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Schumpeter's Knowledge Problem – in the Economy and in the Voting Booth

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– in the economy and in the voting booth

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ABSTRACT

I hope to accomplish two things in this paper. First, I will examine my early engagement with Schumpeter and my work analyzing his ideas. This will include (1) my efforts to challenge the notion that Schumpeter somehow changed his views on entrepreneurship and (2) my reconstruction of his perspective on managerialism and my interpretation of what he truly meant by the "obsolescence of the entrepreneur." Second, I will consider Schumpeter as a Public Choice theorist, reflecting on his contributions to that field in the context of today's contested populist political environment, contrasting his approach with that of the Virginia School of Public Choice.

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Off the Mark about Schumpeter.

It is perhaps not surprising that I first encountered Schumpeter when I was a graduate student. As I began working on my dissertation in the late 1970s, I initially tried to construct formal models of research and development, following the kind of work that scholars like Glenn Loury (1979) had been producing. Very quickly, however, I grew frustrated with that approach. It seemed to me that such models said little that was either meaningful or interesting about research and development, let alone about technological change or the broader dynamics of economic growth. In search of deeper insight, I turned to other sources. Schumpeter was at the center of this. But I also immersed myself in the more appreciative literature on technological change. This very much included the work of Richard Nelson, not only his studies of technology but also his early papers with Sidney Winter on evolutionary economics that eventually culminated in *An Evolutionary Theory of Economic Change* (1982). I read Nathan Rosenberg as well. In the end Rosenberg would serve on my dissertation committee, while Nelson would later become a colleague and mentor during my first position at the Center for Science and Technology Policy at New York University.

Indeed, I would become a member of Nelson's "invisible college," engaging in industry studies, mostly on high-tech industries in computers and semiconductors, as part of several group book projects. At the same time, I was thinking about the economics of organization, attempting to apply dynamic – Schumpeterian – ideas to the field pioneered by Ronald Coase. This led me to the theory of dynamic transaction costs (Langlois 1992). I developed many of these ideas in collaboration with Paul Robertson, which we put together into a book (Langlois and Roberson 1995). Paul and I attended our first Schumpeter Society meeting at Airlie House in Virginia in 1990.

As a sidelight, I was always interested in Schumpeter from the perspective of the history of economic thought. In the late twentieth century – and, indeed, into the twenty-first – the Anglophone literature on technological change often repeated an odd trope about Schumpeter: that he had changed his mind about entrepreneurship as he grew older. According to this view, his *Theory of Economic Development* (translated into English in 1934; henceforth *TED*) reflected his belief in the transformative role of small entrepreneurs in driving capitalism forward, while *Capitalism, Socialism, and Democracy* (first published in 1942; henceforth *CSD*) represented a shift toward the idea that large corporations and professional managers could reliably generate innovation without entrepreneurs. There were, in effect, two Schumpeters: "Mark I," the younger Schumpeter who celebrated the entrepreneur, and "Mark II," the older Schumpeter who embraced managerialism and renounced the entrepreneur's centrality to economic growth.

What made this view dominant is that it was articulately by many of the leading figures in technology studies. The earliest version I can find came from Almarin Phillips (1971), but others, including Richard Nelson, picked up the idea. "In his later writings, [Schumpeter] recanted the proposition that market competition was necessary for the generation of innovation, positing that in large corporate enterprises, innovation itself has become largely routinized. Therefore, he foresaw no particular disadvantages from socialization of the innovation process, as well as the more routine activities of the economy" (Nelson 1977, pp. 134-135). In the view of Burton Klein, "Schumpeter expressed very different views in his later writings than in his earlier works, so much so that one has the impression there were two Schumpeters: Schumpeter the revolter against determinism, and Schumpeter the determinist" (Klein 1977, p. 133). A corollary to this conventional-wisdom interpretation is the notion that Schumpeter "changed his mind" because of what he saw developing in the contemporary economy. As Christopher Freeman put it, the "shift of emphasis from the early Schumpeter ... to the late Schumpeter ... reflected the real change which had taken place in the American economy between the two World Wars and the rapid growth of industrial R&D in large corporations during that period" (Freeman 1982, p. 8).

This is loud testimony to the power of memes, since it would have taken very little textual analysis to explode the idea. For one thing, Schumpeter articulated the "early" view in papers written after *CSD* (Schumpeter 1947, 1951). More to the point, Schumpeter makes exactly the same arguments in both the "early" and "later" books, using almost exactly the same language. Consider the following passages. The first is from the "later" Schumpeter.

