

Talking Capitalism: Schumpeter and Galbraith

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Prophet of Innovation: Joseph Schumpeter and Creative Destruction, by Thomas K.

McCraw, Cambridge: Harvard University Press, 719 + xii pp., \$35

The New Industrial State, by John K. Galbraith, Princeton: Princeton University Press, 518 + lv pp., \$24.95

Most of us get our politics in our early 20s, and never change. Saul Bellow said of his youthful Trotskyism, "like everyone else who invests in doctrines at a young age, I couldn't give them up." A young adult hates the bourgeoisie or loves capitalism or detests free markets or believes passionately in the welfare state. Her politics becomes a cherished identity, a faith. Here I stand. I can no other.

The vintage matters. Someone who invested in doctrines when world capitalism seemed to be working just fine—on the eve of the World War I, say—had a good chance of keeping for life an optimistic opinion of markets and entrepreneurs. So it was with one of the best-known economists of the last century, Joseph Alois Schumpeter (1883–1950) of Vienna, Bonn, and Harvard.

But someone who invested in his human capital when things were dismal and chaotic—early in the Great Depression, say—was likely to take a less cheerful view. So another of the best-known economists, Schumpeter's younger colleague John Kenneth Galbraith (1908–2006) of Ontario, Berkeley, Fortune magazine, and then, at the very end of Schumpeter's two decades there, of that same Harvard.

Both tried out political power early: Schumpeter as a pro-market minister of finance in Austria's brief socialist government after World War I, Galbraith as a New-Dealish deputy director of the Office of Price Administration twenty years later, during World War II. The government experience had opposite effects on the two. Schumpeter became permanently suspicious of state power, Galbraith permanently delighted with it.

Schumpeter and Galbraith spanned the range in the last century from moderate conservative to moderate socialist. These two men of clever words, both master rhetoricians, laid out the case for and the case against unregulated capitalism. Half a century on, Schumpeter's pro-capitalist and conservative case looks better, Galbraith's anti-market and regulatory case worse.

Regulated or not, though, as Schumpeter almost understood, capitalism hangs on words. In the end that's what both men missed, Schumpeter narrowly. Case-making with sweet words is how business decisions are made. It's how regulatory agencies do their jobs, too, and how you shop for furniture. It's how

economic scientists persuade. It's how managers in a free society manage. Talk, talk, talk. Rhetoric rules.

As Thomas McCraw, a professor of business history at Harvard Business School, explains in *Prophet of Innovation*, his charming new biography of the man in full, Joseph Schumpeter from first to last defended the entrepreneur with his own talk, talk, talk. A free economy, Schumpeter claimed from his earliest important book, *The Theory of Economic Development* (1911), runs on innovation, not routine. As Marx had turned Hegel on his head, McCraw writes, "Schumpeter turned Karl Marx on his head. Hateful gangs of parasitic capitalists become, in Schumpeter's hands, innovative and beneficent entrepreneurs." Emotionally speaking, Schumpeter had always been attracted to the aristocratic side of the bourgeoisie. "The innovating entrepreneur," noted one of Schumpeter's colleagues at Harvard, "did have glamour"—which Schumpeter sought—"and was not dominated by middle-class values," which Schumpeter viewed as stuffy conventionality without heroism. The aristocratic bourgeois: There's your Schumpeterian entrepreneur.

Schumpeter liked "to play the part of an aristocrat" in public, McCraw writes, "even though his origins were middle-class and his eminence self-made." At his first academic job in 1909 Schumpeter fought a literal duel with swords against, of all people, the librarian, because the librarian wouldn't make books available to Schumpeter's students. The librarian got an honorable scar out of it, and the two became the best of friends. Schumpeter "liked to disrupt faculty meetings by turning up late, still clad in jodhpurs and helmet from his daily horseback ride." Schumpeter would say in later years that his ambition was to become the world's greatest economist, the world's greatest lover, and the world's greatest horseman. "Things are not going so well," he would add smiling, "with the horses."

Schumpeter's best-known book is his hastily written but glittering *Capitalism, Socialism, and Democracy*, which received scant notice when it first appeared in 1942. It contained Schumpeter's usual praise for the businessperson, but it also predicted that capitalism would not survive, and that democracy might not either. The book "admits, and rather cheerfully, that the patient is dying," said the economist Paul Samuelson in 1970 in a *Newsweek* column, "but of a psychosomatic ailment. No cancer but neurosis is [the capitalist's] complaint. Filled with self-hate, he has lost his will to live."

