



**CAPITALISM, SOCIALISM AND DEMOCRACY
80 YEARS LATER**

*Looking at capitalism today in light of its past and
possible future*

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**When words matter. An analysis of capitalist cultural paradigm in the light of
Schumpeter's predictions**

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“There is nothing more difficult to plan, more doubtful of success, nor more dangerous to manage than the creation of a new system. For the initiator has the enmity of all who would profit by the preservation of the old system, and merely lukewarm defenders in those who should gain by the new one”

Il Principe (1513), Niccolò Machiavelli

The notions of economic growth is debated constantly in the economic literature. The limits of this concept are generally recognised and there is a regular attempt to articulate a more extensive definition of development. Nevertheless, the mainstream economic thought still confine the definitions of growth within its economic meaning, neglecting the intrinsic complexity of this concept. Therefore, using an interdisciplinary approach and the conceptual framework of the institutional economics, this paper proposes to change the expression “economic growth” with “progress”. Words matter, as they convey a precise worldview and the idea that the accumulation of material wealth is a priority for human beings.

Valuable efforts have been made to overcome the statistical limits of the GDP growth rate, but hardly its conceptual meaning is discussed. The real revolution is putting human wellbeing at the centre of any decision-making process at any level (individual, political and economic) in order to guarantee social rights.

1. PROGRESS VS. ECONOMIC GROWTH

The notion of economic growth – as traditionally defined – is conceptually misleading. It contributes to create a cultural framework according to which GDP is the primary, absolute goal. Joseph Schumpeter’s book, *Capitalism, Socialism and Democracy* (2003) carries out a deep analysis of the way the capitalist system functions, forecasting its disappearance not as a result of its *dysfunction*, but its *achievements*. Schumpeter focuses chiefly on the technical economic characteristics of capitalism and foresees a transformation actually occurred, that is the evolution of the “entrepreneurial capitalism” into “finance capitalism”. In particular, the part II of the Schumpeter’s book, *Can capitalism survive?*, provides some interesting insights to our analysis. Along this line, Shumpeter (2003) argues that: *Whatever else our index [GDP] may do or may not doIt does not take account of the commodity, Voluntary Leisure. New commodities escape or are inadequately represented by an index which must rest largely on basic commodities and intermediate products (p. 66)*. Moreover, he stated that: *... this measure [GDP] would still fail to convey an adequate idea of what it means for the dignity or intensity or pleasantness of human life—for all that the economists of an earlier generation subsumed under the heading of Satisfaction of Wants. And this, after all, is for us the relevant consideration, the true “output” of capitalist production, the reason why we are interested in the index of production and the pounds and gallons that enter into it and would hardly be worthwhile in themselves (p. 66-67)*. Empirical analysis has investigated deeply on the determinants of economic growth (physical capital, human capital, new technologies, R&D and so on). Nevertheless, the open issue is that countries with similar economic characteristics grow more rapidly than others do¹. Probably,

¹Some empirical studies show that human capital may be the cause of different levels of economic growth (Drazen and Azariadis, 1990).

reforms aimed at improving economic growth may fail in the absence of an adequate institutional context (Rodrik, 1999)². Beyond the discussion on the determinants of growth, some researchers criticise the validity of the GDP growth rate as an indicator of wellbeing (Layard, 2005). The GDP growth rate, actually, is not the only parameter measuring the development of a country³, as actually it measures the growth of commodities and services. Simon Kuznets (1934), the creator of GDP, underlined in his report to the US Congress that: ... *the welfare of a nation (could) scarcely be inferred from a measure of national income*. Indeed, the GDP growth rate encompasses also negative economic activities such as, for example, the production of cigarettes, or highly polluting activities. Therefore, even from a strictly material point of view, GDP fails to measure the genuine welfare of people. Against this background, several researchers have proposed alternative measures, which try:

- To separate the positive from the negative components of economic activity, like for example pollution⁴;
- To add non-market goods and services, like, for example, child and elderly care;
- To adjust for the income distribution effects⁵.

