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Capitalism, Socialism, And Democracy

In capitalism, socialism, and democracy Schumpeter argues that Karl Marx is correct. Capitalism will destroy itself. However, the manner and cause of this destruction will differ significantly from Marx's expectations.

Why is this important?

Economics is also about the intuition and value judgements that lie behind technical analyses.

In *Capitalism, Socialism, and Democracy*, Schumpeter gives what we believe is a good primer on economic thought.

Contents

1. The Marxian Doctrine
2. Can Capitalism survive?
3. Can socialism work
4. The compatibility of socialism and democracy
5. A historical sketch of socialist parties

We will focus on parts 1,2, and 3 but the weight of our remarks will be on part 2.

PART 1

Marx: Prophet, Sociologist, Economist, and Teacher

Marx as Prophet & Sociologist

Prophet:

As every true prophet styles himself the humble mouthpiece of his deity, Marx pretended to speak the logic of the dialectic process of history.

Sociologist:

The economic interpretation of history can be summarized in two propositions:

The forms or conditions of production are the fundamental determinant of social structures which in turn breed attitudes, actions and civilizations

The forms of production themselves have a logic of their own; they change according to necessities inherent in them so as to produce their successors merely by their own working.

Marx as Prophet & Sociologist (2)

The stratifying principle consists in the ownership of means of production.

Fundamentally there are two classes;

The capitalist and proletariat are essentially antagonistic to each other

Marx attempts to show how in the ensuing class war capitalists destroy each other and eventually the capitalist system as well

Marx as Economist

Economist:

- Theory of Concentration: the tendency of the capitalist process to increase the size of industrial plants and units of control

Theory of immiserization and of the trade cycle: in the course of capitalist evolution real wage rates and the standard of life of the masses will fall in the better-paid and fail to improve in the worst-paid strata

Marx as Economist (2)

Marx's idea of the replacement of variable (wage) capital by constant capital is similar to Ricardo's analysis of a firm undergoing mechanization.

Marx's performance in the field of business cycles is mixed.

While Marx does extol the power of capitalism to develop society's capacity to produce, he also places undue emphasis on the growing misery of the masses

Schumpeter concludes by noting that even though Marx's facts and reasoning were problematic, his argument that capitalism will destroy itself is plausible.

Marx as Teacher

Teacher:

In the Marxian argument sociology and economics pervade each other. All the major concepts and propositions are equally economic and sociological

Theoretically Scientific Socialism consists in the proof that socialism is inevitable irrespective of human volition or of desirability.*

Marx correctly saw several tendencies of capitalism's evolution as conditions for socialism's emergence

The presence of giant units of industrial control+

The presence of an oppressed, but also very numerous and organized proletariat

PART 2

Schumpeter argues that the actual and prospective performance of the capitalist system mean that it won't break down under the weight of economic failure. However, its very success undermines the social institutions which protect it, and “inevitably” creates conditions that end it and lead to socialism.

The Rate of Increase of total output

A first test of economic performance is total output~from 1870 to 1930, the average annual rate of growth was 3.7 %

Allowing for 1.7 %, approximate rate of increase in “available output” is 2 %/ year.

Assuming that rate of increase remains constant for the next 50 years, average real income per head would increase at a compound interest rate of 1.63%

Schumpeter argues that because capitalism possesses an inherent tendency towards equality, rather than inequality, our increase in output estimates are quite conservative.

The Rate of Increase of total output (2)

Consequently, if capitalism repeated its past performance according to our assumptions, this would eliminate poverty by contemporary standards.

The technique and atmosphere of the struggle for social legislation ignores

Part of this legislation presupposes previous capitalist success

Much of what social legislation develops and generalizes had been previously initiated by the action of the capitalist stratum itself.

Plausible Capitalism

Three points stand out in evaluating the productivity of capitalism.