> This social function [entrepreneurship] is already losing importance and is bound to lose it at an accelerating rate in the future even if the economic process itself of which entrepreneurship was the prime mover went on unabated. For, on the one hand, it is much easier now than it has been in the past to do things that lie outside the 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. The romance of earlier commercial adventure is rapidly wearing away, because so many *things can be strictly calculated* that had of old to be visualized in a flash of genius. (Schumpeter 1950, p. 132, emphasis added).

Schumpeter quickly goes on (p. 133) to liken the changes he foresees in the entrepreneur's role with those that have already taken place in the function of the military commander. Now consider the following passage from the "early" Schumpeter.

> The more accurately, however, we learn to know the natural and social world, the more perfect our control of facts becomes; and the greater the extent, with time and progressive rationalisation, within which *things can be simply calculated, and indeed quickly and reliably calculated*, the more the significance of this function decreases. Therefore the importance of the entrepreneurial type must diminish just as the importance of the military commander has already diminished. (Schumpeter 1934, p. 85, emphasis added.)

The 1934 English version of *TED* is a translation of the greatly revised second edition of a book first published in German in 1911. Far from reflecting the "early" Schumpeter, the second edition reveals a mature theory of entrepreneurship essentially identical to that in *CSD*. It is thus hard to see how Schumpeter would have been influenced by the large American corporations he observed form his perch at Harvard in the 1930s.

If Schumpeter did "change his mind," the change occurred before the 1934 book that English-speaking writers have portrayed as the "early" Schumpeter. Even here, however, the change was more methodological than substantive. Rather than conceptualizing entrepreneurship as a psychological characteristic of a subset of the population as he had in 1911, he came to portray entrepreneurship in a "depersonalized" way as an ideal type (Becker and Knudsen 2003). In the post-1926 theory, entrepreneurship needn't fill the vessel of any actual person; it reflects instead a category of action into which individuals (organizations?) may fall at various times and places. This change enabled the obsolescence thesis, since it made the entrepreneur less "pushy" and therefore permitted an easy movement to an institutionalized version of entrepreneurship. The entrepreneur has become a carrier of change rather than a cause of change. No matter how one interprets this transition from the "old" Schumpeter to the "new," however, it is not the transition that writers in the Anglo-American literature of technological change have believed they saw. That one never happened.

Similarly, Schumpeter's views on the obsolescence of the entrepreneur and the inevitability of socialism were already in place before the 1926 second edition, an evolution in his thought that arguably had much more to do with the Great War and a stint in the socialist post-war government of Austria than it did with observing American corporations. Schumpeter ends his 1918 essay "The Crisis of the Tax State" this way: "By and by private enterprise will lose its social meaning through the development of the economy and the consequent expansion of the sphere of social sympathy. The signs of this are already with us and it was inherent in the tendencies of the second half of the nineteenth century, whose perhaps final aberration was all that which culminated in the world war.

Society is growing beyond private enterprise and tax state, not because but in spite of the war" (Schumpeter 1991, p. 131). As Alexander Ebner (2006, p. 322) points out, most of Schumpeter's arguments on the feasibility of socialism

> had already been formulated in an essay on the "possibilities of socialism," published in 1920, following Schumpeter's political activities as a Member of the German Commission on Socialisation which were followed by his brief intermezzo as an Austrian Minister of Finance in a socialist dominated government. In this essay, institutional changes that altered the character of the market economy, and thereby seemed to prepare the ground for socialism, were not yet described as a specific phase of capitalist development, but as indicators of socialist transformation. Schumpeter argued that industrial concentration and the emergence of corporate trusts would lead to the economic dominance of bureaucratic organisations, accompanied by a rationalisation of economic life, as indicated by the automatisation of technological progress. This would imply the replacement of personal entrepreneurship by administrative guidance with managed science dominating the sphere of invention, while the innovative application of inventions would be established as a business routine in large enterprises (Schumpeter 1920/21, p. 318n). Moreover, rationalisation would cut loose the economic sphere from pre-capitalist and non-economic sentiments and ties, illustrated by the decreasing role of family values as a motive for the private accumulation of wealth (Schumpeter 1920/21, p. 312n).

None of this is surprising considering that themes of "demise" were common to German-language economics in that period (Boehm 1990, p. 228).

The real transition in Schumpeter is not between his earlier and later views but between earlier and later capitalism. It was once true that economic growth was driven by the creative destruction of individual capitalists leading the means of production into new channels. Increasingly, and certainly in the future, Schumpeter claimed, innovation could be rationalized and made predictable. This means that entrepreneurship could and would be replaced – indeed, is already being replaced – by the routine administration of trained professionals. This means in turn that socialism could easily crank out innovation and generate economic growth without private ownership. The entrepreneur is becoming obsolete.

