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Schumpeter Plus Optimism Equals Gilder (Ceteris Paribus)

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REVISED EDITION

Schumpeter Plus Optimism Equals Gilder (Ceteris Paribus)

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This paper argues that Wealth and Poverty, recently written by the amateur but influential economist George Gilder, can be seen as a more or less unconscious answer to the gloomy prognosis of the future of capitalism as written by Joseph Schumpeter over forty years ago in Capitalism, Socialism and Democracy. Gilder manages to take almost every tendency which Schumpeter gives as to why capitalism cannot survive in the long run, and to turn it around to show why public policy should be used to fight that tendency, and to show, somewhat paradoxically, why capitalism will last forever. Thus, the Schumpeter-Gilder connection (and hence the Schumpeter-Reaganomics connection, to the extent that Reagan's socioeconomic policies have been based on Gilder's work) constitutes a rather curious note in the history of economic thought.

This paper presents Schumpeter's vision of capitalism. The fact that Schumpeter is reacting to Marx's work, the central role of the entrepreneur, and the development of a specifically capitalist culture are emphasized. Schumpeter's

reasons for the long-run breakdown of capitalism are reviewed; these include the squeezing out of the entrepreneur, the unheroism of capitalism, the breakdown of the bourgeois family leading to anti-savings, anti-work and anti-investment attitudes, and the idea that the rationalism developed so extensively by capitalist culture is used ultimately against that very same capitalist culture to overthrow it.

George Gilder is then introduced. The amount of attention which we are devoting to him is defended on the grounds of his potential public policy influences. Gilder's vision of capitalism, and its similarities to Schumpeter's vision are noted. Gilder's public policy proposals, notably that we should encourage the entrepreneur, admire and (if we are male) emulate the heroism of the entrepreneur, preserve and strengthen Gilder's conception of the bourgeois family, and fight against becoming too rationalistic by turning to spiritual and religious values are noted. In so doing, it is seen that Gilder is (apparently more or less unconsciously) responding to Schumpeter's gloomy prognosis for the downfall of capitalism in such a way that Gilder apparently feels that capitalism will last more or less forever.

Let us recall Schumpeter's vision of capitalism,¹ as presented in part two of his work Capitalism, Socialism and

Democracy. Coming after a long essay on Marx,² it is deeply influenced by Marx's work.³ A major point of the Marx essay is to take Marx seriously, and to show that Schumpeter will be doing a more or less Marxist analysis, since Marx's methodology "establishes both a goal and a method." (p. 44) Schumpeter claims that 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*." (p. 44) Thus, Schumpeter avows that

However, whether favorable or unfavorable, value judgments about capitalist performance are of little interest. For mankind is not free to choose. ... Things economic and social move by their own momentum and the ensuing situations compel individuals and groups to behave in certain ways whatever they may wish to do- ... by shaping the choosing mentalities and by narrowing the list of possibilities from which to choose. If this is the quintessence of Marxism then we all of us have got to be Marxists." (pp. 129-130)

Although Schumpeter's general approach and methodology was heavily influenced by Marx,⁴ and although Schumpeter felt

that capitalism would not survive and would probably be replaced by some form of socialism,⁵ Schumpeter, unlike Marx, did not look forward to its demise.⁶ Indeed, although Schumpeter was apparently accused of "advocating foreign collectivism" (preface to second edition), Schumpeter in fact rather liked capitalism, and was impressed by it, not least because it nurtured and promoted the entrepreneurial spirit.

As is well known, the key figure in the Schumpeterian scenario of capitalism is the entrepreneur. The role of the entrepreneur is to take risks, promote change, and keep investments and hence the economy charging ahead. The capitalist system rewards entrepreneurs. Like poker, it is a game of chance and skill, and the stakes are sufficiently high as to encourage most smart people to become entrepreneurs.

For Schumpeter there is no such thing as perfect competition in the real world; instead, capitalism is characterized by small, temporary monopolies. These little monopolies arise from technical changes, and they receive temporary monopoly profits. Through economic competition, they ruin their competitors, and the value of their competitor's old equipment, which process Schumpeter calls creative destruction. This dynamic process leads to unemployment, flux, and inefficiencies in the short run; in the long run it leads to higher standards of living.

