Can Capitalism Survive?

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Foreword

One of the signs of advancing age in the American college professor is a tendency for him to write less and publish more. This seeming paradox is easily explained by the phenomenon of *Collected Works,* that is, by what on television would be described as reruns. As in television, no great public outcry is needed to bring forth the reruns; a question from his wife, a polite suggestion from a colleague, and the cut-and-paste operation is under way.

I have put together here what I believe to be the best of the rather meager output of my professional career up to this point. For reasons (mostly financial) that always seemed adequate at the moment, I have been more of a speechmaker than a writer. Thus, you will find that many of the pieces in this collection are but speeches put down on paper.

I have edited the manuscripts, but only to make them more readable and to reduce duplication of ideas and

phrasings. In most cases, I successfully resisted the temptation to erase those statements that, in the light of later knowledge, would cast doubt on my omniscience (for example, some moderate words in praise of Richard Nixon, written in May 1971). The papers are grouped in categories that make sense to me, but obviously some of the papers could as easily have been placed in other groupings.

Some of those holding the markers for my intellectual debts are identified in the papers; others, just literally too numerous to mention, will have to be content with an occasional and probably very accurate, "But of course I said that long ago—and more elegantly."

Very explicit words of appreciation need be directed to Catherine Fertig, my secretary and an expert at deciphering handwritten manuscripts; to Marise Melson, my daughter and copyeditor, who is possessed of a good sense of style in manuscripts and in life; and to my late wife, Alice, for her patient, loving, and low-key nagging of me to finish this project.

Can Capitalism Survive?

Part I

Can Capitalism Survive?

The basic ideas of this paper were expressed on a number of occasions and in various forms. It was first presented in the exotic setting of a business conference held at the Playboy Club in Lake Geneva, Wisconsin. In somewhat different form, it was later presented in the Ludwig von Mises Lecture Series at Hillsdale College. I am presenting it here as the first paper because it poses the Big Questions—as identified by Joseph Schumpeter and agreed to by Ben Rogge.

Chapter 1

Can Capitalism Survive?

> Can capitalism survive? No, I do not think it can. The thesis I shall endeavor to establish is that the actual and prospective performance of the capitalist system is such as to negative the idea of its breaking down under the weight of economic failure, but that 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.[1]

These words were written in 1942 by Joseph Schumpeter, Austrian-born Harvard social scientist, in his prophetic work, *Capitalism, Socialism and Democracy*. Inasmuch as I intend to build my comments around this work, it might be appropriate for me to reinforce my own judgment of Schumpeter's competence with a statement by the Nobel Prize-winning economist, Paul Samuelson. In one of his *Newsweek* columns in 1970, Samuelson wrote:

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[1] Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy,* 3rd ed. (New York: Harper & Row, 1962), p. 61.

> It is just twenty years since Joseph Schumpeter died. Although it is not my practice to tout profitable speculations, today I'd like to suggest that Schumpeter's diagnosis of the probable decay of capitalism deserves a new reading in our own time. The general reader cannot do better than begin with his 1942, *Capitalism, Socialism and Democracy*.
>
> Nothing that has happened in recent years at Berkeley or Harvard would come as a surprise to those who have absorbed this work. And if there are good clubs in the great beyond, one can picture Schumpeter—an 87-year-old by this time, martini glass in hand—reading *The New York Review of Books* and chuckling with clinical amusement. Only his Viennese veneer keeps him from saying, "I told you so."[2]

(In common with his sometime colleague at Harvard, John Kenneth Galbraith, Schumpeter was possessed of a very healthy ego. He is reported to have remarked in his later years that, as a young man, he had had three ambitions: to become one of the world's greatest economists, one of the world's greatest horsemen, and one of the world's greatest lovers. He continued by saying that he was happy to report that he had succeeded in two of those ambitions. He did not identify which two.)

I

On what does Schumpeter base his forecast, and how does all this relate to the life and times of the

[2] Paul A. Samuelson, "Joseph Schumpeter," *Newsweek*, April 13, 1970, p. 75.

American businessman today? Bear with me; all will be revealed in due course. We begin with the analysis.