Moreover, socialism is not only feasible but inevitable. The very process of rationalization that is making innovation routine has long been undermining bourgeois civilization by casting skeptical light on the constellation of pre-rational and pre-modern institutions that, Schumpeter believes, have so far protected "the bourgeois stratum." One of these institutions is the figure of the entrepreneur itself, understood as a positive cultural icon: once cultural heroes, entrepreneurs are now all robber barons. Socialism will succeed because, without the entrepreneur to guard it, "the bourgeois fortress ... becomes politically defenseless," open to plunder by a New Class of socialist intellectuals and government officials.[1] "Defenseless fortresses invite aggression, especially if there is rich booty in them. Aggressors will work themselves up into a state of rationalizing hostility – aggressors always do. No doubt it is possible, for a time, to buy them off. But this last resource [sic] fails as soon as they discover that they can have it all" (Schumpeter 1950, p. 143).

Schumpeter was certainly right about the New Class laying siege to the bourgeois castle, but I have always believed he was wrong about the possibility of routinizing innovation. Economic history since Schumpeter's death in 1950 bears this out (Langlois 2023). Although many important ideas – and even a few innovations, which is not the same thing – have come from corporate research labs, the phenomenal economic growth of the post-war era has in the main been driven by the same kind of entrepreneurship Schumpeter saw in supposedly "early" capitalism.

Why did Schumpeter get it wrong? One possibility is that he never meant to get it right. In this reading, *CSD* is meant as provocation, and the march into socialism is meant as a kind of satire. It is certainly true that Schumpeter is often winking at us. And the socialism he portrays sounds not only genuinely awful as a civilization but maybe even ultimately ineffective, despite his official claims to the contrary.

1 In this view, Schumpeter calls to mind the American neoconservatives of the postwar era, for whom Schumpeter was an important figure. We might even say that Schumpeter was the first neoconservative.

But if we take Schumpeter literally, the problem, I have long argued, lies in Schumpeter's account of knowledge.[2] The argument in favor of the eventual routinization of innovation relies on a confusion of two different understandings of knowledge.

Schumpeter is clear that in early capitalism, and indeed in the pre-modern world more generally, humans relied on empirical, on-the-spot knowledge, much of it in the nature of what Michael Polanyi (1958) called tacit knowledge, much of it contained inexplicitly in various habits, conventions, and institutions. "The assumption that conduct is prompt and rational," he says, "is in all cases a fiction. But it proves to be sufficiently near to reality, if things have time to hammer logic into men. ... But this holds good only where precedents without number have formed conduct through decades and, in fundamentals, through hundreds of thousands of years, and have eliminated unadapted behavior" (Schumpeter 1934, p. 80). This account implies that economic knowledge is inherently open-ended or evolutionary in character, and, since it is grounded in not a matter of logical deduction from explicit premises, that kind of knowledge is potentially unbounded. There is always new knowledge that is not yet within the agent's "calculative sphere" or means/ends framework. Indeed, the job of the entrepreneur is precisely to introduce new knowledge. Novelty is what distinguishes the entrepreneurial function from that of the manager or the capitalist: one is an entrepreneur only while carrying out new combinations, not once the business is well established.

The crucial point for my argument is that a conception of entrepreneurship (or something very much like it) is essential for any theory that proposes to deal with innovation and economic growth. Conventional neoclassical models tell stories about the adjustment of known means to

2 The most careful elaboration of this argument is in my 2007 Routledge volume, drawn from the Graz Schumpeter Lectures I delivered in 2004. To my great delight, this book was a recipient of the 2006 Schumpeter Prize of the Joseph A. Schumpeter Society.

given ends, but they say very little about how those means and ends change or come into being in the first place. There has to be a mechanism by which new knowledge enters the system. And that mechanism cannot be rational calculation, for as David Hume (1978, p. 164) long ago observed, “no kind of reasoning can give rise to a new idea.”

As we saw, however, with “progressive rationalization” – the stripping away of unexamined folk ways and the general disenchantment of the world – this on-the-spot empirical knowledge is giving way to scientific knowledge: things can be calculated, and indeed quickly and reliably calculated. Notice the syllogism. Because the unknown can be increasingly calculated rationally, the “extra-logical” function of the entrepreneur becomes increasingly unnecessary, and so the importance of the entrepreneurial type must diminish.

