X

The Contradictions of Joseph Schumpeter

In 1930, while most people were occupied with the darkening depression, Keynes was toying with an idea of a very different hue. In disregard of his own dictum that in the long run we are all dead, he had just taken a glimpse into the future—the long-term future—and he had come up with a prophecy quite in contrast with the contemporary rumblings of stagnation. For what Keynes saw ahead, barring such catastrophes as an uncontrollable flood of population or a totally destructive war, was not a continuation of the current state of misery and doubt, but a prospect so fair as to be almost unbelievable—nothing less than Adam Smith's heralded land of universal plenty.

Keynes called his little excursion into the future *Economic Possibilities for Our Grandchildren* (of whom, it might be added, he himself had none). And what were these possibilities? Well, not to wax too lyrical, they hinted at something like a modest millennium: by the year 2030, Keynes thought, the economic problem might be solved—not just the immediate crimp of depression, but the economic problem itself, the age-old fact of Not Enough to Go Around. For the first time in history, mankind—British mankind, at any rate—would have emerged from a struggle against want into a new milieu in which everybody could with ease be given a generous helping at the communal table.

It was a typically Keynesian thrust in an unexpected direction. After the First World War, when the world was basking in a glow of self-congratulation, it was Keynes who had rattled the skeleton in the closet; now in the thirties, when the world turned to self-commiseration, it was the same Keynes who bravely talked of an impending end to its travail. But he was not merely whistling in the dark. On the contrary, he was only taking up a strand of economics which had absorbed all the master planners of the past—the tendency of capitalism to grow.

In times of depression that tendency was apt to be overlooked. And yet, looking backward over two hundred years of capitalism, it was not merely a meaningless succession of exhilarating booms and frustrating busts that characterized the system, but a steady, albeit highly irregular, upward climb. The forty million Englishmen of Keynes's day most certainly did not consider themselves the benefactors of a bountiful providence, but, for all the hardship of the times, they unquestionably enjoyed a far better seat at Nature's table than the ten million Englishmen of Malthus's time.

It was not that Nature herself had become more generous. On the contrary, as the famous Law of Diminishing Returns made clear, Nature yielded up her wealth more grudgingly as she was more intensively cultivated. The secret to economic growth lay in the fact that each generation attacked Nature not only with its own energies and resources, but with the heritage of equipment accumulated by its forebears. And as that heritage grew—as each generation added its quota of new knowledge, factories, tools, and techniques to the wealth of the past—human productivity increased with astonishing rapidity. A factory worker in the 1960s in the United States worked with technological powers that made him a Superman compared with his post–Civil War grandfather. If only this process of steadily enhancing productivity would continue for another century—a mere three generations—then capitalism would have done the trick. For another hundred years of amassing wealth, Keynes calculated, at the same pace as the last hundred years, would multiply England's real productive wealth by ***seven and one-half*** times. By the year 2030, every worker would have at his elbow enough machinery to make *him* a Superman in terms of his grandfather who lived in 1930.

And such a vast increase in productiveness could make all the difference. It could relegate economics as a science of scarcity to the history books. The new problem of society would be not how to find leisure, but how to cope with unprecedented quantities of it. With a grin Keynes quoted the traditional epitaph of the old charwoman:

> Don't mourn for me, friends, don't weep for me never,
> For I'm going to do nothing for ever and ever.
> With psalms and sweet music the heavens'll be ringing,
> But I shall have nothing to do with the singing.

It was, of course, only a theoretical jaunt into the future and no one took it very seriously. The machinery was clanking too alarmingly in 1930 for anyone to regard such a prospectus as much more than a pleasant fantasy, and Keynes himself soon lost sight of it in the immediate problem of analyzing the nature of the unemployment that was paralyzing the world.

But wishful or sober, Keynes's vista is important for us. For with *Economic Possibilities for Our Grandchildren* we are for the first time confronted with the question of our own futures. Everything we have considered heretofore is, after all, only history. The evolution of the regulated and codified world of the seventeenth century into the atomistic market capitalism described by Adam Smith; the near escape of that capitalism from the landlord-dominated economy anticipated by Ricardo or the overpopulated subsistence society feared by Malthus; its presumptive self-destruction forecast by Marx; its chronic depressive tendency dissected by Keynes—all these adventures and misadventures of capitalism, however interesting, nevertheless lacked a certain element of suspense. For we knew at each juncture of history what the outcome would finally be. Now we are placed in a more uncomfortable position. As we turn to the modern economists, we are no longer discussing the ideas that helped

shape our past: it is our own society, our own fate, our children's inheritance that lie in the balance.

And so we must turn from a study of our past to an appraisal of the future. Where does capitalism stand today? What signposts point to the years ahead? These are the great questions of the modern world, to which we must now bend our attention.

