

Seeking a *histoire raisonnée*

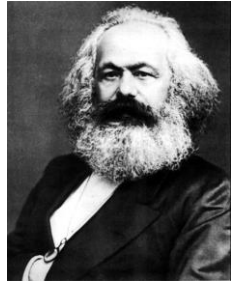
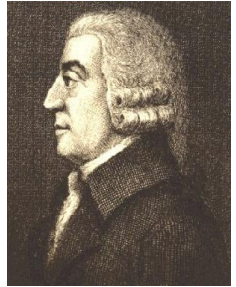
The Role of Political Economy

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“History is not was, it is.”

(W. Faulkner)

1. Introduction

Our World appears to be at the crossroads

- The Western Antarctic Ice Sheet has been subsiding into the sea at an accelerating speed. This process is taken to be irreversible and with it the **climate change** it entails.
- The seemingly unlimited potential of digitalisation might lead up to a critical point, “**technological singularity**”, with artificial super intelligence taking over control from humans.
- The Janus face of technological progress is put into sharp relief: the new technologies involve the possibility of **Big Brother 2.0** or “**GoD**” – the governance of the digital

- “**Superstar firms**” give us a new sense of what Adam Smith called “the **wretched spirit of monopoly**”. National sovereignty is endangered.
- The **distribution of wealth** (and also income) is getting more and more uneven. “**Wealth is power**”, Thomas Hobbes insisted and Adam Smith agreed.
- Democracy is in jeopardy and **pecuniocracy** is on the march: the principle of “One person, one vote” is in danger of becoming “One Dollar, one vote”.
- The **financial sector** is notoriously a source of **instability** threatening the socioeconomic system as a whole.
- The spectre of **secular stagnation** is very much alive and offers a gloomy outlook on the future.

- A **savings glut** poses the problem of sufficient effective aggregate demand.
- Economic policy measures, especially **monetary policy**, have exhausted their potential.
- Threat scenarios and conflicts all over the world might worsen and result in **wars**.
- The **political class** is in a shambles and the **electorate** in many countries in a deplorable situation with workers voting in favour of the hollowing out of their political rights.
- **Nationalism** is on the rise and so is a **neo-mercantile policy**
-

Wait a minute!

- Doesn't **the Queen/King** of the social sciences, Economics, provide a **most comforting message**?
- The message reads: **If individuals are left to their own devices, the socioeconomic system will self-organise into a state that has satisfactory welfare properties.**
- Or, as one author put it: **“Nothing but selfishness is necessary to yield socially beneficial outcomes.”**
- Seen from this point of view, the problems mentioned are just **figments of some people's imagination.**

Wait another minute!

Is that really so?

- This is (i) a **factual** question, (ii) a question regarding the **teachings of a particular economic theory** and (iii) a question concerning the **history of economic analysis**, since Adam Smith and his metaphor of the “**Invisible Hand**” are typically interpreted in this way.
- Ad (i): Climate change etc. provide compelling evidence that the comforting message cannot be sustained in general. The **complex dynamic and adaptive socioeconomic system** is variously passing thresholds, or **critical points**, that affect its behaviour not only quantitatively, but **qualitatively**.

- Ad (ii): Marginalist theory **has not proved what its comforting message claims**. Hayek rightly warned: Beware of the “**presumption of knowledge**”. What would he say about the finding of Mantel, Sonnenschein and Debreu that G.E. stability cannot be established on the basis of the usual assumptions on individuals. Any process which would ensure a convergence to G.E. would use an infinite amount of information (Saari and Simon).
- Ad (iii): **Adam Smith did not hold the view** ascribed to him, but it was Bernard Mandeville who did. According to Smith political economy was perhaps the most important part of a kind of master political science, encompassing the “**science of the legislator**”.

- According to Smith the working of self interest is often beneficent, **not because of some natural coincidence between the self interest of an agent and the general good, but because social institutions compel self interest to work in directions in which it will be beneficent.**
- This is not a once-for-all, but a **permanent task**, because self interest is always on the lookout for possibilities to circumnavigate any restrictions and fetters it faces (cf. “the sneaking arts of underling tradesmen” (Smith))

Histoire raisonnée

J.A. Schumpeter (1942: 44) credited Marx with having been “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*.”

Interpreting the past and delineating the confines within which future developments will probably take place.

“Innovations are the overwhelming fact in the history of the capitalist society” (Schumpeter, *Theory of Economic Development*, 1912)

Capitalism is a **restless system**.