The system keeps the best and brightest working hard

to get rich. It develops a capitalist culture which is anti-metaphysical, anti-romantic, and anti-heroic. In partial replacement of these pre-capitalist elements, capitalist culture develops rationality, math and the physical sciences, modern technology and modern industry. It is a culture which requires stamina in order to become rich and is pacifist - the goal for most people being to make money, not war. (Chapters V - XI)

It is also a culture and a system which will kill itself. Here are the reasons.

A major reason, in some sense the reason, is that as capitalism develops it tends to squeeze out the entrepreneur. For Schumpeter, the "function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention or more generally, an untried technological possibility." (p. 132) Yet, according to Schumpeter, this social function is losing importance since innovation itself is being reduced to a routine process. As Schumpeter views the development of capitalism, economic progress becomes depersonalized, automatized, bureaucratized, and the role and social position of the capitalist entrepreneur become undermined. It is Schumpeter's contention that if "capitalist evolution - 'progress' - either ceases or becomes completely automatic, the economic basis of the industrial bourgeoisie will be reduced

eventually to wages such as are paid for current administrative work." (p. 134) And Schumpeter fears that this is indeed happening, because "capitalist enterprise, by its very achievements, tends to automatize progress, we conclude that it tends to make itself superfluous" and "the perfectly bureaucratized giant industrial unit ... ousts the entrepreneur." (1)

An additional problem according to Schumpeter is that the bourgeois is not a good ruler. He is too rationalistic and unheroic. Hence, "without protection by some non-bourgeois group, the bourgeoisie is politically helpless and unable not only to lead its nation but even to take care of its particular class interests. Which amounts to saying that it needs a master." (p. 138) Yet, the capitalist process does away with its protecting master. It destroyed the institutional arrangements of the feudal world, including the artisan, the lord and the peasant. Moreover, it continues to destroy many sources of potential support in the capitalist world, not only, as was seen above, the entrepreneur, but also the small producer and the small trader.

Furthermore, in the large corporations capitalism creates salaried executives and salaried managers. These people develop an employee attitude; hence, they have no real affect for the capitalist system or the will to fight for it. Property becomes disembodied. For capitalists, mere pieces of paper

replace real plant and equipment. Yet, absentee ownership does not call forth a spirited defense of private property. Hence, the capitalist process paradoxically manages to produce an "atmosphere of almost universal hostility to its own social order." It decreases the importance of the function by which the capitalist class lives, and in so doing "the bourgeois finds to his amazement" that the rationalist attitude which he fostered turns to attack private property and the whole scheme of bourgeois values. (p. 143)

Recall that for Schumpeter the rational recognition of capitalism's economic performance stands out only if, as with most of the classical economists, we take a long-run view. Yet, in the short run it is the profits, inefficiencies, temporary monopolies and structural unemployment generated by the capitalist system which dominate people's consciousness. Thus, it happens that ever-rising living standards come to be taken for granted while each individual is faced with uncertainty and insecurity. (pp. 144-145)

In this scene, this turbulent, potentially unstable brew, the relatively scurrilous intellectuals make their own contributions. According to Schumpeter, the intellectual wields the power of the spoken and written word, with an absence of direct responsibility for practical affairs. They live on criticisms. They tend to be unemployed and underemployed, are

hostile to the capitalist system, and stir up the discontent of the masses.