Thus we move to a worldly philosopher who, perhaps even more than Keynes, speaks to us with a voice that is unmistakably contemporary. The voice belongs to a small, dark, aristocratic man with a taste for portentous prose and theatrical gestures. When he lectured on the economy at Harvard in the midst of the depression, Joseph Schumpeter strode into the lecture hall, and divesting himself of his European cloak, announced to the startled class in his Viennese accent, "Chentlemen, you are vorried about the depression. You should not be. For capitalism, a depression is a good cold *douche.*" Having been one of those startled listeners, I can testify that the great majority of us did not know that a *douche* was a shower, but we did grasp that this was a very strange and certainly un-Keynesian message.

Schumpeter himself would have been the first to emphasize that his view of economic life was at odds with that of Keynes. The two men shared many social views—above all their admiration for cultivated bourgeois life and their belief in the general values of capitalism—and yet came out with diametrically differing views as to the future. For Keynes, as we have seen, capitalism was intrinsically threatened with the possibility of stagnation; the optimistic outlook for our grandchildren really hinged on appropriate government support. For Schumpeter, capitalism was intrinsically dynamic and growth-oriented; he saw no need for government spending as a permanent auxiliary engine, although he agreed that it might be used to alleviate social distress when a depression occurred.

Yet, for all his faith in the inherent buoyancy of capitalism, Schumpeter's long-term outlook was the very opposite of Keynes's. In his almost perversely teasing way he first maintained that in the "short run" capitalism would indeed trace a long climbing trajectory, adding that "in these things, a century is a 'short run.'" But then came the disconcerting final judgment: "Can capitalism survive? No. I do not think it can." We shall have to learn more about this curiously contradictory man.

Joseph Alois Schumpeter was born in Austria in 1883—the same year as Keynes's birth—of solid but undistinguished stock. His father died when he was four; seven years later his mother married a distinguished general and young Schumpeter was sent to the Theresianum, an exclusive school for the sons of the aristocracy. The exposure of the youngster to an entirely different stratum of society was, by general account, of decisive importance in shaping his outlook. Schumpeter soon adopted the manners and tastes of his schoolmates, acquiring aristocratic airs that clung to him all his life. He irritated his colleagues at more than one university by appearing in faculty meetings in riding habit, and he liked to maintain that he had always had three wishes—to be a great lover, a great horseman, and a great economist—but that, alas, life had granted him only two of the three. For all the aristocratic airs, however, we shall see that in the end Schumpeter awards the laurel of history to another group. But that is a twist to the story that will have to wait until the end of this chapter.

He entered the University of Vienna, a great center of economic learning at the time, and was immediately a star student—"never a beginner," in the opinion of the famous economist Arthur Spiethof—but also immediately an enfant terrible, risking his fate by disagreeing openly with his even more famous teacher, Eugen von Bohm-Bauwerk. After Vienna there was a sojourn in England that led to a brief and unhappy marriage, and then a lucrative position as financial adviser to a princess in Egypt. There Schumpeter performed the miracle of cutting in half the rents on the princess's estates while doubling her income—simply by taking no more for his personal income than he was legally entitled to. More important, while in Egypt he published his first book on the nature of economic theorizing, a book that landed him a professorship in Austria, and three years later, at age twenty-seven, he published *The Theory of Economic Development*, instantly recognized as a small masterpiece.

The Theory of Economic Development sounds like an analysis of what we have come to call the underdeveloped world. But in 1912 the special economic status and problems of that "world" had not yet come into existence—this was still the age of unabashed colonialism. Schumpeter's book was about another kind of development—the way in which capitalism develops its propensities for growth. Scholarly in tone and tedious in style (although lit from time to time with lightning flashes), the book would not strike the casual reader as being of much political importance. Yet this academic treatise was destined to become the basis for one of the most influential interpretations of capitalism ever written.

The exposition begins in Schumpeter's contradictory way. It is a book about capitalist growth and dynamics, but it opens with a depiction of a capitalist economy in which growth is totally absent. Schumpeter's initial portrait describes a capitalism that lacks the very ingredient that brought growth into the worlds of Smith and Mill and Marx and Keynes—namely, the accumulation of capital. Schumpeter describes instead a capitalism sans accumulation—a capitalism whose flow of production is perfectly static and changeless, reproducing itself in a "circular flow" that never alters or expands its creation of wealth.

The model resembles the stationary state envisaged by Ricardo and Mill, with the difference that the stationary state seemed the end of capitalism to the earlier writers, whereas for Schumpeter it was the setting for the beginning of capitalism. Therefore we must examine the characteristics of the circular flow a little more carefully. Because the system has no momentum, inertia is the rule of its economic life: "All knowledge and habit, once acquired," writes Schumpeter, "becomes as firmly rooted in ourselves as a railway embankment in the earth." Thus having found by trial and error the economic course that is most advantageous for ourselves, we repeat it by routine. Economic life may have originally been a challenge; it becomes a habit.