The above-mentioned valuable efforts aim to overcome the statistical limits of the GDP growth rate but do not question its conceptual meaning, while hereafter we will tackle a theoretical and conceptual debate. The idea of progress is not only related to economic growth, but involves many variables, including knowledge and institutions: “(...) *While there is evidently a strong relationship, since economic growth is an important means to human development, human outcomes do not depend on economic growth and levels of national income alone. They also depend on how these resources are used – whether for developing weapons or producing food, building palaces or providing clean water. And human outcomes such as democratic participation in decision-making or equal rights for men and women do not depend on incomes*”... (Human Development Report 2004, p.153 – Italian version). In the 1990s, under the influential thought of Amartya Sen, the Human Development Index was built combining the normalized measures of life expectancy, literacy, educational attainment, and per capita GDP for countries worldwide. The U.N.D.P.⁶ utilises this index for measuring the degree of development of each country. Although it is an indicator more useful and comprehensive than GDP growth rate, it includes only at a specific set of variables involved in the development process: incomes, education, and health. Instead, in a broader sense and using an interdisciplinary approach, we focus on a comprehensive idea of progress. The term progress entails here the economic, social, and cultural evolution of a country, in other words the path human beings follow towards freedom. Since the earliest times, humanity has been fighting to free themselves from poverty, scarcity of resources, disease, abuse of power by a group, environmental disaster. Freedom in all

²Rodrik (1999) gives a number of examples to show that institutions matter: the failure of the Russian transition to a liberal system; the Asian crisis due to financial liberalization without financial regulation; the structural reforms in Latin American without a welfare system.

³See for example Fitoussi et al., 2008.

⁴It would be better to include, in the calculation of GDP, social costs and benefits in addition to private ones. For example, the Genuine Progress Indicator includes positive and negative elements of economic growth. For further details, see OECD (2006).

⁵These include the Measure of Economic Welfare (Nordhaus and Tobin, 1972), the Index of Sustainable Economic Welfare (Daly and Cobb, 1989), Redefining Progress' more recent variation of ISEW, the Genuine Progress Indicator (Anielski and Rowe, 1999) and another variation of ISEW, the Sustainable Net Benefit Index (Lawn and Sanders 1999). 16 In order to build effective institutions, actually, the most important resource is “local knowledge” (Rodrik, 1999).

⁶The UNDP is the United Nations' lead agency on international development, helping countries achieve the Sustainable Development Goals.

its dimensions is both “*the primary end and the principal means of development*” (Sen, A., 1999, p. 36). The theory of human development states that three closely intertwined components characterise human development or the progress of societies: socioeconomic development, emancipative cultural value change and democratisation, which contribute to determine the freedom of choice. The most fundamental question is: “*What is the common denominator underlying socioeconomic development, emancipative value change and effective democracy?*” (Inglehart, Welzel, Klingemann, 2003, p. 344)⁷.

This paper aims at giving a contribution in this direction, following the Institutional Economics literature. According to Dewey (1916, p. 3-4): *Society exists through a process of transmission quite as much as biological life. This transmission occurs by means of communication of habits of doing, thinking, and feeling from the older to the younger. Without this communication of ideals, hopes, expectations, standards, opinions, from those members of society who are passing out of the group life to those who are coming into it, social life could not survive. If the members who compose a society lived on continuously, they might educate the newborn members, but it would be a task directed by personal interest rather than social need. Now it is a work of necessity* Similarly, the transmission of habits and information comes not merely from the individual’s natural parents but from an indefinite number of “*ancestors*” (Hayek, 1988). From an historical point of view, institutions act in response to the environment and progressive forces determine the change of general rules, imposing new rules. Probably, progressive forces arise from two elements: the natural attitude of human beings to free themselves⁸ and understand life’s meaning and phenomena. Utilitarianism and teleology are not useful to explain progress. For what purpose, Galileo Galilei would have affirmed a new scientific principle and gone to prison for that? In our view, progressive forces are more than the Ayres technological change⁹, without denying the importance of scientific advancements. We consider progressive forces a comprehensive notion coming from institutional economics. In other words, they entail Veblen’s dichotomy between instinct and rational behaviour (historically, scientific progress has been much more the result of human instinct to solve a problem than a rational behaviour); Ayres’ dichotomy between science and ceremony; Dewey’s focus on the importance of freedom and culture for a truly democratic society. All these authors give an important contribution to the foundation of an alternative theory of Progress. As far as socio-economic studies are concerned, we should concentrate mainly on how the environment (institutions) fosters and encourages social evolution. Institutions change thanks to progressive forces¹⁰ and the transmitted knowledge is the source of progressive forces. Institutional transformations come from a dialectic process among progressive forces and ceremonial attitudes¹¹. Transformations may derive from formal (law) or informal changes (values). On the other hand, institutions may survive even if they are inefficient, if the structure of incentive is favourable to them. The rules established for reaching a desired level of development are highly specific to local conditions; this is empirically proved for a number of countries (Rodrik, 1999). Following this reasoning, a proxy for the progress of a society may be the capability of triggering institutional change aimed at freeing people from the “chains” of daily life: starvation, illness, family yoke, political

⁷It is important to differentiate effective democracy from formal democracy. In the first case, you have a concrete chance to exercise your rights (Dewey J., 1989).

