THE QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS 12, NO. 4 (2009): 3–21

ENTREPRENEURSHIP, ECONOMIC EVOLUTION, AND THE END OF CAPITALISM: RECONSIDERING SCHUMPETER'S THESIS

MATTHEW MCCAFFREY

ABSTRACT: This paper seeks to explore and to critically evaluate, from an economic standpoint, Joseph Schumpeter's theory of the decline of capitalism, as put forward in his *Capitalism, Socialism, and Democracy*. It begins by exploring and criticizing Schumpeter's entrepreneurial theory, and then explains how this flawed theory led to Schumpeter's conclusion vis-à-vis capitalist evolution into socialism. It then introduces into the theory of capitalist evolution an uncertainty-bearing entrepreneur, and re-examines the theory on this basis, both in general and, in the appendix, for the specific case of artificial increases in the supply of bank credit. The conclusion reached is that Schumpeter's argument cannot hope to explain the decline of capitalism into socialism. However, while not valid for a truly capitalist system, Schumpeter's theory is nevertheless applicable to an interventionist economy.

I. INTRODUCTION

Joseph Schumpeter has the unenviable distinction of being one of the most oft-quoted, yet least understood economists in history. This is due in part to his ambiguous position between the Austrian economists and the various neoclassical schools, an ambiguity most evident when examining his extraordinary yet sometimes neglected work,

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Matthew McCaffrey (mcm0016@auburn.edu) is a graduate student in economics at Auburn University. The author would like to thank David Gordon, David Howden, Mateusz Machaj, Joseph Salerno, and Mark Thornton for their insightful comments on early drafts of this paper. Any remaining errors are entirely my own.

Capitalism, Socialism, and Democracy. Although there are many gems of economic insight in this book, the central thesis around which they are constructed is often dismissed without serious theoretical analysis (Heilbroner 1981). The thesis, in a nutshell, is that capitalism's inherent *strengths* ultimately lead, first to its decline, and then to its collapse and replacement by socialism.[1] The purpose of this paper is to reconsider this thesis, and attempt both to criticize and to update it.

To that end, I first examine Schumpeter's theory of the entrepreneur, which provides much of the groundwork for his theory of capitalism. It is in his flawed conception of the entrepreneur wherein the seeds of his later thesis in regard to capitalist evolution are sown. However, by repairing Schumpeter's conception of the entrepreneur—i.e., by making it more Misesian—we may follow his reasoning and arrive at a thesis which is both more stable theoretically and more familiar to Misesians. In place of the claim that capitalism's inherent strengths will destroy it, we instead hope to show that capitalism's inherent strengths will only result in its own demise given the presence of a system of economic intervention, that is, given the partial subversion of the capitalist system.

II. THE THESIS

Schumpeter's theory is first and foremost a theory of social change, or what he would call "economic sociology." This paper will set aside the sociological claims that he puts forward, and deal solely with economic problems.[2] Since the sociological changes brought about under capitalism are mainly a function of its economic characteristics—the former is merely a sort of social aggregation of the latter—we can do justice to the theory despite this omission. We are also limited by the fact that the strictly sociological points would require analysis which is not rigorous from the economic point of view. At the very least they would require us to make empirical statements concerning the actual values human beings possess, and this would take us outside the realm of theoretical economics.

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[1] Schumpeter had actually started thinking about the problem of capitalist evolution as early as his *Theory of Economic Development* (1912, discussed below), and his "The Instability of Capitalism" (1928), but it receives its clearest and most exhaustive treatment in *Capitalism, Socialism, and Democracy*.

[2] There is certainly scope for empirical and sociological research on this subject. Cf. Inman (1991) and the papers collected in Heertje (1981b).

Let us turn to the thesis itself. Schumpeter begins with a surprising claim:

> 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 . . . 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. (1942, p. 61)[3]

More explicitly, capitalism is perceived as an essentially dynamic mechanism for economic change in society, and perpetual change is in some sense capitalism's defining characteristic (1942, p. 83). This ceaseless process of change, with its corresponding introduction of new processes of production and its necessary elimination of the old methods eventually produces a system of values in society which undermine the values of capitalism, and thus lead to its replacement by a socialist system. Economically, capitalism eliminates the entrepreneurial function, aided by the anti-capitalist sentiments of the intellectual class, and transforms it into what is an essentially static state of affairs, one susceptible to socialist management. In short,

