

1985

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Recommended Citation

Raines, J. Patrick and Clarence R. Jung. "Rationalism, Capitalism, and Democracy: The Views of Schumpeter and Knight." E.C.R.S.B. 85-4. Robins School of Business White Paper Series. University of Richmond, Richmond, Virginia.

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THE VIEWS OF SCHUMPETER AND KNIGHT

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RATIONALISM, CAPITALISM, AND DEMOCRACY: THE VIEWS OF SCHUMPETER AND KNIGHT

by

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INTRODUCTION

The concept of rationality is both the origination point and the Achilles' heel of the study of economic theory. Two of America's most important economists, J. A. Schumpeter and Frank H. Knight, held highly developed views of the rationalistic civilization and rational thought. Although considerable concordance is present in their visions of rationality, conceptual differences exist.

Rational behavior is, in many respects, like beauty in that its meaning is defined by the extent to which there is a mapping with the values of the observer. Any discussion of rationality must begin with this difficult problem of relativity in values.

Both Knight and Schumpeter were, of course, keenly aware of this problem of the relativism of value judgments in economics and the role of such judgments in the sociology of knowledge. Their writings on values in economics coalesce with similar emphasis in other fields such as Einstein's theory of relativity, Freud's theory of the subconscious, and Godel's theory on undecidable propositions.

This paper begins, therefore, by identifying the definitions and origins of rationality according to Schumpeter and Knight. The paper then moves to

an explication of the views Knight and Schumpeter held on rationality and the implications they perceived for capitalism and democracy.

SCHUMPETER ON RATIONALITY AND CAPITALISM

Definition and Origin

In order to avoid confusion when using the verb "to rationalize," Schumpeter explains rationalizing as supplying ourselves and others with reasons for an action which satisfy our standard of values.¹ It is not necessary in his view that such reasons take into account the true impulses for the action. Actions which satisfy moral values, for an example, may actually be undertaken because economic benefits outweigh economic costs.

He describes rationality in Marxian terms as the socio-psychological superstructure of capitalism. It is the mentality which characterizes capitalist society and particularly the bourgeois class. He argues that primitive human economic necessities forced rationality upon the human mind and explains; "it is the everyday economic task to which we as a race owe our elementary training in rational thought and behavior."² Further, he does not hesitate to say that all logic is derived from the pattern of economic decisions. A phrase which Schumpeter is particularly fond of is: "the economic pattern is the matrix of logic."³ It follows that the influence of the rational thought process spreads to all decisions as the unending rhythm of economic wants is favorably satisfied.

¹Joseph A. Schumpeter, Capitalism, Socialism and Democracy (New York, N.Y.: Harper and Row, 1942), p. 143

²Ibid., p. 122

³Ibid., p. 123

It is not Schumpeter's view that rationalism is inherent only in modern capitalist activity. In fact, he suspects that pre-capitalist man was no less "grabbing" than capitalist man. However, he contends that capitalism has been the propelling force of the rationalization of human behavior.

One way capitalism develops rationality is through the exaltation of the monetary unit. The importance of money as a unit of account in capitalist systems facilitates rational cost-profit calculations. Cost-profit calculations, in Schumpeter's view, crystalize and define numerically economic rationality--in short, they "powerfully propel the logic of enterprise."⁴ Once rationality pervades the economic sector it influences and indeed subjugates everything from man's outlook on life to his concepts of beauty and justice. Even his spiritual ambitions are affected by the rationalizing propensity: the perceived benefits of the hereafter exceed the human costs of the here-and-now.

When the rationalist mental attitude is produced, the capitalist process provides a means for propelling the rationalization of human behavior--legislation. Schumpeter contends that capitalism produces both the means and the will to spread capitalist rationality. This is accomplished through conspicuous capitalist success and institutional changes for the benefit of the masses. Policies and laws, from food stamps to affirmative action, are designed to promote social well being and, thereby, facilitate the capacity to act rationally.

Schumpeter asserts that the growth of rational science and its long list of accomplishments are the recognizable results of the profit economy. He writes:

⁴Ibid.

Not only the modern mechanized plant and the volume of output that pours forth from it, not only modern technology and economic organization, but all the features and achievements of modern civilization are, directly or indirectly, the products of the capitalist process.⁵

Interestingly, rationalism - the cost-profit calculus of capitalism--does not insure the survival of market systems. Instead, it produces an "antiheroic" civilization; a society which pragmatically accepts the world this side of the grave. As capitalism exalts the rationalization process, the entrepreneurial spirit, which is imperative for the survival of the capitalist order, withers. Schumpeter holds that the material success of the capitalist economy favors the status quo. Thus, the revolutionary pattern of entrepreneurial activities will be replaced by logical bureaucratized management.