⁸The attitude of human beings embodying progressive forces to free themselves generates somehow a struggle against the surrounding environment for survival.

⁹Ayres stated that “deceremonialization, deinstitutionalization, and ‘institutional decomposition’ can occur only if there are advances in science and technology that are so rapid and pervasive that more and more people become increasingly occupied, in thinking and doing, in activities that are devoid of ceremonial and mythological contents.” (Quoted in Asso, Fiorito, 2003, op. cit.).

¹⁰See paragraph 1, Ayres (1962).

¹¹Dewey (1916), Life is a self-renewing process through action upon the environment.

dictatorship, corruption, violence, and rent-seeking. As societies develop over time, the rule system should be modified accordingly. If this adjustment does not occur, the development process may be delayed (or even cancelled). Institutional rigidity paved the way for persistent poverty (Kasper, W., 1997). For example, historians, economists, and sociologists have underlined how institutions made possible the beginning and the consolidation of the Industrial Revolution in Europe (Kasper, 2002). The role of economic growth in preventing starvation is undeniable, but economic growth alone cannot guarantee the idea of progress we are supporting. Progress (meant as social progress) is linked in particular to the guarantee of equal opportunities, to the level of democracy, and to the possibility for progressive forces to produce a positive change. A number of elements guarantee “equal opportunities” as well as the possibility for progressive forces to produce the change: employment policies, tax system, distribution choices, welfare state, lifelong learning, the quality of educational system, and the system of communication of knowledge. Moreover, negative institutional characteristics delaying progress are to be taken into account as well: corruption, absence of meritocracy, social immobility, red tape, rent seeking, and all those behaviours obstructing the creation of a free cultural environment¹². Finally, a democratic system is the basic requirement for equal opportunities and progressive forces to rise and grow. Better institutions are likely to be found where executive, legislative, and judicial powers are independent, can control and sanction each other, and party interests do not prevent politicians from pursuing collective purposes (Straub, 2000). Democracy is also the output of a country’s historical and cultural path. The way which people reach it by and its duration influence the level and the kind of democracy. It seems interesting to conclude with the following Dewey’s (1916 p. 99) statement: *... an undesirable society, in other words, is one, which internally and externally sets up barriers to free intercourse and communication of experience. A society which makes provision for participation in its good of all its members on equal terms and which secures flexible readjustment of its institutions through interaction of the different forms of associated life is in so far democratic. Such a society must have a type of education, which gives individuals a personal interest in social relationships and control, and the habits of mind, which secure social changes without introducing disorder.* In the next paragraph, we are going to discuss why the capability of institutional context to adapt and let progressive forces operate is a sign of progress¹³.

3. “Form is substance”: the power of language

What triggers positive institutional changes¹⁴, are they the result of exogenous variables (shocks) or path-dependent (North, 1990)¹⁵? It is not easy to answer this question, a vast literature deals with this issue. However, simply looking at the behaviour of human beings, we may agree on the fact that the structure of incentives provided by the institutional context conditions the agents’ choices and then determines the path of change.

Joseph Schumpeter (2003) warns that *capitalist enterprise, by its very achievements, tends to automatize progress* (p. 134). He states that: *On the other hand, personality and will power must count for less in environments which have become accustomed to economic change—best instanced by an incessant stream of new consumers’ and producers’ goods— and which, instead of resisting, accept it as*

¹²To this respect, also religion plays an important role. Historically, new scientific discoveries have met the opposition of religious institutions. An example for all is Galileo Galilei.

¹³It would be better to improve national accounting too, in order to reduce the statistical limits of GDP.

¹⁴It seems worthwhile to give a definition of “institution” before going on with the discussion. An institution may be formal and informal. Informal institutions, in a given society, are a range of social rules, conventions, moral values, traditions, religious beliefs, and other behavioural rules that have been transferred from generation to generation over time and have survived. If all the members of a society share them, they affect their behaviour (Knight, 1992). Formal institutions are the law, including the constitution, rules and organizations.