> There would be nothing left for entrepreneurs to do . . . profits and along with profit the rate of interest would converge towards zero. The bourgeois strata that live on profits and interest would tend to disappear. The management of industry and trade would become a matter of current administration, and the personnel would unavoidably acquire the characteristics of a bureaucracy. Socialism of a very sober type would almost automatically come into being. (Schumpeter 1942, p. 131)

A historical analysis of such a thesis is not our goal, although the genesis of the argument is certainly colored by Schumpeter's own historical experience and impressive historical knowledge. But the issue of whether or not the process described has actually occurred is really a

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[3]It should be noted from the start that Schumpeter is no apologist for socialism. As he puts it,

> Prognosis does not imply anything about the desirability of the course of events that one predicts. If a doctor predicts that his patient will die presently, this does not mean that he desires it. One may hate socialism or at least look upon it with cool criticism, and yet foresee its advent. Many conservatives did and do. (1942, p. 61)

matter for economic history. What must concern us is the theoretical ground upon which the theory rests; that is, we must discover if the capitalist system itself has any inherent tendencies of the sort Schumpeter predicted which make its decline "inevitable." To do this, we must first evaluate the Schumpeterian entrepreneur, because, as will be explained below, it is his fate that ultimately determines the fate of the capitalist system.

III. CAPITALIST EVOLUTION AND THE CONCEPT OF THE ENTREPRENEUR

Schumpeter's contributions to the theory of the entrepreneur are among the most important of his career, and serve, both directly and indirectly, as the foundation for much of his argument regarding capitalist evolution.[4] Schumpeterian entrepreneurship is most clearly described in his *Theory of Economic Development*, where among other things he lays the groundwork for his famous concept of "Creative Destruction." There are, however, certain problems with his theory of the entrepreneur that require emphasis.

As mentioned above, for Schumpeter the entrepreneur plays the most important role in capitalist society because he introduces change, which is the fundamental fact of capitalist life. When the entrepreneurial function becomes unnecessary or is somehow altogether eliminated, it follows that the mechanism of change must grind to a halt, and a period of economic stagnation be introduced. "Economically and sociologically, directly and indirectly, the bourgeoisie therefore depends on the entrepreneur, and, as a class, lives and will die with him" (1942, p. 134). This is true as far as it goes; what matters for us though, is the claim that the capitalist system *itself* will produce this result.[5]

What precisely is the entrepreneurial function, according to Schumpeter? As Kirzner observes, "[for Schumpeter,] entrepreneurship is reserved for the brilliant, imaginative, daring, resourceful innovator" (1973, p. 129). In Schumpeter's view, the entrepreneur is the driving force of all economic transformation under capitalism. He does this by "carrying out new combinations" (1961, p. 132, and throughout), by which is meant that he introduces innovation, be it a new invention or

[4]There is no need to go into an elaborate treatment of Schumpeter's theory of entrepreneurship; a brief survey of the major points will suffice.

[5]Once again though, we are interested specifically in Schumpeter's arguments, although we can imagine that the form of this argument could take on any number of variations.

merely a new production process. Examples include the building of a new railway (1961, p. 62) or the introduction of power-looms in place of hand looms (1961, pp. 129–30). The entrepreneur also acts in "isolation from the means of production" (1961, p. 160), that is, he does not direct production, but enjoys a somewhat passive role; once the innovation is introduced, for the entrepreneur, the work is essentially complete. We can already see in the above that the entrepreneurial function is defined rather narrowly, a fact even Schumpeter acknowledges (1961, p. 75).

For us to get at the core of Schumpeter's entrepreneurial theory, we must also understand something about his general equilibrium concept. Schumpeter argued for a "circular flow" concept of the economic process, essentially a variation of Walrasian general equilibrium. Change is only introduced to the model through the entrepreneurs, who launch various economic innovations, which they finance exclusively through credit created especially for the entrepreneurs by banks. Once introduced, innovations inspire imitations, and competition between the alternatives bids the rate of profit down to zero. Thus, entrepreneurial profit tends toward zero, and is zero in the long run (Rothbard 1987). Eventually, the economy adjusts to innovation and returns to another equilibrium state.