More important, in this changeless flow competition will have removed all earnings that exceed the value of anyone's contribution to output. This means that competition among employers will force them to pay their workers the full value of the product they create, and that owners of land or other natural wealth will likewise receive as rents whatever value their resources contribute. So workers and landowners will get their shares in the circular flow. And capitalists? Another surprise. Capitalists will receive nothing, except their wages as management. That is because any contribution to the value of output that was derived from capital goods they owned would be entirely absorbed by the value of the labor that went into making those goods plus the value of the resources they contained. Thus, exactly as Ricardo or Mill foresaw, *in a static economy there is no place for profit!*

Why does Schumpeter present us with such a strange—not to say strained—image of the system? Perhaps we have already divined the purpose behind his method: the model of a static capitalism is an attempt to answer the question of where profits come from.

The source of profits is a question that has been gingerly handled by most economists. Smith wavered between viewing profit as a deduction from the value created by labor and as a kind of independent return located in capital itself. If profits *were* a deduction, of course, the explanation implied that labor was shortchanged; and if they were a contribution of capital, one would have to explain why the profits went to the *owner* of the machine, not to its inventor or user. Mill suggested that profits were the reward for the "abstinence" of capitalists, but he did not explain why capitalists were entitled to a reward for an activity that was clearly in their own interest. Still other economists described profits as the earnings of "capital," speaking as if the shovel itself were paid for its contribution to output. Marx, of course, said that Smith was right in the first place though he didn't know it—that profits *were* a deduction from the actual value created by the workingman. But that was part of the labor theory of value which everyone knew to be wrong and therefore did not have to be reckoned with.

Schumpeter now came forward with a brilliant answer to this vexing question. Profits, he said, did not arise from the exploitation of labor or from the earnings of capital. They were the result of quite another process. Profits appeared in a static economy when the circular flow failed to follow its routinized course.

Now we can see why the wildly unrealistic circular flow is so brilliant a starting point. For of all the forces leading to disruptions in routine, one stands out. This is the introduction of technological or organizational innovations into the circular flow—new or cheaper ways of making things, or ways of making wholly new things. *As a result of these innovations a flow of income arises that cannot be traced either to the contribution of labor or of resource owners.* A new process enables an innovating capitalist to produce the same goods as his competitors, but at a cheaper cost, exactly as a favorably located piece of land enables its owner to produce crops more cheaply than less well-situated fellow landlords. Again, exactly like the fortunate landlord, the innovating capitalist now receives a "rent" from the differential in his cost. But this rent is not derived from God-given advantages in location or fertility. It springs from the will and intelligence of the innovator, and it will disappear as soon as other capitalists learn the tricks of the pioneer. The new flow is not therefore a more or less permanent rent. It is a wholly transient profit.

An innovation implies an innovator—someone who is responsible for combining the factors of production in new ways. This is obviously not a "normal" businessman, following established routines. The person who introduces change into economic life is a representative of another class—or more accurately, another group, because innovators do not necessarily come from any social class. Schumpeter took an old word from the economic lexicon and used it to describe these revolutionists of production. He called them *entrepreneurs.* Entrepreneurs and their innovating activity were thus the source of profit in the capitalist system.

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There is much more to *The Theory of Economic Development* than a paean to the entrepreneur. From Schumpeter's analysis of the impact of innovations on the circular flow there emerges not only a theory of the origin of profits, but of interest and credit, and beyond that an explanation of the business cycle. Innovations were usually the work of pioneers, said Schumpeter, but whereas leadership is rare and difficult, followership is easy. On the heels of the innovator comes a swarm—the word is Schumpeter's—of imitators. The original improvement is thereby generalized throughout the industry, and a rash of bank borrowing and investment spending gives rise to a boom. But the very generalization of the innovation removes its differential advantage. Competition forces prices down to the new cost of production; profits disappear as routine takes over. As profits decline, so does investment. Indeed, contraction may set in as some of the swarm turns out to have made ill-timed or ill-engineered investments.

We will come back to Schumpeter's explanation of the cycle, but right now it is his emphasis on the functions of the entrepreneur that interests us. Note that the entrepreneur is not himself necessarily a profit receiver, even though he is *the* profit generator. Profits go to the owner of the enterprise, just as rent goes to the owner of land. Even more than Ricardo's capitalist, Schumpeter's entrepreneur is squeezed out of his share of income by the very dynamics of the process that he has set in motion.

Moreover, entrepreneurship is not a profession, or a position that can be handed down from one generation to the next. It is a special kind of leadership—not the glamorous kind that creates generals or statesmen, but a much less socially esteemed talent for perceiving and seizing business advantage.