Relation between capitalist order and observed rate of increase in output

Rate of increase was due to capitalism and not just favorable conditions

Any reason why the capitalist engine should fail to go on working as in the past

Capitalism is a combination of social and biological selection

Classical economist found fault in capitalism

Its sole motivation is profit-making

Plausible Capitalism (2)

Marshall-Wicksell theory - for firms in the case of perfect competition, the profit interest of the producer tends to maximize production

Will produce such that marginal cost is equal to cost. This is “socially desirable.”

In actuality, principle is oversimplified

Many of the propositions by Marshall-Wicksell generation economist are inapplicable or more difficult to prove

Recognition of prevalence of monopolistic competition and oligopoly

The Prevailing Theme: Capitalism can work for social good but this requires perfect competition. In reality perfect competition isn't common among most markets so even if we attain equilibrium, it isn't the socially ideal state.

The Process of Creative Destruction

To argue no value in capitalism one must prove:

From economic vantage, observed progress actually a long string of favorable conditions compensating for the perils of capitalism

From a historical vantage, they must create a golden age of perfect competition

Monopolistic competition has only declined

Items have gotten cheaper (in terms of hours of labor required for purchase)

Capitalism is an evolutionary process

Destruction and replacement of old systems is Creative Destruction

Composed of cycles of innovation and quiet

The Process of Creative Destruction (2)

- Must judge capitalism by Creative Destruction over time
- Requires eliminating tradition concept of competition
- Focus on innovation over price competition
- Increases field of competitors

“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.”

Table 2 The Churn: Recycling America's Labor*₁ Fewer than 5,000.

Job Destruction	Now (2002)	Then	Year
Railroad employees	111,000	2,076,000	1920
Carriage and harness makers	*	109,000	1900
Telegraph operators	*	75,000	1920
Boilermakers	*	74,000	1920
Milliners	*	100,000	1910
Cobblers	*	102,000	1900
Blacksmiths	*	238,000	1910
Watchmakers	*	101,000	1920
Switchboard (telephone) operators	119,000	421,000	1970
Farm workers	716,000	11,533,000	1910
Secretaries	2,302,000	3,871,000	1980
Metal & plastic working machine operators	286,000	715,000	1980
Optometrists	33,000	43,000	1998
Job Creation	Now (2002)	Then	Year
Airplane pilots and mechanics	255,000	0	1900
Auto mechanics	867,000	0	1900
Engineers	2,028,000	38,000	1900
Medical technicians	1,879,000	0	1910

Truck, bus, and taxi drivers	4,171,000	0	1900
Electricians	882,000	*	1900
Professional athletes	95,000	*	1920
Computer programmers/operators/scientists	2,648,000	160,613	1970
Actors and directors	155,000	34,643	1970
Editors and reporters	280,000	150,715	1970
Medical scientists	89,000	3,589	1970
Dietitians	74,000	42,349	1970
Special education teachers	374,000	1,563	1970
Physicians	825,000	295,803	1970
Pharmacists	231,000	114,590	1970
Authors	139,000	26,677	1970
TV, stereo, and appliance salespersons	309,000	111,842	1970
Webmasters	500,000	0	1990

Source: W. Michael Cox and Richard Alm

Creative Destruction Examples

Telecommunications

1970 telephone industry employed 421,000

Americans made 9.8 billion long-distance calls

Average operator handled 64 calls

2000 industry employed 156,000

106 billion long-distance calls made

Average operator handles 1,861 calls

With 1970s technology, the same volume of calls would require 4.5 million employees and calls would cost 6x as much