Meanwhile, the rationality of the capitalists tends to conquer all fields, including the decision to procreate (shades of Gary Becker). Capitalists do a cost-benefit analysis on whether to have children, and frequently decide that the costs of offsprings outweighs the benefits. This leads to an atrophying and disintegration of the bourgeois family, reduces the desirability of incomes beyond a certain level, inhibits the drive to work, invest and save, and creates a Keynesian anti-savings frame of mind. (pp. 156-163)

Thus, too much rationalism, which leads to a decline of the family and anti-savings attitudes, coupled with absentee ownership and the decline and replacement of the entrepreneur, coupled also with short run insecurities and inefficiencies as well as hostile intellectuals leads to a difficult impasse for capitalism as a system:

The capitalist process, by substituting a mere parcel of shares for the walls of and the machines in a factory, takes the life out of the idea of property. It loosens the grip that once was so strong - the grip in the sense of the legal right and the actual ability to do as one pleases with one's own; the grip also in the sense that the holder of the title loses the will to fight,

economically, physically, politically, for "his" factory and his control over it, to die if necessary on its steps. And this evaporation of what we may term the material substance of property - its visible and touchable reality - affects not only the attitude of holders but also that of the workmen and of the public in general. Dematerialized, defunctionalized and absentee ownership does not impress and call forth moral allegiance as the vital form of property did. Eventually there will be nobody left who really cares to stand for it - nobody within and nobody without the precincts of the big concerns. (p. 142 emphasis in original)

So says Joseph Schumpeter in a book first published in 1942. Now, some forty years later, into this situation enters the amateur economist George Gilder. In presenting Gilder, it may be true, as Robert Solow said in reviewing one of Gilder's works that Gilder has a questionable use of data, that he is not strong on logic and that he is full of "undocumented claims and claptrap". (Solow) It may also be true as another economist said that Gilder borders on crankiness, and that his work bristles with dubious assertions, theoretical non sequiturs, unwarranted interpretations of data, simple confusion, bizarre

readings of economic theory, history, and contemporary events, hence the reader has a "difficult job of separating the polemics, ideology, and mysticism from the facts, analysis, and genuine insights." (Higgs, p. 958)

On the other hand, as Leonard Silk has pointed out, Gilder's work probably should not be lightly dismissed, and Silk himself concludes that "it will surely take its place among the sacred texts of right-wing American populism." (Silk, p. 46) As the back cover of Gilder's book Wealth and Poverty announces, a Business Week review claimed that "reading Wealth and Poverty is indispensable for anyone who wishes to understand the intellectual basis for widespread changes that have already altered the direction of American politics and will help shape public policy in the 1980's." A review in Barron's accuses it of being "the seminal economic work of the decade. ... All of Washington will be looking to it as a blueprint of the shape of things to come." Forbes has a review which claims that it is "a first-rate analysis of the supply-side school of economics, whose practitioners will provide the cutting edge for economic policy in the Reagan administration." Finally, David Stockman, bless his heart, assures us that it is "Promethean in its intellectual power and insight. It shatters once and for all the Keynesian and welfare state illusions that burden the failed conventional wisdom of our era."

Well, silliness from some of our business press and former public officials aside, Gilder's Wealth and Poverty is important insofar as it has been a guide to the supply side strain of Reagan's public policies and insofar as its proposals and positions may be influential in future public policy both in the United States and abroad. Yet, it is also very interesting from a scientific, history of economic thought point of view ~~for~~ a rather peculiar reason. For, in apparent innocence from a close reading of Schumpeter's work, it is as if Gilder has taken most every reason why Schumpeter says that capitalism cannot survive, and turned them around to show why capitalism can and must survive. Hence, Gilder's work (and hence Reagan's policies, to the extent that they are based on the Gilder-type of analysis) can be seen as a more or less unconscious answer to Schumpeter's prediction of the demise of capitalism of forty years earlier. The rest of this paper will attempt to substantiate this interpretation.⁷

For Gilder, as for Schumpeter, the key to the capitalist economy is the entrepreneur. However, Gilder does not see the entrepreneur as necessarily being squeezed out by large corporations; nor does Gilder see any reason why capitalism should necessarily be replaced by another social system especially since "capitalism, like the family, is not an

institution that can become obsolete or decrepit as long as human societies persist." (p. 6) For, in Gilder's view "the fact is that the United States is probably the most mobile society in the history of the world. The virtues that are most valuable in it are diligence, discipline, ambition, and a willingness to take risks." (p. 99) For this reason, "the conception of a huge and unnegotiable gap between poverty and wealth is a myth" (p. 55) and Gilder strongly believes that "small firms, begun by enterprising men, can rise quickly to play important roles in the national economy." (p. 52) Hence, Gilder feels that capitalisms past, present, and future have been and ought to be continued to be tied up with the success of the entrepreneur. The public policy aspect of his vision is that the government should help the entrepreneur grow and flourish (since essentially what is good for the entrepreneur is good for the economy) through such policies as deregulating industry and reducing taxes on nonwage income. (see e.g. chapter 7 "The Entrepreneurial Future")