> We shall understand, therefore, [Schumpeter writes] that we do not observe [in the entrepreneur's position] the emergence of all those affective traits which are the glory of all other kinds of social leadership. Add to this the precariousness of the economic position both of the individual entrepreneur and of the group, and the fact that when his economic success raises him up socially he has no cultural tradition or attitude to fall back on, but moves about in society as an upstart, whose ways are readily laughed at, and we shall understand why this type has never been popular . . .

Why, then, does the entrepreneur carry out his precarious, often thankless task? "First," says Schumpeter, "there is the dream and the will to found a private kingdom, usually, although not necessarily, also a dynasty. . . . Then there is the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself. . . . Finally, there is the joy of creating, of getting things done, or simply of exercising one's energy and imagination."

It is a strange portrait, a mixture of someone driven by the instinct of workmanship celebrated by Veblen and by the predatory drive he so despised. Certainly there is nothing of the desire for public esteem that motivates Smith's accumulating capitalist, and none of the complicated pressures that force Marx's magnates to expand their capital. Schumpeter's entrepreneur is closer to a romantic figure, a kind of knight errant of the system. Not himself a bourgeois by necessity, the entrepreneur aspires to become one, and by seeking to realize his aspiration, breathes life into a society that would otherwise be as tame as the God-fearing merchantdom in Thomas Mann's *Buddenbrooks*. Moreover, as we shall later see, the entrepreneur plays a role that has even larger implications than those that Schumpeter himself explicitly spelled out. But that too will have to await the final explication of Schumpeter's vision.

The Theory of Economic Development launched Schumpeter on an academic career that was to be interrupted only briefly just after the First World War by a foray into government and business. In 1919 he agreed to join a commission on the nationalization of industry established by the new socialist German government. A young economist asked him how someone who had so extolled enterprise could take part in a commission whose aim was to nationalize it. "If somebody wants to commit suicide," Schumpeter replied, "it is a good thing if a doctor is present." In that same year he was asked to become finance minister in the newly formed center-socialist government of Austria. He worked out an ambitious plan to stabilize the Austrian currency, but conflicts and disagreements forced his resignation before the plan could be approved. It would probably have failed—nothing could have arrested the inflationary juggernaut gathering momentum at that time. There followed a brief stint as president of the Biedermann bank, a private bank in Vienna, but that was pulled down by the storm (as well as by the dishonesty of some of his associates). When the bank went under, its new president found himself personally in considerable debt. It is characteristic of the would-be aristocrat that he paid his creditors in full rather than hiding behind the bankruptcy laws, although it cost him his capital, and that he continued to pay his debts from his income over the next ten years. To add to his personal misfortune, he now married the charming twenty-one-year-old daughter of the superintendent of his mother's apartment house—with whom he had been in love for five years, and within a year she died in childbirth, a loss that further darkened Schumpeter's already saturnine personality. Because it is so revelatory, a near-comic story must accompany this genuine tragedy. Schumpeter could not bring himself to tell his friends of Annie's humble background—when she was away for a year before their marriage, he explained that she was being properly educated in French and Swiss schools. In fact she was earning her living in Paris as a maid.

Thereafter, his real career began, first as a visiting professor in Japan, then in Germany, soon thereafter at Harvard, where his manner and his cloak quickly made him into a campus figure. It was there also that he married Elizabeth Boody, herself an economist; and finally, it was there that he declared the depression to be a good cold douche, a remark that at least one young student never forgot.

The depression was, in fact, a test of Schumpeter's ideas. If capitalism derived its energy from the innovations of entrepreneurs, why was their stimulus missing in the grim years of the 1930s? Keynes had said that depressions reflected the state of expectations of businessmen, but his theory did not require him to account for the reason *why* their "animal spirits" were low. Schumpeter had a more demanding task because he explained boom and bust by the bunching of innovations and the swarming of businessmen. The endless depression therefore cried out for reasons why the new innovations were failing to arrive on time.

Schumpeter leaned on two explanations in *Business Cycles,* a thousand-page, two-volume work published in 1939. Partly he attributed the severity of the depression to the fact that there were not one but three different kinds of business cycles—one of quite short duration, a second with a rhythm of seven to eleven years, and a third with a vast fifty-year pulse associated with epochal inventions like the steam locomotive or the automobile—and that all three cycles were touching their respective bottoms at the same time. A second reason was the negative impact of external factors, ranging from the Russian Revolution to generally inept government policy. These latter were "outside" the reach of business cycle theory, but they contributed nonetheless to the gravity of the situation.

