in turn.

Our first problem may be reformulated as follows. On the one hand, we have a considerable body of statistical data descriptive of a rate of "progress" that has been admired even by very critical minds. On the other hand, we have a body of facts about the structure of the economic system of that period and about the way it functioned; from these facts, analysis has distilled what is technically called a "model" of capitalist reality, i.e., a generalized picture of its essential features. We wish to know whether that type of economy was favorable, irrelevant, or unfavorable to the performance we observe and, if favorable, whether those features may be reasonably held to yield adequate explanation of this performance. Waiving technicalities as much as possible, we shall approach the question in a common-sense spirit.

1 Unlike the class of feudal lords, the commercial and industrial bourgeoisie rose by business success. Bourgeois society has been cast in a purely economic mold: its foundations, beams and beams are all made of economic material. The building faces toward the economic side of life. Prizes and penalties are measured in pecuniary terms. Going up and going down means making and losing money. This, of course, nobody can deny. But I wish to add that, within its own frame, that social arrangement is, or at all events was, singularly effective. In part it appeals to, and in part it creates, a schema of motives that is unsurpassed in simplicity and force. The promises of wealth and the threats of destitution that it holds out, it redeems with ruthless promptitude. Wherever the bourgeois way of life asserts itself sufficiently to dim the beacons of other social worlds, these promises are strong enough to attract the large majority of supernormal brains and to identify success with business success. They are not proffered at random; yet there is a sufficiently enticing admixture of chance: the game is not like roulette, it is more like poker. They are addressed to ability, energy and supernormal capacity for work; but if there were a way of measuring either that ability in general or the personal achievement that goes into any particular success, the premiums actually paid out would probably not be found proportional to either. Spectacular prizes much greater than would have been necessary to call forth the particular effort are thrown to a small minority of winners, thus propelling much more efficaciously than a
more equal and more "just" distribution would, the activity of that large majority of businessmen who receive in return very modest compensation or nothing or less than nothing, and yet do their utmost because they have the big prizes before their eyes and overrate their chances of doing equally well. Similarly, the threats are addressed to incompetence. But though the incompetent men and the obsolete methods are in fact eliminated, sometimes very promptly, sometimes with a lag, failure also threatens or actually overtakes many an able man, thus whipping up everyone, again much more efficaciously than a more equal and more "just" system of penalties would. Finally, both business success and business failure are ideally precise. Neither can be talked away.

One aspect of this should be particularly noticed, for future reference as well as because of its importance for the argument in hand. In the way indicated and also in other ways which will be discussed later on, the capitalist arrangement, as embodied in the institution of private enterprise, effectively chains the bourgeois stratum to its tasks. But it does more than that. The same apparatus which conditions for performance the individuals and families that at any given time form the bourgeois class, ipso facto also selects the individuals and families that are to rise into that class or to drop out of it. This combination of the conditioning and the selective function is not a matter of course. On the contrary, most methods of social selection, unlike the "methods" of biological selection, do not guarantee performance of the selected individual; and their failure to do so constitutes one of the crucial problems of socialist organization that will come up for discussion at another stage of our inquiry. For the time being, it should merely be observed how well the capitalist system solves that problem: in most cases the man who rises first into the business class and then within it is also an able businessman and he is likely to rise exactly as far as his ability goes—simply because in that schema rising to a position and doing well in it generally is or was one and the same thing. This fact, so often obscured by the auto-therapeutic effort of the unsuccessful to deny it, is much more important for an appraisal of capitalist society and its civilization than anything that can be gleaned from the pure theory of the capitalist machine.

2. But is not all that we might be tempted to infer from "maximum performance of an optimally selected group" invalidated by the further fact that that performance is not geared to social service—production, so we might say, for consumption—but to money-making, that it aims at maximizing profits instead of welfare? Outside of the bourgeois stratum, this has of course always been the popular opinion. Economists have sometimes fought and sometimes espoused it. In doing so they have contributed something that was much more valuable than were the final judgments themselves at which they arrived individually and which in most cases reflect little more than their social location, interests and sympathies or antipathies. They slowly increased our factual knowledge and analytic powers so that the answers to many questions we are able to give today are no doubt much more correct although less simple and sweeping than were those of our predecessors.

To go no further back, the so-called classical economists were practically of one mind. Most of them disliked many things about the social institutions of their epoch and about the way those institutions worked. They fought the landed interest and approved of social reforms—factory legislation in particular—that were not all on the lines of laissez faire. But they were quite convinced that within the institutional framework of capitalism, the manufacturer's and the trader's self-interest made for maximum performance in the interest of all. Confronted with the problem we are discussing, they would have had little hesitation in attributing the observed rate of increase in total output to relatively unfettered enterprise and the profit motive—perhaps they would have mentioned "beneficial legislation" as a condition but by this they would have meant the removal of fetters, especially the removal or reduction of protective duties during the nineteenth century.

It is exceedingly difficult, at this hour of the day, to do justice to these views. They were of course the typical views of the English bourgeois class, and bourgeois blinders are in evidence on almost every page the classical authors wrote. No less in evidence are blinders of another kind: the classics reasoned in terms of a particular historical situation which they uncritically idealized and from which they uncritically generalized. Most of them, moreover, seem to have argued exclusively in terms of the English interests and problems of their time. This is the reason why, in other lands and at other times, people disliked their economics, frequently to the point of not even caring to understand it. But it will not do to dismiss their teaching on these grounds. A prejudiced man may yet be speaking the truth. Propositions developed from special cases may yet be generally valid. And the enemies and successors of the classics had and have only different but not fewer blinders and preconceptions; they envisaged and envisage different but not less special cases.

From the standpoint of the economic analyst, the chief merit of the classics consists in their despising, along with many other gross errors, the na"ive idea that economic activity in capitalist society, because it

2 The term Classical Economists will in this book be used to designate the leading English economists whose works appeared between 1776 and 1848. Adam Smith, Ricardo, Malthus, Senior and John Stuart Mill are the outstanding names. It is important to keep this in mind because a much broader use of the term has come into fashion of late.
turns on the profit motive, must by virtue of that fact alone necessarily run counter to the interests of consumers; or, to put it differently, that moneymaking necessarily deflects producing from its social goal; or, finally, that private profits, both in themselves and through the distortion of the economic process they induce, are always a net loss to all excepting those who receive them and would therefore constitute a net gain to be reaped by socialization. If we look at the logic of these and similar propositions which no trained economist ever thought of defending, the classical refutation may well seem trivial. But as soon as we look at all the theories and slogans which, consciously or subconsciously, imply them and which are once more served up today, we shall feel more respect for that achievement. Let me add at once that the classical writers also clearly perceived, though they may have exaggerated, the role of saving and accumulation and that they linked saving to the rate of “progress” they observed in a manner that was fundamentally, if only approximately, correct. Above all, there was practical wisdom about their doctrine, a responsible long-run view and a manly tone that contrast favorably with modern hysterics.

But between realizing that hunting for a maximum of profit and striving for maximum productive performance are not necessarily incompatible, to proving that the former will necessarily—or in the immense majority of cases—imply the latter, there is a gulf much wider than the classics thought. And they never succeeded in bridging it. The modern student of their doctrines never ceases to wonder how it was possible for them to be satisfied with their arguments or to mistake these arguments for proofs; in the light of later analysis their theory was seen to be a house of cards whatever measure of truth there may have been in their vision.8

3. This later analysis we will take in two strides—as much of it, that is, as we need in order to clarify our problem. Historically, the first will carry us into the first decade of this century, the second will cover some of the postwar developments of scientific economics. Frankly I do not know how much good this will do the non-professional reader; like every other branch of our knowledge, economics, as its analytic engine improves, moves fatally away from that happy stage in which all problems, methods and results could be made accessible to every educated person without special training. I will, however, do my best. The first stride may be associated with two great names revered to

8 The reader will recall my emphasis on the distinction between one’s theory and one’s vision in the case of Marx. It is however always important to remember that the ability to see things in their correct perspective may be, and often is, divorced from the ability to reason correctly and vice versa. That is why a man may be a very good theorist and yet talk absolute nonsense whenever confronted with the task of diagnosing a concrete historical pattern as a whole.
can get for that increment, i.e., that they will produce as much as they can without running into loss. And this can be shown to be as much as it is in general "socially desirable" to produce. In more technical language, in that case prices are, from the standpoint of the individual firm, not variables but parameters; and where this is so, there exists a state of equilibrium in which all outputs are at their maximum and all factors fully employed. This case is usually referred to as perfect competition. Remembering what has been said about the selective process which operates on all firms and their managers, we might in fact conceive a very optimistic idea of the results to be expected from a highly selected group of people forced, within that pattern, by their profit motive to strain every nerve in order to maximize output and to minimize costs. In particular, it might seem at first sight that a system conforming to this pattern would display remarkable absence of some of the major sources of social waste. As a little reflection should show, this is really but another way of stating the content of the preceding sentence.