(1) The first question that Schumpeter seeks to answer is this: Has capitalism proved to be a successful economic system in the sense of producing over time continuing improvement in the economic well-being of the masses? His answer to this is an unequivocal and resounding, Yes! In his words, "The capitalist process, not by coincidence, but by virtue of its mechanism, progressively raises the standards of life of the masses."[3] "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."[4]

I direct your attention to his phrase, "not by coincidence. . . ." Critics of capitalism usually argue that the economic performance under capitalism in England and the United States was not the *result* of capitalism but of a combination of fortuitous circumstances and wise governmental action to counteract capitalist excesses.

Schumpeter takes each of the "fortuitous circumstances" in turn and discards them as possible explanations of the capitalist track record. For example, the virgin land and other natural resources of the Amer-

[3] Schumpeter, *Capitalism,* p. 68.

[4] Ibid., p. 67.

ican continent were but "objective opportunities" waiting to be exploited by an efficient economic system —and capitalism was that system. I might add that some million or so Indians lived lives of severe economic privation on top of those self-same resources in an area where over 200 million now live lives of Galbraithian affluence.

In the same way the technological revolution of the last two hundred years has been not an historic accident but a predictable concomitant of the capitalist system. More on this later.

To the claim that capitalism's success was significantly produced by governmental corrections of capitalist excesses, he makes two replies. The first is that the track record (in terms of improvement in real wages) was just as good in the period of minimal state intervention and minimal trade union activity (1870–1914) as in later periods. The second is that most such interventions actually reduced the rate of improvement in economic well-being. For example, he argues that the unemployment figure was increased by the anti-capitalist policies of the 1930s. He concludes: "We have now established a reasonable case to the effect that the observed behavior of output per head of population during the period of fullfledged capitalism was not an accident but may be held to measure roughly capitalist performance."[5]

[5] Ibid., p. 110.

(2) Schumpeter turns next to the question of whether there are any purely economic factors that would prejudice the chances of capitalism continuing to bring improvement in the economic well-being of the masses. In this section, he is answering the doomsayers of the thirties (including and particularly John Maynard Keynes) who saw in the depression evidence of a deeper malaise in the capitalist economy, in the form of a vanishing of the investment opportunity that had sparked the capitalist engine for so many decades.

His attacks here are centered upon an enemy that has largely disappeared by now, as the "stagnation thesis" which so captured our imagination in the thirties has been undone by the simple course of events. I'll spare you the details of the argument and report only one of the assumptions of the stagnationists: that, by the late 1930s, all of the great technological breakthroughs had been made, and the capitalist world from then on would be missing this great stimulus to private investment spending. This is an example of what the *New Yorker* refers to as the "clouded crystal ball." Schumpeter correctly labels this assumption of the stagnationists as nonsense and describes their other assumptions as either equally nonsensical or irrelevant. His conclusion is that there were no purely economic factors to obstruct continuing success for the capitalist system.

(3) In his answer to his next question, Schumpeter presents what I believe to be the most accurate and

useful description of the nature of competition under capitalism ever developed. His question is this: How can capitalism be so successful a system when capitalist reality has always been at such odds with the perfect competition requirement of the textbook models? There are only two possible explanations. One is that "fortuitous circumstances" produced economic growth in spite of the gross imperfections of the capitalist system—but Schumpeter has already denied the validity of this thesis. The second, and the one for which he opts, is that the traditional textbook model of competition and monopoly, with its emphasis on perfect competition as the ideal and the target, is simply not relevant. As he puts it, "If we economists were given less to wishful thinking and more to the observation of facts, doubts would immediately arise as to the realistic virtues of a theory that would have led us to expect a very different result."[6]

Perhaps the best way to explain the difference between the textbook and the Schumpeter models of competitive behavior is with an example. In Table A you are given the shares of the diuretic market held by various firms over a ten-year period. By the criteria of the textbook model, each year—taken separately—would reveal a grossly imperfect market structure. Why? Because a few firms dominate the market. In addition (although the data given here do not reveal

[6] Ibid., p. 75.

TABLE A

Drug Companies' Shares of the Diuretic Market, 1951–1960

Letter = company
Digit = trade name product

	A1	B2	C3	D4	F6	G8	G9	H10	H12	J13	Others
1951	32%	22%	19%	17%							10%
1952	9	25	37	18							11
1953		23	33	12	15%						17
1954		10	16	5	59						10
1955		6	13		61	13%					7
1956			11		67	9					13
1957			9		67		12%				12
1958					14			78%			8
1959					10			58	18%	7%	7
1960					8			45	23	7	17

Source: Marketing Division, Eli Lilly Company, Indianapolis, Indiana

this), the profit margins on these products for the leading firms each year would most probably be very handsome indeed—perhaps far above what would be thought to be a "normal" profit. The technical description of the market structure, in the language of the textbook model, would be that of "oligopoly"—the rule of the few.