It was by no means an unintelligent assessment of the crisis, although the phenomenon of swarming as the cause of business cycles was never well established. But Schumpeter's book interests us for quite another reason. It is that capitalism, like any other social system, does not live by bread alone. It requires a faith—in its case, faith in the values and virtues of the civilization that capitalism produces and that in turn reproduces capitalism. *And despite the economic success of the system, this faith was losing its mobilizing force.*

Thus the book ends—once again!—on a contradictory note. Judging purely on an economic basis, capitalism still had a long run for its money; indeed, as Schumpeter says in the next to last sentence, if his schema of three interacting investment cycles was correct, the next three decades ought to be much more buoyant than the last two. Then comes the disconcerting last sentence: "But the sociological drift cannot be expected to change."

We already find hints of the argument in his *Theory of Capitalist Development* and more than hints in *Business Cycles*. But the fully developed vision of the future of capitalism does not emerge until 1942, when Schumpeter published *Capitalism, Socialism and Democracy*, a book that changed the way we think about the system.

The book begins with Marx. Oddly, Schumpeter, who was the most self-involved person, defined his intellectual life not so much for himself as against others. Keynes was his immediate bête noire, for Schumpeter was not only philosophically opposed to the Keynesian vision but personally irked that Keynes attracted the attention and admiration of the whole world, while he had to content himself with the recognition of his academic peers. Rather uncharacteristically, he could never bring himself to award to Keynes the credit that was his due: when the *General Theory* appeared, Schumpeter reviewed it with scrapings and bowings to the master ("one of the most brilliant men who ever bent their energies to economic problems"), but with an unbecoming and, worse, uncomprehending dismissal of the book ("the less said about [it] the better").

But the real antagonist in Schumpeter's intellectual life was not Keynes but Marx. Schumpeter had studied Marx in his student days and had participated in seminar discussions with scholars such as Rudolph Hilferding and Otto Bauer, two of the most brilliant young Marxist scholars of their day. He was more deeply familiar than any Western economist with Marx's work as it was then understood—much of that work did not appear in the Anglo-American world until the 1950s. During his Harvard years he was always ready to discuss Marx with his younger colleagues; indeed he was more open-minded about Marx than about Keynes! So it is little wonder that *Capitalism, Socialism and Democracy* begins with Marx, as the only opponent truly worthy of his steel.

Marx the Prophet, Marx the Sociologist, Marx the Economist, Marx the Teacher: those are the four chapters with which the book starts. Perhaps it is already evident where the two men will agree and disagree. For Marx the very essence of capitalism is dialectical change and self-created disequilibrium. All this is grist for Schumpeter's mill—indeed, Marx's conception of capitalism's immanent development is undoubtedly the source of Schumpeter's view. But Marx places the cause of this dynamism in the struggle between the working class and the owning class—a struggle that continually squeezes out surplus value and thereby motivates all capitalists (not just pioneers) to rescue their profits by labor-saving innovations.

Here is where Schumpeter departs from Marx. He offers another view of the system—one that stresses the "bourgeois" side of capitalism, not its insatiable and rapacious aspects. For Schumpeter this bourgeois component was the cultural expression of the rational, hedonist businessman whom he viewed as the very antithesis of the swashbuckling, glory-minded warrior. "The evolution of the bourgeois style of life," he writes, "could be easily—and perhaps most tellingly—described in terms of the genesis of the lounge suit," a remark worthy of Veblen. Thus, in Schumpeter's view, capitalism does *not* achieve its all-important thrust from its central figure, the bourgeois capitalist, but from an outsider, an interloper—the upstart entrepreneur. Marx or Veblen would have doubted the difference, but it is crucial to Schumpeter's interpretation of the system.

We need not linger over other differences with Marx. Schumpeter may not have an exact measure of his opponent, but it is clear that he has outlined a formidable intellect, who must be met and bested on his own ground. And that is precisely what he sets out to do. For we turn the page after the chapter on Marx the Teacher to read: "Can capitalism survive?" Now the answer comes with a double shock: "No. I do not think it can."

But if capitalism is doomed, it cannot be for the reasons that Marx sets forth. And so we embark on a tour de force description of what Schumpeter calls "plausible capitalism." What is plausible capitalism? It is much like a carefully reasoned scenario of the very prospect that Keynes has already laid before us, a scenario of the possibilities for a century of growth. Here is Schumpeter at his absolute best. The fears of the stagnationists as to vanishing investment opportunities are set aside with an airy wave: the conquest of the air, he said, will be as great as that of India. The worries of other economists about the sclerosis of spreading monopolization are similarly sent flying with a description of capitalist innovation as a "perennial gale of creative destruction" in which the agents for innovatory change are the "monopolies" themselves. The stage is thus set for what appears to be a direct refutation of Marx. Plausible capitalism is a reasoned model of an economic system that is caught up in a process of continuous self-renewing growth.