This is all opposed, of course, to the thinking of Böhm-Bawerk or Mises, who hold that new (sustainable) investments must come from past saving (Mises 1966, p. 260; Böhm-Bawerk 1959, pp. 102–05). Contrary to this position, Schumpeter argues that, "The entrepreneur does not save in order to obtain the means which he needs, nor does he accumulate any goods before he begins to produce" (1961, p. 136). He merely plays a sort of a game with credit created upon his request:

> The entrepreneur is never the risk bearer. . . . The one who gives credit comes to grief if the undertaking fails. For although any property possessed by the entrepreneur may be liable, yet such possession of wealth is not essential, even though advantageous. . . . Risk-taking is in no case an element of the entrepreneurial function. Even though he may risk his reputation, the direct economic responsibility of failure never falls on him. (1961, p. 137)[6]

The above highlights the central problem with this theory, to which we now turn. The problem in question is the assertion that the entrepreneur

[6]Cf. also "Uncertainty obviously always falls on the owner of the means of production or of the money-capital which was paid for them, hence never on the entrepreneur as such" (1961, p. 75, n. 1; emphasis in original).

does not bear uncertainty in the marketplace.[7] Without uncertainty, we can perhaps explain entrepreneurial success but we cannot explain entrepreneurial loss, or more correctly, this approach simply does offer an explanation. Accordingly, one-half of the entrepreneur's economic function disappears from the analysis; it is simply ruled out by this somewhat pedantic focus on successful innovation.[8] However the entrepreneur of Böhm-Bawerk, Mises, and Rothbard, who does own resources and who does bear uncertainty, escapes these issues (Salerno 2008).[9] What is more, in Schumpeter's theory we lose sight of a fundamental economic problem—the social function of bankruptcy. Without an explicit acknowledgement that entrepreneurs bear uncertainty, and the corresponding realization that entrepreneurs can easily fail in their endeavors and thus squander society's resources, it is relatively easy to accept a static circular flow model of economic affairs, one that is susceptible to socialist economic planning.[10] As we will see, much of Schumpeter's argument rests upon this point. We will return to this later, however.

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[7]In this regard the Kirznerian and Schumpeterian entrepreneurs are not as different as was once thought, in the sense that neither entrepreneur truly bears uncertainty. Cf. Rothbard (1997), Shostak (1999), and, of course, Kirzner (2000), who unfortunately does not appear to discuss uncertainty in the sense that the present writer does. Heertje (1981a), a voice outside the Austrian School, points out that Kirznerian entrepreneurship is merely a refinement of Schumpeter's theory.

[8]There is also a notion that once an entrepreneurial activity has been successfully performed, there is no further activity on the part of the original entrepreneur; there is only imitation on the part of others. In this sense too, entrepreneurial uncertainty disappears, at least for the imitators.

[9]The uncertainty-bearing tradition in economics can be traced back at least as far as Cantillon (Hébert and Link 1988, esp. pp. 21–26).

[10]The influence of Wieser on Schumpeter's conception of the entrepreneur is unmistakable. The following passage from Wieser is particularly insightful. It is worth quoting at length:

> The element of disaster should not be too strongly insisted upon in the case of the entrepreneur. By far the larger number of business ventures which are entered upon offers [*sic*] fair prospects of success; the number of those which miscarry is, after all, smaller. Moreover it should not be overlooked that there are always other persons who are subject to the hazards of the enterprise. Thus there are the creditors and, above all, the workers. Under some circumstances the latter are the first to be affected by failure. Even before the entrepreneur feels the effects of disaster they are injured by the dismissals to which the entrepreneur resorts when unfavorable business conditions force curtailment upon him. (1927, p. 325)

IV. SOME ECONOMICS CRITICISM OF SCHUMPETER'S THEORY OF CAPITALIST EVOLUTION

Our analysis of some of the problems of the Schumpeterian entrepreneur leads nicely into an examination of his theory of capitalist evolution, which is in many ways an extension of this theory of entrepreneurship. There are three major arguments upon which Schumpeter's argument turns: first, the obsolescence and disappearance of the entrepreneurs, second, the bureaucratization of firms, and third, the destruction of certain social protections of capitalism. We will deal with these in turn, beginning with the obsolescence of the entrepreneurs.

There are two methods by which the entrepreneur could be eliminated from society, according to Schumpeter. The first is for technology to reach a state of "perfection," wherein further progress becomes impossible. This would introduce an essentially stationary economy, and without the possibility of innovation the entrepreneurial function would cease to exist. Schumpeter discards this possibility, however, and so we proceed to the second. This involves the bureaucratization of the entrepreneurial process, that is, the method through which "innovation itself is . . . reduced to routine" (1942, p. 132). Schumpeter is actually quite vague on the (critical) issue of how this process is to take place, but we can make an educated guess and assume that he simply means innovation can eventually become such a trivial task that it may be easily orchestrated by a bureaucratic planner.