Gilder, as with Schumpeter, sees that there is a lack of heroism in modern culture; however, Gilder, unlike Schumpeter, does not see this lack of heroism as being rooted and caused by a capitalism-induced culture. Instead, he simply treats it as an aspect of modern secularized culture, where most people, especially academics, perhaps especially economists,

and perhaps most especially mathematical economists, are relatively wimpy: " much of modern culture bespeaks the vainglorious postures, narrow preoccupations, and morbid anxieties of human minds frozen by fear on the thresholds of higher consciousness. ... Similarly, the endless tomes of mathematical economics and sociology owe their sterile obsessions and banal outcomes to a refusal to acknowledge that all creativity requires a leap of imagination and faith." (p. 264)

Yet, interestingly enough, in this secular, unheroic age, it is the entrepreneurs themselves who are heroic. It is entrepreneurship itself which infuses life and vitality into our society, since entrepreneurship "is a personal and psychological drama that decides whether a man dares to borrow and take risks to carry out an innovative idea that all the statistics show will probably - like two-thirds of all new businesses in America - fail within five years. This decision will be affected by government; it will be much deterred by high taxes and interest rates; but it will most essentially express an impulse of faith, a belief in the future, and a sensitivity to the needs of others, even if unstated." (p. 266)

Against relatively impossible odds, it is entrepreneurship itself which keeps the system going. This is an heroic, perhaps the heroic endeavor of our age and inspires the enthusiastic Gilder to wax eloquently:

Above the vast architecture of production, and surrounding it, is a statistically invisible atmosphere of moods and ideas, a phantasmagoria of images and visions of the future, which either admit, or eclipse, the sustaining light and power of the sun: the life-giving faith in the possibility that free enterprises can prevail among the unpredictable forms of wealth in the unknown world to come. (p. 63)

Hence, for Gilder, the key struggles in modern society is not between social classes, or between nations, but is between the past and the future, the past being old capitals and the future being new capitals led by valiant entrepreneurs. The key struggle in modern society thus turns out to be none other than Schumpeter's gales of creative destruction, which Gilder sees as "a conflict between established factories, technologies, formations of capital, and the ventures that may soon make them worthless - ventures that today may not even exist; that today may flicker only as ideas, or tiny companies, or obscure research projects, of fierce but penniless ambitions; that today are unidentifiable and incalculable from above, but which, in time, in a progressing economy, must rise up if growth is to occur." (p. 235)⁸

Like Schumpeter, Gilder also sees the decline of the family as an inhibiting factor against the ambition, drive and pro-investment and pro-savings attitudes which capitalism needs. However, Gilder does not place his perceived decline in the family as a result of a cost benefit analysis on whether to have children; instead, he places it squarely in the growing women's movement in general and in particular in the growing labor force participation rate of women. For example, by Gilder's reckoning, "male earnings cannot be considered without regard to female earnings. Most men make the sacrifices necessary to reach the higher reaches of the American economy chiefly to support their wives and families. When the wives earn more, the men feel a decline of urgency in their work and a loss of male nerve and drive. When the wives earn less, the men tend to work more and are far more likely to reach the pinnacles of achievement." (p.151)

According to Gilder, women in the workforce hurt males and their maleness. It discourages men, reduces their work effort, leads to a breakdown of the family and hence to a decline in morals. The public policy aspect of this is that the government should support policies designed to preserve and encourage traditional nuclear families with the women at home nurturing the offspring and the man out in the competitive heroic world of free enterprise.⁹