In such an environment, innovation will be the responsibility "of teams of trained specialists who turn out what is required and make it work in predictable ways."⁶ The renowned economic progress of capitalism inspired by individual entrepreneurship will become depersonalized and automatized. Vision will be replaced by rationalized and specialized office work.

Schumpeter summarizes the dangers of these developments as follows: "Since capitalist enterprise, by its very achievements, tends to automatize progress, we conclude that it tends to make itself superfluous--to break to pieces under the pressure of its own success."⁷

Intellectuals account for much of the criticism of the capitalist order. Schumpeter blames this situation on the emphasis on and the accessibility of higher education in the later stages of capitalist civilization. University

⁵Ibid., p.

⁶Ibid., p. 132

⁷Ibid., p. 134

education produces a surplus of quasi-professional intellectuals who may be simultaneously too ill-trained for professional employment and physically unemployable in manual occupations. Given this set of circumstances, employment may require acceptance of unsatisfactory working conditions and/or wages below skilled manual workers. This unemployed or unsatisfactorily employed population develops a thoroughly discontented attitude. In effect, the intellectual's indignation about the wrongs of capitalism represents a rationalization of his personal situation.

Ultimately, discontented intellectuals express their hostility through political party activities, staffing government agencies and acting as advisors to elected officials. In this way, Schumpeter asserts, as intellectuals impress their mentality on almost everything that gets done, public policy grows more and more hostile to capitalist interests.⁸ The aforementioned propensity for social legislation may be indicative of this trend.

The point is capitalist rationality which once inspired progress, ultimately creates a mentality of logic which undermines the essence of the system. In the face of spreading rationalism, capitalism cannot endure. In working so well, capitalism generates expectations based upon a rational belief in the possibility of a superior system.

⁸Warren J. Samuels points out in "A Critique of Schumpeter," contained in Capitalism and Democracy Schumpeter Revisited (Notre Dame Press, 1985), that Schumpeter's prediction of the demise of capitalism is much more complex and subtle than his scapegoating of intellectuals. Specifically, Samuels argues, his criticism of rationalism and intellectuals is a stratagem for criticizing the corporate system's replacing individualist entrepreneurial capitalism as a system of economic control.

Rationalism and Democracy

Schumpeter's fundamental assumption regarding the relationship between the rational attitude and the state is the capitalist process undermines its own institutional framework.

The classical definition of democracy as Schumpeter interprets it is "an institutional arrangement for arriving at political decisions which realizes the common good by making the people decide issues through the election of individuals. . . ."9 But, he contends, the classical state cannot exist. First, rational arguments cannot induce agreement upon a common good for all people. This is due to the fact that society's view of what life should be is beyond mere logic. Compromises are possible in some areas and impossible in others. Thus, it is impossible to discern a single unique common good. Further, the idea of a "volonte generale" or common will of the people is easily dismissed, when one realizes all individual wills do not naturally gravitate toward a natural equilibrium even with rational discussion. In fact, the will of the people is the product of the political process. This manufactured will is the product of politicians or exponents of an economic interest who are able to fashion the will of the people.

Schumpeter is exceedingly skeptical about human nature in politics. He doubts the common man's powers of observation and interpretation of facts as well as his ability to make rational inferences. He elaborates considerable evidence against the assumption of rationality inherent in the classical definition of democracy. Specifically, he points out that economists are learning that the consumers portrayed in textbooks do not have wants nearly as definite as assumed and do not act upon those wants in such a rational

⁹Schumpeter, Capitalism, Socialism and Democracy, p. 250

and prompt way. He suspects ordinary man is so susceptible to the influence of advertising that producers dictate to consumers rather than being directed by them. Schumpeter infers from this state of affairs that extreme public gullibility exists in the realm of political action.

