

# Project 2001: Significant Works in Twentieth-Century Economic History

## Capitalism, Socialism and Democracy

Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*. New York: Harper & Row, 1942, 381 pp.; Third edition, 1950, 431 pp.

Review Essay by Thomas K. McCraw, Harvard Business School.

### **The Creative Destroyer: Schumpeter's *Capitalism, Socialism, and Democracy***

Does Joseph Schumpeter's *Capitalism, Socialism and Democracy* rank with the most important works of economic history of the twentieth century? Of course it does. Has there been a more penetrating analyst of capitalism than Joseph Schumpeter? No, I do not think there has.

Schumpeter led a melodramatic life (1883-1950), moving from Austria to England to Egypt to Germany before coming to Harvard for good in 1932. He was a phenomenally productive scholar, despite occasional forays into business and government in addition to a plethora of romantic liaisons that included three marriages. His first published article appeared in 1905, his last in 1950. His output included fifteen books (several of immense length), six pamphlets, about one hundred book reviews, and 148 articles, comments, and occasional pieces.

Long after his death, his influence continues to grow. Massimo M. Augello's *Joseph Alois Schumpeter: A Reference Guide* appeared in 1990 and ran to over 350 pages. Since then, several dozen articles on Schumpeter have appeared, in addition to biographies by Eduard März, Robert Loring Allen, Richard Swedberg, and Wolfgang Stolper. All of this work has enriched our knowledge of this remarkable polymath.

Just how great was Schumpeter? Tibor Scitovsky places him at the very top: "America's most brilliant economist." The intellectual historian Martin Kessler agrees, arguing that Schumpeter was, apart from Keynes, "the only truly great economist the twentieth century has produced." Oskar Morgenstern sensibly comments that at this level rankings become pointless, that "all will agree that [Schumpeter]

belongs to that small top group where a further ranking becomes almost impossible."1

Many scholars of business history, most notably Alfred D. Chandler, Jr., have looked to Schumpeter as the economist who best understood the rise of big business and the central roles of innovation and entrepreneurship.2 In economic history, the work of Nathan Rosenberg and William Lazonick, among others, is imbued with Schumpeterian insights.3 In the study of "business strategy," a term probably coined by Schumpeter in *Capitalism, Socialism and Democracy*, Michael Porter's seminal work places a distinctly Schumpeterian emphasis on relentless innovation as the essence of competitive strategy.4 Within economics, Schumpeter's influence in America is perhaps best exemplified by the work of F. M. Scherer and Richard R. Nelson. Scherer, a prolific scholar and author of a standard textbook in industrial organization, acknowledges his intellectual debts in a book entitled *Innovation and Growth: Schumpeterian Perspectives*. Nelson's Schumpeterian proclivities are on display in *An Evolutionary Theory of Economic Change*, co-authored with Sidney G. Winter.5 A few other economists have tried to implement parts of the Schumpeterian system, particularly those having to do with innovation.6

Most mainstream economists have been frustrated by the difficulty of operationalizing Schumpeter's models. His aversion to equilibrium as a realistic picture of capitalist economies restricts the mathematicization of his system. Then, too, because he insisted on fusing economics with history, sociology, and psychology, the number of variables becomes almost impossible for the analyst to control.7

As a scholar Schumpeter never advanced a program of economic reform. He believed that doing so compromised "scientific" work. In particular he criticized Keynes and other English economists for their "Ricardian Vice" of leaping into policy debates with abstract models as general prescriptions for change.8 Schumpeter himself took a very different approach in *Capitalism, Socialism, and Democracy*.

### ***Capitalism, Socialism, and Democracy* and Its Predecessor Book**

Schumpeter's core argument in *Capitalism, Socialism, and Democracy* is reducible to three major tenets:

1. The essence of capitalism is innovation ("creative destruction") in particular sectors. Certain standard tools of economics, such as static

equilibrium and macroeconomic analysis, can therefore disguise reality and mislead scholars and students.

2. The virtues of capitalism--in particular its steady but gradual pattern of growth--are long-run and hard to see; its defects, such as inequality and apparent monopoly, are short-run and conspicuously visible.

3. It is dangerous for economists to prescribe "general" recipes, because political and social circumstances are always changing.