4. Let us take the second stride. The Marshall-Wicksell analysis of course did not overlook the many cases that fail to conform to that model. Nor, for that matter, had the classics overlooked them. They recognized cases of "monopoly," and Adam Smith himself carefully noticed the prevalence of devices to restrict competition and all the differences in flexibility of prices resulting therefrom. But they looked upon those cases as exceptions and, moreover, as exceptions that could and would be done away with in time. Something of that sort is true also of Marshall. Although he developed the Cournot theory of monopoly and although he anticipated later analysis by calling attention to the fact that most firms have special markets of their own in which they set prices instead of merely accepting them, he as well as Wicksell framed his general conclusions on the pattern of perfect competition so as to suggest, much as the classics did, that perfect competition was the rule. Neither Marshall and Wicksell nor the classics saw that perfect competition is the exception and that even if it were the rule there would be much less reason for congratulation than one might think.

If we look more closely at the conditions—not all of them explicitly stated or even clearly seen by Marshall and Wicksell—that must be fulfilled in order to produce perfect competition, we realize immediately that outside of agricultural mass production there cannot be many instances of it. A farmer supplies his cotton or wheat in fact under those conditions: from his standpoint the ruling prices of cotton or wheat are data, though very variable ones, and not being able to influence them by his individual action he simply adapts his output; since all farmers do the same, prices and quantities will in the end be adjusted as the theory of perfect competition requires. But this is not so even with many agricultural products—with ducks, sausages, vegetables and many dairy products for instance. And as regards practically all the finished products and services of industry and trade, it is clear that every grocer, every filling station, every manufacturer of gloves or shaving cream or handsaws has a small and precarious market of his own which he tries—must try—to build up and to keep by price strategy, quality strategy—"product differentiation"—and advertising. Thus we get a completely different pattern which there seems to be no reason to expect to yield the results of perfect competition and which fits much better into the monopolistic schema. In these cases we speak of Monopolistic Competition. Their theory has been one of the major contributions to postwar economics.

There remains a wide field of substantially homogeneous products—mainly industrial raw materials and semi-finished products such as steel ingots, cement, cotton gray goods and the like—in which the conditions for the emergence of monopolistic competition do not seem to prevail. This is so. But in general, similar results follow for that field inasmuch as the greater part of it is covered by largest-scale firms which, either individually or in concert, are able to manipulate prices even without differentiating products—the case of Oligopoly—Again the monopoly schema, suitably adapted, seems to fit this type of behavior much better than does the schema of perfect competition.

As soon as the prevalence of monopolistic competition or of oligopoly or of combinations of the two is recognized, many of the propositions which the Marshall-Wicksell generation of economists used to teach with the utmost confidence become either inapplicable or much more difficult to prove. This holds true, in the first place, of the propositions turning on the fundamental concept of equilibrium, i.e., a determinate state of the economic organism, toward which any given state of it is always gravitating and which displays certain simple properties. In the general case of oligopoly there is in fact no determinate equilibrium at all and the possibility presents itself that there may be an endless sequence of moves and countermoves, an indefinite state of warfare between firms. It is true that there are many special cases in which a state of equilibrium theoretically exists. In the second place, even in these cases not only is it much harder to attain than...
Can Capitalism Survive?

The equilibrium in perfect competition, and still harder to preserve, but the "beneficial" competition of the classic type seems likely to be replaced by "predatory" or "cutthroat" competition or simply by struggles for control in the financial sphere. These things are so many sources of social waste, and there are many others such as the costs of advertising campaigns, the suppression of new methods of production (buying up of patents in order not to use them) and so on. And most important of all: under the conditions envisaged, equilibrium, even if eventually attained by an extremely costly method, no longer guarantees either full employment or maximum output in the sense of the theory of perfect competition. It may exist without full employment; it is bound to exist, so it seems, at a level of output below that maximum mark, because profit-conserving strategy, impossible in conditions of perfect competition, now not only becomes possible but imposes itself.

Well, does not this bear out what the man in the street (unless a businessman himself) always thought on the subject of private business? Has not modern analysis completely refuted the classical doctrine and justified the popular view? Is it not quite true after all, that there is little parallelism between producing for profit and producing for the consumer and that private enterprise is little more than a device to curtail production in order to extort profits which then are correctly described as tolls and ransoms?

CHAPTER VII

THE PROCESS OF CREATIVE DESTRUCTION

The theories of monopolistic and oligopolistic competition and their popular variants may in two ways be made to serve the view that capitalist reality is unfavorable to maximum performance in production. One may hold that it always has been so and that all along output has been expanding in spite of the secular sabotage perpetrated by the managing bourgeoisie. Advocates of this proposition would have to produce evidence to the effect that the observed rate of increase can be accounted for by a sequence of favorable circumstances unconnected with the mechanism of private enterprise and strong enough to overcome the latter's resistance. This is precisely the question which we shall discuss in Chapter IX. However, those who espouse this variant at least avoid the trouble about historical fact that the advocates of the alternative proposition have to face. This avers that capitalist reality once tended to favor maximum productive performance, or at all events productive performance so considerable as to constitute a major element in any serious appraisal of the system; but that the later spread of monopolist structures, killing competition, has by now reversed that tendency.

First, this involves the creation of an entirely imaginary golden age of perfect competition that at some time somehow metamorphosed itself into the monopolistic age, whereas it is quite clear that perfect competition has at no time been more of a reality than it is at present. Secondly, it is necessary to point out that the rate of increase in output did not decrease from the nineties from which, I suppose, the prevalence of the largest-size concerns, at least in manufacturing industry, would have to be dated; that there is nothing in the behavior of the time series of total output to suggest a "break in trend"; and, most important of all, that the modern standard of life of the masses evolved during the period of relatively unfettered "big business." If we list the items that enter the modern workman's budget and from 1899 on observe the course of their prices not in terms of money but in terms of the hours of labor that will buy them—i.e., each year's money prices divided by each year's hourly wage rates—we cannot fail to be struck by the rate of the advance which, considering the spectacular improvement in qualities, seems to have been greater and not smaller than it ever was before. If we economists were given less to wishful thinking and more to the observation of facts, doubts would
immediately arise as to the realistic virtues of a theory that would have led us to expect a very different result. Nor is this all. As soon as we go into details and inquire into the individual items in which progress was most conspicuous, the trail leads to the doors of the firms that work under conditions of comparatively free competition but precisely to the doors of the large concerns—which, as in the case of agricultural machinery, also account for much of the progress in the competitive sector—and a shocking suspicion dawns upon us that big business may have had more to do with creating that standard of life than with keeping it down.

The conclusions alluded to at the end of the preceding chapter are in fact almost completely false. Yet they follow from observations and theorems that are almost completely true. Both economists and popular writers have once more run away with some fragments of reality they happened to grasp. These fragments themselves were mostly seen correctly. Their formal properties were mostly developed correctly. But no conclusions about capitalist reality as a whole follow from such fragmentary analyses. If we draw them nevertheless, we can be right only by accident. That has been done. And the lucky accident did not happen.

The essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process. It may seem strange that anyone can fail to see so obvious a fact which moreover was long ago emphasized by Karl Marx. Yet that fragmentary analysis which yields the bulk of our propositions about the functioning of modern capitalism persistently neglects it. Let us restate the point and see how it bears upon our problem.

Capitalism, then, is by nature a form or method of economic change and not only never is but never can be stationary. And this evolutionary character of the capitalist process is not merely due to the fact that economic life goes on in a social and natural environment which changes and by its change alters the data of economic action; this fact is important and these changes (wars, revolutions and so on) often condition industrial change, but they are not its prime movers. Nor is this evolutionary character due to a quasi-automatic increase in population and capital or to the vagaries of monetary systems of

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1 As a matter of fact, those observations and theorems are not completely satisfactory. The usual expositions of the doctrine of imperfect competition fail in particular to give due attention to the many and important cases in which, even as a matter of static theory, imperfect competition approximates the results of perfect competition. There are other cases in which it does not do this, but offers compensations which, while not entering any output index, yet contribute to what the output index is in the last resort intended to measure—the cases in which a firm defends its market by establishing a name for quality and service for instance. However, in order to simplify matters, we will not take issue with that doctrine on its own ground.

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2 Those revolutions are not strictly incessant; they occur in discrete rushes which are separated from each other by spans of comparative quiet. The process as a whole works incessantly however, in the sense that there always is either revolution or absorption of the results of revolution, both together forming what are known as business cycles.
Can Capitalism Survive?

within the situation created by it. It must be seen in its role in the perennial gale of creative destruction; it cannot be understood irrespective of it or, in fact, on the hypothesis that there is a perennial lull.