The role of competition (centripetal vs. centrifugal forces)

Classical political economy was born when the economic system took off on a path of economic development and growth.

Cycles since about 1820, when the manufacturing sector had reached sufficient economic weight.

Economic History of Mankind

2

THE AMERICAN ECONOMIC REVIEW

MARCH 1999

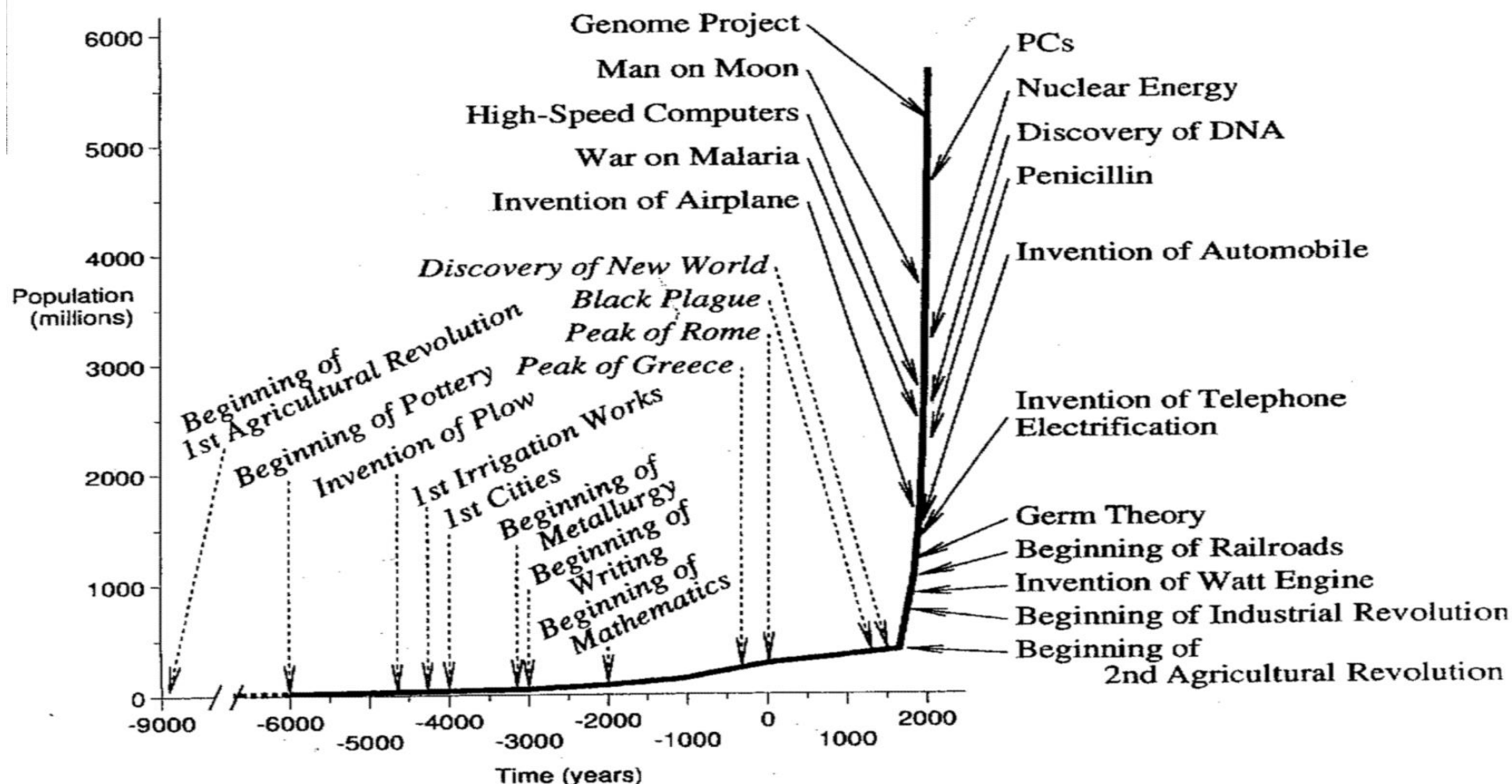
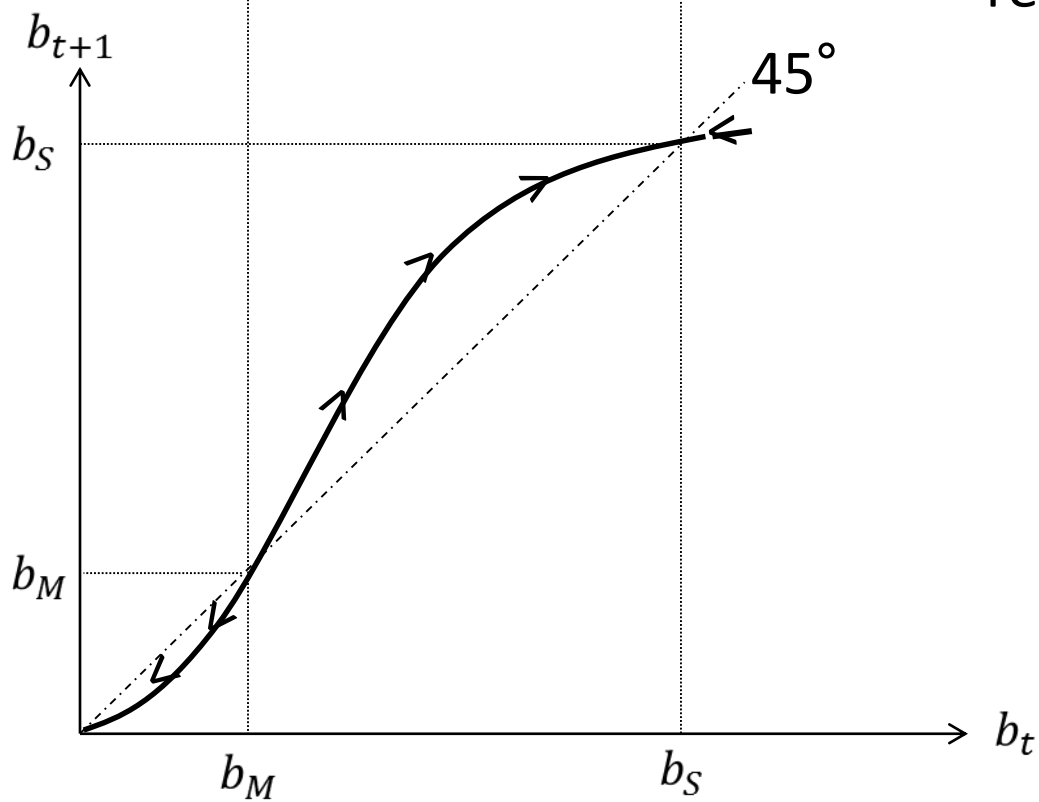
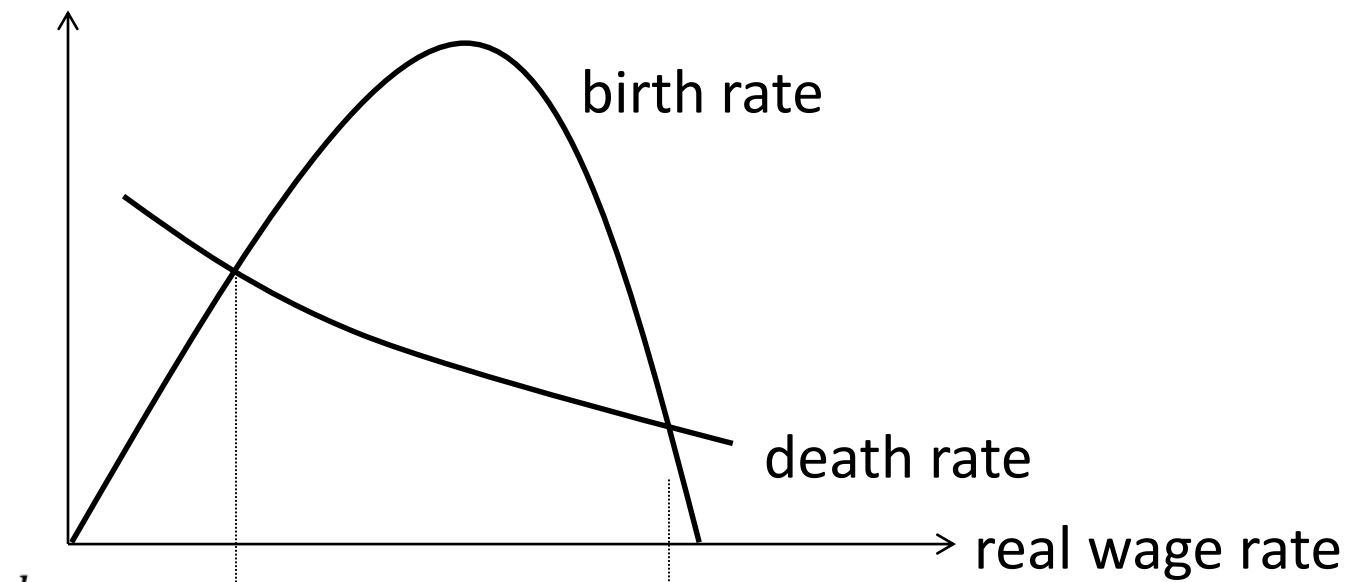