The question to ask then, is "Can progress, that is, economic adjustments in the future, be made a matter of routine in a capitalist economy?" The short answer is no, they cannot. The problem with this argument is

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The above is an explicit de-emphasis on entrepreneurial failure, and shows quite well the sort of opinion that molded Schumpeter's own thinking. Note also that Wieser essentially equates the uncertainty borne by entrepreneurs with that borne by workers, further trivializing the role of entrepreneurial uncertainty. In addition, Wieser uses several phrases to describe the entrepreneur which are strikingly similar to Schumpeter's. For example, Wieser characterizes entrepreneurs as, "Great personalities . . . bold technical innovators, organizers with a keen knowledge of human nature, far-sighted bankers, reckless speculators, the world-conquering directors of the trusts" (1927, p. 327). I am indebted to Professor Guido Hülsmann for pointing out the influence of Wieser on Schumpeter's theory of entrepreneurship.

To answer an obvious objection to this comparison, note that while *Social Economics* was published only after *The Theory of Economic Development*, it does not represent new ground in Wieser's thought. Schumpeter himself—with corresponding praise—remarks, "While adding nothing essentially new, [*Social Economics*] is an impressive summary of a lifetime's economic thought" (1963, p. 848).

closely related to the problem of uncertainty alluded to above. As Mises points out, "every action is embedded in the flux of time and therefore involves a speculation" (Mises 1966, p. 253). All plans are subject to error on the part of actors, and forecasts are no exception. A successful bureaucratization would require a consistently accurate forecast as to what innovations will be required at particular times and places.[11] However, it is precisely the presence of uncertainty that makes continued success so difficult for entrepreneurs.

Rothbard sums this point up quite nicely,

> Inventions, innovations, technological developments, by their very nature, by definition, cannot be predicted in advance and therefore cannot be centrally and bureaucratically *planned*. Not only does no one know *what* will be invented *when*; no one knows *who* will do the inventing . . . bureaucracy, incompetent enough to plan a stationary system, is vastly more incompetent at planning a progressive one. (Rothbard 2004, p. 961; emphasis in original)[12]

This is not to say that correct anticipations of consumer wants cannot occur, or that it is impossible to plan for future production based upon as-yet-unrealized patterns of preference. All we mean is simply that any such plans are tentative, and subject to error. But to make progress a matter of routine would require constant accuracy in entrepreneurial forecasting, something that is assumed by Schumpeter's entrepreneurial theory, but which, viewed in the light of praxeology and the constant threat of error in human action, is an impossibility. In dealing with the uncertain future, acting man cannot "plan" in any way beyond what is meant by the ordinary usage of that term: man cannot do better than to act purposively in the face of uncertainty.

Continuing with this argument, Schumpeter goes on to claim,

> It is much easier now than it has been in the past to do things that lie outside familiar routine—innovation itself is being reduced to routine. Technological progress is increasingly becoming the business of teams of trained specialists who turn out what is required and make it work in predictable ways. (1942, p. 132)

[11]It is also possible that Schumpeter falsely conflates "bureaucratization" and "mechanization."

[12]In addition, Hülsmann (1999) makes an important epistemological point in this regard, when he observes that we can never really know how many entrepreneurial opportunities—either individually or on net—actually exist, or for that matter how many fail to be created.

What he misses of course with this argument is that it is not merely the creation of particular goods or processes that matters for the entrepreneur. It is not the knowledge and employment of new methods per se which are economically relevant, or for that matter how these processes are first discovered. What matters is only whether the product can be sold on the market at prices that exceed costs, and that resources are devoted to the highest valued ends of the consumers. By emphasizing successful entrepreneurs, Schumpeter loses sight of failed endeavors, and thus focuses on physical products and processes[13] rather that the true end of entrepreneurship; uncertainty-bearing investment based upon speculation as to the values of consumers.

Schumpeter also contends that entrepreneurs are driven primarily by a desire for social prestige, a prestige eliminated by capitalist progress. The claim that entrepreneurs are driven by the desire for social prestige, and that their abilities and interests are products of their social class, is too broad and empirical for a rigorous economic rebuttal. However, we point out in passing that the necessary acceptance of the system of monetary calculation which characterizes the entrepreneur's efforts does not tell us anything about his motivations.[14] Of course, any number of values could ultimately drive the entrepreneur, but this absence of a necessary connection between the acceptance of calculation as a guiding principle and social prestige is worth mentioning. In any case, since even Schumpeter provides only some vague historical-sociological arguments for his position, we are certainly not bound to accept it.