Ultimately, however, for Gilder as for Schumpeter, the basic problem facing capitalism is probably that the spirit and values of the age are not pro-capitalist enough. However, unlike Schumpeter, Gilder does not root the spirit and values of the age as arising from capitalism itself; rather, for Gilder, "our central problem arises from a deep conflict between the processes of material progress and the ideals of 'progressive' government and culture. Equality, bureaucratic rationality, predictability, sexual liberation, political 'populism' and the pursuit of pleasure - all the values of advanced culture - are quite simply inconsistent with the disciplines and investment of economic and technical advance." (p. 259)

Yet, many if not all of these values seem also to be rooted in rationality. Gilder realizes this and seems to come out against rationality itself. He bemoans that there is too much rationality in modern society.¹⁰ (Again, Gilder, unlike Schumpeter does not root this rationality as being ruthlessly promoted by the capitalist process itself). With awesome self assurance, and displaying an encyclopedic understanding of modern social sciences, Gilder sermonizes:

A secular rationalist will distrust a mystery and will wish to develop more automatic and rationalized modes of progress. Throughout the history of thought, but especially in the modern era, men

have tried to develop systems of rationalism that are self-contained; ... Logical positivism, behavioral psychology, Freudianism, Marxism, classical economics, neo-Keynesianism, Bayesian probability analysis, information theory, socialist planning - all represent ways, asserted with varying degrees of conviction and flexibility, of excluding change and novelty from human behavior, either in fact or in theory. (p. 263)

Hence, for Gilder as for Schumpeter, there is too much rationality in modern society. It is this rationality itself which leads people to adopt what are ultimately anti-capitalist policies. So, for example, "in fact, a rational calculation of personal gain would impel an individual above all to avoid risk and seek security. In our world of fortuity, committed to a secular vision, the invisible hand of self-interest acclaimed by Adam Smith would lead to an ever-enlarging welfare state - to stasis and sterility. This is the root of our crisis and the crisis of classical economics today." (p. 266)¹¹

Yet, because Gilder, unlike Schumpeter, does not root this so-called rationality as arising out of the capitalist system itself, he is able to find a way out of this quandary.

For Gilder, what America needs to do is to become less rationalistic, and more religious. For Gilder, a new infusion of religious faith, spirit and belief will help American capitalism. Hence, "We do not need 'myths' so much as we need religious beliefs, which, for all their dubious 'irrationality', bear in their symbolic depths the greatest of pragmatic and historic truths. They tell us that free humans with faith in the future and a commitment to it will prevail." (p. 258) Thus, for Gilder "... all human creativity and discovery require the transcendence of narrow rationality and an embrace of religious values." (p. 267)

Yet, it is not capitalist-induced rationality which inhibits this embrace of religious values and beliefs. If anything, it is the timidity and weakness of men:

The human mind is not necessarily autonomous or limited to the individual brain. The mind has access to a higher consciousness. ... As a person's mind merges with the living consciousness that is the ulterior stuff of the cosmos, he reaches new truths, glimpses the new ideas - the projections of light into the unknown future - by which intellectual progress occurs.

All men, however, shrink from this awesome contact with cosmic mystery and power. It is frightening ... (p. 263)

The public policy aspect of this vision is that the government should do what it can to encourage general religious values and beliefs.¹²

Hence, as if in answer to Schumpeter's gloomy prognosis for capitalism, Gilder argues that we should encourage the entrepreneurs. We should admit, admire and strive to emulate their heroism (if we are male). We should preserve the family, mainly by getting women out of the workforce. And finally, we should not be too rationalistic, and should instead embrace more religious values and spirits. Yet, in contradistinction to Schumpeter, Gilder is an optimist. For him capitalism will not wither away or die from its successes. No, for him, "the crucial rules of economic innovation and progress are faith, altruism, investment, competition, and bankruptcy, which are also the rules of capitalism. The reason capitalism succeeds is that its laws accord with the laws of mind." (p. 265) Such is Gilder's remarkably optimistic view of the congruence between capitalism and human nature, and hence the human future. It is Gilder's answer to Schumpeter.