FIGURE 1. THE GROWTH OF THE WORLD POPULATION AND SOME MAJOR EVENTS IN THE HISTORY OF TECHNOLOGY



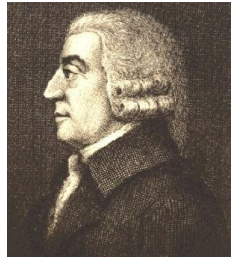
2. Smith: Towards a better society

Theory of Moral Sentiments (1759); *Wealth of Nations* (1776)

A. Ferguson: “History is the result of human action but not of any human design.”

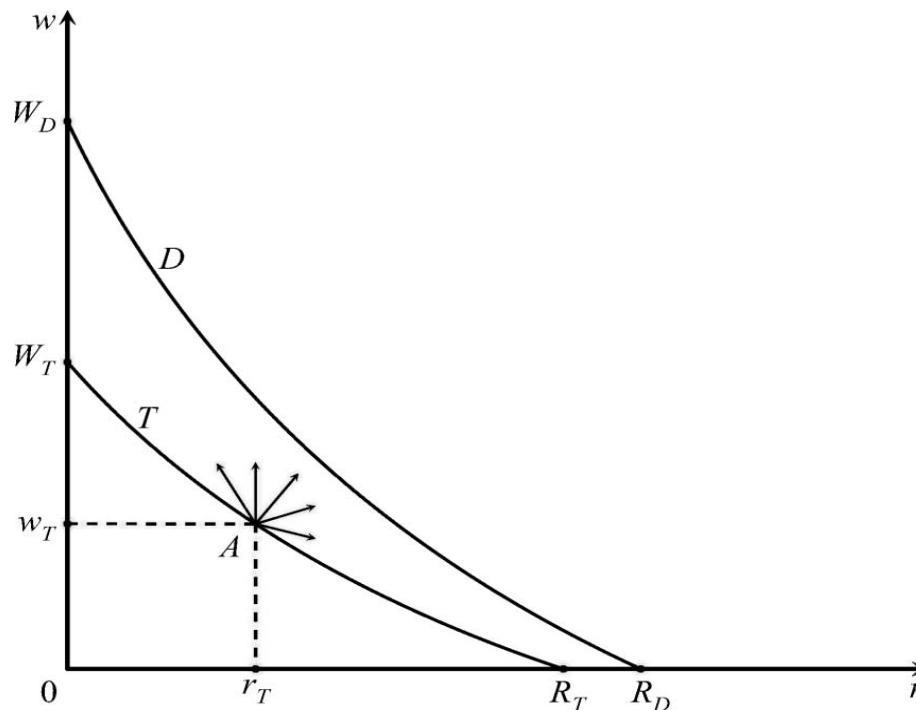
- Non-intended consequences of economic decisions and actions
- “Invisible Hand” arguments
- Self-transformation of socioeconomic systems
- Towards a system of “equality, liberty and justice”

Adam Smith: contradictory statements about socioeconomic develop.



(i) Division of labour

(gains of specialisation; “Taylorisation” and saving of time, better utilization of fixed capital; induced mechanisation)



(ii) With the accumulation of capital: intensified competition of capitals: falling rate of profits

Problems:

- Smith started from free competition (absence of barriers to entry and to exit), how could competition be intensified?
- What about the role of dynamically increasing returns to scale due to an ever deeper social division of labour?