But now comes the Schumpeterian contradiction: capitalism may be an *economic* success, but it is not a *sociological* success. This is because, as we have already seen, the economic base of capitalism creates its ideological superstructure—rational rather than romantic, critical rather than heroic, designed for men in lounge suits, not armor. In the end it is this capitalist frame of mind, this capitalist *mentality*, that brings down the system:

> Capitalism creates a critical frame of mind which, after having destroyed the moral authority of so many other institutions, in the end turns against its own; the bourgeois finds to his amazement that the rationalist attitude does not stop at the credentials of kings and popes but goes on to attack private property and the whole scheme of bourgeois values.

And so the great entrepreneurial adventure comes to an end, not because the working class has risen up or because the system has finally been unable to master a worsening succession of crises, but simply because the atmosphere has changed. Personality and force of character count for less; bureaucratic management for more. Innovation itself becomes institutionalized and reduced to routine. The bourgeois family, the great transmission belt of capitalist values, becomes infected with the disease of rationalism. The bourgeois class loses faith in itself. Thus, while things are going well at the surface, "there is a tendency toward another civilization that slowly works deep down below."

Once again we turn the page: "Can socialism work? Of course it can." It is a very Schumpeterian kind of socialism, a benign, bureaucratic, planned economy. We will talk about it briefly later. But notice the remarkable thing about Schumpeter's argument. He has beaten Marx on his own ground. He surrenders to Marx in what seems to be the crucial point of contention, namely whether capitalism can survive. But he has bested Marx by demonstrating—or at least arguing—that capitalism will give way to socialism for Schumpeter's reasons, not for Marx's! Marx is accorded every honor, but Schumpeter's view nonetheless carries the day.

Does it? The question is of huge importance, not merely to appraise Schumpeter but because the prognosis affects ourselves as residents of the system about whose fate Schumpeter is writing.

We begin with a sense of dazzled admiration mixed with irritation. Schumpeter cannot resist attitudinizing, whether he is tweaking the noses of good bourgeois conservatives or of Marxist zealots. He uses his book to air a great many pet ideas: Marx is a great conservative (!); monopolies "increase the sphere of influence of the better, and decrease the sphere of influence of the inferior, brains"; the more "completely capitalist" a nation is, the less likely it is to be aggressive—a judgment that will interest students of nineteenth-century British imperialism and twentieth-century American foreign policy.

But these characteristic flourishes must be set in perspective by reflecting on the argument as a whole. Does not that argument have a certain ring of authority? Does not the prospect of an immense unexplored technological frontier, of a drift toward bureaucratization in business as well as government, of a waning of the bourgeois ethic strike us as uncannily prescient? Remember now that the book was published in 1942. As a seer, Schumpeter is without equal in his time, at once putting to shame the heady expectations of the contemporary Left, who thought that capitalism was on the way out, the naïve hopes of the contemporary middle, who believed that a modest application of government spending would fix things up once and for all, and the black forebodings of the Right, who saw us headed down the road to serfdom.

Nonetheless, the Schumpeterian prognosis is an uneven one, less impressive on close examination than at first sight. There is no doubt that Schumpeter was right in foreseeing a wide-open technological future, but he did not foresee that the quality of that technology, from nuclear arms and energy to computerization, might pose considerable dangers for capitalism as well as fields for investment. There is no denying his prescience when he spoke of the impending growth of bureaucracy in big business, but it is by no means correct that the rise of lumbering giants would result in a decline in their aggressive behavior: the spectacle of vast multinationals, contending for shares in world markets, does not accord with Schumpeter's prediction of a dwindling capitalist drive for expansion.

And is it really the case that a kind of ennui, a loss of belief, would overtake the capitalist world? If we were writing in the late 1960s, the prognosis would indeed seem farsighted, for Western capitalism then seemed clearly moving toward a kind of planned economy. Thirty-odd years later, the prognosis is less convincing. Not just in the United States but throughout Europe we have witnessed a revival of belief in capitalism, as the movement toward a more planned system produced first growth, then inflation, finally a loss of faith in the planning process itself, to which the collapse of the Soviet system provided the coup de grace.

Of course, Schumpeter is writing about the long run, and we are criticizing him within the time frame of a short run. The revivalist spirit may well prove to be short-lived, and the drift into a kind of mildly socialistic capitalism may resume. Perhaps the movement into bureaucratization will eventually take priority over the drive for business dominance, and the great multinationals will settle down into a kind of giant cartel, dividing up the world into private economic kingdoms, like the imperialism of a century ago.

These are no more than speculations. But Schumpeter's vision is also a speculation—one kind of plausible capitalism, but not the only kind. His scenario may be brilliantly illuminating, but it does not emerge from the preceding development of the system with the same logic as we find in the case of Ricardo or Smith or Marx. *This is because Schumpeter's prognosis is not ultimately an economic one at all.* It is, rather, a set of often shrewd assertions about social and political matters that cannot be predicted with the assurance that enabled Smith or Marx to erect their formidable theories. The disaffected intellectual who plays so large a part in spoiling the outlook for Schumpeter's capitalism cannot be said to obey the same imperative as does the accumulating capitalist or the competitive merchant; the businessman who decides that the game is not worth the candle is bowing to cultural, not economic, pressures. Indeed, is it not Schumpeter's triumphant final conclusion that the processes of economics are not sufficient in themselves to determine how the system goes?

