

CAPITALISM, SOCIALISM AND DEMOCRACY 80 YEARS LATER

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“Versuchsstation des Weltuntergangs”: Viennese Origins of the Debate on Capitalist Decline in Schumpeter, Polanyi, and Hayek*

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1. Introduction

This paper addresses the Viennese intellectual origins of the debate on the decline of contemporary capitalism in the key works of Joseph A. Schumpeter (1883-1950), Karl Polanyi (1886-1964), and Friedrich A. von Hayek (1899-1992). Schumpeter, Polanyi and Hayek have each provided major impulses to the theory of capitalist development, which remain of utmost relevance for current discourses on this subject. Their work is characterized by a common interest in the institutional conditions and long-run perspectives of modern capitalism. Also, they have been decidedly concerned with the advent of socialism and its inherent tendencies of bureaucratisation and authoritarianism. Curiously, all of them spent their formative years as economists in the intellectual context of Vienna’s prolonged *fin de siècle* in between the turn of the century and the interwar era. Related to this issue, the relationship between capitalism, socialism, and democracy proved to be a leitmotif in their thinking that would also inform their major works that were published in the mid-1940s, at the height of World War II: Schumpeter’s “Capitalism, Socialism, and Democracy” (1942), Polanyi’s “Great Transformation” (1944), and Hayek’s “Road to Serfdom” (1944).

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In fact, in view of these major works, their contributions stand for specific paradigmatic visions that were informed by the contemporary crisis of classical political and economic liberalism, pragmatically approximated in terms of Schumpeterian conservatism, Polanyian social democratic institutionalism, and Hayekian liberalism.

In discussing these topics, the paper proceeds as follows. First, the Viennese intellectual setting of the early 20th Century, and especially the phase after World War I, is taken to the fore with a focus on the prevalent cultural scepticism concerning economic and political issues that discuss capitalism, socialism, and democracy. The paper places Schumpeter, Polanyi and Hayek biographically in this specific intellectual milieu of Post World War I Vienna and follows their intellectual trajectories up to the Anglo-American setting of the early 1940s. Second, it discusses the conceptualization of the precarious relationship between capitalism, socialism, and democracy in the works of Schumpeter, Polanyi and Hayek with an emphasis on Schumpeter's "Capitalism, Socialism and Democracy" as compared with Polanyi's "Great Transformation" and Hayek's "Road to Serfdom". The focus of exposition is on the matter of bourgeois cultural demise and the rise of authoritarianism as outlined by Schumpeter, Polanyi and Hayek respectively. Third, in reconstructing Schumpeter, Polanyi and Hayek as exponents of a contemporary Viennese *Zeitgeist*, the paper highlights the relevance of their particular ideas for current debates on the future of capitalism, socialism, and democracy – as denoted by the challenges of economic instability, political authoritarianism, and social inequality.

2. Out of Vienna: Localizing the Intellectual Origins of Schumpeter, Polanyi and Hayek

In exploring commonalities and specificities in the basic analytical questions shared in Schumpeter's "Capitalism, Socialism, and Democracy" (1942), Polanyi's "Great Transformation" (1944), and Hayek's "Road to Serfdom" (1944), one might highlight their

intellectual biography. Indeed, Schumpeter, Polanyi and Hayek originated from the former Austro-Hungarian Empire. All of them experienced their academic education under the critical influence of the Viennese School of economics, they were exposed to the contemporary ideological challenges of Marxism, and they witnessed the political dissolution of the Empire after World War I. All of them went on to seek academic positions in the United States, by doing so bridging the intellectual worlds of European traditionalism and American modernity (Swedberg 1991; Dale 2016; Caldwell and Klausinger 2022). Thus, they shared a certain kind of cultural scepticism reflecting the idea that the economic dynamism of the market system may be confronted by endogenously caused social, cultural and political hindrances that would come to endanger its existence, potentially replacing it with an authoritarian setting of both political and economic affairs that would inevitably endanger individual liberty. In basic terms, this cultural scepticism was characteristic of the Viennese intellectual milieu of the late Austro-Hungarian Empire, resonating with a contemporary *Zeitgeist* of the Austrian epoch of early modernity that has informed the labelling of Vienna between the turn of the century and World War I as “*Versuchsstation des Weltuntergangs*“ – roughly translated “laboratory of world demise” – by Viennese satirical writer Karl Kraus. This term was meant to address a certain mindset that would view the long-run perspective of cultural decomposition and demise as an inevitable outcome of modern affairs (Kraus 1914).