But economists who, *ex visu* of a point of time, look for example at the behavior of an oligopolist industry—an industry which consists of a few big firms—and observe the well-known moves and countermoves within it that seem to aim at nothing but high prices and restrictions of output are making precisely that hypothesis. They accept the data of the momentary situation as if there were no past or future to it and think that they have understood what there is to understand if they interpret the behavior of those firms by means of the principle of maximizing profits with reference to those data. The usual theorist's paper and the usual government commission's report practically never try to see that behavior, on the one hand, as a result of a piece of past history and, on the other hand, as an attempt to deal with a situation that is sure to change presently—as an attempt by those firms to keep on their feet, on ground that is slipping away from under them. In other words, the problem that is usually being visualized is how capitalism administers existing structures, whereas the relevant problem is how it creates and destroys them. As long as this is not recognized, the investigator does a meaningless job. As soon as it is recognized, his outlook on capitalist practice and its social results changes considerably.¹

The first thing to go is the traditional conception of the *modus operandi* of competition. Economists are at long last emerging from the stage in which price competition was all they saw. As soon as quality competition and sales effort are admitted into the sacred precincts of theory, the price variable is ousted from its dominant position. However, it is still competition within a rigid pattern of invariant conditions, methods of production and forms of industrial organization in particular, that practically monopolizes attention. But in capitalist reality as distinguished from its textbook picture, it is not that kind of competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance)—competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and

¹ It should be understood that it is only our appraisal of economic performance and not our moral judgment that can be so changed. Owing to its autonomy, moral approval or disapproval is entirely independent of our appraisal of social (or any other) results, unless we happen to adopt a moral system such as utilitarianism which makes moral approval and disapproval turn on them *ex definitione*.
Now a theoretical construction which neglects this essential element of the case neglects all that is most typically capitalist about it; even if correct in logic as well as in fact, it is like Hamlet without the Danish prince.

Well he may manage within his inescapable limitations, he can never adapt himself to the methods of competitors who can afford to sell at the price at which he buys.

CHAPTER VIII
MONOPOLISTIC PRACTICES

What has been said so far is really sufficient to enable the reader to deal with the large majority of the practical cases he is likely to meet and to realize the inadequacy of most of those criticisms of the profit economy which, directly or indirectly, rely on the absence of perfect competition. Since, however, the bearing of our argument on some of those criticisms may not be obvious at a glance, it will be worth our while to elaborate a little in order to make a few points more explicit.

1. We have just seen that, both as a fact and as a threat, the impact of new things—new technologies for instance—on the existing structure of an industry considerably reduces the long-run scope and importance of practices that aim, through restricting output, at conserving established positions and at maximizing the profits accruing from them. We must now recognize the further fact that restrictive practices of this kind, as far as they are effective, acquire a new significance in the perennial gale of creative destruction, a significance which they would not have in a stationary state or in a state of slow and balanced growth. In either of these cases restrictive strategy would produce no result other than an increase in profits at the expense of buyers except that, in the case of balanced advance, it might still prove to be the easiest and most effective way of collecting the means by which to finance additional investment. But in the process of creative destruction, restrictive practices may do much to steady the ship and to alleviate temporary difficulties. This is in fact a very familiar argument which always turns up in times of depression and, as everyone knows, has become very popular with governments and their economic advisers—witness the NRA. While it has been so much misused and so faultily acted upon that most economists heartily despise it, those

1 Theorists are apt to look upon anyone who admits this possibility as guilty of gross error, and to prove immediately that financing by borrowing from banks or from private savers or, in the case of public enterprise, financing from the proceeds of an income tax is much more rational than is financing from surplus profits collected through a restrictive policy. For some patterns of behavior they are quite right. For others they are quite wrong. I believe that both capitalism and communism of the Russian type belong in the latter category. But the point is that theoretical considerations, especially theoretical considerations of the short-run kind, cannot solve, although they contribute to the solution of, the problem which we shall meet again in the next part.
same advisers who are responsible for this\textsuperscript{3} invariably fail to see its much more general rationale.

Practically any investment entails, as a necessary complement of entrepreneurial action, certain safeguarding activities such as insuring or hedging. Long-range investing under rapidly changing conditions, especially under conditions that change or may change at any moment under the impact of new commodities and technologies, is like shooting at a target that is not only indistinct but moving—and moving jerkily at that. Hence it becomes necessary to resort to such protecting devices as patents or temporary secrecy of processes or, in some cases, long-period contracts secured in advance. But these protecting devices which most economists accept as normal elements of rational management\textsuperscript{4} are only special cases of a larger class comprising many others which most economists condemn although they do not differ fundamentally from the recognized ones.

If for instance a war risk is insurable, nobody objects to a firm’s collecting the cost of this insurance from the buyers of its products. But that risk is no less an element in long-run costs, if there are no facilities for insuring against it, in which case a price strategy aiming at the same end will seem to involve unnecessary restriction and to be productive of excess profits. Similarly, if a patent cannot be secured or would not, if secured, effectively protect, other means may have to be used in order to justify the investment. Among them are a price policy that will make it possible to write off more quickly than would otherwise be rational, or additional investment in order to provide excess capacity to be used only for aggression or defense. Again, if long-period contracts cannot be entered into in advance, other means may have to be devised in order to tie prospective customers to the investing firm.

In analyzing such business strategy \textit{ex visu} of a given point of time, the investigating economist or government agent sees price policies that seem to him predatory and restrictions of output that seem to him synonymous with loss of opportunities to produce. He does not see that restrictions of this type are, in the conditions of the perennial gale, incidents, often unavoidable incidents, of a long-run process of expansion which they protect rather than impede. There is no more of paradox in this than there is in saying that motorcars are traveling faster than they otherwise would because they are provided with brakes.

\textsuperscript{3} In particular, it is easy to show that there is no sense, and plenty of harm, in a policy that aims at preserving “price parities.”

\textsuperscript{4} Some economists, however, consider that even those devices are obstructions to progress which, though perhaps necessary in capitalist society, would be absent in a socialist one. There is some truth in this. But that does not affect the proposition that the protection afforded by patents and so on is, in the conditions of a profit economy, on balance a propelling and not an inhibiting factor.

2. This stands out most clearly in the case of those sectors of the economy which at any time happen to embody the impact of new things and methods on the existing industrial structure. The best way of getting a vivid and realistic idea of industrial strategy is indeed to visualize the behavior of new concerns or industries that introduce new commodities or processes (such as the aluminum industry) or else reorganize a part or the whole of an industry (such as, for instance, the old Standard Oil Company).

As we have seen, such concerns are aggressors by nature and wield the really effective weapon of competition. Their intrusion can only in the rarest of cases fail to improve total output in quantity or quality, both through the new method itself—even if at no time used to full advantage—and through the pressure it exerts on the preexisting firms. But these aggressors are so circumstanced as to require, for purposes of attack and defense, also pieces of armor other than price and quality of their product which, moreover, must be strategically manipulated all along so that at any point of time they seem to be doing nothing but restricting their output and keeping prices high.

On the one hand, largest-scale plans could in many cases not materialize at all if it were not known from the outset that competition will be discouraged by heavy capital requirements or lack of experience, or that means are available to discourage or checkmate it so as to gain the time and space for further developments. Even the conquest of financial control over competing concerns in otherwise unsailable positions or the securing of advantages that run counter to the public’s sense of fair play—railroad rebates—move, as far as long-run effects on total output alone are envisaged, into a different light;\textsuperscript{4} they may be methods for removing obstacles that the institution of private property puts in the path of progress. In a socialist society that time and space would be no less necessary. They would have to be secured by order of the central authority.

On the other hand, enterprise would in most cases be impossible if

\textsuperscript{4} The qualification added removes, I think, any just cause for offense that the above proposition might conceivably cause. In case that qualification is not explicit enough, I beg leave to repeat that the moral aspect is in this case, as it must be in every case, entirely unaffected by an economic argument. For the rest, let the reader reflect that even in dealing with indubitably criminal actions every civilized judge and every civilized jury take account of the ulterior purpose in pursuit of which a crime has occurred and of the difference it makes whether an action that is a crime has or has not also effects they consider socially desirable. Another objection would be more to the point. If an enterprise can succeed only by such means, does not that prove in itself that it cannot spell social gain? A very simple argument can be framed in support of this view. But it is subject to a severe \textit{ceteris paribus} proviso. That is to say, it holds for conditions which are just about equivalent to excluding the process of creative destruction—capitalist reality. On reflection, it will be seen that the analogy of the practices under discussion with patents is sufficient to show this.
it were not known from the outset that exceptionally favorable situations are likely to arise which if exploited by price, quality and quantity manipulation will produce profits adequate to tide over exceptionally unfavorable situations provided these are similarly managed. Again this requires strategy that in the short run is often restrictive. In the majority of successful cases this strategy just manages to serve its purpose. In some cases, however, it is so successful as to yield profits far above what is necessary in order to induce the corresponding investment. These cases then provide the baits that lure capital on to untried trails. Their presence explains in part how it is possible for so large a section of the capitalist world to work for nothing: in the midst of the prosperous twenties just about half of the business corporations in the United States were run at a loss, at zero profits, or at profits which, if they had been foreseen, would have been inadequate to call forth the effort and expenditure involved.