All of this Schumpeter would label as nonsense. Why? Because the investigator would be examining "each year—taken separately" rather than the never-ending game of leapfrog that the data reveal and that represents the true nature of the competitive process.

To the textbook economist, both the size of the firms relative to the market and the high profits on individual products would be evidence of market imperfection, implying "corrective" action (e.g. breaking up the larger firms). To Schumpeter, not only are size and profits not anticompetitive per se; both are natural and desirable features of the competitive process, when viewed as a dynamic process operating through the course of time. The size is often needed to assure innovative efficiency, and the profits are needed to keep the challengers trying. (In fact, says Schumpeter, when the losses of the failures are combined with the profits of the successes, the net cost to the consumer of all this may be zero—or less.)

Neither the Yankees nor IBM nor General Motors need be dismembered; time and tide and "creative destruction" will operate on each and bring a demotion

in rank—unless they behave as if they face immediate and equal rivals, i.e. unless they behave "competitively." And, of course, unless they receive governmental assistance in maintaining their market positions.

Schumpeter concludes his work in this area by saying that "long-run cases of pure monopoly must be of the rarest occurrence. . . . The power to exploit at pleasure a given pattern of demand . . . can under the conditions of intact capitalism hardly persist for a period long enough to matter . . . unless buttressed by public authority."[7]

My own conviction, deriving largely from Schumpeter, is that competition does not have to be created or protected; it inheres in the very nature of man. It can be reduced or eliminated *only* by coercive acts of governments. All that a government need do to encourage competition is not to get in its way.

I agree with Schumpeter's words in his preface to the second edition of *Capitalism, Socialism and Democracy,* when he writes, "I believe that *most* of the current talk about monopoly is nothing but radical ideology. . . ."

In my opinion the antitrust laws of this country are anticapitalist in intent and in effect and, in addition, constitute one of the major sources of confusion and unwarranted guilt feelings on the part of the businessman. These laws brand as antisocial precisely those

[7] Ibid., p. 99.

achievements by which the businessman evaluates his performance—growth in size, superiority over rivals, increasing market share, profits above average, etc.

They also produce such absurdities as the case brought a few years ago against Topps Chewing Gum for monopolizing the baseball picture card industry. In the words of the FTC examiner, Topps had been "hustling around getting the players' signatures, pretty well cornering the major league players." He added, in a dramatic after-climax, that "players were paid $5.00 for a five-year contract." Who could possibly compete with a company that was willing to throw money around like that? (That was ten years ago; today, under the influence of potential rivals, the figure has gone up to no less than $250 a year!)

(4) Schumpeter's case for capitalism is now complete and it is impressive indeed. Why does this not assure the public and political acceptance of the system? Because, says Schumpeter, "it is an error to believe that political attack arises primarily from grievance and that it can be turned by justification. . . . In no case is [rational argument] a match for the extra-rational determinants of conduct."[8]

In effect if capitalism is to survive, it must defend itself in the arena of values and emotions—and here its very success as an economic system reduces its chances of victory. We can best see Schumpeter's analysis of

[8] Ibid., p. 144.

this by examining the impact of capitalism on each of the groups in society that might serve as a bulwark against the system.

(5) We begin with the principal beneficiaries of capitalism—the masses. Why do they not defend the system that has made them the most affluent people in the history of man? Because they do not connect their affluence with the capitalist system, because they are incapable of understanding *any* economic system as such, because they are more aware of their daily frustrations and insecurities under the system than they are of their long-run gains from the system, and because they are taught by the intellectuals in society to resent the capitalist system and its central figure—the businessman.

This same point is eloquently made by another distinguished social observer, Ortega y Gasset. In *Revolt of the Masses,* he writes:

> The common man, finding himself in a world so excellent, technically and socially, believes it has been produced by nature, and never thinks of the personal efforts of highly endowed individuals which the creation of this new world presupposed. *Still less will he admit the notion that all these facilities still require the support of certain difficult human virtues, the least failure of which would cause the rapid disappearance of the whole magnificent edifice.*[9]

[9] Jose Ortega y Gasset, *Revolt of the Masses* (New York: Norton, 1932).