*Capitalism, Socialism, and Democracy* was Schumpeter's most popular success by far. Translated into at least sixteen languages, it still sells widely in paperback editions. Although the author often compared it unfavorably with his more scholarly books, it retains its seminal quality three generations after it appeared.

Despite the book's title, it contains little of lasting interest about either socialism or democracy. But it bursts with ideas about capitalism, and as a "performance"--a term Schumpeter liked to apply to others' works--it may be the best analysis of capitalism ever written.

Only three years before the appearance of this great work, Schumpeter had brought out another book he thought would be his magnum opus: the 1100-page *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*. The virtues of the second book, *Capitalism, Socialism, and Democracy*, can be fully understood only against the shortcomings of this prior work.

The first problem with *Business Cycles* was its extraordinary and wholly unnecessary length. A second characteristic was the author's misguided attempt to turn business cycle patterns into predictive scientific wave theories borrowed from physics. As Schumpeter wrote, "Barring very few cases in which difficulties arise, it is possible to count off, historically as well as statistically, six Juglars [8-10-year business cycles] to a Kondratieff [50-60 years] and three Kitchins [40 months] to a Juglar--not as an average but in every individual case." Why this was so, he admitted, "is indeed difficult to see."<sup>9</sup> As his former student Paul Samuelson wrote thirty-five years later, the whole exercise "began to smack of Pythagorean moonshine."<sup>10</sup>

The third noteworthy aspect of *Business Cycles* was its remarkable richness of historical detail and understanding. Though the explanation of cycles remained problematical, the historical vision was squarely on

point: that capitalism--not all economic activity, just capitalism--is fundamentally an unstable, disequilibrating process.<sup>11</sup>

Simon Kuznets, a macroeconomist and future Nobel laureate, wrote for the *American Economic Review* a fifteen-page analysis of *Business Cycles*. It was the most thorough and important of the reviews, kindhearted in tone but still devastating. Kuznets conceded that Schumpeter had written a "monumental treatise" that raised all the right questions and did relate short-term business cycles to long-run economic movements. Still, Kuznets wrote, business cycles are essentially quantitative phenomena. Instead of robust statistical argument, Schumpeter had presented the reader with "an intellectual diary," an account of his own "journey through the realm of business cycles and capitalist evolution, a journal of his encounters there with numerous hypotheses, diverse historical facts, and statistical experiments." These efforts could not substitute for robust quantitative analysis.<sup>12</sup> Two other reviewers noticed Schumpeter's implicit distaste for macroeconomics, referring to his "vigorous stand against 'the curse of aggregative thinking.'"<sup>13</sup>

Given the harsh reception of *Business Cycles*, published only three years earlier, the content and also the detached and ironic tone of *Capitalism, Socialism and Democracy* appear in a different light. It is as though Schumpeter, now deeply pessimistic about the state of the world, decided to unburden himself not only on economics but on a broad array of other subjects as well. Hence the candor and breadth of the 1942 book, which produced thousands of future citations by scholars in sociology, history, economics, and other disciplines.<sup>14</sup>

Some of the major themes represent reworkings of ideas Schumpeter had first presented in articles published long before, while in his twenties (he was fifty-nine in 1942). A capitalist economy, he now wrote in *Capitalism, Socialism and Democracy*, "is not and cannot be stationary. Nor is it merely expanding in a steady manner. . . . Every situation is being upset before it has had time to work itself out. Economic progress, in capitalist society, means turmoil."<sup>15</sup>

In a 54-page analysis of Karl Marx at the beginning of *Capitalism, Socialism and Democracy*, Schumpeter considers Marx as Prophet, Sociologist, Economist, and Teacher. It's hard to avoid the thought that the author construed himself in the same roles. Certainly his critique of Marx is full of insight: "Now Marx saw this process of industrial change more clearly and he realized its pivotal importance more fully than any other economist of his time." He accomplished a

fusion of history and theory whose result represented something different from either one alone. Marx "was the first economist of top rank to see and to teach systematically how economic theory may be turned into historical analysis and how the historical narrative may be turned into *histoire raisonnée*." Nevertheless, Schumpeter's final verdict is negative, because of the "failure of [Marx's] prediction of increasing misery," which in turn derived from "wrong vision and faulty analysis." Although Marx the economist and sociologist was mostly correct, Marx the prophet and teacher proved to be disastrously wrong.<sup>16</sup>

