



Entrepreneurial Economist Predicted Socialism

by Russell S. Sobel

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

—Joseph A. Schumpeter (1942), *Capitalism, Socialism, and Democracy* (Harper & Brothers), p. 61.

Introduction

Capitalism is doomed to be replaced by socialism. At least that was the view of the well-known Harvard economist Joseph Schumpeter who is most famous for his popularization of the term “creative destruction”—the process by which new entrepreneurial innovations arise and subsequently cause the old way of doing things to disappear.¹ Somewhat ironically, despite Schumpeter being a staunch defender of free-market capitalism and its long-run merits, this view put him in agreement with the noted socialist writer, Karl Marx.

Schumpeter explicitly discussed his agreement Marx's prediction, though he also stressed that his view of both the causes and desirability of the transition were clearly different. While Marx believed that the end of capitalism would come in the form of a working-class revolt due to capitalism's failures, Schumpeter in-

stead believed that capitalism's very successes would eventually destroy the system from within. Rather than Marx's view that the transition would then lead to an improvement in the living standards of the average person, Schumpeter saw the transition as leading to economic decline and stagnation for the entire society.

Many people today believe that Schumpeter's predictions are coming true or at least the wheels of this transition are in motion in many of the world's historically capitalist-based economies such as Canada, the United States, and most of Western Europe. These countries have all witnessed the size of government and economic intervention both growing rapidly. But to some, perhaps the clearest indicator that Schumpeter's predicted transition, and its causes, are emerging is the growing prevalence (now dominance?) of anti-capitalist (i.e., pro-socialist) views among the intellectual elite on college campuses.

¹ The term creative destruction, while sometimes attributed to Schumpeter, was actually first used by German economist and sociologist Werner Sombart in his 1913 book *War and Capitalism*. Nonetheless, Schumpeter is the one who popularized the term and brought it to the forefront of economic theory in his writings about capitalism as an evolutionary process.

Joseph Schumpeter is rightly seen as one of the great and most accomplished economists of the twentieth century. Let us begin by taking a closer look at Joseph Schumpeter and the origins of his views on the future of capitalism before we delve deeper into his views on why capitalism would fail, and where we stand today relative to his predictions.

Who was Joseph Schumpeter?

Joseph Schumpeter was born in 1883 in a small town in the Austro-Hungarian Empire that is now part of the Czech Republic. He attended the University of Vienna, which at the time was one of the top universities in the world, comparable to Oxford and Cambridge. He was heavily influenced by several of his college professors including noted economist Eugen von Böhm-Bawerk. Böhm-Bawerk had trained under Carl Menger, who was a founding member of the Austrian School of Economics and one of three key figures in the Marginalist Revolution in the field of economics.² Schumpeter held a mathematical, scientific approach to economics. In fact, Schumpeter's most famous student, Paul Samuelson, would become one of America's most prominent and influential economists in the 1950s and further helped to mathematize economic theory. Interestingly, another well-known economist, Ludwig von Mises, was a contemporary of Schumpeter's at the University of Vienna.

Schumpeter had brief stints outside of academics as Austria's Secretary of Finance and as a bank president in that country. Unfortunately, the crash of the Vienna stock market in 1924 caused Schumpeter to lose much of his wealth. He accumulated so much debt that he spent the next decade paying off those debts using his earnings from academic writing and lectur-

ing. Many biographers have concluded that Schumpeter's personal experience in these non-academic roles played a critical role in shaping his viewpoints on the role of entrepreneurship, business cycles, and capital allocation.

Schumpeter also suffered significant personal tragedy in his life. He lost his father at the age of four to a hunting accident, and later in life within quick succession he lost his mother to a cardiovascular event and his wife to complications from giving birth to their first child, who also died roughly an hour after being born. Schumpeter would write several of his friends that the only thing that enabled him to survive this period and move on was focusing on his academic work, which he did until the time of his death in 1950, at the age of 66, of a cerebral hemorrhage.

Schumpeter quickly rose to prominence in the economics profession after the publication of his breakthrough book on economic progress and the role of the entrepreneur, *The Theory of Economic Development*. Schumpeter's upward career trajectory continued and he eventually became the first foreign-born president of the American Economics Association, one of the most prestigious offices in the country for an economist.

While Schumpeter was a professor at Harvard, he published many other influential books and articles, including what is perhaps his most famous work, *Capitalism, Socialism and Democracy*. This book, published in 1942, contained both his prognosis that capitalism would eventually be replaced by socialism and his pioneering description of "creative destruction"—that economies were always evolving through continual disruptions caused by entrepreneurial innovations,

² The Marginalist Revolution marks the dividing line between classical and modern economics. It is when economists started modelling individual choice as being made "at the margin," in other words, by considering only the additional (or 'change in') costs and benefits resulting from a decision.

new combinations of resources, and new methods of organization and production.

Let us now turn to a more detailed examination of his prognosis for the future of capitalism contained in *Capitalism, Socialism and Democracy*.