Most intellectuals in the 1930s and early 1940s had the same neurosis, and the same pessimism. Schumpeter believed that capitalism was raising up its own grave diggers--- not in the proletariat, as Marx had expected, but in the sons of daughters of the bourgeoisie itself. Lenin's father, after all, was a high-ranking educational official, and Lenin himself a lawyer. It wasn't the children of auto workers who pulled up the paving stones on the Left Bank in 1968. The most

radical environmentalists and anti-globalists nowadays are socialist children of capitalist parents.

And yet Schumpeter's cultural pessimism about capitalism has proven wrong. The American economy has continued to show startling entrepreneurial vigor---both Schumpeter and Galbraith thought that committees would kill it. The capitalist idea has flourished worldwide. If there is perhaps in the long run some cultural contradiction of capitalism in one country, as Daniel Bell put the same idea in 1976, the waves of new capitalists in China, India, Brazil, South Africa, or immigrants to America, can postpone it, at any rate until the whole world is capitalistic. Schumpeter would have been delighted in his mischievous way to point out that such a story is merely orthodox Marxism. Socialism proper comes only after capitalism has borne fruit, to be plucked by a communistic anarchism.

By 1967, when Galbraith published *The New Industrial State*, his most considered book (he revised it three times down to 1985), he was already famous among general readers for *The Affluent Society* (1958). In private goods, he had said there, we Americans have grown affluent, loaded down with refrigerators and finned automobiles. Splendid. But we have neglected the public goods of education and public parks and decent provision for the poor. In Sweden, he averred, they do things better. Ten years later *The New Industrial State* was in effect additional Sweden-admiring. Progressive Americans did a lot of Sweden-admiring in the 1950s. Let us too adopt democratic socialism, said Galbraith. Let us concede that the new industrial state is one of massive corporations facing massive unions, under the benevolent and skillful regulation of massive governments. Relax and enjoy a regulated, centralized economy.

The New Industrial State has now been reissued with an introduction by his son James, also a notable economist on the Democratic left. The elder Galbraith argued that the great scale of modern industry has created a "technocracy," which runs the world with committees. Anyone who has worked in a large corporation or a large university knows the feeling. Advertising, Galbraith argued, manipulates demand in order to fit with technical necessities. Anyone who has lusted for an iPhone knows that feeling, too. A new model of your father's Oldsmobile was so very expensive in planning and took so very long to bring to market---ask Airbus today about all this---that the demand had to be guaranteed with advertising and distribution. Look at the drug companies. It couldn't be left to a mere market. "If the market is uncontrolled it will not know these things," such as when the new car will roll off the line or when the new drug will pass FDA approval. The planning system therefore is just the ticket. "The small competitive firm cannot afford the outlays that [modern, big-time] innovation demands." The so-called price system is therefore a fake. If modernity needs big corporate bureaucracies to do such big stuff, surely we need big governments to coordinate everything.

Thus the Democratic left, those moderate socialists. (Come to think of it, thus too the Republican, country-club right, those moderate statist.) You can't leave industrial planning or oil diplomacy to markets, surely, said Galbraith, and the neocons.

Re-examining Galbraith long after his heyday through this reissue, his zingers are still funny, his arch sneers at the conventional wisdom still amusing—until you realize that the zinging and the sneering are there to cover his tracks. “For a public official to be called an economic planner was less serious than to be charged with Communism or imaginative sexual proclivities but it reflected adversely nonetheless.” “The real accomplishment of modern science and technology consists in taking ordinary men, informing them narrowly and deeply. . . . This dispenses with the need for genius.” “Leisure is something to be regarded with misgivings,” say the defenders of the conventional wisdom, “especially in the lower income brackets.” Zing, zing.

The problem is that the tracks Galbraith is covering over with arch zingers are light. His updating of Thorstein Veblen's ideas never really faced its intellectual opponents with evidence. Galbraith, like Veblen, merely ran ahead laughing.

By contrast, Schumpeter wears better a half-century on, because he always acknowledged the best academic and political case of his socialist opponents. Galbraith confined himself to making merry of pamphlets from the National Association of Manufacturers.

McCraw's book on Schumpeter is an absorbing read, with short chapters, lots of personal detail and historical scene-setting, and an important and anti-Galbraithian economic theme. Schumpeter's search for "exact economics," McCraw argues, the ruling passion of modern economics, was inconsistent with Schumpeter's profound discovery about the marketplace, namely, that it depends on invention, innovation, entrepreneurship, all things counter, original, spare, strange. In Schumpeter's famous phrase from *Capitalism, Socialism, and Democracy*, borrowed from Werner Sombart long before, capitalism depends on "perennial gales of creative destruction."