(iii) Structural Change

(Agriculture – Manufacturing – Domestic Trade – Foreign Trade)

$$\frac{Y_1}{K_1} > \frac{Y_2}{K_2} \geq \frac{Y_3}{K_3} > \frac{Y_4}{K_4} > 0.$$

$$g = \frac{S}{K} = \left(\frac{S}{Y}\right) \left(\frac{Y}{K}\right) = s \left(\frac{Y}{K}\right).$$

The economics of corn and trumpery/trinkets

Smith stresses “the **great and essential difference** which nature has established between corn and almost every other sort of goods.” (WN IV.v.a.23)

Corn is the only **basic product** in the system.

$$(1) \quad Ap_a = (1 + r)A_{aa}p_a + qB_a$$

$$(2) \quad Mp_m = (1 + r)A_{ma}p_a$$

$$(3) \quad p_a = 1$$

$$(4) \quad r = \frac{A - (A_{aa} + qB_a)}{A_{aa}}.$$

- Important socio-economic transformations are frequently brought about by people who promoted “an end which was no part of [their] intention” (WN IV.ii.9).

Example: demise of the feudal and rise of the capitalist class.

“[T]he silent and insensible operation of foreign commerce and manufactures ... gradually furnished the great proprietors with something for which they could exchange the whole surplus produce of their lands, and which they could consume themselves without sharing it either with tenants or retainers. All for themselves, and nothing for other people, seems, in every age of the world, to have been the vile maxim of the masters of mankind. ... For a pair of diamond buckles perhaps, or for something as frivolous and useless, they exchanged the maintenance ... of a thousand men for a year, and with it the whole weight and authority which it could give them. (WN III.iv.10)

- The implication was “decisive” and consisted in a dramatic loss of power of the landed gentry: “for the gratification of the most childish, the meanest and the most sordid of all vanities, they [the landlords] gradually bartered their whole power and authority.”

(WN III.iv.10)

- “A revolution of the greatest importance to the public happiness, was in this manner brought about by two different orders of people, who had not the least intention to serve the public. To gratify the most childish vanity was the sole motive of the great proprietors. The merchants and artificers, much less ridiculous, acted merely from a view to their own interest, and in pursuit of their own pedlar principle of turning a penny wherever a penny was to be got. Neither of them had either knowledge or foresight of that great revolution which the folly of the one, and the industry of the other, was gradually bringing about.

(WN III.iv.17; emphasis added)

“Well governed society”

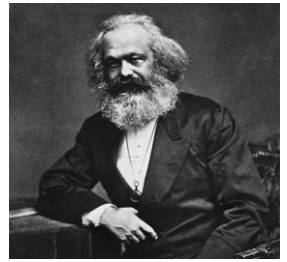
- An empirically supported anthropology to understand man's light and dark sides. (TMS)
- Political economy
 - has to fight superstition and false beliefs in matters of economic policy,
 - to debunk views that present individual interests as always promoting the general good and
 - to propose institutions and regulatory frameworks for markets that ward off changing threats to society and provide incentives such that self-seeking behaviour has also socially beneficial effects.

3. Marx: Towards an ideal society

Marx had begun to read Smith carefully in 1844 and formed a radical variant of the latter's basic idea: with the self-transformation of capitalism eventually a classless society will come into being, ending the exploitation of man by man. In this final act, the invisible hand would itself become redundant, because humans took control of their own destiny. Marx, the atheist, anticipated the salvation of mankind not in the hereafter, but on earth.

- Marx's political economy – a particular variant of the doctrine of the unintended consequences of self-interested behaviour – an “Invisible Hand” doctrine.
- Capitalists do not want to fall victim to their “inimical brothers” in the competitive struggle. The “**coercive law of competition**” makes them restlessly pursue lower costs and higher profits through technological change. However, “**behind their backs**”, their nemesis was taking shape: the general rate of profits, the system's key variable, was falling.
- **The cunning of history was taken to ensure that the self-seeking behaviour of capitalists as a class spells their doom and opens the way to socialism.**