This is a strange commingling of an empiricist and a rationalist theory of economic knowledge. In “early” capitalism (not the “early Schumpeter”) economic rationality derived largely from evolved habit and convention; attempts to step outside this configuration of knowledge could not be accomplished by conscious rationality and explicit calculation. Rationality was “bounded,” in effect. In “later” capitalism (not the “later Schumpeter”) the bounds of rationality are being broken. Conscious rationality is beginning to conquer not merely the entrenched conventions of the past but also the previously unknowable future.

But this is of course a fallacy. Even in the modern world – even in our modern world 75 years after Schumpeter – scientific knowledge cannot substitute for the rough-and-ready empirical knowledge of the particular circumstances of time and place (Hayek 1945). Such lowly empirical knowledge is essential not only for guessing what consumers may want but even for imagining what kinds of technologies are available and seeing how to recombine them in novel ways.

Schumpeter offers one particular example in *CSD* that helps to illustrate his understanding of how scientific knowledge substitutes for local knowledge – and also shows why that understanding is wrong as a general proposition. As we saw, Schumpeter believed that agents could act in an objectively rational way if their unexamined practices had faced empirical test over time. Yet only with the coming of scientific knowledge could people consciously examine the causal connection between means and ends. For example, he says,

> generation after generation may suffer from irrational behavior in matters of hygiene and yet fail to link their sufferings with their noxious habits. As long as this is not done, objective consequences, however regular, of course do not produce subjective experience. Thus it proved unbelievably hard for humanity to realize the relation between infection and epidemics: the facts pointed to it with what to us seems unmistakable clearness; yet to the end of the eighteenth century doctors did next to nothing to keep people afflicted with infectious disease, such as measles or smallpox, from mixing with other people (Schumpeter, 1950, p. 259).

In this example, people's "noxious habits" are irrational in the sense that they do not correctly solve the objective means-ends problem of avoiding disease. Evolutionary trial and error failed to weed out dysfunctional behavior. And something like the (scientific) germ theory of disease was necessary to induce rational behavior.

My suspicion is that, like others, Schumpeter overgeneralized from examples like this. It is certainly true that in many cases scientific insights helped improve people's success in achieving their aims. But this is not the same thing as saying that scientific knowledge can substitute for local knowledge in most or all circumstances. Scientific knowledge is certainly more explicit and systematic than tacit local knowledge, but as philosophers like Popper (1963) have argued, scientific knowledge itself is also in the end the result of empirical trial and error.

Schumpeter and Public Choice.

I have always been fascinated by Schumpeter's take on what has come to be called Public Choice Theory. It seems especially salient in our era of polarization and populism, as we have all become amateur Public Choice economists, at least over the dinner table.[3]

In Part IV of *CSD*, Schumpeter considers – once again, maybe not entirely with a straight face – the question of whether socialism is compatible with democracy. But what is democracy? Schumpeter sets himself against the "eighteenth-century philosophy of democracy," which he identifies with the Philosophical Radicals. These hopelessly narrow and naïve thinkers held that "the democratic method is that institutional arrangement for arriving at political decisions which realizes the common good by making the people itself decide issues through the election of individuals who are to assemble in order to carry out its will" (Schumpeter 1950, p. 250). Under this view, "there exists a Common Good, the obvious beacon light of policy, which is always simple to define and which every normal person can be made to see by means of rational argument."

This is nonsense, Schumpeter believes. Some people may want things other than the common good, and, more importantly, individuals will hold very different understandings of what constitutes the common good. As a result, any attempt to aggregate individual wills through some democratic process would lack "not only rational unity but also rational sanction" (p. 253). It is here, in confronting the "irrationality" of voting, that Schumpeter lays down the outline of his theory of non-market decision-making. As in the theory of entrepreneurship, this account will turn on Schumpeter's understanding of what "rationality" means (Egidi 2017).

3 Frank Knight supposedly called *Capitalism, Socialism, and Democracy* "superbly entertaining dinner-table conversation."

In a paper written for a seminar in 1940 and not published until long after his death, Schumpeter makes a "distinction between objective rationality (= applicability of a rational schema to the actor's behavior) and subjective rationality (= conformity of the actor's mental processes to a rational schema)" (Schumpeter 1984 [1940], p. 583). In effect, rationality has both a conscious or deliberate component and an unconscious or habitual component, a distinction akin to the philosopher's distinction between theoretical rationality and practical rationality. "Rationality of thought and rationality of action are two different things. Rationality of thought does not always guarantee rationality of action. And the latter may be present without any conscious deliberation and irrespective of any ability to formulate the rationale of one's action correctly" (Schumpeter 1950, p. 259 n. 11). He uses this distinction to argue for what amounts to a methodological position not unlike the one later popularized by Milton Friedman (1953).[4] We can usefully assume conscious (subjective) rationality in our models even if economic agents are getting the (objective) job done some other way, perhaps through unconsciously applied habits or routines. "For a man's behavior may conform to [a model] and be economically described by it, even if its contents are as foreign to his mind as the law of gravitation is foreign to a stone" (Schumpeter 1984 [1940], p. 580).