When typical citizens enter the political field, Schumpeter suggests, they drop to a lower level of mental performance. In fact, the common man argues and analyzes in a manner which he would readily recognize as infantile within the sphere of his real, i.e., personal interests. In summary, the weakness of the rational process applied to politics, the absence of logical control over the arrived at results, and since moral standards are relaxed in political affairs the ordinary citizen is rendered "more unintelligent and irresponsible than he usually is."¹⁰ Thus, Schumpeter concludes that "the people" do not hold a definite and rational opinion about every individual question and it is unlikely that they can elect representatives to carry out that opinion.¹¹

KNIGHT ON RATIONALITY IN ECONOMICS AND POLITICS

Individual Economic Rationality

Knight sardonically notes: "That 'man is a rational animal' is one of those interesting statements which do not have to be proved, since the subject admits it."¹² Even though man may hold such a view of himself, Knight considers the description to be too one-dimensional as well as generally false. To describe human beings as rational ignores the fundamental romantic element

¹⁰Ibid., p. 262

¹¹David McCord Wright, "Schumpeter's Political Philosophy," Schumpeter, Social Scientist (Freeport, New York: Libraries Press, 1969): 130-135

¹²Frank H. Knight, "The Planful Act: The Possibilities and Limitations of Collective Rationality," Freedom and Reform (Indianapolis: Liberty Press, 1982), p. 405

of human behavior. Further, Knight argues that the ordinary meaning of rationality is efficiency: the premeditated maximization of limited resources to achieve an envisioned end. In Knight's pursuit to emphasize man's romantic nature and to debunk social and economic dogma, he points out that humans seldom seek the "naked" and "cold" results of efficiency. Thus, man's view of himself as a rational creature is most likely a conviction based upon premises inferred from conclusions. (Man is rational because he is the highest order of reasoning animal.) Thus, Knight holds: "Man is certainly not the rational animal that he pretends to be He is very superior to other animals in reasoning power, but reason is not distinctive of man and is hardly his predominant trait; it is often used for irrational ends."¹³

Knight considers his major contribution to economic methodology to be his clarification of the nature and significance of the economic man.¹⁴ Knight recognized that in order to build a rigorous and useful model of economic maximization man must be described as purposely and consciously utilizing means to attain predefined ends--the rational economic man. However, he also contends "there is no such man" because human beings do not know what they want--not to mention what is "good" for them--and do not act very intelligently to get the things which they have decided to acquire. Besides, to act completely rational would require totally impersonal and non-romantic behavior which is not only irrational but impossible. Hence, he believed a science of conduct is an impossibility because data of conduct is provisional,

¹³Frank H. Knight, "The Free Society: Historical Background," Intelligence and Democratic Action (Cambridge, Mass.: Harvard University Press, 1960), p. 52

¹⁴William Breitt, "Frank H. Knight - Philosopher of the Counter-Revolution in Economics," The Academic Scriblers (New York, N.Y.: Holt, Rinehart and Winston, 1971), p. 200

shifting, and specific to individual situations to such a high degree that generalization is relatively fruitless.¹⁵ Consequently, Knight has always cautioned against the overzealous application of economic theory to non-economic problems and argued that economic theory is not an explanatory science of reality. Perhaps, ironically, Knight's link to neoclassical economics is that modern positivist economists have used Knight's restated economic man to justify their position that assumptions of economic theories are secondary to predictive power.

In order to understand the essence of Knight's view of individual rationality and its place in economics, it is necessary to know the definition and description of rationality which was being promulgated by economic writers in Knight's day. For, as he himself acknowledged, Frank Knight was essentially a critic and much of his work is a search for logical contradictions in economic theory. He saw his main task, and the task of general education, to be to "unteach" the acceptance of dogma and to develop the will to be intelligent, i.e., objective and critical. Further, it appears that Frank Knight was not pleased with the course modern economics was taking. He particularly disapproved of the "economic" explanation of human behavior as well as attempts at predicting real world results from idealized theoretical economic models. Thus, he found Marshallian and other definitions of economics, viz., "the ordinary business of life" or "the science of rational activity," useless and misleading.¹⁶ To Knight, such definitions suggested that economics is the science of everything that generally concerns mankind. On the one hand,

¹⁵Frank H. Knight, "Ethics and the Economic Interpretation," Ethics of Competition (Freeport, New York: Libraries Press, 1969), p. 35

¹⁶Frank H. Knight, The Economic Organization (New York, N.Y.: Harper & Row Publishers, 1933, 1951), p. 4

economizing behavior does not encompass all human activity, and on the other, life must be much more than rational conduct or the intelligent use of resources to achieve pre-determined results.