The transdisciplinary discourse on the contemporary crisis of bourgeois civilisation had become a key motive of the Viennese intellectual atmosphere already since the late 19th century, persisting over the turn of the centuries, only to maintain its position as a dominant perspective with the demise of the Habsburg Empire and the ruptures in the making of the democratic republic during the 1920s (Cockett 1923). In academic and related intellectual efforts, various interpersonal networks and “circles”, the so-called *Kreise*, were constitutive for the exchange of ideas among the leading intellectuals in pre-war as well as interwar Vienna, covering a comprehensive range of academic disciplines and topics involving economic affairs. Most distinctly focussed on economic issues was the network around Ludwig von Mises, organized as an essentially private continuation of Böhm-Bawerk’s original seminar with its advanced theoretical debates. The underlying debates would include Schumpeter, Hayek, and Polanyi, all of whom were concerned with the dynamics and crisis of liberal civilization, the prospects of socialism, and the course of the relationship between democracy and economic affairs in market society (Dekker 2016).

Indeed, these Viennese debates that culminated in the socialist calculation debate between Neurath, Mises and others soon after World War I provided an intellectual home for both liberal theorists of the market economy and their not-so liberal counterparts from all strands of the political spectrum. Hayek would later on join Mises in refuting socialist efforts as “social engineering”, that is, the science-based political construction and implementation of social institutions. Schumpeter held a kind of intermediate position in arguing that socialism would require overcoming resource scarcity – thus markets, private property, and private sector entrepreneurship would maintain their socially beneficial functions for the time being, most suitably framed by liberal democracy. Polanyi with his beliefs in the socialist reformism of the local government of “Red Vienna” suggested that a socialist economy might require market elements with prices set according to social valuation – while the available sketches of bureaucratic centralist planning remained anathema to him. However, the soon to be besieged camps of liberalism and socialism would come to face a common adversary in romanticist nationalism that heralded the political advent of Austro-fascism. Still, the increasingly fatalist atmosphere of interwar Vienna would give way to a dedicated debate about the future course of market capitalism and liberal democracy briefly before, during and after World War II, following the Western migration of Viennese scholars such as Schumpeter, Hayek, and Polanyi to the United Kingdom and the United States respectively.

3. Schumpeter, Hayek, Polanyi and the Crisis of Capitalism and Democracy

When it comes to Schumpeter, Polanyi, and Hayek, this specific kind of mindset concerning the polycrisis of capitalism and democracy can be traced in their distinct approaches to the projected decline of capitalist civilization. Indeed, in their diagnoses of the perspectives of capitalism in the early 1940s, the allocative workability of the market mechanism as such was basically confirmed. Instead, it was the incursions of interventionist policies and regulations that were viewed as incompatible with the market system, thus leading to an ever more pressing mismatch between market economy and a democratic polity striving for socialist

transformation. The looming crisis of liberalism, which was a leitmotif in the assessments of Schumpeter, Polanyi, and Hayek alike, would be paralleled by the rise of authoritarian forces and solutions (Ebner 2015a). Crucially, this viewpoint was paralleled by lamenting the encompassing decomposition of the cultural setting. Schumpeter's conservatism informed a distanced sarcasm on this issue, which is most prominent in his *opus magnum* "Capitalism, Socialism and Democracy" where the demise of the values and structures of bourgeois civilization is a prominent motive (Schumpeter 1942). In this publication, Schumpeter actually reiterated his earlier concern with the advent of socialism under the guise of democratic mass appeal, paralleling the ideological, social, institutional and cultural decline of private sector entrepreneurship, which was already endangered by the bureaucratic organisations of monopolistic capitalism (Ebner 2006).