Our argument however extends beyond the cases of new concerns, methods and industries. Old concerns and established industries, whether or not directly attacked, still live in the perennial gale. Situations emerge in the process of creative destruction in which many firms may have to perish that nevertheless would be able to live on vigorously and usefully if they could weather a particular storm. Short of such general crises or depressions, sectional situations arise in which the rapid change of data that is characteristic of that process so disorganizes an industry for the time being as to inflict functionless losses and to create avoidable unemployment. Finally, there is certainly no point in trying to conserve obsolescent industries indefinitely; but there is point in trying to avoid their coming down with a crash and in attempting to turn a rout, which may become a center of cumulative depressive effects, into orderly retreat. Correspondingly there is, in the case of industries that have sown their wild oats but are still gaining and not losing ground, such a thing as orderly advance.5

6A good example illustrative of this point—in fact of much of our general argument—is the postwar history of the automobile and the rayon industry. The first illustrates very well the nature and value of what we might call “edited” competition. The bonanza time was over by about 1916. A host of firms nevertheless crowded into the industry afterwards, most of which were eliminated by 1925. From a fierce life and death struggle three concerns emerged that by now account for over 80 per cent of total sales. They are under competitive pressure inasmuch as, in spite of the advantages of an established position, an elaborate sales and service organization and so on, any failure to keep up and improve the quality of their products or any attempt at monopolistic combination would call in new competitors. Among themselves, the three concerns behave in a way which should be called co-operative rather than competitive; they refrain from certain aggressive devices (which, by the way, would also be absent in perfect competition); they keep up with each other and in doing so play for points at the frontiers. This has now gone on for upwards of fifteen years and it is not obvious that if conditions of theoretically perfect competition had prevailed during that period, better

All this is of course nothing but the tritest common sense. But it is being overlooked with a persistence so stubborn as sometimes to raise the question of sincerity. And it follows that, within the process of creative destruction, all the realities of which theorists are in the habit of delegating to books and courses on business cycles, there is another side to industrial self-organization than that which these theorists are contemplating. “Restraints of trade” of the cartel type as well as those which merely consist in tacit understandings about price competition may be effective remedies under conditions of depression. As far as they are, they may in the end produce not only steadier but also greater expansion of total output than could be secured by an entirely uncontrolled onward rush that cannot fail to be studded with catastrophes. Nor can it be argued that these catastrophes occur in any case. We know what has happened in each historical case. We have a very imperfect idea of what might have happened, considering the tremendous pace of the process, if such pegs had been entirely absent.

Even as now extended however, our argument does not cover all cases of restrictive or regulating strategy, many of which no doubt have that injurious effect on the long-run development of output which is uncritically attributed to all of them. And even in the cases our argument does cover, the net effect is a question of the circumstances and of the way in which and the degree to which industry regulates itself in each individual case. It is certainly as conceivable that an all-pervading cartel system might sabotage all progress as it is that it might realize, with smaller social and private costs, all that perfect competition is supposed to realize. This is why our argument does not amount to a case against state regulation. It does show that there is no general case for indiscriminate “trust-busting” or for the prosecution of everything that qualifies as a restraint of trade. Rational as distinguished from vindictive regulation by public authority turns out to be an extremely delicate problem which not every government agency, particularly when in full cry against big business, can be trusted to solve.6 But our argument, framed to refute a preva-
lent theory and the inferences drawn therefrom about the relation between modern capitalism and the development of total output, only yields another theory, i.e., another outlook on facts and another principle by which to interpret them. For our purpose that is enough. For the rest, the facts themselves have the floor.

3. Next, a few words on the subject of Rigid Prices which has been receiving so much attention of late. It really is but a particular aspect of the problem we have been discussing. We shall define rigidity as follows: a price is rigid if it is less sensitive to changes in the conditions of demand and supply than it would be if perfect competition prevailed.7

Quantitatively, the extent to which prices are rigid in that sense depends on the method and the material of measurement we select and is hence a doubtful matter. But whatever the material or method, it is certain that prices are not nearly as rigid as they seem to be. There are many reasons why what in effect is a change in price should not show in the statistical picture; in other words, why there should be much spurious rigidity. I shall mention only one class of them which is closely connected with the facts stressed by our analysis.

I have adverted to the importance, for the capitalist process in general and for its competitive mechanism in particular, of the intrusion of new commodities. Now a new commodity may effectively bring down the preexisting structure and satisfy a given want at much lower prices per unit of service (transportation service for instance), and yet not a single recorded price need change in the process; flexibility in the relevant sense may be accompanied by rigidity in a formal sense. There are other cases, not of this type, in which price reduction is the sole motive for bringing out a new brand while the old one is left at the previous quotation—again a price reduction that does not show. Moreover, the great majority of new consumers' goods—particularly all the gadgets of modern life—are at first introduced in an experimental and unsatisfactory form in which they could never conquer their potential markets. Improvement in the quality of products is hence a practically universal feature of the development of individual concerns and of industries. Whether or not this improvement involves additional costs, a constant price per unit of an improving commodity should not be called rigid without further investigation.

Of course, plenty of cases of genuine price rigidity remain—of prices which are being kept constant as a matter of business policy or which remain unchanged because it is difficult to change, say, a price set by a cartel after laborious negotiations. In order to appraise the influence of this fact on the long-run development of output, it is first of all necessary to realize that this rigidity is essentially a short-run phenomenon. There are no major instances of long-run rigidity of prices. Whichever manufacturing industry or group of manufactured articles of any importance we choose to investigate over a period of time, we practically always find that in the long run prices do not fail to adapt themselves to technological progress—frequently they fall spectacularly in response to it—unless prevented from doing so by monetary events and policies or, in some cases, by autonomous changes in wage rates which of course should be taken into account by appropriate corrections exactly as should changes in quality of products.8

And our previous analysis shows sufficiently why in the process of capitalist evolution this must be so.

What the business strategy in question really aims at—after all, in any case, that it can achieve—is to avoid seasonal, random and cyclical fluctuations in prices and to move only in response to the more fundamental changes in the conditions that underlie those fluctuations. Since these more fundamental changes take time in declaring themselves, this involves moving slowly by discrete steps—keeping to a price until new relatively durable contours have emerged into view. In technical language, this strategy aims at moving along a step function that will approximate trends. And that is what genuine and voluntary price rigidity in most cases amounts to. In fact, most economists do admit this, at least by implication. For though some of their arguments about rigidity would hold true only if the phenomenon were a long-run one—for instance most of the arguments averring that price rigidity keeps the fruits of technological progress from consumers—in practice they measure and discuss primarily cyclical rigidity and especially the fact that many prices do not, or do not promptly, fall in recessions and depressions. The real question is there-

7 This definition suffices for our purposes but would not be satisfactory for others. See D. D. Humphrey's article in the Journal of Political Economy, October 1937, and E. S. Mason's article in the Review of Economic Statistics, May 1938. Professor Mason has shown, among other things, that contrary to a widespread belief price rigidity is not increasing or, at all events, that it is no greater than it was forty years ago, a result which in itself suffices to invalidate some of the implications of the current doctrine of rigidity.

8 They do not as a rule fall as they would under conditions of perfect competition. But this is true only ceteris paribus, and this proviso rob the proposition of all practical importance. I have adverted to this point before and shall return to it below (§ 5).

From a welfare standpoint, it is proper to adopt a definition different from ours, and to measure price changes in terms of the hours of labor that are currently necessary to earn the dollars which will buy given quantities of manufactured consumers' goods, taking account of changes of quality. We have already done this in the course of a previous argument. A long-run downward flexibility is then revealed that is truly impressive. Changes in price level raise another problem. So far as they reflect monetary influences they should be eliminated for most of the purposes of an investigation into rigidity. But so far as they reflect the combined effect of increasing efficiencies in all lines of production they should not.
fore how this short-run rigidity\textsuperscript{10} may affect the long-run development of total output. Within this question, the only really important issue is this: prices that stay up in recession or depression no doubt influence the business situation in those phases of the cycles; if that influence is strongly injurious—making matters much worse than they would be with perfect flexibility all round—the destruction wrought each time might also affect output in the subsequent recoveries and prosperities and thus permanently reduce the rate of increase in total output below what it would be in the absence of those rigidities. Two arguments have been put forth in favor of this view.

In order to put the first into the strongest possible light, let us assume that an industry which refuses to reduce prices in recession goes on selling exactly the same quantity of product which it would sell if it had reduced them. Buyers are therefore out of pocket by the amount to which the industry profits from the rigidity. If these buyers are the kind of people who spend all they can and if the industry or those to whom its net returns go does not spend the increment it gets but either keeps it idle or repays bank loans, then total expenditure in the economy may be reduced thereby. If this happens, other industries or firms may suffer and if thereupon they restrict in turn, we may get a cumulation of depressive effects. In other words, rigidity may so influence the amount and distribution of national income as to decrease balances or to increase idle balances or, if we adopt a popular misnomer, savings. Such a case is conceivable. But the reader should have little difficulty in satisfying himself\textsuperscript{31} that its practical importance, if any, is very small.