As prophet, the same might be said of Schumpeter himself. On page 61 of *Capitalism, Socialism and Democracy* Schumpeter asks, "Can capitalism survive?", then replies, "No. I do not think it can."<sup>17</sup> This provocative passage may have been sincere, or simply Schumpeter's way of getting the reader's full attention. His purpose was to lay bare the core nature of capitalism--to show how it works, to demonstrate why, on balance, it is a good thing; and then to highlight its fragility.<sup>18</sup>

In response to the standard charge that capitalism distributes its fruits inequitably, Schumpeter points out that "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 capitalist process, not by coincidence but by virtue of its mechanism, progressively raises the standard of life of the masses."<sup>19</sup>

A by-product of capitalism is the dominance of all life by an economic calculus, which Schumpeter calls "rationality." He shows how powerfully the economic way of thinking bestows rewards and penalties: "Prizes and penalties are measured in pecuniary terms. Going up and going down means making and losing money. . . . The promises of wealth and the threats of destitution that [this arrangement] holds out, it redeems with ruthless promptitude." Constant, relentless change is the hallmark of capitalism. "It may seem strange that anyone can fail to see so obvious a fact which moreover was long ago emphasized by Karl Marx."<sup>20</sup>

Underscoring the deficiencies of any conceptual system that proceeds from static assumptions, Schumpeter compares the universe of Adam Smith and other classical economists with the reality of modern industry. The classicists "recognized cases of 'monopoly,' and Smith himself carefully noticed the prevalence of devices to restrict competition." Yet neither Smith nor most other classical and

neoclassical economists "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 . . . 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."<sup>21</sup>

Schumpeter contrasts this situation with modern business, parts of which involve constantly evolving oligopolies. These new situations do not easily lend themselves to mathematical modeling. In oligopolies, "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."<sup>22</sup>

The contemporary structure of business is best understood as having evolved from long "organizational development." It reflects a "process of industrial mutation--if I may use that biological term--that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one."<sup>23</sup>

In sum, the process is one of "creative destruction"--the sweeping out of old products, old enterprises, and old organizational forms by new ones. It is what capitalism consists in and what every capitalist concern has got to live in."<sup>24</sup> For the scholar, this necessitates a lengthy time frame for analysis: "Every piece of business strategy acquires its true significance only against the background of that process and 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. . . . As long as this is not recognized, the investigator does a meaningless job."<sup>25</sup>

One result of this approach should be a sharper focus on product quality and on marketing, and a reduced emphasis on price. "[I]n capitalist reality as distinguished from its textbook picture, it is not [price] 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." A theoretical analysis that "neglects this essential element of the case . . . even if correct in logic as well as in fact, is like Hamlet without the Danish prince."<sup>26</sup>

Schumpeter then turns to the question of monopoly. He mounts a devastating attack on what he regards as popular American attitudes toward this subject, which, in his judgment, spill over onto big business in general. Much of what Schumpeter says here was conditioned by what happened in the 1930s, and specifically by New Dealers' assaults on big business. He argues that the very nature of giant, capital-intensive enterprise requires strategic behavior not contemplated by orthodox economic theory except to the extent that the theory holds such behavior monopolistic. As a matter of historical record, Schumpeter insists, long-run price rigidities are practically unknown. The same is true of long-run cases of monopoly, which are rarer than instances of perfect competition.<sup>27</sup>

It seemed plain to Schumpeter that big business, instead of exploiting consumers, had radically elevated their living standards. Organizational innovation, not monopolistic profits, accounted for the prosperity of most great companies. They should be viewed with pride and awe, not with detestation and fear. "These units not only arise in the process of creative destruction and function in a way entirely different from the static scheme, but in many cases of decisive importance they provide the necessary form for the achievement. They largely create what they exploit." Monopoly rents might flow for awhile, but they are inevitably temporary, "the prizes offered by capitalist society to the successful innovator." Under capitalism, the idea of a permanent monopoly is ludicrous, especially in manufacturing.<sup>28</sup>

Schumpeter next mounts a savage assault on the idea of perfect competition. He implies that it has evolved from an analytical tool of theoretical economics into an ideal toward which theory should guide public policy. This, he suggests, is catastrophic:

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. . . . In the last resort, [cases approaching perfect competition, such as] American agriculture, English coal mining, [and] 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.<sup>29</sup>

Pushing his analysis to its limits, Schumpeter identifies capitalist entrepreneurship with technological progress itself. As a matter of historical record, they were "essentially one and the same thing," the first being "the propelling force" of the second."<sup>30</sup>

At this point in the book, Schumpeter begins to lay the foundations for his famous argument that capitalism contains the seeds of its own destruction--not for economic reasons but for sociological ones. His reasoning proceeds as follows:31

1. In pre-capitalist times, no sheer economic achievement, by itself, could advance anyone into the ruling class.

2. When capitalism began to develop, persons of "supernormal ability and ambition" became upwardly mobile provided they would "turn to business."