Karl Marx: the “pons asini” of political economy



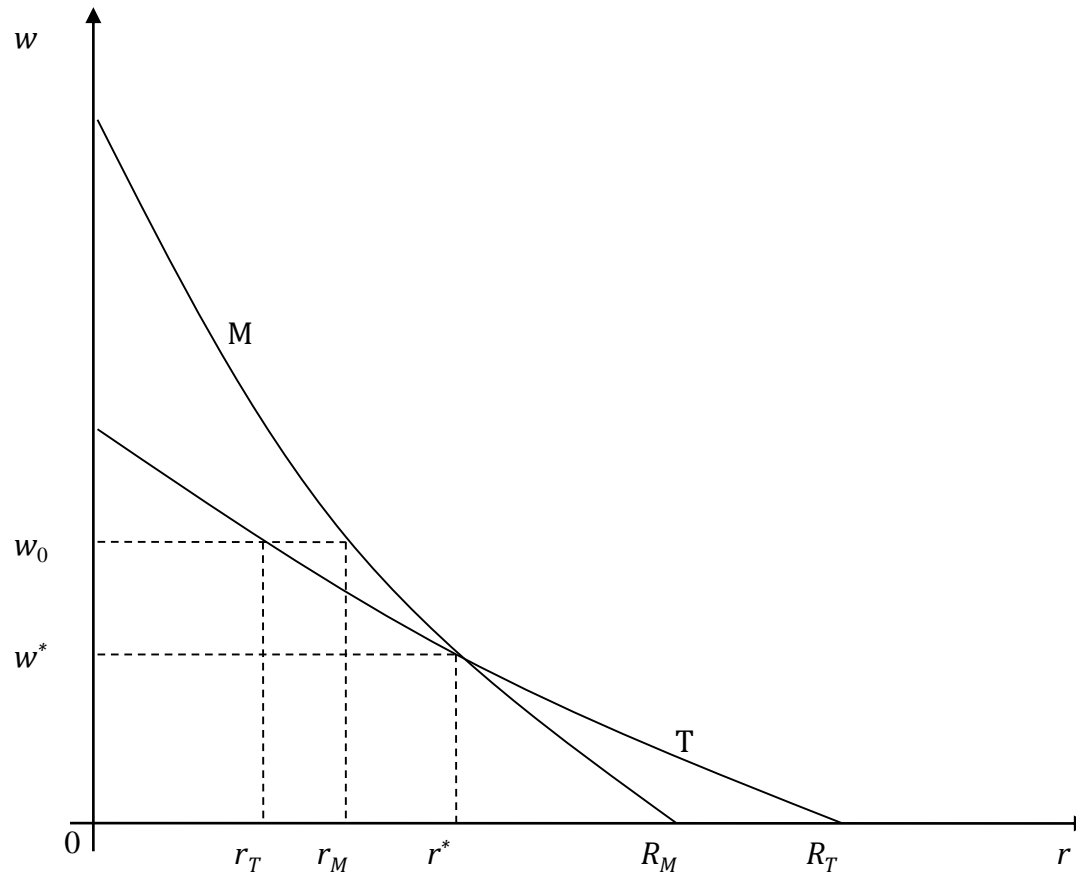
- A falling rate of profits rings the “death bell” of capitalism.
- “From an historical point of view it is the most important law”
- Developing the forces of production is “the historical task and justification of Capital. In this way it creates **unconsciously** the material conditions of a higher form of production.”
- Dominant form of technical progress: *direct* labour saving, *indirect* labour using: “organic composition of capital” (C/L) rises \Leftrightarrow the maximum rate of profits ($R = L/C$) falls

$$r = \frac{M}{C + V} = \frac{M/L}{(C/L) + (V/L)} = \frac{1 - \omega}{(1/R) + \omega} = \frac{R(1 - \omega)}{1 + R\omega}$$

$$\frac{\partial r}{\partial \omega} = \frac{-R(1 + R)}{(1 + R\omega)^2} < 0$$

$$\frac{\partial r}{\partial R} = \frac{1 - \omega}{(1 + R\omega)^2} > 0$$

Marx's inspiration: Ricardo on the gross produce reducing form of technical change ("On Machinery")



Problems:

- A rising organic composition bounded from above involves a positive maximum and actual rate of profits that are bounded from below.
- An organic composition rising without limit is neither observable nor to be expected.
- A rising labour productivity implies for a given real wage rate a falling share of wages ω and the impact on r cannot be seen at a glance.
- Marx: “No capitalist ever voluntarily adopts a new method of production ..., if it reduces the rate of profit.”
- “Ricardo-Sraffa-Okishio-Theorem”

- “Scientific socialism” did not demonstrate conclusively that the general rate of profits was bound to fall and socialism therefore inevitable.
- MEGA²: What would have happened if the MEGA project had been completed shortly after Marx’ death, and Marx’ own doubts and self-criticism had become known? Would his statements have been treated as set in stone, as the words of a prophet? Real existing socialism as an unintended consequence of the publication of only the first volume of *Das Kapital*.
- What about the prospects of socialism in case capitalism leaves behind a plundered planet?