The second argument turns on the dislocating effects price rigidity may exert if, in the individual industry itself or elsewhere, it leads to an additional restriction of output, i.e., to a restriction greater than that which must in any case occur during depression. Since the most important conductor of those effects is the incident increase in unemployment—unstabilization of employment is in fact the indirect

\textsuperscript{10}It should, however, be observed that this short run may last longer than the term “short run” usually implies—sometimes ten years and even longer. There is not one cycle, but there are many simultaneous ones of varying duration. One of the most important ones lasts on the average about nine years and a half. Structural changes requiring price adjustments do in important cases occur in periods of about that length. The full extent of the spectacular changes reveals itself only in periods much longer than this. To do justice to aluminum, rayon, or motorcar prices one must survey a period of about forty-five years.

\textsuperscript{31}The best method of doing this is to work out carefully all the assumptions involved, not only in the strong case imagined but also in the weaker cases that are less unlikely to occur in practice. Moreover, it should not be forgotten that the profit due to keeping prices up may be the means of avoiding bankruptcy or at least the necessity of discontinuing operations, both of which might be much more effective in starting a downward “vicious spiral” than is a possible reduction in total expenditure. See the comments on the second argument.

The argument most commonly directed against price rigidity—and the consequent decrease in total expenditure, this argument then follows in the tracks of the first one. Its practical weight is considerably reduced, although economists greatly differ as to the extent, by the consideration that in the most conspicuous cases price rigidity is motivated precisely by the low sensitiveness of demand to short-run price changes within the practicable range. People who in depression worry about their future are not likely to buy a new car even if the price were reduced by 25 per cent, especially if the purchase is easily postponable and if the reduction induces expectations of further reductions.

Quite irrespective of this, however, the argument is inconclusive because it is again vitiated by a ceteris paribus clause that is inadmissible in dealing with our process of creative destruction. From the fact, so far as it is a fact, that at more flexible prices greater quantities could ceteris paribus be sold, it does not follow that either the output of the commodities in question, or total output and hence employment, would actually be greater. For inasmuch as we may assume that the refusal to lower prices strengthens the position of the industries which adopt that policy either by increasing their revenue or simply by avoiding chaos in their markets—that is to say, so far as this policy is something more than a mistake on their part—it may make fortresses out of what otherwise might be centers of devastation. As we have seen before, from a more general standpoint, total output and employment may well keep on a higher level with the restrictions incident to that policy than they would if depression were allowed to play havoc with the price structure.\textsuperscript{12} In other words, under the conditions created by capitalist evolution, perfect and universal flexibility of prices might in depression further unstabilize the system, instead of stabilizing it as it no doubt would under the conditions envisaged by general theory. Again this is to a large extent recognized in those cases in which the economist is in sympathy with the interests immediately concerned, for instance in the case of labor and of agriculture; in those cases he admits readily enough that what looks like rigidity may be no more than regulated adaptation.

Perhaps the reader feels some surprise that so little remains of a doctrine of which so much has been made in the last few years. The rigidity of prices has become, with some people, the outstanding defect of the capitalist engine and—almost—the fundamental factor in the explanation of depressions. But there is nothing to wonder at in this. Individuals and groups snatch at anything that will qualify as a discovery lending support to the political tendencies of the hour. The
Can Capitalism Survive?

4. Another doctrine has crystallized into a slogan, viz., that in the era of big business the maintenance of the value of existing investment—conservation of capital—becomes the chief aim of entrepreneurial activity and bids fair to put a stop to all cost-reducing improvement. Hence the capitalist order becomes incompatible with progress.

Progress entails, as we have seen, destruction of capital values in the strata with which the new commodity or method of production competes. In perfect competition the old investments must be adapted at a sacrifice or abandoned; but when there is no perfect competition and when each industrial field is controlled by a few big concerns, these can in various ways fight the threatening attack on their capital structure and try to avoid losses on their capital accounts; that is to say, they can and will fight progress itself.

So far as this doctrine merely formulates a particular aspect of restrictive business strategy, there is no need to add anything to the argument already sketched in this chapter. Both as to the limits of that strategy and as to its functions in the process of creative destruction, we should only be repeating what has been said before. This becomes still more obvious if we observe that conserving capital values is the same thing as conserving profits. Modern theory tends in fact to use the concept Present Net Value of Assets (= capital values) in place of the concept of Profits. Both asset values and profits are of course not being simply conserved but maximized.

But the point about the sabotage of cost-reducing improvement still calls for comment in passing. As a little reflection will show, it is sufficient to consider the case of a concern that controls a technological device—some patent, say—the use of which would involve scrapping some or all of its plant and equipment. Will it, in order to conserve its capital values, refrain from using this device when a management not fettered by capitalist interests such as a socialist management could and would use it to the advantage of all?

Again it is tempting to raise the question of fact. The first thing a modern concern does as soon as it feels that it can afford it is to establish a research department every member of which knows that his bread and butter depends on his success in devising improvements. This practice does not obviously suggest aversion to technological progress. Nor can we in reply be referred to the cases in which patents acquired by business concerns have not been used promptly or not been used at all. For there may be perfectly good reasons for this; for example, the patented process may turn out to be no good or at least not to be in shape to warrant application on a commercial basis. Neither the inventors themselves nor the investigating economists doctrine of price rigidity, with a modicum of truth to its credit, is not the worst case of this kind by a long way.

13 Incidentally, it should be noticed that the kind of restrictive practice under discussion, granted that it exists to a significant extent, would not be without compensatory effects on social welfare. In fact, the same critics who talk about sabotage of progress at the same time emphasize the social losses incident to the pace of capitalist progress, particularly the unemployment which that pace entails and which slower advance might mitigate to some extent. Well, is technological progress too quick or too slow for them? They had better make up their minds.

14 It should be observed that even if the argument were correct, it would still be inadequate to support the thesis that capitalism is, under the conditions envisaged, "incompatible with technological progress." All that it would prove is, for some cases, the presence of a lag of ordinarily moderate length in the introduction of new methods.
It is however not true that private firms owning equipment the value of which is endangered by a new method which they also control—if they do not control it, there is no problem and no indictment—will adopt the new method only if total unit cost with it is smaller than prime unit cost with the old one, or if the old investment has been completely written off according to the schedule decided on before the new method presented itself. For if the new machines when installed are expected to outlive the rest of the period previously set for the use of the old machines, their discounted remainder value as of that date is another asset to be taken account of. Nor is it true, for analogous reasons, that a socialist management, if acting rationally, would always and immediately adopt any new method which promises to produce at smaller total unit costs or that this would be to the social advantage.

There is however another element which profoundly affects behavior in this matter and which is being invariably overlooked. This is what might be called ex ante conservation of capital in expectation of further improvement. Frequently, if not in most cases, a going concern does not simply face the question whether or not to adopt a definite new method of production that is the best thing out and, in the form immediately available, can be expected to retain that position for some length of time. A new type of machine is in general but a link in a chain of improvements and may presently become obsolete. In a case like this it would obviously not be rational to follow the chain link by link regardless of the capital loss to be suffered each time. The real question then is at which link the concern should take action. The answer must be in the nature of a compromise between considerations that rest largely on guesses. But it will as a rule involve some waiting in order to see how the chain behaves. And to the outsider this may well look like trying to stifle improvement in order to conserve existing capital values. Yet even the most patient of comrades would revolt if a socialist management were so foolish as to follow the advice of the theorist and to keep on scrapping plant and equipment every year.

5. I have entitled this chapter as I did because most of it deals with the facts and problems that common parlance associates with monopoly or monopolistic practice. So far I have as much as possible refrained from using those terms in order to reserve for a separate section some comments on a few topics specifically connected with them. Nothing will be said however that we have not already met in one form or another.

(a) To begin with, there is the term itself. Monopolist means Single

16 There are of course many other elements. The reader will please understand that in dealing with a few questions of principles it is impossible to do full justice to any of the topics touched upon.
on. But this is not all. Economists, government agents, journalists and politicians in this country obviously love the word because it has come to be a term of opprobrium which is sure to rouse the public's hostility against any interest so labeled. In the Anglo-American world monopoly has been cursed and associated with functionless exploitation ever since, in the sixteenth and seventeenth centuries, it was English administrative practice to create monopoly positions in large numbers which, on the one hand, answered fairly well to the theoretical pattern of monopolist behavior and, on the other hand, fully justified the wave of indignation that impressed even the great Elizabeth.

Nothing is so retentive as a nation's memory. Our time offers other and more important instances of a nation's reaction to what happened centuries ago. That practice made the English-speaking public so monopoly-conscious that it acquired a habit of attributing to that sinister power practically everything it disliked about business. To the typical liberal bourgeois in particular, monopoly became the father of almost all abuses—in fact, it became his pet bogey. Adam Smith,15 thinking primarily of monopolies of the Tudor and Stuart type, frowned on them in awful dignity. Sir Robert Peel—who like most conservatives occasionally knew how to borrow from the arsenal of the demagogue—in his famous epilogue to his last period of office that gave so much offense to his associates, spoke of a monopoly of bread or wheat, though English grain production was of course perfectly competitive in spite of protection.16 And in this country monopoly is being made practically synonymous with any large-scale business.