3. It was hard to succeed in business, yet success remained inglorious: "no flourishing of swords about it, not much physical prowess, no chance to gallop the armored horse into the enemy. . . . The stock exchange is a poor substitute for the Holy Grail."

4. There can be no assurance that people are "happier" or "better off" under industrialism than in the medieval manor or village. Efficiency is only one of many human desiderata, and perhaps not the most important one.

5. So the future of capitalism can't be assured purely because of its economic superiority. "I am not going to argue, on the strength of that performance, that the capitalist intermezzo is likely to be prolonged."

6. Capitalism all but destroyed most of the secular underpinnings of civilized society--the manor, village, and craft guild. Yet it replaced these institutions with nothing: no idealism, no sense of organic life, no essential ability for social organization of a non-economic nature.

7. In particular, the talents necessary for economic success don't translate well into other realms of life. "A genius in the business office may be, and often is, utterly unable outside of it to say boo to a goose--both in the drawing room and on the platform."

8. So, without protection from some other source, "the bourgeoisie is politically helpless and unable not only to lead its nation but even to take care of its particular class interest."

9. Because capitalist evolution, and particularly the rise of big business, attacks masses of small producers and merchants, it alienates its natural allies, indirectly giving reinforcements to the enemy.

10. The substitution of a share of stock for tangible goods "takes the life out of the idea of property." If this process goes on long enough and thoroughly enough, "there will be nobody left who really cares to stand for [property]."

11. Capitalism works gradual changes within the psyches of individuals. By reducing everything to an economic calculus, it "rationalizes" thinking. It "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."

12. The philosophical case for capitalism is beyond the intellectual capacity of most persons, even most economists. "Why, practically every nonsense that has ever been said about capitalism has been championed by some professed economist."

13. Most important, the case for capitalism "must rest on long-run considerations." In the short run, it is impossible for most people, even intellectuals, to ignore exasperating "profits and inefficiencies" and focus instead on long-range trends.

14. Uniquely among types of societies, capitalism is so successful economically that it "creates, educates and subsidizes a vested interest in social unrest." It underwrites a class of hostile intellectuals who have no "direct responsibility for practical affairs" and little experience in managing anything.

15. The rise of mass media makes this situation more dangerous by multiplying the access of demagogues to short-run human instincts and desires. In the process, "public policy grows more and more hostile to capitalist interests."

16. Bureaucracies in Europe antedate the capitalist epoch and owe no allegiance to bourgeois values. Bureaucracies in America, however, with no real civil service tradition, hold onto their antipathy toward capitalism because they don't grasp the vast stakes at issue. Given 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."

17. Most alarming of all, the bourgeois family may disintegrate. As soon as men and women "introduce into their private life a sort of inarticulate system of cost accounting," they will become aware that "children cease to be economic assets." When this happens, the last pillar of bourgeois society will fall.

Much of Schumpeter's argument here might be interpreted as a cry from the heart of a brilliant but unlucky European elitist, who had witnessed one catastrophe after another during the bloody first half of the twentieth century. Even in contemporary America, a unique opportunity for the development of an advanced capitalist society

stood on the edge of disaster. It was happening in the United States because of the Great Depression, the ascendance of fascism and communism in Europe, and the onset of World War II. It had not happened earlier because "The scheme of values that arose from the national task of developing the economic possibilities of the country drew nearly all the brains into business and impressed the businessman's attitudes upon the soul of the nation."<sup>32</sup>

Schumpeter professed to see not only the decline of capitalism but also the ultimate triumph of socialism. "Can socialism work?" he asks. "Of course it can." In large part, it can work because it inspires people to noble ends, to something larger than themselves. Socialism implies "a new cultural world" whose psychic rewards may be worth the price of optimal economic efficiency. For true believers, "Socialist bread may well taste sweeter to them than capitalist bread simply because it is socialist bread, and it would do so even if they found mice in it."<sup>33</sup>