Yet, especially in *CSD*, Schumpeter is interested in the ways in which agents do employ conscious (subjective) rationality, especially the possible "discrepancy" between the agent's rationality and the "objectively rational model" (Schumpeter 1984 [1940], p. 586). The discrepancy is least in the ordinary business of life, when agents benefit from local knowledge and effective feedback. "In the ordinary run of often repeated decisions the individual is subject to the salutary and rationalizing influence of favorable and unfavorable experience" (Schumpeter 1950,

4 I suspect that this 1940 paper was in part Schumpeter's response to the so-called marginalist controversy, which would spur not only Friedman's contribution but also important ones from Armen Alchian (1950) and Fritz Machlup (1967).

p. 258). In the ordinary business of life, when feedback is strong, people are not fooled by advertising in the medium or long run; they willingly and effectively consult genuine experts and even become experts themselves in their personal spheres of life. In their small worlds, economic agents are rational in a practical, empirical sense.

But this kind of rough-and-ready rationality transfers poorly to the realm of non-market decision making. Perhaps in the case of town-meeting local democracy, feedback is strong enough, and people remain knowledgeable about the issues. Concentrated special interests certainly have an incentive to remain informed and pursue their aims with practical rationality. But when we consider political decision making for issues beyond the local level, Schumpeter believes, people lose both the incentive and – more interestingly – the ability to act rationally. “Voters thereby prove themselves bad and indeed corrupt judges of such issues, and often they even prove themselves bad judges of their own long-run interests, for it is only the short-run promise that tells politically and only short-run rationality that asserts itself effectively” (p. 261). Indeed, he thinks, when people stray far from their small worlds, they begin to lose all sense of reality.

Anthony Downs, one of the founders of postwar Public Choice Theory, famously invoked Schumpeter’s “profound analysis of democracy” as providing the “inspiration and foundation” for his theory of democracy. Downs stressed the idea that voters are rationally ignorant: they are uninformed because it simply doesn’t pay them to become informed. A close reading suggests that Downs was influenced by Schumpeter’s account of democracy as the competition for power (on which more below) not by Schumpeter’s account of the rationality of voters. On the matter of voter behavior, Schumpeter held not that voters are ill-informed rational agents but that they are flat-out irrational.

It is certainly true that Schumpeter sees the voter as rationally ignorant. In matters of national affairs, the voter "is a member of an unworkable committee, the committee of the whole nation, and this is why he expends less disciplined effort on mastering a political problem than he expends on a game of bridge" (p. 261). But the problem is more than just rational ignorance. For Schumpeter, the voter becomes less rational – less able to process the abundant information that is available and less able to make connections between means and ends.[5] "Thus the typical citizen drops down to a lower level of mental performance as soon as he enters the political field. He argues and analyzes in a way which he would readily recognize as infantile within the sphere of his real interests. He becomes a primitive again. His thinking becomes associative and affective" (p. 262). This is particularly significant read in the context of one of the main themes of *CSD*, the progressive rationalization brought about by bourgeois civilization. The bourgeois attention to the ordinary business of commercial life, and the feedback that focus generates, have made people generally more hard-headed, less associative and affective. But large-scale political processes have the opposite effect – they induce people to revert to what are in effect pre-modern magical and mystical accounts of social causation, including, of course, conspiracy theories.[6]

One implication of this "irrationality" is that voters become much more susceptible to concentrated special interests "with an ax to grind." Yet,

> even if there were no political groups trying to influence him, the typical citizen would in political matters tend to yield to extrarational or irrational prejudice and impulse. The weakness of the rational processes he applies to politics and the absence of effective logical

5 This claim is reminiscent of Herbert Simon's famous assertion that economic agents are "boundedly rational." It implies a strong definition in which an agent's rationality is judged against an objectively correct solution to a means-ends problem, and the agent's boundedness is a matter of poor cognitive processing power not just a matter of poor information. From the point of view of a weaker definition of rationality – that agents do the best they can with what they have and what they know – bounded rationality can look like optimal decision-making (Langlois 1990). At several points in the 1940 essay, Schumpeter points out that agents we might think irrational are actually behaving rationally when we correctly understand the means-ends problem they are facing. But he never goes all the way down the path of his Viennese classmate Ludwig von Mises (1949, pp. 19-22), who sees all action as rational by definition, since we can't presume to understand let alone judge the means-ends problem the agent is facing.