¹⁵External change, learning and skills are the most cited causes of institutional change.

a matter of course. The resistance which comes from interests threatened by an innovation in the productive process is not likely to die out as long as the capitalist order persists. It is, for instance, the great obstacle on the road toward mass production of cheap housing which presupposes radical mechanization and wholesale elimination of inefficient methods of work on the plot. But every other kind of resistance—the resistance, in particular, of consumers and producers to a new kind of thing because it is new—has well-nigh vanished already. Thus, economic progress tends to become depersonalized and automatized. Bureau and committee work tends to replace individual action. Once more, reference to the military analogy will help to bring out the essential point (p. 132-133)

This behaviour contribute to delineate the cultural framework of the capitalist society. Two approaches emerge when considering the behaviour of the decision makers, based on the idea of their full rationality or bounded rationality. Traditional economic literature builds its models assuming that individuals carry out a rational conduct aimed at reaching the maximum utility under the constraint of the available resources. Instead of debating if the agents' behaviour is rational or not we may reformulate this paradigm taking into account that institutionalised people act according to the rules of the environment where they live to survive or to gain an advantage at the best. Decision makers implement a very complex decision process entailing many variables. This process is a function of institutions, which are the rules of the game¹⁶:

$D_n = f(I, O_n)$ Where “D” are the decisions put into action by n individuals, “I” are institutions as defined previously, and “O” synthesises personal characteristics of the “n” decision makers¹⁷. We have n functions of decision (D), the form of which depends upon the kind of decision implemented.

The decision process may give rise to progressive (positive change) or ceremonial decisions (stagnation). Progressive decisions determine positive institutional changes, in other words changes that increase the wellbeing of people. Implementing surveys to investigate what are the determinants of wellbeing in people opinion, we may define progressive decisions as those pursuing wellbeing even if a change is necessary. To encourage progressive decisions, policy makers should provide the right structure of incentives¹⁸. The sum of decisions shapes a society and the “recursive causality” determines that “D” and “I” influence each other. Empirically, we need to specify progressive decisions, analysing the best practices on the various fields: politics, economics, social, and cultural advancements¹⁹. A positive Institutional change, aiming at increasing the wellbeing of people, is a clear sign of progress. A society is more advanced than another is if institutions allow people (individuals and policy makers) to take progressive decisions and pursuing their wellbeing.

Against this background, the institutional context determines the structure of incentives, and then it becomes the paradigm of the decision-making process. Therefore, being the actual institutional context governed by the chasing of economic growth (instead of wellbeing), the economic growth objective moulds any decision process. Even policy-making related to the social and personal sphere of people takes into account economic growth, not only the economic theory but also the entire cultural framework is built in accordance with the goal of “economic growth”. The decision process is biased towards it, losing the track of other important goals for well-being. Economic growth is the ultimate goal of quite every policy: technological advancements may reduce costs then create growth, slowing down criminality, obesity and every health problem or

¹⁶See Bottone, G. (2009), “Education in Italy: is there any return?”, ISAE Working Papers n. 109, March.

¹⁷Decision makers may be individuals or policy makers.

¹⁸For example, the decision to invest in knowledge (human capital) depends upon the institutional context (Bottone, 2008, op. cit.) and the personal characteristics of the decision-maker.

¹⁹For example, if citizens vote for a progressive party they implement a progressive decision. Moreover, if many associations against corruption emerge in a country, this factor shows progressive cultural and social advancement.

invest in R&D and education may be a way to generate economic growth, and so on. Reasoning within this knowledge framework, people become unable to look over and understand what their priorities for wellbeing are.

Probably the culture of economic growth should be put under discussion. The limits to material growth have recently become increasingly clear and evident. Even Shumpeter (2003 p. 162) foresees that: *there is inherent in the capitalist system a tendency toward self-destruction which, in its earlier stages, may well assert itself in the form of a tendency toward retardation of progress.*

Using the conceptual Old Institutionalist's framework, we may say that the culture of growth has affected the culture of daily life and the whole structure of societies, creating a loop. The idea behind "financial insanity" is that life satisfaction is strictly correlated to material wealth. It is obvious that poverty is bad and wealth is good, but no relativity is applied to the concept of wealth. Wealth is a relative concept as well as poverty is; moreover, wealth is a multidimensional notion, as well as poverty is. For example, is one richer than another is because he/she lives in a less polluted environment? Yes, but these considerations are not included in the GDP calculation. Institutions have brought forward the idea that the richer one is the freer and happier he is. In other words, money is considered a tool to gain freedom and power, but paradoxically it may conduct to "slavery". The culture of the GDP growth rate has guaranteed the validity of current economic modelling, without questioning the capacity to solve real economic issues. If we had recognised the importance of institutions in reaching a fair level of progress and a greater quality of life, probably we would have taken a different direction and would have built different economic models. Together with material goods, people aspire to social trust, peace, public services, friendship, meritocracy, democracy, freedom of choice and whatever contributes to the life satisfaction or the quality of life. None of these elements is included in the GDP.

In conclusion, the knowledge framework, historically accumulated in the past, establishes the rules to set priorities in society. It is essential to analyse the historical path, but it is similarly essential to favour the action of progressive forces to evolve and change the rules when needed.

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