His vision, then, cannot be judged by quite the same criteria as those of the other worldly philosophers. His is not so much an economic prognosis as a social one, a judgment about the direction from which the winds of cultural change would blow. With his aristocratic taste, his aloof scholarly stance, his hard experiences in real politics and enterprise, Schumpeter may have been better placed to pass judgment about the drift of things than Keynes, to whom worldly success came too easily, or Marx, to whom it came not at all. Yet the cutting edge of his insight was gained at the expense of the strict economic logic that gave such power to the visions of the classical seers.

The implications of Schumpeter's thesis are disquieting—not merely for capitalism but for economics. Was not the great achievement of the worldly philosophers their ability to deduce the direction in which society was moving? Is not economics built on the capacity to predict—in the large if not in the small? And does not the Schumpeterian scenario mean that all that is now past—that whatever the predictive capability of economics, it no longer matters? We will turn back to this decisive question in our last chapter. But we are not quite finished with the quixotic figure of Schumpeter himself. There remains that last twist to his story. We shall see that it adds more than just an insight into Schumpeter's biography.

Let us begin by reflecting again on the central contradiction in Schumpeter's depiction of capitalism. It lies in the juxtaposition we find in his Theory of Economic Development—capitalism portrayed as a static, inert, changeless "circular flow" and as a system caught up in a dynamic of change, a dynamic that would later be called the gale of creative destruction. How could Schumpeter have allowed himself to depict the system in such inconsistent terms? What possible sense does it make to speak of a changeless circular flow as representing the quintessence of a system that could also be characterized as a continuous process of self-created transformation?

We know Schumpeter's explanation: the circular flow allows us to appreciate the impact of entrepreneurship—not merely as the driving force within capitalism, but as the source of its unique flow of profit income. But there is another way of interpreting Schumpeter's odd juxtaposition. Schumpeter's entrepreneurs, let us recall, do not come from any particular class—they are simply the possessors of a talent for innovation. Capitalist "development" is not therefore intrinsic to capitalism as such. It is the dynamization of society at the hands of a noncapitalist elite!

There is no doubt that Schumpeter himself was a believer in the importance of "elites" in history—minorities of individuals with unusual gifts. Let us read what he has to say about them in his *Theory of Economic Development,* where he takes the case of musical ability:

> We can assume that every healthy man can sing if he will. Perhaps half the individuals in an ethnically homogeneous group have the capacity for it to an average degree, a quarter in a progressively diminishing measure, and let us say, a quarter in a measure above the average; and within this quarter, through a series of continually increasing singing ability and continually diminishing number of people who possess it, we come finally to the Carusos.

As it is with singing ability, so it is with the capacity for leadership, including economic leadership. About a quarter of the population, says Schumpeter, is so deficient in this quality that it is consigned to the most routine aspects of economic life—the clerks and functionaries of the business world. Then comes the next half, the possessors of a normal amount of innovating capacity: here we find "practically all business people," who rely mainly on the comfortable ruts of experience but are capable of adapting themselves to the normal range of daily challenges. From there, we reach the true elite—"people who are a type characterised by supernormal qualities of intellect and will."

So history, as a narrative of change and development, is the story of the impact of elites on the inert mass of society. In different social settings the qualities needed to exercise influence will change—military talent has its place in a feudal society, economic talent in a market society—but the driving force of an elite of one kind or another is always there. Thus the echelon of leaders constitutes a special group. As such it assumes its rightful place at the apex of society. There the leaders may change, but not leadership. "The upper strata of society," Schumpeter writes, "are like hotels which are indeed always full of people, but people who are forever changing."

What we have here is yet another thrust at Marx—directed at the Marxian idea of the revolutionary force of the proletariat. All wrong, says Schumpeter. The proletariat cannot be the force for change because by virtue of its sheer numbers it must mainly lie in the normal range of humankind. Individual proletarians may possess leadership capabilities, but leadership itself can be possessed only by a tiny minority.

Perhaps this is why Schumpeter is so philosophical about the advent of socialism. For who will run the managerial economy that he envisages as the end product of capitalism's decline? It will be the possessers of ability, of course, the bourgeoisie. "Here is a class," he writes, "which, by virtue of the selective process of which it is the result, harbors human material of a supernormal quality and hence it is a national asset which it is rational for any social organization to use." So there is no reason for the managerial class to fear socialism. The skills needed to direct a socialist system are sufficiently like those needed to run an advanced capitalist one that the bourgeois elite will find its natural position at the top.