Even if we accept though, that as an historical datum the lone entrepreneur is not as prestigious socially as he once was, this does little to support Schumpeter's thesis. It is immaterial whether innovation is produced by a bold individual lauded by society or by a group of humble researchers; the entrepreneurial activity still remains the same within the context of catallactics.

Next we turn to Schumpeter's claim that as capitalist society evolves, firms tend to bureaucratize themselves, leading away from competitive capitalism into the sort of planned progress mentioned above. Schumpeter believes that capitalism eventually enters a period characterized by the

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[13]There is also an undue emphasis on the physical and psychological traits of the entrepreneur. Cf. Schumpeter (1942, pp. 84–94, 132). While such characteristics may exist in entrepreneurs empirically speaking, they are unimportant for the theory of the entrepreneur, and have relevance only for considering the success or failure of the entrepreneur in individual cases.

[14]Nor do any of the other economic traits of the entrepreneur have a necessary connection to social prestige; only sociological or psychological traits can.

absence of entrepreneurial control over resources, or in other words the transformation of business into bureaucratized firms, run by committees and managers who engage exclusively in "administrative work" (1942, p. 134). This leads innovation also to become less personal and more bureaucratic; entrepreneurial endeavor "loses its dangers, and tends to be carried out as a matter of course on the advice of specialists" (1928, p. 384).

The problem with the above assertion is that in a capitalist system firms are bound by the forces of economic calculation. Any move away from calculation results in the rapid disappearance of capital values and the eventual bankruptcy of the firm. As Klein (1996) points out, calculation limits both the size of firms and their internal management policies. However, calculation only performs this function when consumer sovereignty is allowed due influence on the price system, for it is from consumers that capital receives its value. Calculation cannot serve its purpose where consumers' values are not permitted to determine the price of capital on the market. But for now, we need only note that the level of bureaucratization in market firms tends to an optimum through calculation, and cannot grow to the point where calculation may be disregarded, precisely because calculation regulates bureaucratizing forces.

It is not surprising that Schumpeter would have failed to take proper account of the role of calculation; in dealing with calculation as regards socialism, he displays a somewhat superficial understanding of the arguments of Mises, for which he is duly criticized by Hayek (1945, pp. 89–91).[15] Schumpeter's position appears to stem from his undue emphasis on circular-flow equilibrium. It is very easy to imagine the planning of progress when entrepreneurs do not actually earn profits or losses in the long run; when the economy proceeds in a never-ending round of changeless production.

The final portion of Schumpeter's argument has to do with the erosion of certain social protections which society affords the capitalist system, the most important of which is of course the institution of private property. Capitalism, asserts Schumpeter, attacks all social practices and institutions by the very nature of its incessant process of Creative Destruction, and inevitably must turn upon itself, must attack its own institutions (1942, pp. 134–43). Specifically, Schumpeter argues, along with most Austrians, that capitalism "rationalizes" society's economic conduct. "Capitalist practice turns the unit of money into a tool of rational cost-profit calculations" (1942, p. 123). Calculation then is the

[15]Although, of course, similar criticisms have been leveled at Hayek himself vis-à-vis the socialist calculation debate (Machaj 2007).

tool used to analyze the viability of alternative methods of the production and distribution of goods in society. According to Schumpeter, this analysis in turn leads to the spread of a critical attitude in society that seeks to rationalize all social institutions. It is adherence to this attitude that eventually turns society against the basic values of a capitalist society, which it examines and finds wanting. The implication is that private property is just as easy an institution to discard as any of those institutions which capitalism has rendered obsolete in the past.[16]

However, Schumpeter failed to recognize that ownership is an essential component of the calculation process (Mahoney 2002; Machaj 2007), and cannot proceed without it. This is the fundamental point regarding the impossibility of socialist calculation. As just mentioned, this point eluded Schumpeter, leading him to a false theory of calculation, one that led him falsely to believe in the possibility of a calculating socialist economy, in addition to leaving out considerations of calculation in his circular-flow model. His obsession with the transition between different states of Walrasian equilibrium forced him to concentrate on the disequilibrating action of his (always successful) entrepreneur, and the shift between different production functions instead of the role of the money unit and ownership for appraisement and calculation. Had he realized the true role of property, however, he would have been forced to admit the impossibility of capitalism rationalizing itself away, because the process would require the institution of property to contradict its own economic function.[17]

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[16]Schumpeter does not actually claim that the institution of private property is "irrational," but he does appear to imply it. What he does say amounts, at the very least, to claiming that private property rights are no more defensible than any of the now-defunct social institutions of the past:

> Capitalism creates a critical frame of mind which, after having destroyed the moral authority of so many other institutions, in the end turns against its own . . . the rationalist attitude does not stop at the credentials of kings and popes but goes on to attack private property and the whole system of bourgeois values. (1942, p. 143)

Suffice it to say that it is by no means clear that property rights may be rationalized away in the same sense that we have discarded the "science" and social institutions of mankind's past.