Polanyi's social democratic views shaped the moral indignation and despair that fuelled the reasoning on the coincidence of the crisis of liberalism, endemic societal uncertainty, and the endangerment of liberty in his "Great Transformation" (Polanyi 1944). Crucially, in this perspective on the crisis of market economy and liberal democracy, Polanyi's monograph "The Great Transformation" from 1944 reiterated his journalistic works during the 1920s and 1930s, which prepared the ground for his subsequent analysis of the downfall of liberal democracy due to the authoritarian promises of a reintegration of economy and polity. This authoritarian dimension of political efforts at re-embedding the economy into the regulations of social and political institutions reflected contemporary commonalities in both communist and fascist critiques of the market system that went astray of Polanyi's own beliefs in a democratized social economy (Ebner 2011). Moreover, while Polanyi shared Schumpeter's concern with the bureaucratic decomposition of economy and polity, he differed from Schumpeter's conservative positions by emphasizing Marxian concerns with private property of the means of production as a somewhat dysfunctional relict of the competitive market system that would have to be overcome in the context of an extended division of labour, which might require a stronger element of social regulation and political democratization (Ebner 2015a).

Also, Hayek's liberal alarmism addressed most prominently the collectivist onslaught on individual liberty, as outlined in his "Road to Serfdom", published in the same contemporary context as Schumpeter's "Capitalism, Socialism, and Democracy" as well as Polanyi's "Great Transformation" (Hayek 1944). Hayek's reasoning was meant to exercise polemical influence on contemporary British concerns with the Beveridge Plan and the formation of a welfare state, which proceeded while the war efforts against the axis powers further intensified. Hayek joined the debate on the crisis market system and democratic polity by emphasizing that the ongoing war effort had promoted ideas of economic planning while the forthcoming welfare state would be meant to further related ideas of social planning and political programming. In this way, Hayek differed from Schumpeter's reasoning on the feasibility of the bureaucratic abominations of the forthcoming socialist system, which might include consumer markets in a statist planning context paralleled by political authoritarianism and an entrepreneurial function exercised by the state. To Hayek, who did not share Schumpeter's Walrasian perspectives on the state as auctioneer in communicating scarcities in the price system, such a system would not be viable at all. Instead, it might lead to a fully bureaucratized dictatorial dystopia. Of course, Polanyi's ideas on social welfare and economic democracy as safeguards against bureaucratic degeneration, which were not mentioned by Hayek at all, also belonged to the domain of ideas that would unintendedly prepare the ground for an authoritarian future. Instead, Hayek insisted on the spontaneous and decentralised character of cultural evolution as means to overcome deficits in the contemporary political economies (Ebner 2015b).

4. Addressing the Polycrisis: Schumpeterian Perspectives in Polanyian and Hayekian Light

Basically, one may argue that the lines of reasoning expressed by Schumpeter, Polanyi and Hayek during the height of World War II in the early 1940s reiterated the previous motives of the persistent demise of the bourgeois age that were coined in the intellectual context of the *Versuchsstation des Weltuntergangs* of Post-World War I Vienna. The ingredients of this *Zeitgeist* cocktail combined the crisis of political and economic liberalism with the fear of a pending socialist revolution, altogether highlighted the question of capitalist survival in the face of radical transformative forces. This Viennese scenario would return with a vengeance

in the context of World War II. Again, the future of capitalist order and bourgeois civilisation as well as the contested relationship between market economy and democratic polity weresubjects of a fierce debate that seemed to project Viennese intellectual constellations widely into Western academic and political circles. In fact, one might conclude, the very same concerns seem to persist even nowadays in the global age of anti-liberalism and post-democracy – as outlined in recent research on the Viennese intellectual milieu during the 1920s and its impulses for economic, social, and political ideas throughout the 20th century. In this way, it is fair to argue that Schumpeterian conservatism, Polanyian socialism, and Hayekian liberalism, which had been originally marked by Viennese debates on the prospects of capitalism and socialism under democratic auspices, not only shaped their major works on this subject during the 1940s, but went on to inform ideological discourses that still linger on to the present day.