Despite memorable aphorisms such as this one, Schumpeter's analysis of socialism and democracy is a good deal less compelling than his dissection of capitalism. He says of democracy that it is best understood not as a system but merely a "method"--an "institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote." Of course there is much more to democracy than this, but Schumpeter's real interests lie elsewhere.<sup>34</sup>

At the very end of *Capitalism, Socialism and Democracy*, Schumpeter delivers a philippic about the intrusion of modern government, and specifically the New Deal state, into economic life. He mentions counter-cyclical policies, redistributive taxation, antitrust, price controls, monetary policy, the regulation of labor, securities legislation, and the "indefinite extension of the sphere of wants" to be supplied by public enterprise. Yet, ever the "scientist" reluctant to succumb to the Ricardian Vice, Schumpeter closes with this remarkable statement: "It would spell complete misunderstanding of my argument if you thought that I "disapprove" or wish to criticize any of these policies. Nor am I one of those who label all or some of them "socialist."<sup>35</sup>

### **The Book's Reception**

*Capitalism, Socialism and Democracy* received a modicum of attention in 1942, when it was first published. A second edition, which appeared in 1946, attracted wider notice, and the third, in 1950, became an international best-seller.

Reviewing the first edition, the Cambridge economist Joan Robinson found that Schumpeter "has little love for socialism, and none at all for socialists. His natural sympathy is all with the heroic age of expanding capitalism." Herself a leading theorist of imperfect competition, Robinson found Schumpeter's analysis of that subject the "most brilliant" part of the book: "his argument blows like a gale through the dreary pedantry of static analysis." Although Schumpeter had little to say about contrary evidence, especially in his argument about the fadeout of capitalism and its replacement by socialism, "The reader is swept along by the freshness, the dash, the impetuosity of Professor Schumpeter's stream of argument." Whether or not the reader was totally convinced, "this book is worth the whole parrot-house of contemporary orthodoxies, right, left, or centre."<sup>36</sup>

Reviewing the 1946 edition of *Capitalism, Socialism and Democracy*, Arthur M. Schlesinger, Jr. wrote that the book "burst into the generally sterile atmosphere of political discussion like a collection of firecrackers and skyrockets." Schumpeter's analysis made it pointless to keep repeating mindless slogans about the evils of monopoly. Even if he were wrong, "there is no percentage in dodging the uncomfortable points he raises. The intellectual rigor of his analysis sets a standard that liberal writers should try to meet." The book "is the performance of an intellectual virtuoso, brilliant, complex, perfectly controlled."<sup>37</sup> In 1981, a retrospective analysis of the book appeared, entitled *Schumpeter's Vision: Capitalism, Socialism, and Democracy After 40 Years*.<sup>38</sup> Here several of Schumpeter's former students and associates joined with some European scholars in evaluating the book's legacy. Paul Samuelson led off, conceding that the subject under discussion was "a great book." He added that from a game theoretic viewpoint Schumpeter might have taken account of the propensity of democratic groups to change the nature of capitalism and to bend it to their own self-interest. Schumpeter's praise of Marx for "being learned, bold to speculate, and broad in his dynamic vision" describes Schumpeter himself, Marx thereby being "a veritable chip off the new block." Yet "Schumpeter was of all my teachers the one whose economics was essentially farthest from Marx's."<sup>39</sup>

The sociologist Tom Bottomore, a man of the Left, lamented Schumpeter's disinclination to cast his analysis in terms of economic and social class. Thus, he had overlooked some important changes that now (in the 1980s) were clearer: "A very large part of the middle class, in spite of variations. . . has maintained a political orientation which is much more favourable to parties of the right and the centre than to those of the left. . . . [Schumpeter] thought that the 'march

into socialism' was well-nigh irresistible, and deplored the fact. I, on the contrary, think that this 'march' has come to an untimely halt, and regret the eclipse of the highest ideal that has emerged in modern Western culture."<sup>40</sup>