Creative Destruction Examples

Video Content and Netflix

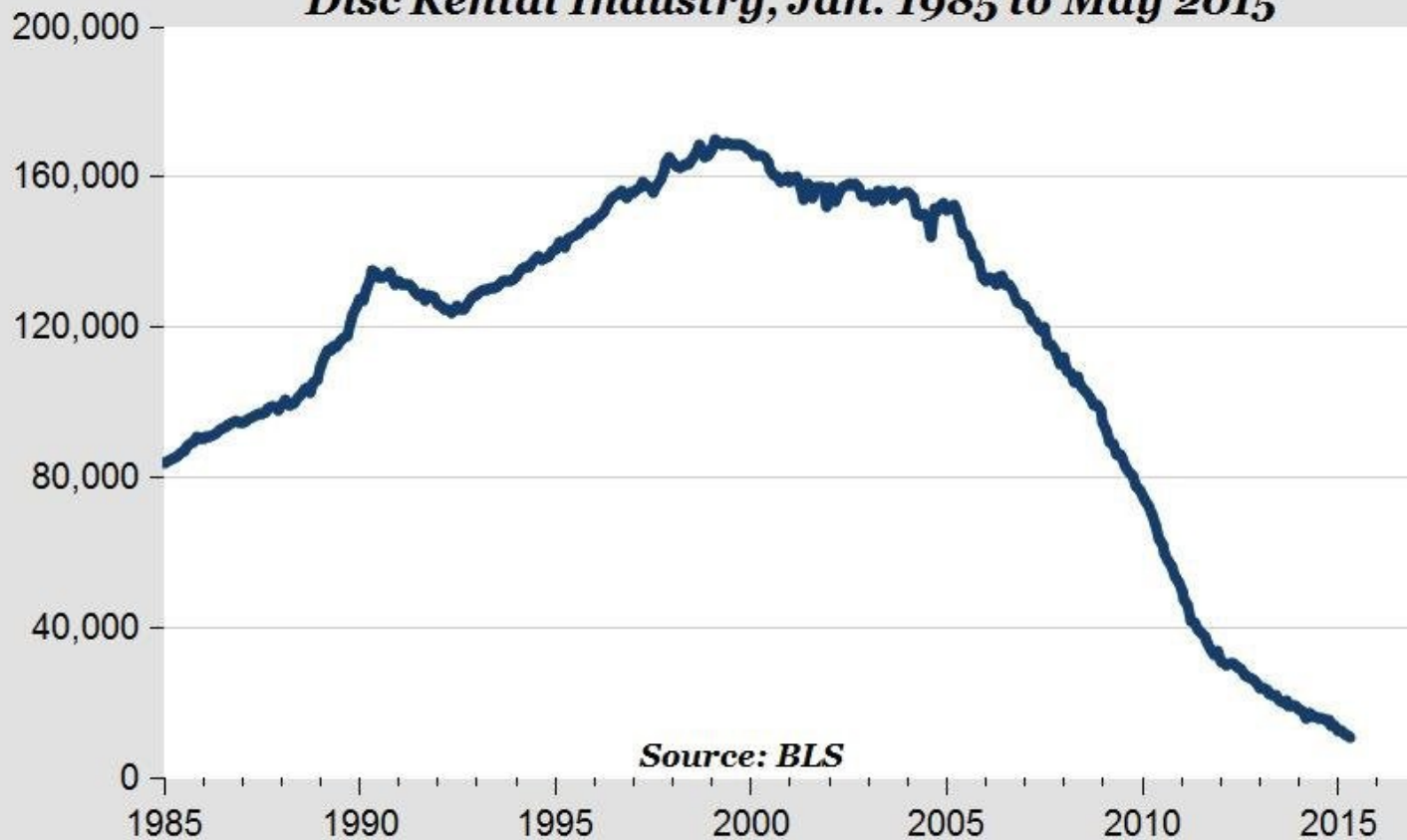
Market disruption described as “Netflix Effect”

Competitors span many markets

Video Tape and Disc Rental

PayTV (i.e. Cable Networks)

US Employees in the Video Tape and Disc Rental Industry, Jan. 1985 to May 2015



Source: BLS

Year-to-date Returns: Netflix (+157%) v. Disney (+15.3%), CBS (-6.3%), Time-Warner (-21.5%) & FOX (-22.75%)



Monopolistic Practices

To summarize creative destruction, the impact of new things on the existing structure of an industry reduces the long-run scope and importance of practices that aim to conserve established positions.

Policies have greater significance due to creative destruction than they would in a stationary state.*

Practically any investment entails safeguarding activities such as insuring or hedging
Necessary to use protecting devices or actions

Enterprise would be impossible without known financial opportunities
Potential for profit

Monopolistic Practices (2)

But failure is always possible

One “storm” can end an otherwise stable firm

Goal should be orderly retreat instead of crash

But how do attempts to manage Creative Destruction affect industry practices and production?