[17]This argument also addresses an argument Schumpeter makes regarding ownership under capitalism. Schumpeter argued that the sale of shares and other methods of de-emphasizing "the material substance of property" (1942, p. 142) result in the apathy of the shareholders (that is, the majority of the true owners of capital) because they do not experience the sort of ownership that can "impress and call forth moral allegiance as the vital form of property did" (ibid., p. 142). This may be true

V. SCHUMPETER AND INTERVENTIONISM

We now arrive at another fundamental question of this paper: what, if anything, can we salvage from Schumpeter's argument? We have seen that Schumpeter's theory of entrepreneurship is lacking, and that if we view his theory of capitalism in light of a more correct theory of entrepreneurship, we come to the conclusion that his argument is fatally flawed. However, what if we replace the capitalist system in Schumpeter's argument with a system of economic interventionism? Under these conditions, I believe we can breathe new life into the argument. By inserting a Misesian entrepreneur, one who bears market uncertainty, into Schumpeter's system, we develop something of a parallel to Mises's argument that interventionism leads to socialism.

From the first, our conclusions should be somewhat obvious: in the interventionist economy, state controls over the economy can guarantee all of Schumpeter's conditions for the decline of capitalism, albeit in a manner slightly different than that which he perceived. If we acknowledge that all state intervention by necessity redistributes wealth and distorts the market structure in certain identifiable ways, no matter which particular sort of intervention we focus on, whether price controls, patent privileges, etc., the general principle of economic development remains the same.[18] Let us re-visit Schumpeter's three major arguments.

In an interventionist economic environment, where production decisions are made to some extent independent of the nexus of calculation, it is practically inevitable that the entrepreneurial function become obsolete, not in the sense that the process could be bureaucratized, not in the sense used above, but in the sense that new production methods cannot be introduced due to various legal barriers. Intervention of various sorts can render firms' production decisions at least partially immune from changes in consumer preferences. When there is no uncertainty in entrepreneurial undertakings because the State "insures" them or promises reimbursement in case of failure, then the very essence of entrepreneurial

as far as "moral allegiance" is concerned, but the salient point is still that the managers and entrepreneurs are subject to the wants of consumers, and so production must proceed accordingly. Even the most apathetic of shareholders do not countenance the earning of losses by the managers, and will be quick to preserve as much of the value of their wealth as possible (preserve their property) in case of mismanagement. Yet again, if one assumes circular flow equilibrium where profits tend toward zero, then this concern does not arise. This sort of disregard for the institution of property becomes a genuine possibility, however, when positive returns to the stockholders can somehow be guaranteed. See below.

[18]For an illuminating practical example of this tendency, see the appendix.

activity disappears, because there is no longer a purposive choice to risk resources among competing uses in the hopes of correctly anticipating consumers' wants. There is only a political game, with investment serving the political ends of any particular administration. Even if the State cannot literally insure against failure in the market, the net result of its interference is to finance endeavors that are viewed as riskless by those who undertake them. We arrive here at the fundamental fact of moral hazard. We should note briefly here that the difficulties in exposing good and bad investments under interventionism is certainly likely to generate feelings of antipathy among the members of society toward the capitalist system, especially because it might often seem as if the capitalist system is to blame for the problems that actually arise from intervention.

With systematic intervention, a state necessarily closes off some of the avenues of potential profitability with every policy it enacts. So while the process of entrepreneurship can never be completely mechanized or bureaucratized, it can be directed by means of coercion, and potentially, eliminated altogether. This is the only type of progress which can be planned—the elimination of competition and the introduction of monopoly-driven economic stagnation.