In the opening pages of The Economic Organization, he points out that common definitions of Economics are too broad, and the rational economic conception of life is too narrow. He draws out the implications of the statement by noting: "Living intelligently includes more than the intelligent use of means in realizing ends; it is fully as important to select the ends intelligently," and "Living is an art; and art is more than a matter of scientific technique, and the richness and value of life are largely bound up in the 'more.'"¹⁷ In this he concurs with John M. Clark that an irrational passion for dispassionate rationality would take all of the joy out of life. Although Knight was not a utopian, he expresses hope for a society where the everyday struggle to maximize the production of material necessities will give way to a culture devoted to problems of truth, improved human relations, and beauty.

Collective Rationality and Democracy

In his essay, "Can the Mind Solve the Problems Raised by Its Liberation," Knight recognizes the tendencies released by liberal culture toward "acute discontent, criticism, and fault-finding."¹⁸ He infers, much like Schumpeter, that favorable capitalist conditions have caused this critical attitude to develop with astonishing speed as a culture trait. He concedes that the propensity to dissent against economic and political conditions has existed

¹⁷Ibid., pp. 3-4

¹⁸Frank H. Knight, "Can the Mind Solve the Problems Raised by Its Liberation," Intelligence and Democratic Action (see No. 14), p. 144

all along but speculates it was held in check by the harsh discipline of precapitalist-preliberal culture.

Knight is probably as skeptical as Schumpeter about the possibility of society making rational political selections in a democracy. In dealing with the existence of collective rationality in a democracy, Knight, as always, is attempting to show something of the complexity and difficulty of accepting traditional truths. He recognizes that collective rationality in a democracy involves rationally delegating power. This implies: the will and intellect exist to choose a representative; the mechanics to rationally select an agent are operational; once selected, the agent is given instructions concerning the process to use in order to achieve a rational end; and a means must exist for holding the agent responsible for carrying out the instructions. Using an analogy whereby a patient must choose a physician, Knight expresses his reservations concerning the public's ability to rationally choose political leadership.

First, it is impossible for a leader to be selected intelligently, in the scientific sense. In order to select his doctor scientifically, the patient would have to know all the medical science known by all the candidates under consideration, and in addition know how much of this knowledge was possessed by each separate candidate. Secondly, the relation between leader and follower must be a moral relation, one of confidence and trust on the part of the client and of moral integrity and of candour tempered by judgment on the part of the counselor. Thirdly, where the leader is chosen by the follower or client on the basis of active competition for the position, the follower becomes the real leader; for the methods of competition by those seeking appointment will run largely to competition in promising to do what the client wants done, and by debating technical details will make him the judge of these, and to promising results of whose probability of realization the counsel-seeker must judge. And all this is the more certainly true where the follower is a group, amenable to manipulation through crowd psychology. Fourthly, active competition for positions of leadership, especially leadership of groups of considerable size, means the progressive degradation of the entire system through the use of salesmanship or

"influence,"--flattery, cajolery, outright deception, and sheer pressure of suggestion and assertion. This means appeal from intelligence to the most irrational emotions. The methods of competition adopted by aspirants to positions of leadership must be those which "work"; candidates in any way restrained by "principles" will simply be eliminated. And it goes without saying that competence to persuade is only accidentally and improbably associated with competence to counsel and to lead.¹⁹

Clearly, Knight thought that due to human nature and the complexity of modern decisions there are very narrow limits to the achievement of collective rationality. He argued that in the political field the possibility of knowledge adequate for rational group action is extremely limited.

Even though Knight is skeptical about the possibility of collective rationality, he held that intelligent social action is distinctly possible. In fact, Knight contends in a truly democratic system men must use freedom intelligently and intelligent is preferable to rational.

The first step in Knight's system for intelligent social action is to compare the alternatives, beginning with understanding what they are. This procedure must logically be conducted prior to action. After knowledge of alternatives and conditions is assimilated, it is possible to proceed to the second stage of the analytical process of social reform: the formulation of an ideal or a rationally desired end. To Knight, it is imperative that reformers have a detailed view of the consequences of change before action is undertaken. The final task in Knight's model for undertaking intelligent social action is to decide the appropriate means for social change. Knight is quick to point out that inaction and the "natural" course of events may be the best alternative. His basic axiom is that it is better not to act

¹⁹Knight, "Economic Theory and Nationalism," Ethics of Competition, pp. 304-305

unless it can be done intelligently because the chances are good that harmful results will follow from acting randomly--or unintelligently.

In summary, Knight concurred with Lord Bryce that democracy should ideally be "government by discussion." Thus, in a Jeffersonian sense, Knight held that the cost of freedom is intellectual initiative and the will to use intelligence intelligently.