6 Karl Popper argued that conspiracy theories are a "secularization of a religious superstition. The belief in the Homeric gods whose conspiracies explain the history of the Trojan War is gone. The gods are abandoned. But their place is filled by powerful men or groups — sinister pressure groups whose wickedness is responsible for all the evils we suffer from — such as the Learned Elders of Zion, or the monopolists, or the capitalists, or the imperialists" (Popper 2020 [1945], p. 360).

> control over the results he arrives at would in themselves suffice to account for that. Moreover, simply because he is not "all there," he will relax his usual moral standards as well and occasionally give in to dark urges which the conditions of private life help him to repress. But as to the wisdom or rationality of his inferences and conclusions, it may be just as bad if he gives in to a burst of generous indignation. This will make it still more difficult for him to see things in their correct proportions or even to see more than one aspect of one thing at a time. Hence, if for once he does emerge from his usual vagueness and does display the definite will postulated by the classical doctrine of democracy, he is as likely as not to become still more unintelligent and irresponsible than he usually is. At certain junctures, this may prove fatal to his nation (p. 262).

Schumpeter is often accused of having been influenced by Nietzsche (Reinert and Reinert 2006), and this passage calls to mind another famous follower of Nietzsche – H. L. Mencken.[7]

It is this emphasis on the "irrationality" of the voting agent that explains the cold reception Schumpeter has typically received from the Virginia School of Public Choice, which stressed the economic rationality of agents in non-market situations (Mitchell 1984). But some recent authors have taken up a Schumpeterian line. Bryan Caplan (2007) considers voters to be irrational in the sense that they are driven by folk understandings of economics and thus systematically believe in, and vote for, polices that operate against their own economic interests (like protectionism and price controls). In a strikingly Schumpeterian book, Jason Brennan (2017) separates voters into two categories: hobbits, who tend their own gardens and are little interested in political matters, and hooligans, for whom political beliefs and political engagement are a major part of their identities.8 (Only a small fraction of voters are Vulcans, who think rationally and scientifically about political issues.) Hooligans consume political information, often voraciously, but always in a biased and self-reinforcing way without genuinely considering beliefs they don't agree with. Like

7 "When a candidate for public office faces the voters he does not face men of sense; he faces a mob of men whose chief distinguishing mark is the fact that they are quite incapable of weighing ideas, or even of comprehending any save the most elemental – men whose whole thinking is done in terms of emotion, and whose dominant emotion is dread of what they cannot understand" (Mencken 1920).

8 It is part of Schumpeter's thesis in *CSD* that bourgeois society tends to produce hobbits. "The bourgeois who is primarily absorbed in his private concerns is in general — as long as these concerns are not seriously threatened — much more likely to display tolerance of political differences and respect for opinions he does not share than any other type of human being. Moreover so long as bourgeois standards are dominant in a society this attitude will tend to spread to other classes as well" (p. 298).

Schumpeter, Brennan rejects the *volonté générale* view of democracy, as well as the view that democracy is a good in itself, holding that democracy should be appraised on its consequentialist merits. And he sees few such merits: democracy largely functions to empower the hooligans to impose their wills on others, including the poor hobbits.

Other writers have attempted to move the Schumpeterian insights back in the direction of rationality, perceiving a method in the madness of democracy. Geoffrey Brennan and Loren Lomasky (1993) argue that, precisely because one's vote doesn't matter for concrete outcomes, people vote for other reasons, notably to express themselves and to validate (or perhaps even help create) their identities. Downs (1957) had suggested that ideologies stand in for a complex array of beliefs about cause and effect and thus act as informational crutches for voters.[9] If we see those ideologies as consumption goods for hooligans rather than informational technologies for Vulcans, we move Public Choice much closer to Schumpeter.[10] In this reading, expressive voting behavior is perfectly rational, even if the collective effect of that rational behavior can be a proliferation of bad policy outcomes that ultimately lower the utility of the agents. Democracy is a tragedy of the commons. This is more than just a matter of terminology, since recasting Schumpeterian irrationality as the rational quest for expression and identity makes that behavior susceptible to economic analysis. If, for example, the spread of social media has lowered the cost, or maybe even raised the individual benefit, of identitarian expression, then we might predict that the fraction of hooligans in the population would rise or the intensity of their engagement would increase.