(b) The theory of simple and discriminating monopoly teaches that, excepting a limiting case, monopoly price is higher and monopoly output smaller than competitive price and competitive output. This is true provided that the method and organization of production—and everything else—are exactly the same in both cases. Actually how to dawn to the effect that even though some pressure can be exerted on them in the short run, long-run developments might eventually destroy practically all that was left on the lists.

There was more excuse for that uncritical attitude in the case of Adam Smith and the classics in general than there is in the case of their successors because big business in our sense had not then emerged. But even so they went too far. In part this was due to the fact that they had no satisfactory theory of monopoly which induced them not only to apply the term rather promiscuously (Adam Smith and even Senior interpreted for instance the rent of land as a monopoly, gain) but also to look upon the monopolists' power of exploitation as practically unlimited which is of course wrong even for the most extreme cases. This instance illustrates the way in which the term keeps on creeping into illegitimate uses. Protection of agriculture and a monopoly of agrarian products are entirely different things. The struggle was over protection and not over a non-existent cartel of either landowners or farmers. But in fighting protection it was just as well to beat up for applause. And there was evidently no simpler means of doing so than by calling protectionists monopolists.

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Monopolistic Practices ever there are superior methods available to the monopolist which either are not available at all to a crowd of competitors or are not available to them so readily: for there are advantages which, though not strictly unattainable on the competitive level of enterprise, are as a matter of fact secured only on the monopoly level, for instance, because monopolization may increase the sphere of influence of the better, and decrease the sphere of influence of the inferior, brains, or because the monopoly enjoys a disproportionately higher financial standing. Whenever this is so, then that proposition is no longer true. In other words, this element of the case for competition may fail completely because monopoly prices are not necessarily higher or monopoly outputs smaller than competitive prices and outputs would be at the levels of productive and organizational efficiency that are within the reach of the type of firm compatible with the competitive hypothesis.

There cannot be any reasonable doubt that under the conditions of our epoch such superiority is as a matter of fact the outstanding feature of the typical large-scale unit of control, though mere size is neither necessary nor sufficient for it. These units not only arise in the process of creative destruction and function in a way entirely different from the static schema, but in many cases of decisive importance they provide the necessary form for the achievement. They largely create what they exploit. Hence the usual conclusion about their influence on long-run output would be invalid even if they were genuine monopolies in the technical sense of the term.

Motivation is quite immaterial. Even if the opportunity to set monopolist prices were the sole object, the pressure of the improved methods or of a huge apparatus would in general tend to shift the point of the monopolist's optimum toward or beyond the competitive cost price in the above sense, thus doing the work—partly, wholly, or more than wholly—of the competitive mechanism, even if re-
striiction is practiced and excess capacity is in evidence all along. Of course if the methods of production, organization and so on are not improved by or in connection with monopolization as is the case with an ordinary cartel, the classical theorem about monopoly price and output comes into its own again. So does another popular idea, viz., that monopolization has a soporific effect. For this, too, it is not difficult to find examples. But no general theory should be built upon it. For, especially in manufacturing industry, a monopoly position is in general no cushion to sleep on. As it can be gained, so it can be retained only by alertness and energy. What soporific influence there is in modern business is due to another cause that will be mentioned later.

§ 1. The term dynamics is loosely used and carries many different meanings. The restriction is practiced and excess capacity is in evidence all along. The grocer in a village on the Ohio may be a true monopolist for hours or even days during an inundation. Every successful corner may spell monopoly for the moment. A firm specializing in paper labels for beer bottles may be so circumstanced—potential competitors realizing that what seems to be good profits would be immediately destroyed by their entering the field—that it can move at pleasure on a moderate but still finite stretch of the demand curve, at least until the metal label smashes that demand curve to pieces.

New methods of production or new commodities, especially the latter, do not per se confer monopoly, even if used or produced by a single firm. The product of the new method has to compete with the products of the old ones and the new commodity has to be introduced, i.e., its demand schedule has to be built up. As a rule neither patents nor monopolistic practices avail against that. But they may in cases of spectacular superiority of the new device, particularly if it can be leased like shoe machinery; or in cases of new commodities, the permanent demand schedule for which has been established before the patent has expired.

Thus it is true that there is or may be an element of genuine monopoly gain in those entrepreneurial profits which are the prizes offered by capitalist society to the successful innovator. But the quantitative importance of that element, its volatile nature and its function in the process in which it emerges put it in a class by itself. The main value to a concern of a single seller position that is secured by patent or monopolistic strategy does not consist so much in the opportunity...

Monopolistic Practices

to behave temporarily according to the monopolist schema, as in the protection it affords against temporary disorganization of the market and the space it secures for long-range planning. Here however the argument merges into the analysis submitted before.

6. Glancing back we realize that most of the facts and arguments touched upon in this chapter tend to dim the halo that once surrounded perfect competition as much as they suggest a more favorable view of its alternative. I will now briefly restate our argument from this angle.

Traditional theory itself, even within its chosen precincts of a stationary or steadily growing economy, has since the time of Marshall and Edgeworth been discovering an increasing number of exceptions to the old propositions about perfect competition and, incidentally, free trade, that have shaken that unqualified belief in its virtues cherished by the generation which flourished between Ricardo and Marshall—roughly, J. S. Mill's generation in England and Francesco Ferrara's on the Continent. Especially the propositions that a perfectly competitive system is ideally economical of resources and allocates them in a way that is optimal with respect to a given distribution of income—propositions very relevant to the question of the behavior of output—cannot now be held with the old confidence. Much more serious is the breach made by more recent work in the field of dynamic theory (Frisch, Tinbergen, Roos, Hicks and others). Dynamic analysis is the analysis of sequences in time. In explaining why a certain economic quantity, for instance a price, is what we find it to be at a given moment, it takes into consideration not only the state of other economic quantities at the same moment, as static theory does, but also their state at preceding points of time, and the expectations about their future values. Now the first thing we discover in working out the propositions that thus relate quantities belonging to different points of time is the fact that, once equilibrium has been destroyed by some disturbance, the process of establishing a new one is not so sure and prompt and economical as the old theory of perfect competition made it out to be; and the possibility that the very struggle for adjustment might lead such a system farther away from instead of nearer to a new equilibrium. This will happen in most cases unless the disturbance is small. In many cases, lagged adjustment is sufficient to produce this result.

All I can do here is to illustrate by the oldest, simplest and most familiar example. Suppose that demand and intended supply are in...
equilibrium in a perfectly competitive market for wheat, but that bad weather reduces the crop below what farmers intended to supply. If price rises accordingly and the farmers thereupon produce that quantity of wheat which it would pay them to produce if that new price were the equilibrium price, then a slump in the wheat market will ensue in the following year. If now the farmers correspondingly restrict production, a price still higher than in the first year may result to induce a still greater expansion of production than occurred in the second year. And so on (as far as the pure logic of the process is concerned) indefinitely. The reader will readily perceive, from a survey of the assumptions involved, that no great fear need be entertained of ever higher prices and ever greater outputs alternating till doomsday. But even if reduced to its proper proportions, the phenomenon suffices to show up glaring weaknesses in the mechanism of perfect competition. As soon as this is realized much of the optimism that used to grace the practical implications of the theory of this mechanism passes out through the ivory gate.

But from our standpoint we must go further than that. If we try to visualize how perfect competition works or would work in the process of creative destruction, we arrive at a still more discouraging result. This will not surprise us, considering that all the essential facts of that process are absent from the general schema of economic life that yields the traditional propositions about perfect competition. At the risk of repetition I will illustrate the point once more.

Perfect competition implies free entry into every industry. It is quite true, within that general theory, that free entry into all industries is a condition for optimal allocation of resources and hence for maximizing output. If our economic world consisted of a number of established industries producing familiar commodities by established and substantially invariant methods and if nothing happened except that additional men and additional savings combine in order to set up new firms of the existing type, then impediments to their entry into any industry they wish to enter would spell loss to the community. But perfectly free entry into a new field may make it impossible to enter it at all. The introduction of new methods of production and new commodities is hardly conceivable with perfect—and perfectly prompt—competition from the start. And this means that the bulk of what we call economic progress is incompatible with it. As a matter of fact, perfect competition is and always has been temporarily suspended whenever anything new is being introduced—automatically or by measures devised for the purpose—even in otherwise perfectly competitive conditions.

Similarly, within the traditional system the usual indictment of rigid prices stands all right. Rigidity is a type of resistance to adaptation that perfect and prompt competition excludes. And for the kind of adaptation and for those conditions which have been treated by traditional theory, it is again quite true that such resistance spells loss and reduced output. But we have seen that in the spurts and vicissitudes of the process of creative destruction the opposite may be true: perfect and instantaneous flexibility may even produce functionless catastrophes. This of course can also be established by the general dynamic theory which, as mentioned above, shows that there are attempts at adaptation that intensify disequilibrium.