In a third essay, Schumpeter's fellow Austrian and longtime Harvard colleague Gottfried Haberler wrote that although Schumpeter never said so in *Capitalism, Socialism and Democracy*, it was clear that his "real feeling" was "that capitalism or the 'bourgeois' society is very much worth fighting for." Schumpeter's forecast of capitalism's downfall "has shocked and puzzled many people. If all qualifications, reservations, and elucidations are given their proper attention, however, the forecast of capitalism's early doom becomes less apodictic and the demise of capitalism loses much of its inevitability." Then, too, Schumpeter's emphasis on rising resentment of taxation anticipated the American tax revolt that began in the 1970s, a movement of extraordinary importance.<sup>41</sup>

The economist Robert L. Heilbroner, a first-rate stylist himself, judged *Capitalism, Socialism and Democracy* partly on artistic terms: "There is [in the book] a great deal of attitudinizing. . . an open delight in epater le bourgeois and tweaking the noses of radicals. There is also pomposity and pedantry, mixed with an arrogance that teeters on the edge of a dangerous elitism." Yet the book remains full of "perceptive insights," such as Schumpeter's remark that "The evolution of the capitalist lifestyle is best described 'in terms of the genesis of the modern lounge suit,' a remark worthy of Thorstein Veblen."<sup>42</sup>

Arthur Smithies, Schumpeter's former student and colleague, saw *Capitalism, Socialism and Democracy* in part as a reaction against Keynesianism. Schumpeter had openly derided the "stagnation thesis" introduced in Keynes's *General Theory*. This thesis holds that as a country grows richer investment opportunities shrink but the propensity to save increases; therefore savings and investment balance only at high unemployment. "If valid," wrote Smithies, "the long-run Keynesian argument provided an impregnable case for socialism." Yet Schumpeter saw that the underpinnings of the stagnation thesis were the atypical conditions of the Great Depression. He "maintained his sanity" and insisted that such problems were not permanent but cyclical. As for Schumpeter's concern with inflation, in the 1940s Anglo-American economists thought it "obsessive," but in fact Schumpeter proved remarkably prescient.<sup>43</sup>

Herbert K. Zassenhaus, another economist from the generation just behind Schumpeter, detected "a certain mysticism" in *Capitalism, Socialism, and Democracy*. "In the shape of the 'entrepreneur,'" Schumpeter introduces "a social miracle in the precise sense of the word: an event beyond the laws of nature and society."<sup>44</sup>

In perhaps the most telling of all the retrospective comments, the Dutch scholar Henrik Wilm Lambers recalled Schumpeter's influence on him as a youth and the continued appeal of his book. In *Capitalism, Socialism and Democracy*, Lambers wrote, "Schumpeter accomplished the feat of moving five layers of thought--the firm, the markets, the institutions, the cultural values, the leaders of society--as one interwoven dynamic process. With incomparable skill he made history go through time as one stream." Lambers' own students were invariably taken with the book: "After many an oral graduate examination, I have often heard remarks like: 'to be honest, the one stimulating book was Schumpeter'." Radical and conservative students alike "say, each in their own way, 'he keeps me puzzled: is it my fault or did he intend to?'"<sup>45</sup>

*Capitalism, Socialism, and Democracy* continues to puzzle and provoke readers--to make them think, to question their own perceptions measured against their own ideologies and to wonder about the author's intentions. Only the very greatest books do this, and age so well.

#### Endnotes:

1. Tibor Scitovsky, "Can Capitalism Survive? -- An Old Question in a New Setting," Ely Lecture, *American Economic Review*, 70 (May 1980), p. 1; Martin Kessler, "The Synthetic Vision of Joseph Schumpeter," *Review of Politics*, 23 (July 1961), p. 334; O. Morgenstern, "Obituary," *Economic Journal*, 61 (March 1951), p. 203.

2. Chandler, *Strategy and Structure: Chapters in the History of the Industrial Enterprise*, Cambridge, MA: MIT Press, 1962, p. 284; and Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism*, Cambridge: Harvard University Press) pp. 597, 830-831 n1.