We now move to the second argument; the bureaucratization of firms. As we noted above, when the consumers' values are allowed to determine prices on the market, economic calculation enables the market to adjust firm sizes optimally, and requires constant vigilance on the part of the entrepreneurs regarding how to allocate resources. However, once we introduce intervention, the price system does not completely reflect the values of the consumers. Economic calculation cannot then function to limit the size of firms, or to control the choice of methods of production. Scope then exists for firms to become increasingly bureaucratic as they become increasingly less sensitive to the wants of consumers (Mises 2007, pp. 53–60). If we acknowledge Rothbard's theory of monopoly we also know that such a wedge can only meaningfully be driven between firms and consumers through intervention in the market.[19]

[19]Schumpeter comes curiously close (perhaps without intending to) to acknowledging the Rothbardian theory of monopoly when he writes:

> The power to exploit at pleasure a given pattern of demand—or one that changes independently of the monopolist's actions and of the reactions it provokes—can under the conditions of intact capitalism hardly persist for a period long enough to matter . . . unless buttressed by public authority. . . . A modern business concern not so protected . . . and yet wielding that power (except temporarily) is not easy to find or even to imagine. (1942, p. 99)

The protective institutions of capitalism also appear susceptible to attrition through intervention. In an economy where monopoly privileges guarantee income to some at the expense of others, it is reasonable to suggest that feelings of attachment to the system of private property will begin to wane, for those who reap the benefits of monopoly, as well as for those who are exploited by it. The former certainly can have no enduring love for the institution of property, for its violation is the source of their livelihood. Added to this, we must remember that the incentive in any system of intervention is to join the ranks of the exploiters as quickly as possible, if for no other reason than to minimize one's losses. This results in a swell in the ranks of the exploiters and a compensating decrease in the ranks of the exploited. As every man struggles to ensure his own economic security, he further attacks the very notion of property rights.[20]

As is often the case with Schumpeter however, his insight does not carry over to his own positive exposition.

[20]As a final point, there is something truly original in Schumpeter's work that greatly adds to Mises's arguments regarding intervention and socialism: Schumpeter's path-breaking work on "the sociology of the intellectuals," which provides a missing cornerstone for Mises's idea that "the middle-of-the-road-policy leads to socialism." Mises held that the interventionist planners continually face two options: either to abandon their efforts to direct economic affairs, or instead to expand them, until eventually all of society's economic activity is controlled by the central planners. But Mises never explained why it is that the planners should always continue to expand their control of economic affairs instead of simply abandoning it. That is, he explained the movement from interventionism to socialism *only given the assumption that the planners do not wish to relinquish economic control.* But there is no rigorous economic reason to assert that such determination exists (or if it does exist, that it cannot change), however attractive such a belief may be intuitively. It is a possibility that the interventionist planners would willingly concede failure, and so we must find a valid reason to assume that the interventionists have incentives to continue their program of control even though, as Mises states, they result in consequences which, from the point of view of the planners themselves, are worse than the original state of affairs.

Schumpeter attempts to supply such a reason, by exploring the idea of the intellectual class, who, by its very nature, is hostile to the capitalist system. The intellectuals, he claims, are insulated from the practical problems of economy, and are thus highly critical of capitalism, and foster this animosity from generation to generation. This characterization is largely supported by Hayek (1997), who, in connection with his own theory of the intellectuals, comes very close to agreeing with some of the major points of this paper. Schumpeter and Hayek yield us a more plausible approach to understanding the planners, and although this approach in some sense depends upon their own sociological-historical understanding of the intellectual class, it nevertheless provides more solid ground from which to view the problem. Suffice it to say that these points merit further study beyond the scope of the present paper.

What emerges then from this alternative understanding of Schumpeter's thesis should be neither surprising, nor entirely original. Had Schumpeter had a more complete theory of the entrepreneur, he would have, I believe, formulated a theory with a more Misesian tone.[21]

VI. CONCLUSION

This paper discussed the problematic aspects of Schumpeter's thesis regarding the decline and fall of capitalism, and also to exposed the failings of the thesis in Schumpeter's incomplete theory of entrepreneurship. A new version of Schumpeter's theory was then proposed, one that is based upon the Misesian entrepreneur, and one which more closely coincides with Mises's own theory about the decline of capitalism.

We always run the risk of doing a great injustice to scholars of the past when we speculate on the history of thought, and we tread perilous ground whenever we make pronouncements about "what would have been thought" had circumstances been otherwise than they were. We can, however, follow separate—sometimes divergent, sometimes parallel—lines of thought, and by altering premises, imagine how these lines may be brought into similar courses, and eventually, to similar conclusions. The idea that when economic freedom is infringed upon, that social change will be both dramatic and deep-seated is a commonplace, and perhaps even a basic assumption, in most Austrian writing, but it is in some sense a new entry in the thought of Joseph Schumpeter. This is perhaps a strange answer to Schumpeter's thesis. But as Schumpeter himself would say, "History sometimes indulges in jokes of questionable taste."