Again, under its own assumptions, traditional theory is correct in holding that profits above what is necessary in each individual case to call forth the equilibrium amount of means of production, entrepreneurial ability included, both indicate and in themselves imply net social loss and that business strategy that aims at keeping them alive is inimical to the growth of total output. Perfect competition would prevent or immediately eliminate such surplus profits and leave no room for that strategy. But since in the process of capitalist evolution these profits acquire new organic functions—I do not want to repeat what they are—that fact cannot any longer be unconditionally credited to the account of the perfectly competitive model, so far as the secular rate of increase in total output is concerned.

Finally, it can indeed be shown that, under the same assumptions which amount to excluding the most characteristic features of capitalist reality, a perfectly competitive economy is comparatively free from waste and in particular from those kinds of waste which we most readily associate with its counterpart. But this does not tell us anything about how its account looks under the conditions set by the process of creative destruction.

On the one hand, much of what without reference to those conditions would appear to be unrelieved waste ceases to qualify as such when duly related to them. The type of excess capacity for example that owes its existence to the practice of "building ahead of demand" or to the practice of providing capacity for the cyclical peaks of demand would in a regime of perfect competition be much reduced. But when all the facts of the case are taken into consideration,
it is no longer correct to say that perfect competition wins out on that score. For though a concern that has to accept and cannot set prices would, in fact, use all of its capacity that can produce at marginal costs covered by the ruling prices, it does not follow that it would ever have the quantity and quality of capacity that big business has created and was able to create precisely because it is in a position to use it "strategically." Excess capacity of this type may—it does in some and does not in other cases—constitute a reason for claiming superiority for a socialist economy. But it should not without qualification be listed as a claim to superiority of the perfectly competitive species of capitalist economy as compared with the "monopoloid" species.

On the other hand, working in the conditions of capitalist evolution, the perfectly competitive arrangement displays wastes of its own. The firm of the type that is compatible with perfect competition is in many cases inferior in internal, especially technological, efficiency. If it is, then it wastes opportunities. It may also in its endeavors to improve its methods of production waste capital because it is in a less favorable position to evolve and to judge new possibilities. And, as we have seen before, a perfectly competitive industry is much more apt to be routed—and to scatter the bacilli of depression—under the impact of progress or of external disturbance than is big business. In the last resort, American agriculture, English coal mining, the English textile industry are costing consumers much more and are affecting total output much more injuriously than they would if controlled, each of them, by a dozen good brains.

Thus it is not sufficient to argue that because perfect competition is impossible under modern industrial conditions—or because it always has been impossible—the large-scale establishment or unit of control must be accepted as a necessary evil inseparable from the economic progress which it is prevented from sabotaging by the forces inherent in its productive apparatus. What we have got to accept is that it has come to be the most powerful engine of that progress and in particular of the long-run expansion of total output not only in spite of, but to a considerable extent through, this strategy which looks so restrictive when viewed in the individual case and from the individual point of time. In this respect, perfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency. It is hence a mistake to base the theory of government regulation of industry on the principle that big business should be made to work as the respective industry would work in perfect competition. And socialists should rely for their criticisms on the virtues of a socialist economy rather than on those of the competitive model.

It is for the reader to decide how far the preceding analysis has attained its object. Economics is only an observational and interpretative science which implies that in questions like ours the room for difference of opinion can be narrowed but not reduced to zero. For the same reason the solution of our first problem only leads to the door of another which in an experimental science would not arise at all.

The first problem was to find out whether there is, as I have put it (p. 72), "an understandable relation" between the structural features of capitalism as depicted by various analytic "models" and the economic performance as depicted, for the epoch of intact or relatively unfettered capitalism, by the index of total output. My affirmative answer to this question was based upon an analysis that ran on lines approved by most economists up to the point at which what is usually referred to as the modern tendency toward monopolistic control entered the scene. After that my analysis deviated from the usual lines in an attempt to show that what practically everyone concedes to the capitalism of perfect competition (whether a theoretical construction, or, at some time or other, a historical reality) must also to even a greater degree be conceded to big-business capitalism. Since however we cannot put the driving power and the engine into an experiment station in order to let them perform under carefully controlled conditions, there is no way of proving, beyond the possibility of doubt, their adequacy to produce just that result, viz., the observed development of output. All we can say is that there was a rather striking performance and that the capitalist arrangement was favorable to producing it. And this is precisely why we cannot stop at our conclusion but have to face another problem.

A priori it might still be possible to account for the observed performance by exceptional circumstances which would have asserted themselves in any institutional pattern. The only way to deal with this possibility is to examine the economic and political history of the period in question and to discuss such exceptional circumstances as we may be able to find. We will attack the problem by considering those candidates for the role of exceptional circumstances not inherent in the business processes of capitalism which have been put up by economists or historians. There are five of them.

The first is government action which, though I quite agree with
CHAPTER XIV

DECOMPOSITION

1. Faced by the increasing hostility of the environment and by the legislative, administrative and judicial practice born of that hostility, entrepreneurs and capitalists—in fact the whole stratum that accepts the bourgeois scheme of life—will eventually cease to function. Their standard aims are rapidly becoming unattainable, their efforts futile. The most glamorous of these bourgeois aims, the foundation of an industrial dynasty, has in most countries become unattainable already, and even more modest ones are so difficult to attain that they may cease to be thought worth the struggle as the permanence of these conditions is being increasingly realized.

Considering the role of bourgeois motivation in the explanation of the economic history of the last two or three centuries, its smothering by the unfavorable reactions of society or its weakening by disuse no doubt constitutes a factor adequate to explain a flop in the capitalist process—should we ever observe it as a permanent phenomenon—and one that is much more important than any of those that are presented by the Theory of Vanishing Investment Opportunity. It is hence interesting to observe that that motivation not only is threatened by forces external to the bourgeois mind but that it also tends to die out from internal causes. There is of course close interdependence between the two. But we cannot get at the true diagnosis unless we try to disentangle them.

One of those "internal causes" we have already met with. I have dubbed it Evaporation of the Substance of Property. We have seen that, normally, the modern businessman, whether entrepreneur or mere managing administrator, is of the executive type. From the logic of his position he acquires something of the psychology of the salaried employee working in a bureaucratic organization. Whether a stockholder or not, his will to fight and to hold on is not and cannot be what it was with the man who knew ownership and its responsibilities in the full-blooded sense of these words. His system of values and his conception of duty undergo a profound change. Mere stockholders of course have ceased to count at all—quite independently of the clipping of their share by a regulating and taxing state. Thus the modern corporation, although the product of the capitalist process, socializes the bourgeois mind; it relentlessly narrows the scope of capitalist motivation; not only that, it will eventually kill its roots.¹

¹ Many people will deny this. This is due to the fact that they derive their impression from past history and from the slogans generated by past history during the industrial dynasties period.
amount of loss of comfort, of freedom from care, and opportunity
to enjoy alternatives of increasing attractiveness and variety—alternatives to be compared with joys of parenthood that are being subjected to a critical analysis of increasing severity. The implication of this is not weakened but strengthened by the fact that the balance sheet is likely to be incomplete, perhaps even fundamentally wrong. For the greatest of the assets, the contribution made by parenthood to physical and moral health—to "normality" as we might express it—particularly in the case of women, almost invariably escapes the rational searchlight of modern individuals who, in private as in public life, tend to focus attention on ascertainable details of immediate utilitarian relevance and to sneer at the idea of hidden necessities of human nature or of the social organism. The point I wish to convey is, I think, clear without further elaboration. It may be summed up in the question that is so clearly in many potential parents' minds: "Why should we stunt our ambitions and impoverish our lives in order to be insulted and looked down upon in our old age?"

While the capitalist process, by virtue of the psychic attitudes it creates, progressively dims the values of family life and removes the conscientious inhibitions that an old moral tradition would have put in the way toward a different scheme of life, it at the same time implements the new tastes. As regards childlessness, capitalist inventiveness produces contraceptive devices of ever-increasing efficiency that overcome the resistance which the strongest impulse of man would otherwise have put up. As regards the style of life, capitalist evolution decreases the desirability of, and provides alternatives to, the bourgeois family home. I have previously adverted to the Evaporation of Indus-

rial Property; I have now to advert to the Evaporation of Consumers' Property.

Until the later decades of the nineteenth century, the town house and the country place were everywhere not only pleasant and convenient shells of private life on the higher levels of income, but they were indispensable. Not only hospitality on any scale and in any style, but even the comfort, dignity, repose and refinement of the family depended upon its having an adequate foyer of its own that was adequately staffed. The arrangements summarized by the term Home were accordingly accepted as a matter of course by the average man and woman of bourgeois standing, exactly as they looked upon marriage and children—the "founding of a family"—as a matter of course.

Now, on the one hand, the amenities of the bourgeois home are becoming less obvious than are its burdens. To the critical eye of a critical age it is likely to appear primarily as a source of trouble and expense which frequently fail to justify themselves. This would be so even independently of modern taxation and wages and of the attitude of modern household personnel, all of which are typical results of the capitalist process and of course greatly strengthen the case against what in the near future will be almost universally recognized as an outmoded and uneconomical way of life. In this respect as in others we are living in a transitional stage. The average family of bourgeois standing tends to reduce the difficulties of running the big house and the big country place by substituting for it small and mechanized establishments plus a maximum of outside service and outside life—hospitality in particular being increasingly shifted to the restaurant or club.