Beyond the insights into Schumpeter the economist and precursor of "strategy" courses in business schools, McCraw has dug out illuminating gossip about "Joe," as the very European and sophisticated Schumpeter absurdly called himself in his American life. Schumpeter's diaries, available in full, get us into the head of a work-obsessed man—work-obsessed at any rate after a terrible summer in Bonn in 1926, age 43, in which the beloved mother of this beloved only child died suddenly of a stroke and his adored second wife with her newborn son died in her only childbirth. He wrote to a fellow economist, "Everything now hangs on my ability to work. If so, the engine will keep running, even if my personal life is over." His personal life was not quite over. In 1937 he married for a third time, to Elizabeth Boody, herself a brilliant scholar,

who sustained this peculiar working machine until his death in 1950. She herself died in 1952, exhausted in compiling from the chaos of Schumpeter's notes his last great work, *The History of Economic Analysis* (1954: 1260+ xxv pages).

The chapter detailing the FBI's Keystone-Cops pursuit of Joe and Elizabeth during World War II is alone worth the price of the book. Elizabeth Boody Schumpeter had correctly predicted that Japan would be no military pushover. That sufficed in the heat of wartime paranoia to draw the attention of the federal police. The agent reporting to J. Edgar Hoover about a volume on the Japanese economy edited by Elizabeth (the agent styled her maiden name and first-marriage name "aliases") could, unhappily, find no information "which shows clearly any intention either to aid or to oppose the Japanese." Hoover shot back that on the contrary, "this case presents fairly good possibilities for eventually reaching prosecution." After all, husband Joe himself was suspect, as an Austrian native who had doubts that unconditional surrender was a wise policy to impose on Germany a second time, or that killing many hundreds of thousands of Axis civilians with bombs was worthy of British or American values. (It was Galbraith, by the way, who headed the inquiry after the War showing how ineffective strategic bombing had been in Germany.) FBI agents swarmed over Cambridge and, McCraw notes, "inevitably, many of [the Schumpeters'] acquaintances began to view them in a different light, and they suffered some cold shoulders."

Galbraith thought of Schumpeter as "the most sophisticated conservative of this century." The two got along well, trading wittily expressed opinions about capitalism. Both men had good senses of humor, whatever their disagreements. Schumpeter always thought of himself as a conservative, and planned a book on the matter, though he once said to Galbraith that "I am pretty sure that no conservative would recognize himself in the picture." He was a conservative libertarian, well before the word "libertarian" got much respect. That is, he was not radically libertarian, willing to turn the society upside down, abolishing the government into the margins, in the style of Ludwig von Mises, his classmate in a little economics seminar with the great Böhm-Bawerk at the University of Vienna in 1905. Schumpeter was, like John Stuart Mill, one of the few economists wholly fair to his intellectual opponents. He was pro-capitalist, but in a non scene-shaking way. He could see the good intent of socialism, and had many socialist friends---Galbraith, for example. And on the conservative side he could see the symbolic and emotional point of government, the necessity, so to speak, of symbolic kings.

But "I am not in the habit of crowning our bourgeoisie with laurel wreaths," wrote Schumpeter in "The Crisis of the Tax State" in 1918. Notice the sneeringly aristocratic imagery, conventional by then in European rhetoric, and prominent in all of Galbraith's writings. As Schumpeter remarked a quarter of a century later, "The public mind has by now so thoroughly grown out of humor

with [capitalism and the bourgeois life] as to make condemnation of capitalism and all its works almost a requirement of the etiquette of discussion.”

Schumpeter was bowing in 1918 to anti-bourgeois etiquette precisely in order to set up the opposite point, that in fact the bourgeoisie "can do exactly what is needed now," and should be given its head. The irony, McCraw points out, is characteristic of the man, and characteristic of his theory of political economy. Irony of ironies: capitalism was wholly successful economically, but doomed sociologically.

Galbraith, like many other economists of his generation, worried about private monopoly, though embracing public monopolies. Schumpeter the pro-capitalist never had such worries. Creative destruction, he argued, would take care of the trusts and pools and over-big corporations. In truth the list of companies that Galbraith held in awe as great forces in 1967 looks quaint now. US Steel, AT & T, General Motors belie his assertion “of great stability in [a great corporation’s] position in the planning system.” Eight years after the first publication of *The New Industrial State* Bill Gates founded Microsoft. Let creative destruction rip.

McCraw himself italicizes a very un-ripping assertion of his own that "the two pillars that support all successful business systems [are] a modern concept of private property and a framework for the rule of law.” That’s nothing like Schumpeter’s idea. Laws are necessary, of course, but so are road-mending and the making of bricks. Private property and a framework for the rule of law have existed in written form since ancient Mesopotamia, and in every substantial civilization from 3rd-century B.C. China to 12th-century A.D. Timbuktu. Roman law, with its detailed concept of private property, was worshipped in Europe for two millennia. Yet those civilizations, Schumpeter emphasized, never reached the standard of economic production and progress the modern West has. Not even close.