VII. APPENDIX

The most instructive example of how to produce conditions conducive to the decline of capitalism is given in the case of the issuance of credit by a central bank or similar institution. Expansion of the credit supply via nonmarket forces ensures the emergence of all the conditions Schumpeter imagined would herald the end of capitalism. It should be

[21]At least in terms of his analysis, and the analytic claim that there is an inherent tendency for intervention to lead to socialism, as opposed to normative judgments regarding the desirability of such a situation. Any speculations about the possible normative opinions of Schumpeter's economic policy are left to the reader.

duly noted that of all the possible policy instruments available to any sort of central bank director, the ability to create bank credit is unequalled in its systematic distortion and rearrangement of the capital structure, and what is more, in the economic power it bestows upon the creators of the credit flows. The combination of these two effects is the prerequisite for the sort of social transformation Schumpeter imagined.

When the economy is subject to an expansion of credit brought about by a central banking authority, entrepreneurial appraisements are to some extent falsified, because the value of all stages of production becomes distorted. It becomes exceedingly difficult to determine via calculation which production processes are likely to be truly sustainable, because the availability of real resources and the status of consumption and saving preferences are unknown when prices (and especially interest rates) are manipulated through government intervention. Thus the entrepreneurial function in certain sectors of the economy is gradually eliminated, as monetary policy indirectly pushes production in certain new directions. Even State mandate cannot rationally mechanize the entrepreneurial process, because the future is uncertain. However, the State can, through various interventions, determine and direct the range of entrepreneurial goals and the methods chosen for their pursuit. The concentration of capital in industries supported by bank credit expansion eliminates the need for entrepreneurs, along with the possibility for new entrepreneurial endeavors in the industries which are rendered relatively less profitable by the influx of credit.

Next, firm size and corresponding decisions of internal policy lose their connection with economic calculation when the value of money is altered by forces other than consumers' valuations, thus allowing for the increase in bureaucratization described by Schumpeter. Given the method and timing of new injections of credit into an economy, it is perfectly reasonable to assume not that only single firms, but whole classes of firms—entire industries—could exist only because of distortions in the structure of production caused by expansionist credit policy. Monetary expansion reduces the number of entrepreneurs, and the issuers of credit step in to take their place as newly created credit is substituted for real capital assets owned by firms. As Professor Hülsmann has pointed out, "The entrepreneur who operates with 10 percent equity and 90 percent debt is not really an entrepreneur anymore. His creditors (usually bankers) are the true entrepreneurs who make all essential decisions. *He is just a more or less well-paid executive—a manager*" (2008, pp. 180–81; emphasis mine). Thus, by essentially becoming the entrepreneurs, the monetary authorities and their intermediaries eliminate true entrepreneurship from capitalist society. This is perhaps the point of strongest contradiction between the Misesian and Schumpeterian schools of thought in regard entrepreneurship, money and capitalism.[22] The distortion of calculation shifts decision-making power from entrepreneurs to the managers, who in their turn have an incentive to protect their newly acquired social position. This can easily be accomplished by further promoting a system of centralized banking. In this sense, we witness the advent of a new class of individuals fundamentally opposed to the capitalist system, a class entirely created by interventionism in the monetary sphere.

Even more problematic from the point of view of capitalism is the issue of property rights necessitated by the issuance of fiduciary media. When a central bank issues new money in this way, it creates opportunities for itself and the government to acquire property on the market. Thus, ownership and property are at even greater risk under monetary interventionism because the central authority can effectively create the means to attain titles to ownership of any good in society simply via its own mandate. The concept of property loses its meaning when one organization can change the entire pattern of ownership in society without the consent of the original property owners.

As for the institution of property itself, the influence of monetary policy can also be felt there as well. If one wishes to generate the feeling in society that property rights are unimportant, one has only to enforce a social order wherein the purchasing power of an individual's income can change rapidly and without warning; a society where it is impossible truly to determine which investments ensure a degree of financial security and which will become worthless tomorrow; where the ability of freely exchanging individuals to affect the supply of credit is insignificant next to that of the monetary authority. Constancy of value is never guaranteed on the market, to be sure, but the sudden and violent losses that we associate with economic depression and the exaggerated feelings of uncertainty in investors they engender are among the most notable products of monetary intervention.

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[22]Cf., for instance, Hülsmann (2008, p. 181).

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