On the other hand, the home of the old type is no longer an indispensable requirement of comfortable and refined living in the bourgeois sphere. The apartment house and the apartment hotel represent a rationalized type of abode and another style of life which when fully developed will no doubt meet the new situation and provide all the essentials of comfort and refinement. To be sure, neither that style nor its shell are fully developed anywhere as yet and they proffer cost advantage only if we count in the trouble and annoyance incident to running a modern home. But other advantages they proffer already—the facility of using to the full the variety of modern enjoyments, of travel, of ready mobility, of shifting the load of the current little things of existence to the powerful shoulders of highly specialized organizations.

It is easy to see how this in turn bears, in the upper strata of capitalist society, upon the problems of the child. Again there is interaction: the passing of the spacious home—in which alone the rich life of a numerous family can unfold—and the increasing friction with which it functions supply another motive for avoiding the cares of parenthood; but the decline of philoprogenitiveness in turn renders the spacious home less worth while.

I have said that the new style of bourgeois life does not as yet offer any decisive cost advantage. But this refers only to the current or prime costs of servicing the wants of private life. As to overhead, even the purely pecuniary advantage is obvious already. And inasmuch as the outlay on the most durable elements of home life—especially the house, the pictures, the furniture—used to be financed mainly from previous earnings we may say that the need for accumulation of "consumers' capital" is drastically reduced by that process. This does not mean of course that demand for "consumers' capital" is at present, even relatively, smaller than it was; the increasing demand for durable consumers' goods from small and medium incomes more than counterbalances this effect. But it does mean that, so far as the hedonic component in the pattern of acquisitive motives is concerned, the desirability of incomes beyond a certain level is reduced. In order to satisfy

2 Modern relations between parents and children are of course partly conditioned by the crumbling of that steady frame of family life.
herself of this, the reader need only visualize the situation in a thoroughly practical spirit: the successful man or couple or the "society" man or couple who can pay for the best available accommodation in hotel, ship and train, and for the best available qualities of the objects of personal consumption and use—which qualities are increasingly being turned out by the conveyor of mass production—will, things being what they are, as a rule have all they want with any intensity for themselves. And it is easy to see that a budget framed on those lines will be far below the requirements of a "seignioral" style of life.

3. In order to realize what all this means for the efficiency of the capitalist engine of production we need only recall that the family and the family home used to be the mainspring of the typically bourgeois kind of profit motive. Economists have not always given due weight to this fact. When we look more closely at their idea of the self-interest of entrepreneurs and capitalists we cannot fail to discover that the results it was supposed to produce are really not at all what one would expect from the rational self-interest of the detached individual or the childless couple who no longer look at the world through the windows of a family home. Consciously or unconsciously they analyzed the behavior of the man whose views and motives are shaped by such a home and who means to work and to save primarily for wife and children. As soon as these fade out from the moral vision of the businessman, we have a different kind of homo oeconomicus before us who cares for different things and acts in different ways. For him and from the standpoint of his individualistic utilitarianism, the behavior of that old type would in fact be completely irrational. He loses the only sort of romance and heroism that is left in the unromantic and unheroic civilization of capitalism—the heroism of navigare necesse est, vivere non necesse est. And he loses the capitalist ethics that enjoins working for the future irrespective of whether or not one is going to harvest the crop oneself.

The last point may be put more tellingly. In the preceding chapter it was observed that the capitalist order entrusts the long-run interests of society to the upper strata of the bourgeoisie. They are really entrusted to the family motive operative in those strata. The bourgeoisie worked primarily in order to invest, and it was not so much a standard of consumption as a standard of accumulation that the bourgeoisie struggled for and tried to defend against governments that took the

Effects on consumers' budgets of the increasing eligibility of mass-produced articles are enhanced by the price difference between them and the corresponding custom-made articles which increases owing to the increase in wages pari passu with the decrease in the relative desirability of the latter; the capitalist process democratizes consumption.

"Seafaring is necessary, living is not necessary." Inscription on an old house in Bremen.

short-run view. With the decline of the driving power supplied by the family motive, the businessman's time-horizon shrinks, roughly, to his life expectation. And he might now be less willing than he was to fulfill that function of earning, saving and investing even if he saw no reason to fear that the results would but swell his tax bills. He drifts into an anti-saving frame of mind and accepts with an increasing readiness anti-saving theories that are indicative of a short-run philosophy.

But anti-saving theories are not all that he accepts. With a different attitude to the concern he works for and with a different scheme of private life he tends to acquire a different view of the values and standards of the capitalist order of things. Perhaps the most striking feature of the picture is the extent to which the bourgeoisie, besides educating its own enemies, allows itself in turn to be educated by them. It absorbs the slogans of current radicalism and seems quite willing to undergo a process of conversion to a creed hostile to its very existence. Haltingly and grudgingly it concedes in part the implications of that creed. This would be most astonishing and indeed very hard to explain were it not for the fact that the typical bourgeois is rapidly losing faith in his own creed. And this again becomes fully understandable as soon as we realize that the social conditions which account for its emergence are passing.

This is verified by the very characteristic manner in which particular capitalist interests and the bourgeoisie as a whole behave when facing direct attack. They talk and plead—or hire people to do it for them; they snatch at every chance of compromise; they are ever ready to give in; they never put up a fight under the flag of their own ideals and interests—in this country there was no real resistance anywhere against the imposition of crushing financial burdens during the last decade or against labor legislation incompatible with the effective management of industry. Now, as the reader will surely know by this time, I am far from overestimating the political power of either big business or the bourgeoisie in general. Moreover, I am prepared to make large allowances for cowardice. But still, means of defense were not entirely lacking as yet and history is full of examples of the success of small groups who, believing in their cause, were resolved to stand by their guns. The only explanation for the meekness we observe is that the bourgeois order no longer makes any sense to the bourgeoisie itself and that, when all is said and nothing is done, it does not really care.

Thus the same economic process that undermines the position of the bourgeoisie by decreasing the importance of the functions of entre...
preneurs and capitalists, by breaking up protective strata and institutions, by creating an atmosphere of hostility, also decomposes the motor forces of capitalism from within. Nothing else shows so well that the capitalist order not only rests on props made of extra-capitalist material but also derives its energy from extra-capitalist patterns of behavior which at the same time it is bound to destroy.

We have rediscovered what from different standpoints and, so I believe, on inadequate grounds has often been discovered before: there is inherent in the capitalist system a tendency toward self-destruction which, in its earlier stages, may well assert itself in the form of a tendency toward retardation of progress.

I shall not stay to repeat how objective and subjective, economic and extra-economic factors, reinforcing each other in imposing accord, contribute to that result. Nor shall I stay to show what should be obvious and in subsequent chapters will become more obvious still, viz., that those factors make not only for the destruction of the capitalist but for the emergence of a socialist civilization. They all point in that direction. The capitalist process not only destroys its own institutional framework but it also creates the conditions for another. Destruction may not be the right word after all. Perhaps I should have spoken of transformation. The outcome of the process is not simply a void that could be filled by whatever might happen to turn up; things and souls are transformed in such a way as to become increasingly amenable to the socialist form of life. With every peg from under the capitalist structure vanishes an impossibility of the socialist plan. In both these respects Marx's vision was right. We can also agree with him in linking the particular social transformation that goes on under the capitalist structure with a vision of behavior which at the same time it is bound to destroy.

The resulting state of things will be workable, let alone permanent, is quite another thing. Before humanity chokes (or basks) in the dungeon (or paradise) of socialism it may well burn up in the horrors (or glories) of imperialist wars. ⁶

Third, that the various components of the tendency we have been trying to describe, while everywhere discernible, have as yet nowhere fully revealed themselves. Things have gone to different lengths in different countries but in no country far enough to allow us to say with any confidence precisely how far they will go, or to assert that their "underlying trend" has grown too strong to be subject to anything more serious than temporary reverses. Industrial integration is far from being complete. Competition, actual and potential, is still a major factor in any business situation. Enterprise is still active, the leadership of the bourgeois group still the prime mover of the economic process. The middle class is still a political power. Bourgeois standards and bourgeois motivations though being increasingly impaired are still alive. Survival of traditions—and family ownership of controlling parcels of stock—still make many an executive behave as the owner-manager did of old. The bourgeois family has not yet died; in fact, it clings to life so tenaciously that no responsible politician has as yet dared to touch it by any method other than taxation. From the standpoint of immediate practice as well as for the purposes of short-run forecasting—and in these things, a century is a "short run"—all this surface may be more important than the tendency toward another civilization that slowly works deep down below.

⁶Written in the summer of 1935.

This is why the facts and arguments presented in this and the two preceding chapters do not invalidate my reasoning about the possible economic results of another fifty years of capitalist evolution. The thirties may well turn out to have been the last gasp of capitalism—the likelihood of this is of course greatly increased by the current war. But again they may not. In any case there are no purely economic reasons why capitalism should not have another successful run which is all I wished to establish.