Monopolistic Practices (3)

Price Rigidity - price is considered rigid if it is less sensitive to changes in demand and supply than it would be if perfect competition prevailed

Creative destruction doesn't have to mean lower prices

Business strategy aims to avoid seasonal, random, and cyclical fluctuations in price

Aims for step function of short-term rigidity

Some rigidity can add stability

Monopolistic Practices (4)

In the era of big business the maintenance of the value of existing investment becomes the chief aim

In a small industrial field without perfect competition this can slow or halt progress

This doesn't mean R&D departments are bad

In general, they try to maximize present net value of total assets which is equal to the discounted value of expected net returns

Value of past investment does not enter into this

Adopting new methods of production should be looked at as a link in a chain of improvements

Monopolistic Practices (5)

Monopolies - single sellers who face a given demand schedule that is severely independent of their own action as well as any reactions to their actions by other concerns

With this definition, pure cases of long-run monopoly are rare

Monopolies have been cursed and associated with functionless exploitation
Theory of simple and discriminating monopoly neglects special cases

A new method of production or commodity does not confer monopoly
Possible competition and delays
Substantially easier for devices with “spectacular superiority”

Single seller is most concerned with protection and long-range planning

Monopolistic Practices (6)

The proposition that a perfectly competitive system allows for optimal allocation of resources and income is questionable

Equilibrium can be hard to restore

Actual free entry is impossible and stifles growth

Surplus profits under monopolistic principles aren't necessarily wasteful

And the absence of profit doesn't imply superiority

Large-scale establishment or unit control isn't a necessary evil

But its benefits are undeniable

Closed season

Referring back to plausible capitalism, the first problem was to find out whether there is “an understandable relation” between the structural features of capitalism and its economic performance.

Schumpeter argues that such a relationship exists based on standard economic analysis up till the modern tendency toward monopolistic control.

After that his analysis deviated slightly to show that the positive outcomes theoretically existing in perfect competition should also exist in big-business or monopolistic capitalism to a greater degree.

Closed season (2)

Theoretically, it might still be possible to account for the observed performance by exceptional circumstances independent of capitalism.

Examining the economic and political history of the period in question and to discuss exceptional circumstances.

Government action may be considered as a factor external to the world of business

Gold

Increase in population

New Land

Technological progress

Closed season (3)

To what extent it is legitimate to assume that the capitalist engine will work on in the near future about as successfully as it did in the past?

The Vanishing of Investment Opportunity

One counter-argument that Schumpeter responds to is the vanishing of investment opportunity.

From a Marxian perspective the negative effects of capital accumulation and capital agglomeration (saturation, population growth, etc) on the rate of profits eliminate the opportunity to invest.

This theory really raises several distinct problems.

whether the forces and mechanisms offered by the theory of vanishing investment opportunity are the ones to stress.

Whether if the above would be sufficient to indicate the presence of a long-run tendency toward ultimate deadlock for capitalism

The Vanishing of Investment Opportunity

(2)

However, product per man-hour is going to rise during the next generation for several reasons such as the unexhausted stream of labor-saving devices

Analysts often make the mistake of assuming that particular features of a historic process are actually fundamental causes i.e. investment in developing countries.

Finally, such opportunities for investment as remain are more suited for public than they are for private enterprise. This is true to some extent..

The Civilization of Capitalism

All the features and achievements of modern civilization are, directly or indirectly, the products of the capitalist process.

Besides raising general standards of living, the capitalist process also provided the means and the will for that socially beneficial legislation.

The capitalist process rationalizes behavior and ideas and by so doing reshapes both our methods of attaining our ends and our ultimate ends themselves.

Crumbling Walls

The obsolescence of the entrepreneurial function

Revisiting the theory of vanishing investment opportunity and the possibility that the economic wants of humanity could be completely satisfied

Assuming that methods of production have reached a state of perfection it would cause capitalism to become atrophic and a form of socialism would begin.