Something is therefore missing. What’s missing is the thing Schumpeter emphasized, and Galbraith attacked, a thing unique about Europe since the Netherlands in 1600 and England in 1715: a business-dominated civilization. "Capitalism does not merely mean that the housewife may influence production by her choice between peas and beans," Schumpeter wrote in his swan song, an essay of 1950 entitled grimly "The March Into Socialism.” Capitalism also "means a scheme of values, an attitude toward life, a civilization—the civilization of inequality and of the family fortune.” The last touch, incidentally, is pure Schumpeter: "the civilization of inequality" politely makes the socialists' case by adopting their very words, yet Schumpeter politely disagrees on how we should judge the outcome.

The American "scheme of values" in the 19th century, Schumpeter said, "drew nearly all the brains into business"—witness, say, Mark Twain's failed entrepreneurial projects—"and impressed the businessman's attitudes upon the

soul of the nation.” Schumpeter remembered wistfully the pre-1914 civilization of Europe itself as following “the beliefs and attitudes of the business class,” “essentially rationalist and utilitarian. It was not favorable to cults of national glory, victory, and so on” (though favorable enough, Professor Schumpeter, to start and sustain the Great European Civil War of 1914–1989).

“Capitalism stands its trial before judges who have the death sentence in their pockets,” wrote Schumpeter. “The only success victorious defense can possibly produce is a change in the indictment.” Thus the socialists of the 1850s indicted capitalism for immiserizing the working people. When this proved scientifically wrong, as the best economic scientists of 1890 could have told you, the socialists of the 1890s indicted it for imperialism. When this proved wrong, at any rate by the lights of the best economic scientists who troubled to look into the matter (among them Joseph Schumpeter), the socialists of the 1950s indicted it for alienation. When this proved wrong, again in the best factual inquiries, the socialists of the 1990s indicted it for environmental decay. “Such refutation,” rationally proving that indictment number N is wrong, “may tear the rational garb of attack [on capitalism and all its work] but can never reach the extra-rational driving power that always lurks behind it.”

Schumpeter stressed the robustness of capitalism in the economy—the vigor with which new entrants dissolve the monopoly profits of the first mover, and the enormous dividend it leaves for the poor—combined mysteriously with its ominous fragility in the polity and the society. “The emotional attachment to the social order,” wrote this conservative, was “the very thing capitalism is constitutionally unable to produce.” No one loves a Rockefeller. Everyone loves a Virgin Queen.

But there’s still something missing in the story. What Schumpeter and Galbraith, too, got right, and most modern economists have gotten wrong, was what the sociologists call capitalism’s “embeddedness” in a society. The economy is nothing without the words supporting it, whether conventional wisdom or creative entrepreneurial projects. Schumpeter was mistaken about the future of self-doubt among the bourgeoisie, as Galbraith was in claiming the reduction of entrepreneurship to committees and the permanence of companies like General Motors. The bourgeoisie claimed back its self-confidence after Reagan and Thatcher, and more to the point after Hayek and Friedman—though there’s still work to be done in praising bourgeois virtues. Entrepreneurship, even within a great organization, still matters. And as for the arrogant corporations, “nor is favor to men of skill; but time and chance happeneth to them all.”

What’s finally missing, then, in both Schumpeter and Galbraith’s grim indictment of capitalism’s future is a theory of language. We humans swim in words. After a long, long enchantment with Marxist or Freudian or behaviorist claims that secret or not-so-secret material interests rule everything, that the

makers of the U.S. constitution were driven by their property values, or that slavery was abolished to strengthen manufacturing, we're realizing this. One quarter of national income is earned from sweet talk. Political action is constrained by political rhetoric. So is economic action, for all the base motives behind propaganda from the National Association of Manufacturers.

"About the end of the seventeenth century," Schumpeter wrote in his great tome *Business Cycles* (1939: 1095+ xxxvi pages) the English political world "dropped all systematic hostility to invention. So did public opinion and the scribes." That's right. And it's what is wrong with the materialist convictions since Marx that ideas are froth on deeper currents. No. Ideas, words, rhetoric, "reason": the world is governed, another economist said, by little else.

McCraw argues that Schumpeter invented what business schools now call "strategy," "an attempt by firms to keep on their feet," as Schumpeter put it, "on ground that is slipping away under them." It's practical business stuff. And of what is the "attempt" constituted? Plans, words, sweet talk. An economics that doesn't acknowledge talk and its creativity may be in some pointless sense "exact." But it doesn't illuminate the world we have, of entrepreneurs— in the market, the corporation, the government, the laboratory, the street. It wouldn't be a Schumpeterian theory. Capitalism is talk, talk, talk all the way down.

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