Creative destruction

Schumpeter saw the economy as always and continuously changing and evolving, not just internally within the system, but the economic system itself. This idea stood in contrast to the viewpoint of most of his fellow economists at the time who, based on their mathematical models, adopted a more neo-classical equilibrium viewpoint of the economy in which economic phenomena always strived to move into a static or stationary state.

One reason for this difference developed from Schumpeter's keen interest in economic history. For him to understand how and why things had changed economically over the previous few centuries into what they had become at the time of his writing required him to take a longer-run view that focused on the process of economic change, rather than some static outcome that may or may not exist at the current time. Schumpeter's writing characterized the historical path to the present as being primarily shaped by the vast improvements in living standards brought about by the continuous introduction of new goods, services, and methods of production by entrepreneurs.

This placed the entrepreneur at the center of Schumpeter's view of economic evolution and progress. Entrepreneurs are constantly bringing their innovations into existence in the marketplace, usually in the form of a new business venture. This is the creative side of the process that propels economic growth and increases prosperity over time.

However, innovations often result in the obsolescence of old products, businesses, and ways of doing things

(like the automobile replacing the horse and buggy, or digital music replacing the compact disc). This duality is why Schumpeter felt the term "creative destruction" best described this process. Importantly for our topic, the destructive aspect creates a group of individuals who try to put the brakes on the very process of entrepreneurship that has been responsible for their prior success—those whose jobs or businesses are being threatened with destruction brought about by the new innovations. As we shall see shortly, they play a role in our discussion of the reasons why capitalism may fail.

In Schumpeter's view, creative (but destructive) innovations are carried out by profit-seeking entrepreneurs experimenting with new combinations of resources. While many of their new ideas are good, others are not so good; the profit and loss system links the commercial success of the entrepreneur's new venture to whether it truly satisfies consumers' desires. The result is that over time the luxuries that once only the wealthy or nobility could afford (Schumpeter famously used silk stockings as an example) become something the average worker can obtain.

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That capitalism worked over the long run to greatly benefit the lower and middle classes through improvements in wages, living standards, and what was available and affordable for consumption stood in stark contrast to the view of Karl Marx. Marx viewed

capitalism as creating wealth and benefits only for the bourgeoisie capitalists who own the means of production and exploit the working-class proletariat majority who suffer at their expense.

The vast and widespread wealth creation that Schumpeter viewed capitalism as creating was simply planting a seed for capitalism's future demise.

The beginning of the end

Schumpeter believed that several factors were working in combination to cause the eventual demise of capitalism and its replacement by socialism. We have alluded to the precursors underlying these series of events, so let us now discuss how he viewed they would come together to destroy capitalism.

"The same entrepreneurs who benefitted from the open and competitive marketplace of capitalism would themselves seek to limit, constrain, and stifle the very process that led to their success."

First, the very process of innovation that Schumpeter is so famous for popularizing with the term "creative destruction" was something that he believed people would begin to take for granted. Innovation would become entrenched in the routine operation of large firms. When this occurred, progress would no longer so visibly be attributed to the innovative actions of

entrepreneurial individuals. The sizeable political and social class of small merchant entrepreneurs and their employees who once felt directly vested in the economic system of capitalism and property ownership would be replaced by emotionally unattached employees, managers, and shareholders of large bureaucratic firms. When this happened, Schumpeter believed, the entrepreneur would fall from the top of society's social pyramid. Children would aspire to be doctors, teachers, bureaucrats, or politicians, but no longer strive to be entrepreneurs.

Second, Schumpeter saw the business failures that accompanied the process of creative destruction would lead to calls for greater government regulation and intervention in the economy. In attempting to preserve their jobs and business profits in the face of new innovative competition, both workers and business owners would seek government intervention to limit competition, keep out new competitors by erecting barriers to entry, and regulate industrial structure. The same entrepreneurs who benefitted from the open and competitive marketplace of capitalism would themselves seek to limit, constrain, and stifle the very process that led to their success. This process would eventually lead to a progression toward crony capitalism (or political capitalism) in which government would enlarge "deep into the flesh of the private economy" to the point where business success would become more dependent upon competing for political favours than competing for customers. As this process unfolds, the system starts to be run and influenced primarily by politically connected large businesses, many of whom are in business solely due to their close connections with government and the favours politicians have granted them in exchange for votes, campaign contributions, and other forms of political support.³

³ There are some interesting parallels between Schumpeter's view and that of F.A. Hayek in his famous 1944 book, *The Road to Serfdom*. As economic interests increasingly seek (and obtain) government protection from competition, government will be less able to resist the similar

The third and perhaps most significant causal factor in Schumpeter's predicted demise of capitalism is the one that most differs from the views of Marx. Unlike Marx's view that capitalism exploits and impoverishes the average person, Schumpeter believed that the enormous productivity of capitalism would easily churn out the goods needed for basic consumption, freeing up labour from the fields and factories to enjoy a leisurely life in the new, modern intellectual class of academics, journalists, and bureaucrats. Rather than leading to widespread subsistence farming and sweat-shop labour as Marx postulated, Schumpeter believed that capitalism freed people from it. The new intellectual class could then spend their days thinking, writing, discussing, and regulating others, all while easily and inexpensively acquiring the food and material goods they need through the productivity of others.