9 "Ideologies are the shared framework of mental models that groups of individuals possess that provide both an interpretation of the environment and a prescription as to how that environment should be structured" (Denzau and North 1994, p. 4).

10 "*For ideologies are not simply lies*; they are truthful statements about what a man thinks he sees. Just as the medieval knight saw himself as he wished to see himself and just as the modern bureaucrat does the same and just as both failed and fail to see whatever may be adduced against their seeing themselves as the defenders of the weak and innocent and the sponsors of the Common Good, so every other social group develops a protective ideology which is nothing if not sincere" (Schumpeter 1949, p. 349, emphasis original).

As George Akerlof and Rachel Kranton point out, the expression of identity gives rise to an oft-overlooked font of externality, and thus of conflict (Akerlof and Kranton 2000, p. 717). A strongly held identity can give meaning to the actions of others and thus evoke a negative response. In effect, strongly held identities can generate the kind of intangible externalities that Calabresi and Melamed (1972) called *moralisms*. If I see a sign on your lawn touting a political identity opposed to, or maybe even different from, my own, my utility declines (and perhaps my dander gets up).

Schumpeter doesn't "solve" the problem of irrationality in democracy so much as side-step it by proposing an alternative view of democracy. For Schumpeter, democracy is not any kind of aggregation of the wills of the voters. Democracy is rather a competitive process for choosing who will govern: "the role of the people is to produce a government, or else an intermediate body which in turn will produce a national executive or government. And we define: the democratic method is that institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote" (p. 269). Schumpeter believes this competitive process would operate much like competition among firms in a market. Rather than directly yielding the will of the people, it would give voice to voters indirectly by empowering political entrepreneurs to transform private desires into votes in much the same way that market entrepreneurs monetize popular desires in the economic sphere. "The principle of democracy then merely means that the reins of government should be handed to those who command more support than do any of the competing individuals or teams" (p. 273). As Schumpeter fully understands, such competition does not ensure good policy outcomes: there is no political Coase theorem (Acemoglu 2003). Yet Schumpeter is optimistic (perhaps unreasonably so) that political competition will weed out bad policies in the long run. At the very least, unlike alternatives like monarchy or dictatorship, democracy ultimately gives "the people" the ability to unseat rulers.

In a footnote (p. 269), Schumpeter suggests that by "executive" he means something like the executives of a business corporation. This is an angle worth pursuing. Henry Hansmann (1996) has suggested that organizations of many types can be understood as cooperatives, that is, as owned by one particular set of what he calls patrons, who own by virtue of holding the residual rights to income and, more importantly, the residual rights of control. This includes the ordinary business corporation, which is a capitalists cooperative. It is owned by shareholders who provide capital.[11] Those shareholders are often numerous and face a problem of rational ignorance akin to that of voters. Indeed, I suggest that we should follow Hansmann (2014) in seeing democratic states as cooperatives of citizens: in effect, democracy means that the state is owned by the voters, who hold residual rights of control, even if their residual income rights are usually negative—they pay taxes.[12] As Schumpeter suggests, political entrepreneurs can arise to vie for control of the parliament much like activist investors in a corporation vie for control of the board of directors. Of course, citizens cannot vote with their feet as cheaply as shareholders, nor can they sell their residual control (voting) rights. These features of the citizens cooperative are what makes the problem of (rational) ignorance and expressive voting far more significant in the case of political democracy.[13]

11 This is because, of all the patrons, the suppliers of capital typically face the highest agency costs. It is a problem so large that, most of the time, the costs it generates outweigh the obvious costs of having to monitor managers, including the costs of collective action among diffuse stockholders. "Ownership of the firm by contributors of capital … largely removes this problem by putting the contributors of capital on both sides of the transaction, in the form of equity investors (i. e., shareholders) who are both lenders to, and owners of, the firm" (Hansmann 2014, p. 3).

12 At the same time, of course, even democratic states hold a monopoly in the use of force over a geographic territory, thus also making them states in the famous sense of Max Weber. Few if any modern democracies are purely associational governments like, say, the free cities of Europe in the Middle Ages.

13 Even shareholders occasionally vote expressively, favoring "green" firms, for example. More often, though, people seek expression in the shareholder space by attempting to persuade other stockholders (notably universities and other institutions) to invest expressively on their behalf.