Even in outlining the differences between their approaches, one may account for complementary orientations. Schumpeter's original approach at theorizing on economic development highlighted the historically specific role of entrepreneurship, credit, and innovation in driving economic development. According to his sociological blend of reasoning on these affairs, the economic process would breed an institutional and cultural decomposition of modern capitalism based on the monopolization and bureaucratization of economy and society. Democracy would prove to be incompatible with the advent of socialism due to the bureaucratic character of a socialist economy and polity. All these ideas were readily available after World War I, when Schumpeter discussed them in more detail, and they were reiterated in the writing of "Capitalism, Socialism, and Democracy" about a quarter of a century later. Crucially, he underlined the incompatibility of democracy and socialism due to the inherently authoritarian character of central economic planning.

Socialism would be economically feasible, but not in a democratic format. In terms of current debates on grand societal challenges, this viewpoint can be interpreted as a caveat in view of a socio-ecological transformative greed that does not account for the societal problems with monopolistic and bureaucratic power structures. To Schumpeter, the remnants of private sector entrepreneurship hold the keys to economic renewal under the condition of individual freedom – a constellation that would be at odds with the regulative intrusions of the democratic polity into the economic sphere.

Polanyi's work shared these concerns from a normatively different angle, as it contributed to

the groundwork of institutionalist reasoning on the relationship between market, state, and social community. Its key concern addressed the historically ubiquitous embeddedness of market-based exchange in non-market institutions of community-based reciprocity and state-based redistribution as means of societal stabilisation to prevent market-driven uncertainty. However, Polanyi's Christian socialist reformism knew centralised state bureaucracies might hinder participatory democratic approaches in grassroots organizations. That is why his envisaged recombination of polity and economy should allow for local democratic structures in the setting of a mixed economy. Applied to current concerns with the polycrisis of capitalism and democracy, the Polanyian perspective would parallel Schumpeter's critical concern with bureaucratic authoritarianism. Hayek's liberalism then put a focus on rule-based market competition as an institutional mechanism of the decentralized coordination of subjective knowledge. An interventionist state would hinder the functioning of the market system and thus threaten the liberal order. In this way, authoritarian socialism would have to contradict classical democratic ideals of individual self-determination to the benefit of a rampant collectivism. Hayek explicitly contradicted both Schumpeter's view on the feasibility of bureaucratic socialism, and implicitly also Polanyi's belief in democratic socialism did not find his approval. Nonetheless, he would have joined their criticism of the bureaucratization and monopolization of economy and society, and he would have shared their position that liberal democracy cannot flourish under authoritarian conditions.

5. Conclusion

In concluding, this paper pointed out that the Viennese intellectual setting of the early 20th Century, and especially after World War I stood for skepticism concerning the stabilization of capitalism and the combination of socialism and democracy. Schumpeter, Polanyi and Hayek were biographically positioned in this Viennese intellectual milieu that would shape their intellectual trajectories up to their Anglo-American settings in the early 1940s. The argument held that this context was largely responsible for their modes of conceptualizing the precarious relationship between capitalism, socialism, and democracy as prevalent in Schumpeter's "Capitalism, Socialism and Democracy", Polanyi's "Great Transformation" and Hayek's "Road to Serfdom". In this way, Schumpeter, Polanyi and Hayek were assessed as exponents of the Viennese "*Versuchsstation des Weltuntergangs*", that is, an intellectual laboratory that explored the potential demise of bourgeois capitalist civilization with all of its

liberal ingredients. This perspective was most pressing during the height of World War II, and it has come back to haunt us during the current polycrisis of capitalism and democracy, which are both challenged by populism and authoritarianism on a global scale. In this way, the paper has pinpointed the persistent relevance of Schumpeter, Polanyi and Hayek for current debates on the future of capitalism, socialism, and democracy – as denoted by the challenges of economic instability, political authoritarianism, and social fragmentation.

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