- The hopes placed in socialism have been shaken. However, there are many forms of capitalism, economic regimes can be quite varied, and the old problem about the “good society” has been made more relevant than ever by the global financial and economic crisis and the degradation of the environment. In the geological notebooks reproduced in Part IV, vol. 26 of MEGA, Marx treats the **earth** and **humanity** as two living organisms, which interact with each other.
- Interestingly he asks: **Will they survive together in the long term or will the earth rid itself of humanity?**

4. Schumpeter: On the brink of the abyss

Capitalism, Socialism and Democracy (1942, 1947, 1950)

- I The Marxian Doctrine
- II Can Capitalism Survive?
- III Can Socialism Work?
- IV Socialism and Democracy
- V Historical Sketch of Socialist Parties

Schumpeter's book on socialism (World War I and World War II; imperialism; Russian revolution; rise of socialism; Keynes; F. D. Roosevelt's "New Deal"; E. v. Böhm-Bawerk, R. Hilferding, O. Bauer; Finance minister; the "Great Systems Debate")

Capitalism will not die because of its economic failures, but because of the way of its success.

Preliminaries:

- “We need not believe that a great achievement must necessarily be a source of light or faultless in either fundamental design or details.” (3) The greatness of an idea is seen in the fact that **it cannot die**, that it recurs time and again.
- “To say that Marx, stripped of phrases admits of **interpretation in a conservative sense** is only saying that he can be taken seriously.” (58)
- Was Schumpeter a Marxist and/or a socialist? He was neither.

“Law of motion”

- **Marxian heritage**: the direction of change is shaped by the forces governing the self-transformation of the socioeconomic system – the “laws” identified by political economy
- **Wieserian heritage**: the course of events may be changed in an unpredictable way by great leaders, bold and energetic people (politicians, founders of religions, military commanders, entrepreneurs, scientists etc.). Wieser’s “**law of small numbers**” (Recht und Macht (1910); Das Gesetz der Macht (1926))
- *CSD* – ironic?



Joseph A. Schumpeter: “creative destruction” and long waves



- Capitalism is a **restless system**. It knows no point of rest or equilibrium, but is continually in motion.
- Economic development proceeds in leaps and bounds – in Kondratieffs (plus Juglars and Kitchins). There is no presumption that the trends of the rate of invention and of the rate of profits are falling.
- Kondratieff downturns may be mistaken for secular stagnation and even the exhaustion of capitalism.
- “The modern state may crush or paralyze [capitalism’s] motive forces” (1954: 1173)
- The erosion of incentives is “the inevitable [!] outcome of capitalist history”.

- Capitalism: private property of means of production; organisation of production and distribution by means of private contracts; system of interdependent markets; banks capacity to create credit
- Socialism: common property of means of production; to a large extent elimination of market-based organisation of production and distribution in favour of central planning.

Beyond this, both systems allow for very different institutional arrangements: both are characterised by “cultural indeterminateness” (170).

- The kind of socialism Marx had in mind had nothing to do with Stalinism and Bolshevism.
- Socialism was supposed to be growing out of mature capitalism (not out of pre-capitalist economic and proprietary conditions).
- Otherwise there was the danger of political despotism (Marx 1857). (Wittfogel: “Asiatic mode of production” and “oriental despotism”).)
- State managers are supposed to be independent and competent and to act on behalf of the general good.
- Apparently Schumpeter went out of his way not to frustrate readers with a socialist orientation from the outset by demonizing socialism.

I The Marxian Doctrine

Schumpeter praises

- Marx' analytical depth and scientific breadth;
- his “economic concept of history”;
- his distinction between “mode” and “relations of production” and his class analysis;
- his view that capitalism was a restless system based on the “coercive laws of competition”;
- his law of the concentration of capital;
- his criticism of the “fairy tale” that savings are the main source of individual and collective wealth
- his understanding of capitalism's self-destructive tendencies

- ... and criticizes
- Marx “had no adequate theory of enterprise and his failure to distinguish the entrepreneur from the capitalist, together with a faulty theoretical technique, accounts for many cases of *non sequitur* and for many mistakes.” (32) (Including his theory of the circulation of elites)
- he did not understand that entrepreneurs were the best friends of workers (invisible hand mechanism) and that profits are not due to exploitation.
- Marx’s failure to specify with sufficient precision what he meant by “socialism”; this “was one of the most serious shortcomings” of his doctrine (162).

II Can capitalism survive?

- „No, I don't think it can.“ This is no prophecy, but follows from the scientific analysis of the factors seen at work. It does not tell us “what *will* happen ... but only what *would* happen if they continued to act as they have been acting ... **and if no other factors intruded.**” (61)
- **[Desperately waiting for other factors to intrude.** (Wilkins Micawber in Charles Dickens' *David Copperfield*: “Something will turn up.”)]
- Capitalism is as vital as it has always been. Marx was wrong. Another explanation of its demise was needed.