It is apparently conventional to refer to Schumpeter's theory of democracy as "elitist," though all this seems to mean is that it is anti-populist (Piano 2019), with the implication that anyone who isn't a populist – who doesn't define democracy as the will of the people – is somehow an elitist. Schumpeter is certainly an anti-populist, in the sense that he understands and fears the tyranny of the majority.[14] He brandishes many cases in which elites and elite institutions sheltered minorities – like the Jews of Medieval Europe, protected by the nobility but persecuted by the masses (p. 242) – or even in which the majority itself benefited from policies imposed by an elite that would never have been approved democratically – like Napoleon's many reforms (p. 256). This is certainly a kind of elitism, but it is elitism as a constraint on democracy not as a theory of democracy.

Recall Schumpeter's peculiar reading of the eighteenth century theory of democracy. Rousseau and Bentham did hold something like the *volonté générale* view he attacks, which is very much a populist conception. By stark contrast, the American Founders, along with the thinkers of the Scottish Enlightenment who influenced them, believed no such thing. They very clearly believed the opposite. In *Federalist 10*, Madison (1961 [1787]) famously catalogued populist majorities as dangerous "faction," and he saw the solution in constitutional restraints – effectively removing some decisions entirely from democratic choice – along with checks-and-balances and other institutional impediments to democratic power.[15] Schumpeter seems strikingly ignorant of this tradition (Wright 1951), another factor that distances him from the Virginia School of Public Choice. But for Schumpeter, the autocratic institutions of the old order – what as a young man he called Tory democracy (Medearis 2001) – serve much the same purpose. Notice the

14 "In particular it is not true that democracy will always safeguard freedom of conscience better than autocracy. Witness the most famous of all trials. Pilate was from the standpoint of the Jews, certainly the representative of autocracy. Yet he tried to protect freedom. And he yielded to a democracy" (p. 243, n. 9).

15 Another neo-Schumpeterian critic of democratic voting, Ilya Somin (2016), argues that the solution to the problem of voter ignorance and irrationality is to shrink the size of government.

continuity with his account of the march into socialism: just as the destruction of protective institutions inherited from the past would leave capitalism defenseless, without inherited (and seemingly obsolete) political institutions, democracy would collapse into irrational populism.

Although Schumpeter does not take a liberal constitutional approach to constraining democracy, he does insist that one of the conditions "for the success of democracy is that the effective range of political decisions should not be extended too far" (p. 291). What he has in mind are government bureaucracies or quasi-governmental corporations. He mentions the (now abolished and unlamented) Interstate Commerce Commission and the Bank of England (technically private before 1914). Delegating decision making to such entities is a way for a parliament to "impose limits on itself" (p. 292). Here again we see the connection with Schumpeter's earlier embrace of expert bureaucracy. Delegating decision-making to apolitical technocrats sidesteps the problems of voter irrationality. Since the inevitable future socialist society will operate on precisely such principles of bureaucratic technocracy, the answer is clear: socialism in and of itself is not incompatible with democracy as Schumpeter defines it. On the other hand, of course, "as a matter of practical necessity, socialist democracy may eventually turn out to be more of a sham than capitalist democracy ever was. In any case, that democracy will not mean increased personal freedom. And, once more, it will mean no closer approximation to the ideals enshrined in the classical doctrine" (p. 302).

One important post-war ideology held that, for asserted epistemic reasons akin to those Schumpeter had adduced in his account of the march into socialism, technocratic bureaucracy had made ideology obsolete (Bell 1960). As many have since argued, the fall of the Soviet Union led to the demise of those widely shared ideologies – ideologies that had helped to unify voters – including the end-of-ideology ideology. This has led to a fractionation of cognitive frames into a multiplicity of identities, many coalescing around personal identities, both inherited and newly created (Egidi 2023; Fukuyama 2018). And the post-war faith in technocratic bureaucracies has vanished, replaced by suspicion and resentment.

It is always tempting to wonder what a figure from the past would think if suddenly brought forward into our own world. Schumpeter would of course be surprised – or at least bemused – by the successes of entrepreneurial capitalism and the failures of socialism. I wonder if he would be surprised that today's expressive – irrational – voters are widely rebelling against the technocratic bureaucracies in which he had seemingly invested so much trust. One widely cited source defines populism as "a thin-centered ideology that considers society to be ultimately separated into two homogenous and antagonistic camps, 'the pure people' versus 'the corrupt elite,' and which argues that politics should be an expression of the *volunté générale* (general will) of the people" (Mudde and Rovira Kaltwasser 2017, p. 6). Whereas once the corrupt elite were thought to be the aristocrats of the old order with whom Schumpeter himself identified, the hated elite today are importantly the very technocrats – "globalists" and "neoliberals" all – whom Schumpeter had seen (perhaps with a wink or a shrug) as the antidote to populism.

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