Many of these effects can also be expected from a development that is clearly observable already

Entrepreneurship is already losing importance and is bound to lose it at an accelerating rate in the future.

Crumbling Walls (2)

Thus, economic progress tends to become depersonalized and automatized*

Since capitalist enterprise, by its very achievements, tends to automatize progress, it tends to make itself superfluous.

Crumbling Walls (3)

The Destruction of the Protecting Strata

Effects further extend to the institutional framework (legal institutions, attitudes of the public, policies) that protects the elites of capital society.

In breaking down the pre-capitalist framework of society, capitalism broke the barriers that impeded its progress and the buttresses that prevented its collapse.

Crumbling Walls (3)

The Destruction of the Institutional Framework of Capitalist Society

The capitalist process undermines its own institutional framework by pushing into the background all the institutions, of free contracting and property particularly, that express the desires and methods of private economic activity.

Monopoly and concentration oust the bourgeoisie from their core function

What really matters beyond fears of ruined competition or over-concentration are the political consequences of concentration*

Growing Hostility

The Social Atmosphere of Capitalism

Capitalist process has produced an atmosphere of almost universal hostility

- Decreases the importance of the function by which the capitalist class lives

- Wears away protective strata

- Break down its own defenses

- Creates a critical frame of mind which turns against itself

Capitalism stands its trial before biased, but justified, judges.

- Any pro-capitalist argument must rest on long-run considerations

- Lack of emotional investment

- Ever-rising standards of life and leisure for the fully employed workman

Growing Hostility (2)

The Sociology of the Intellectual

Neither opportunity nor grievances can cause active hostility against a social order, but conditions favorable to hostility call forth exploitative groups

In defending the intellectuals as a group the bourgeoisie defends itself and its scheme of life.

Only a government of non-bourgeois nature and non-bourgeois creed is strong enough to discipline them.

The increase in the standard of life and lifestyle of the public changed and is still changing the composition of the collective patron of intellectuals.

Growing Hostility (3)

Consequently, there are several consequences that bear upon the size and attitude of the intellectual group.

Because it increases the supply of white-collar workers beyond optimal amounts, education it may create sectional unemployment.

The role of the intellectual group consists primarily in stimulating, energizing, verbalizing and organizing the discontented and only secondarily in adding to it.

Decomposition

Faced by the increasing hostility of the environment and by the legislative, administrative and judicial practice of that hostility, entrepreneurs and capitalists will eventually cease to function.

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..

We have rediscovered that 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.

Decomposition (2)

Things have gone to different lengths in different countries but in no country far enough to allow us to say 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.

PART 3

Socialism is absolutely possible given two assumptions: industrial development has occurred and transitional issues can be solved.

Working definitions

Commercial society - an institution with two defining elements:

- private property for the use of production

- regulation of productive processes by private contract (or management).

Socialist society - an institutional pattern in which control over means of production and production itself are vested in a central authority

- economic affairs of society belong to public and not the private sphere

- Cultural Indeterminateness of Socialism

The Socialist Blueprint

How can socialism survive without guides for rational production?

Rational behavior -> Rational cost calculations -> Pricing cost factors

Production is the rational combination of existing factors within constraints imposed by technological conditions.

Socialism and commercial economies handle this differently

Implementing the System

Egalitarian voucher system

Ministry provides initial suggestions for “prices” charged by social stores

Guess and check until “market” clears

The Socialist Blueprint (2)

Potential Issues

Motivation via inequality of incomes

Both systems require support to increase rate of investment

Management of Production

Just as plausible given coordinated information

Comparison of Blueprints

Preliminary Point

Capitalism provides ladders for talent to climb.

Comparative Efficiency

To pick the more efficient system we must pick the one whose streams are larger based on which yields a greater monetary total than the other

Case For the Superiority of the Socialist Blueprint

Permanent slacking of capitalism increases validity of socialism

Prices are determinate

Socialist institutions can plan progress easing disturbances

Potential to efficiently manage resources from the private sphere.

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THANK YOU

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