- The modus operandi of capitalism is not understood.
- Development comes in leaps and bounds, i.e. cycles; it has of necessity winners and losers.
- To fight cycles means to abolish innovations.
- Economic policy à la Keynes and Roosevelt paralyzes the economy because of its “anticapitalist character”.
- Capitalism is “a method of economic change”, “evolutionary”, based on a “system of incentives” and “a method of social selection”: “spectacular prizes much greater than would have been necessary to call forth the particular effort are thrown to a small minority of winners” (73)
- Workers under capitalist rule, while worse off than members of other strata of society, are better off than workers under socialist rule.

It is necessary to abandon the following articles of faith:

- Big companies are barren when it comes to innovation – No, they routinize and depersonalize *R&D*
- Monopolistic positions are the necessary consequence of successful innovations
- A regulatory policy taking perfect competition as the ideal and forcing firms to fix prices at marginal costs ($<$ average costs in conditions of IRS) is disastrous
- Capitalism is not subject to secular stagnation because of permanently missing options of profitable investment. Capitalism has been constructed with the aim of generating such options. An excessive social policy and high taxation destroy such options.

- Growing lack of understanding of capitalism
- Bureaucratization and rationalization move the entrepreneur into the background and decrease the political power of the bourgeoisie.
- Utilitarianism involves “anti-heroic” attitudes and destroys the bourgeois family.
- Capitalism does not only break “barriers that impeded its progress but also flying buttresses that prevented its collapse.” (139) It removes the stabilising scaffolding.
- Joint stock companies: separation of property and control; critical attitude and hostility towards capitalism; role of intellectuals (“intellectual buccaneers” – Julien Benda (1927): *La trahison des clercs*) who chastise inequality, advocate “laborism” and are responsible for the growing neglect of “the needs of the capitalist machinery”

III Can socialism work?

- “Of course it can.” (167) Barone, Lerner, Lange vs. von Mises, von Hayek re. rational calculation in capitalism.
- “Market socialism”. On “purely logical terms”, Mises’ view not sustainable.
- But both camps missed the main issue: what matters are not static efficiency properties (“bloodless concepts”), but dynamic properties.
- At first sight, socialism looks superior (technol. unemployment; the keeping of reserve capacity; waste; unproductive activities (“rent seeking”))
- “The socialist blueprint is drawn at a higher level of rationality.” (196)

But socialism faces a number of serious problems:

- How to rationally use “human material of supernormal quality” identified by a stiff “selective process”?
- How to enforce efficiency and productivity in a system in which the dole no longer works as a whip?
- Since the capitalist incentive scheme will be abolished, how to enforce discipline? There is the danger of a “reign of terror” as in the Soviet Union.
- How are managers chosen?

Which variant of socialism will eventually be adopted?

IV Socialism and democracy

- Schumpeter strongly influenced by Wieser, H. Kelsen, Pareto, Le Bon. A sober and repeatedly cynical perspective on democracy
- The way of transition to socialism decides about its future
- He rejects the idea that democracy is a “political method” to establish the *volonté générale* (criticism of Bentham’s utilitarianism and Rousseau’s “contrat social”)
- There is “disillusioning evidence” (257) regarding human nature (cognitive distortions, stupidity etc.).
- Democracy is a method to arrive at decisions by deciding who should take them: competition re. political power and positions. Overwhelming importance of leadership.

- While business people are concerned with maximizing profits and do not really care about use values, politicians maximize the number of voters and do not really care about the fate of people. They use all means at their disposal and seek to capture peoples' minds. They wish to get hold of the "subconscious" (Freud).
- The struggle for power detrimental to the quality of policy (politicians compared to horsemen desperately trying to keep staying in the saddle)
- "Socialist democracy may eventually turn out to be more of a sham than capitalist democracy ever was."
(302)

- Leaders who make a difference
- Lenin and Stalin
- F.D. Roosevelt
- J.M. Keynes

6. Concluding remarks

Blind spots in Schumpeter's analysis

- China (Deng)
- Keynes – *Mixed Economy* – Welfare State (a modern form of Schumpeter's "Laborism")
- Theory of market failures
- Public goods; environment
- Hybrid public-private enterprises (Mazzucato)
- Big Five (Apple, Google, Facebook, Amazon, Microsoft) – "Superstar firms" (D. Autor)
- Wealth and power and monopolies