3. See, for example, Lazonick, *Competitive Advantage on the Shop Floor*, Cambridge: Harvard University Press, 1990, pp. 3, 10, 323-324; and Rosenberg, "Joseph Schumpeter: Radical Economist," in *Exploring the Black Box: Technology, Economics, and History*, New York: Cambridge University Press, 1994. Schumpeter often spoke on the

relationship between history and theory: "Personally, I believe that there is an incessant give and take between historical and theoretical analysis and that, though for the investigation of individual questions it may be necessary to sail for a time on one tack only, yet on principle the two should never lose sight of each other"; see Schumpeter's 1949 essay, "Economic Theory and Entrepreneurial History," reprinted in Richard V. Clemence, editor, [Schumpeter's] *Essays: On Entrepreneurs, Innovations, Business Cycles, and the Evolution of Capitalism*, New Brunswick, NJ: Transaction Publishers, 1989. See also Schumpeter, "The Creative Response in Economic History," *Journal of Economic History*, 7 (November 1947).

4. Porter, *The Competitive Advantage of Nations*, New York: Free Press, 1990, p. 778 n.46.

5. Frederic M. Scherer, *Innovation and Growth: Schumpeterian Perspectives*, Cambridge, MA: MIT Press, 1984. Richard R. Nelson and Sidney G. Winter, *An Evolutionary Theory of Economic Change*, Cambridge, MA: Harvard University Press, 1982. Part V of this book (pp. 273-351) is entitled "Schumpeterian Competition," and in it the authors try, mathematically, to apply Schumpeter's insights to the process of innovation.

6. See, in general, Richard V. Clemence and Francis S. Doody, *The Schumpeterian System*, Cambridge, MA: Addison-Wesley, 1950. For more specialized efforts, and critiques of them, see Carolyn Shaw Solo, "Innovation in the Capitalist Process: A Critique of the Schumpeterian Theory," *Quarterly Journal of Economics*, 65 (August 1951), pp. 417-428; Franklin M. Fisher and Peter Temin, "Returns to Scale in Research and Development: What Does the Schumpeterian Hypothesis Imply?" *Journal of Political Economy*, 81 (January/February 1973), pp. 56-70 [see also Comments by Carlos Alfredo Rodriguez and Reply by the authors in *Journal of Political Economy*, 87 (April 1979), pp. 383-389]; Morton I. Kamien and Nancy L. Schwartz, "Market Structure and Innovation: A Survey," *Journal of Economic Literature*, 13 (March 1975), pp. 1-37; Carl A. Futia, "Schumpeterian Competition," *Quarterly Journal of Economics*, 94 (June 1980), pp. 675-695; Meir Kohn and John T. Scott, "Scale Economies in Research and Development: The Schumpeterian Hypothesis," *Journal of Industrial Economics*, 30 (March 1982), pp. 239-249; and Horst Hanusch, editor, *Evolutionary Economics: Applications of Schumpeter's Ideas*, Cambridge: Cambridge University Press, 1988.

7. During the 1990s the Schumpeter literature became especially voluminous, with articles in such publications as the *Journal of Evolutionary Economics* and the *Journal of Institutional Economics*. These pieces often drew as much on Schumpeter's sociology as on his economics. Several sought to apply biology to Schumpeter's evolutionary analysis.
8. Schumpeter actually used the word "sins": "I did not exactly wish to put Ricardo and Keynes on the same level, but I do think that there is striking similarity between their sins." (Letter to Arthur W. Marget, Feb. 24, 1937, Schumpeter Papers, Harvard University Archives.)
9. Joseph A. Schumpeter, *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*, New York: McGraw-Hill, 1939, Volume I, pp. 169, 173, 174.
10. Samuelson, "Joseph A. Schumpeter," *Dictionary of American Biography, Supplement Four, 1946-1950*, New York: Scribner, 1974, p. 723.
11. In this book the orientation appears most clearly in some vivid passages on pages 220-245 of Volume I.
12. Simon Kuznets, *American Economic Review*, 30 (June 1940), pp. 257, 266-271.
13. E. Rothbarth, *Economic Journal*, 52 (June-Sept. 1942), p. 229; J. Marschak, *Journal of Political Economy*, 48 (Dec. 1940), p. 892.
14. An insightful analysis of Schumpeter's state of mind when he wrote *Capitalism, Socialism, and Democracy* may be found in Chapter 7 of Richard Swedberg, *Schumpeter: A Biography*, Princeton, NJ: Princeton University Press, 1991.
15. *Capitalism, Socialism, and Democracy*, New York: Harper Torchbook Edition, 1976, pp. 31-32.
16. *Capitalism, Socialism, and Democracy*, p. 32, 34, 44.
17. *Capitalism, Socialism, and Democracy*, p. 61.
18. In the revised edition of *Capitalism, Socialism and Democracy* appears Schumpeter's final paper, "The March into Socialism" (December 1949). Here he speaks candidly about capitalism's social

implications: "Capitalism does not merely mean that the housewife may influence production by her choice between peas and beans; or that the youngster may choose whether he wants to work in a factory or on a farm; or that plant managers have some voice in deciding what and how to produce: it means a scheme of values, an attitude toward life, a civilization--the civilization of inequality and of the family fortune" (p. 419).