This new intellectual class would become so separated and removed from the actual process of entrepreneurship and production that they would turn against the very philosophical foundations and institutions of the economic system that made their leisurely life possible. Not understanding the roots of their own condition, they would spend their daily efforts deliberately working to undermine the systems of private property, private contracting, and free markets. They would condemn capitalism as a foregone conclusion and view any pro-capitalism position as illogical and anti-social. To Schumpeter, discussion among the intellectuals would require the condemnation of capitalism as "virtually a requirement of the etiquette of discussion"—a prediction many believe has already come true on university campuses in Canada and the United States.

Democracy, socialism, and human well-being

Rather than Marx's view of the workers turning on the bourgeoisie supporters of capitalism, Schumpeter believed that the bourgeoisie would themselves turn on capitalism. In Schumpeter's view, the political system of democracy helps to enable this process. Justified on the misplaced moral credence given to the "will of the majority," there will be a steady march of regulation into the private sector and economic affairs that will only cease when "there is nothing unregulated left" and personal and economic freedoms are greatly curtailed and regulated. Whether or not it's called socialism, it will be so functionally to a large extent—or, in Schumpeter's words, it will merely be "a matter of taste and terminology" whether or not it is called socialism.

While Schumpeter believed that both the automation of the entrepreneur's role and what he viewed as the "rationalizing" of the human mind would play a role in the downfall of capitalism, it would be the lack of intellectual and political supporters to protect the institutions of private property and contracting that underpins capitalism that would, in his view, play the major role in the system's downfall and transition to socialism (or something functionally equivalent to it).

Schumpeter clearly believed that in the long run, a movement away from capitalism and toward socialism would result in both less personal freedom and lower levels of economic prosperity. Thus, while both Schumpeter and Marx believed that the economic system of capitalism had built-in features that would lead to its demise and replacement with socialism, the two authors not only had different rationales for the causes, but also a different prognosis for the impact it would have on the well-being of individuals in society.

demands of others, requiring ever-increasing controls on private activities, and paving the road to serfdom. Hayek was more optimistic, however, that these trends were reversible.

Where we stand today

Even at the time of Schumpeter's writings in the early- to mid-twentieth century, he believed this transition to socialism was already underway. He cited as evidence the rapid growth of government regulations, controls on banking and labour markets, price controls, high levels of taxation and redistribution, and calls for government takeovers of industries.

Viewed in the context of our current world, Schumpeter's writings clearly foreshadowed the growing ability of special interest groups to control the political process, the rise of large firms using the power of government to protect their interests from competitive pressures, the increased bureaucratization of innovation through large firm concentration, the rise of the regulatory state with extensive controls on private business, and the growing levels of fiscal debt and taxation that have occurred. As cases in point, in the last two decades over three-fourths of the major industries in North America have experienced an increase in big firm concentration, and since the 1980s government debt as a share of the economy has more than doubled and inflation-adjusted government spending has more than tripled in both the United States and Canada.

As Schumpeter noted, "any pro-capitalist argument must rest on long-run considerations." As more and more individuals lose sight of capitalism as the true historical source of their prosperity and of its long-run benefits, they instead focus on using expanded government control to alleviate short-run economic concerns and social shortcomings as they see them, without realizing the harmful long-run secondary effects of greater and greater government control and intervention. One short-run crisis at a time, government control becomes more widespread and accepted. This has clearly occurred in over the past few decades with government intervention growing in response to the terrorist attacks in the early 2000s, the COVID-19 pandemic, and virtually every recession.

Schumpeter's main concern, which has also largely manifested itself (especially in the mainstream media and on college campuses), was that in intellectual circles eventually capitalism would be on "trial in front of judges who have the death sentence ready in their pockets... the condemnation of capitalism and all of its works is a foregone conclusion—virtually a requirement of the etiquette of discussion... Any other position is held as not only crazy, but as anti-social..." and this bias would prevent people from understanding the true economic and cultural accomplishments of capitalism.

While a transition to socialism to the full extent Schumpeter described it has yet to unfold, there is no question that government intervention and influence over the economy in western countries has continued to grow rapidly, and that public and intellectual attitudes toward political platforms based on some variant of "democratic socialism" seem to have become more positive (and views toward capitalism more negative).

While Marx personally desired socialism and believed it to be a superior economic system, Schumpeter held the opposite viewpoint. Schumpeter firmly believed in the power of private innovation and entrepreneurship and the benefits that capitalism produced; benefits that he believed were superior to the outcomes under socialism. Unlike Marx, Schumpeter did not want capitalism to be replaced by socialism, nor did he think this transition would be beneficial for the well-being of society. In fact, he thought it would result in major declines in our standard of living.

However, until people once again celebrate and aspire to the creative genius of entrepreneurship and recognize that it is precisely free markets and the systems of private property and unfettered market competition that have lifted them from poverty and the necessity of being farm and factory workers just to survive, we remain solidly on the path Schumpeter predicted in his famous 1942 book, *Capitalism, Socialism, and Democracy*.



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