Conclusion

The following matrix summarizes the views of rationality held by Schumpeter and Knight.

THE SCHUMPETER-KNIGHT MATRIX OF RATIONALITY

	JOSEPH A. SCHUMPETER	FRANK H. KNIGHT
INDIVIDUAL ECONOMIC RATIONALITY IN CAPITALISM	Psychological Superstructure of Capitalist Economic System	Too Limiting Definition of Human Beings
	Common Logic in Economic Relations	Necessary for Economic Models, But Unrealistic
	Self-defeating Principle	Produces Critical Mind-set
COLLECTIVE POLITICAL RATIONALITY IN DEMOCRACY	Uncommon Among "Typical" Citizens	Impossible Without Agreement on Common End
	Promotes Socialist Development	Preferred Critical Intelligence
	Impossible Without Common Will	Insufficient Public Knowledge for Rational Actions

Schumpeter contends that the "matrix of logic" in economic life is rationality; the socio-psychological superstructure of capitalism is founded upon rational cost-profit calculations; and, rationalism inspires an almost universal hostility to capitalism which will promote the demise of the capitalist system.

The view of society's rationality held by Schumpeter is surely elitist and cynical. Most likely it is a product of his aristocratic, Austrian rearing.²⁰ He seems to have perceived only two types of man, the ordinary variety and the uncommonly gifted person. The former may behave rationally in daily matters at home and in business, but as voters, often prove themselves bad and indeed corrupt judges of their own interests. He contended: ". . . the great political questions take their place in the psychic of the typical citizen with those leisure-hour interests that have not attained the rank of hobbies, and with the subjects of irresponsible conversation."²¹ Also, Schumpeter thought the rational acceptance of efficiency in an automated, bureaucratized production process would undermine the entrepreneurial spirit, which is the driving force of capitalism, and hasten the advance of socialism.

Knight's view is more sanguine. He argues that life is more than economics and rational conduct, and that living intelligently requires more than using means to achieve ends. Further, in Knight's view most economic activity is rivalrous and contentious, and, thus, irrational. He thoroughly proves the irrationality of perfect rationality with his description of the "economic

²⁰L. A. O'Donnell, "Rationalism, Capitalism and the Entrepreneur: The Views of Veblen and Schumpeter," History of Political Economy, Vol. 5, No. 1 (Spring 1973): 202

²¹Schumpeter, Capitalism, Socialism, and Democracy, p. 261

man." He also contends that liberal culture's "liberation of the mind" releases a tendency to be critical of capitalist relations. Ultimately, Knight replaces economic calculation with critical intelligence as the imperative mental process for democratic economic and political action.

Knight worked toward and hoped for a society based upon common sense rationality. Such a hope probably sprang from his mid-American roots.²² He recognized that the economic man exists, to some degree, in every person, but the romantic, the social animal, the prejudiced ignoramus also exists alongside the rational maximizer of economic interest. He rejected intellectual elitism and took it upon himself to expose the fallacies, nonsense and absurdities in what is passed off as sophisticated-scientific discourse. Ultimately, he urged society to nurture the will to develop a more critical attitude.

Institutional Economics is positive economics. Institutionalists should attempt to confirm or deny the economic theories and predictions for society by writers like Schumpeter and Knight by investigating evolving economic reality. Herein, it can be said that capitalist rationalism has produced the corporate system as well as critical intellectuals. One might also argue that state-of-the-art empirical techniques are influencing the economic questions asked today and are being overzealously extended to political and economic questions (or as Knight once noted: using empirical trivia to prove water runs downhill). And, with the observance of recent elections of Lyndon LaRouche followers, the existence of collective rationality certainly can be questioned.

²²In a recent paper Donald Dewey presents, with a refreshing combination of the geneological and philosophical perspectives, a detailed and entertaining account of Knight's early years. Donald Dewey, "Frank Knight Before Cornell: Some Light on the Dark Years," paper presented at the 55th annual meeting of the Southern Economic Association, Dallas, November 25, 1985.

Finally, the fact that socialism does not appear likely to replace corporate capitalism in the United States anytime in the near future does not disprove the effects of rationality averred by Schumpeter and Knight. Rather, it reflects the impact a rising standard of living has on social questions.

Thus, in the view of the authors Schumpeter and Knight's views of rationality in capitalism and democracy are penetrating and enlightening, and have borne up remarkably well.