19. *Capitalism, Socialism, and Democracy*, pp. 67-68.

20. *Capitalism, Socialism, and Democracy*, pp. 73-74, 77 n1, 82. In *History of Economic Analysis*, published posthumously (New York: Oxford University Press, 1954), Schumpeter wrote that in capitalism, "Disequilibrium prevails throughout, but Marx saw that this disequilibrium is the very life of capitalism" (p. 1051).

21. *Capitalism, Socialism, and Democracy*, pp. 78-79.

22. *Capitalism, Socialism, and Democracy*, p. 79.

23. *Capitalism, Socialism, and Democracy*, p. 83.

24. *Capitalism, Socialism, and Democracy*, p. 83.

25. *Capitalism, Socialism, and Democracy*, pp. 83-84.

26. *Capitalism, Socialism, and Democracy*, pp. 84-86.

27. *Capitalism, Socialism, and Democracy*, pp. 93, 99.

28. *Capitalism, Socialism, and Democracy*, pp. 101-102.

29. *Capitalism, Socialism, and Democracy*, pp. 104-106.

30. *Capitalism, Socialism, and Democracy*, p. 110. Schumpeter adds that making such a distinction is "quite wrong--and also quite un-Marxian."

31. My summary here is abstracted from *Capitalism, Socialism and Democracy*, pp. 124-157.

32. *Capitalism, Socialism, and Democracy*, p. 331. This point echoes one of Schumpeter's pet themes: that all societies suffer from a paucity of first-rate talent. Legal issues, labor problems, price control

issues, and antitrust prosecutions add up to a "drain on entrepreneurial and managerial energy." So much effort is expended on such issues that an executive often "has no steam left for dealing with his technological and commercial problems." One consequence is that except in very large companies, which can afford numerous specialists, "leading [management] positions tend to be filled by 'fixers' and 'trouble shooters' rather than by 'production men'" (p. 388.)

33. *Capitalism, Socialism, and Democracy*, pp. 167, 170, 190.

34. *Capitalism, Socialism, and Democracy*, p. 269.

35. *Capitalism, Socialism, and Democracy*, p. 418. This passage is from Schumpeter's last address, delivered to the American Economic Association in December, 1949, three weeks before his death. The address was entitled "The March into Socialism."

36. Joan Robinson, in the *Economic Journal*, 53 (December 1943), pp. 381-383.

37. Arthur M. Schlesinger, Jr., in *The Nation*, April 26, 1947, pp. 489-491.

38. Arnold Heertje, editor, *Schumpeter's Vision: Capitalism, Socialism and Democracy after 40 Years*, New York: Praeger, 1981.

39. Paul A. Samuelson, "Schumpeter's Capitalism, Socialism and Democracy," in *Schumpeter's Vision*, pp. 1, 13, and passim.

40. Tom Bottomore, "The Decline of Capitalism, Sociologically Considered," in *Schumpeter's Vision*, pp. 22-29, 44.

41. Gottfried Haberler, "Schumpeter's *Capitalism, Socialism and Democracy after Forty Years*," in *Schumpeter's Vision*, pp. 70, 71, 74-75, 83, 84, 89.

42. Robert L. Heilbroner, "Was Schumpeter Right?" in *Schumpeter's Vision*, pp. 95, 96, 99-100, 101-102, 106.

43. Arthur Smithies, "Schumpeter's Predictions," in *Schumpeter's Vision*, pp. 130-132, 145-146.

44. Herbert K. Zassenhaus, "Capitalism, Socialism and Democracy: The 'Vision' and the 'Theories,'" in *Schumpeter's Vision*, pp. 173, 176, 181, 189.

45. Hendrik Wilm Lambers, "The Vision," in *Schumpeter's Vision*, pp. 107-129.

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