This paper has implicitly argued that economists should take Gilder's work seriously, if for no other reason than for its actual and potential influence upon public policy. In taking Gilder's work seriously, we have seen that his vision and

public policy recommendations are in large part an answer and response (apparently more or less unconscious) to Schumpeter's pessimistic vision of capitalism's future. For most every reason which Schumpeter gives as to why capitalism will not survive in the long run, Gilder has some sort of answer and policy recommendation. Hence, this note in the history of economic thought seems to be another example where, according to John Maynard Keynes, "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back." For in Keynes's view, "in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest." (Keynes, pp. 383-384, emphasis added) So does it appear.

Footnotes

1. For recent work on Schumpeter's vision of capitalism, see the excellent articles in Heertje, Schumpeter's Vision; on Schumpeter's economics in general see the articles in Frisch, Schumpeterian Economics.

2. Part I, "The Marxian Doctrine", pp. 1-58.

3. As Paul Sweezy recently notes, "Joseph Schumpeter not only took Marx seriously; he paid him the compliment of emulation, Schumpeter's overall vision of capitalism being consciously designed as an alternative to Marx's." (Sweezy, pp. 1-2)

4. For a controversial position that Schumpeter's actual vision of capitalism and its future is also strikingly similar to Marx's, see Elliott.

5. "Can capitalism survive? No, I do not think it can." (p. 61) "I have tried to show that a socialist form of society will inevitably emerge from an equally inevitable decomposition of capitalist society." (p. xiii, preface to first edition)

6. There are at least two other crucial differences between Schumpeter's and Marx's work. Marx was much more democratic (in theory at least) than the relatively elitist Schumpeter. Also, Marx used a labor theory of value; Schumpeter, of course, did not.

7. There is also a curious thread of analysis which perhaps deserves more attention. If Schumpeter's work is largely inspired by ~~an~~ an answer to Marx's work, and if Gilder can be seen as answering Schumpeter's work, and if Reagan's socio-economic policies find their justification in Gilder's work, then is there some sort of relationship between Reagan's policies and Marx's theories? Perhaps.

8. Hence, it may be noted that in Gilder's work there are (at least) two types of optimism. In the narrower sense, optimism is needed by entrepreneurs in order to encourage them to invest and innovate, and thus to keep the system going and growing. Gilder's work itself is also optimistic in a broader sense in that Gilder feels that, with suitable public policies, capitalism can last forever.

9. Here, as elsewhere, it is perhaps a bit ironic that Gilder emphasizes public policy to accomplish his vision of how a capitalistic society ought to be. In general, I understand Gilder's arguments and policy proposals as supporting Schumpeter's 19th century, laissez faire, individualistic male-entrepreneurial capitalism and being a desire to somehow return to that system, rather than necessarily supporting its arguable successor, the corporate capitalist system. Hence, in my view there is a creative tension, and not an identity of interests between the interests and needs of the corporate system and Gilder's work. I think this is particularly evident in Gilder's attitudes towards

women; it can also be shown to be evident in the area of labor relations.

10. Which is not to say that Gilder does not use rationality himself. In fact, much of his work can be read as an attempt to use public policy to improve incentives to entrepreneurship, as well as to change incentives to encourage more labor (in the marketplace - for males anyway) and less leisure, and more savings and less consumption. From this vantage point, Gilder's work rests squarely within the traditional neoclassical microeconomic framework of rational individuals responding to changes in expected relative prices.

11. I am not sure what crisis in classical economics Gilder is referring to.

12. Note that Gilder is not calling for faith in any particular religious creed, nor even, necessarily participation in any sort of organized religion. However, Gilder does feel that there is a need for more of a general climate of religious faith and spirit.

I would like to thank the students in my history of economic thought and labor economics courses at Connecticut College for helping me to see the connections between Schumpeter and Gilder, and for insisting that I take Gilder's work seriously; and two anonymous referees for helping me to clarify my interpretation of several aspects of Gilder's work.

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