Is this economics? Not by any of the conventional conceptions. It is better described as historical sociology. It is not classes, but elites, that seize the commanding heights. Economics describes the results in societies that reward skills exercised in the marketplace, rather than on the battlefield or in the pulpit or in the managerial office, but be it one elite or another, it is always the Carusos who run the show.

Thus Schumpeter employs his economic model to flesh out a larger social vision. The word itself, we recall from our early pages, is Schumpeter's. In his magisterial survey of economic thought, on which he was working at his death in 1950, "vision" lies at the center of things. Analysis may be the great glory of economics, but analysis does not spring full-blown from the mind of an economist, any more than Minerva from the brow of Jupiter. There is a "preanalytic" process that precedes our logical scenarios, a process from which we cannot escape, and which is inescapably colored with our innermost values and preferences. "Analytic work," writes Schumpeter, ". . . embodies in the picture of things as we see them, and wherever there is any possible motive for wishing to see them in a given rather than another light, the way in which we see things can hardly be distinguished from the way in which we wish to see them."

It is a brilliant insight, which deserves an illustration of which Schumpeter himself was almost certainly unaware. It is why Marshall, the most careful and thoroughgoing economist, did not anticipate Keynes's discovery of the vital difference between the two flows of consumption and investment.

We find the answer in Marshall's *Principles* when he discusses the nature of *consumers' goods*, compared with what he called *producers' goods*. He notes that "a distinction to which some prominence has been given" lies between these two types of output. We hold our breath, for we can see Keynes's crucial insight just around the corner. But no. Marshall calls the distinction, "vague and perhaps of not much practical use." Why? Because his vision of the economy emphasizes the process by which goods are *priced*, not the consequences of production for future growth. Moreover, from this perspective, Marshall is right: there is no fundamental difference between pricing shirts and machines. He does not see the difference between producing one and the other.

Was there ever a more dramatic example of the analytical difference that vision makes? If Marshall's eyes, like Keynes's, had been focused on the path of total output, he would have seen what Keynes saw; but looking, as he was, only at pricing, he missed the Keyensian boat. One suspects he would not have boarded it.

Is economics, then, an analysis of that which we wish to see or cannot help ourselves from seeing, rather than a detached and objective dissection of a world that is unambiguously "there"? We will come back to this question in our next chapter when we try to weigh up the accomplishment of the worldly philosophers—and the prospects for worldly philosophy as a whole.

One last knot remains in the string. We recall the young Schumpeter thrust into the milieu of an aristocratic school in Vienna, where he absorbed the values that were to become so important in his own life. Are we mistaken in seeing those values transferred to his own vision of history in which an elite becomes the central moving force? Certainly this elite is an aristocracy, embodying the belief in the natural superiority of the chosen few that lies at the core of all aristocratic views of society. But notice that the Schumpeterian few are chosen not by blood but by "intellect and will." It is thus an aristocracy *of talent*. This is the elite to which Schumpeter belongs. The drama of history, as Schumpeter envisions it, thereby justifies not only capitalism, but a group—Schumpeter's own group!—as resting on something more durable and worthy than mere name or birth. Thus there is a final congruence between personal experience and historic vision that unravels many contradictions.

This is perhaps not an assessment that Schumpeter himself would have welcomed. But neither would he likely have denied it. He aspired to be a great economist—whether that was the wish that life had denied him is not clear. It is interesting that Schumpeter would never lecture on his own theories despite entreaties from his students and colleagues; one scholar has suggested that it was because he felt that in the last analysis his formulations were inadequate. We do not know whether he aspired to be a great visionary—that he certainly was. As analyst or visionary, everyone interested in economics must come to grips with him, not only because of what he accomplished within the discipline, but because in his very achievements he demonstrated its limitations.

xi

The End of the Worldly Philosophy?

Our preface warned of a possibly diconcerting finale, which the title of this chapter may seem to confirm. But I would remind my readers that "end" has two meanings: *termination* and *purpose*, a dual significance we must bear in mind as we go on to consider both the future and the usefulness of the subject whose name was so happily given to me many years ago, when I had finished this book and was trying to decide what to call it.

How to begin this demanding task? I think it best to go back to beginnings, by reminding ourselves of what economics is ultimately about. Needless to say, it is not merely a discussion of the figures, forecasts, and government pronouncements that are the stuff of the daily economic news. Neither is it the supply and demand diagrams and equations familiar to every economics student. At its core, economics is an explanation system whose purpose is to enlighten us as to the workings, and therefore to the problems and prospects, of that complex social entity we call the economy.

So far, what we have mainly stressed with respect to these explanatory visions and analyses is their extraordinary variety. To go from the Mercantilist monarch to the Marshallian clerk, or from the Smithian Society of Perfect Liberty to the Veblenian society of business sabotage is to run a gamut that seems to defy any possibility of a unifying object of study. In