Working Papers in Political Science

2011/5

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A Schumpeterian account of the role of leadership

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Abstract

Schumpeter is an author of competitive leadership rather than of the elitist theory of democracy. The paper argues that in contrast to the picture of market competition presented by neoclassical economics and its application to politics by Public Choice theory, and particularly by Anthony Downs, politics is a world of disequilibrium and leadership, as in Schumpeter's account. Schumpeter's emphasis on entrepreneurship in the economy and leadership in politics is an inevitable implication of his break with the neoclassical equilibrium model; he is a precursor of Riker's heresthetics. Schumpeter's invention of the theory of development and disequilibrium in the market economy and in politics has dramatic analytical as well as normative consequences in economics and in democratic theory.

There are two basic assumptions of contemporary liberal and democratic political thinking.

First, not men, but laws rule in a liberal or constitutional state. Second, not few, but many rule in a democracy. However, political leadership is neglected in both of these traditions of political thought.

Most of the classical authors of the liberal tradition, like Locke, Montesquieu, the Federalist, etc., concentrate on the problem of rules and laws rather than on rulers and leadership (Blondel 1987, 42). Machiavelli, who focuses on the problem of leadership, is an exception in the history of political thought. In classical political theory good government is a limited one. An excessive concentration of power is to be avoided. A mixed constitution provides good government and durable laws that keep order and stability. If fundamental laws are already given, leadership is limited to the application of laws, i.e. public administration and judging. Good laws have an "eternal" nature, hence internal leadership has a static, "a-temporal" character (Blondel 1987, 66). Classics, even modern classics like

* A previous version of this paper was presented at the 4th Annual Public Leadership Workshop, Hobart, Australia, 25–26 November 2010. I am grateful to Tibor Mándi for improving the English of the paper.

Rousseau, assume that good laws are previously given by a wise legislator like Solon in Athens or Lycurgos in Sparta. Giving good laws, establishing a republic is a single act and the role of subsequent rulers and leaders is limited to the application of these eternal laws. At a time of peace and normality, good governance requires wise administrators and judges rather than political leaders.

Political leadership is needed only in cases of emergency that may usually happen in foreign affairs, commonly in case of war. John Locke calls this leadership role “federative power”; others hold that royal prerogatives are to be used in case of internal disturbances. But a political leader with discretionary power is seen as a temporary figure, who after having solved the crisis and having re-established order and legality steps down from the scene, giving power back to an impersonal authority.

The archetype of crisis-managing temporary leader was the Roman dictator, who was assigned extraordinary power, unlimited in scope, but limited in time (Schmitt 1928). Since then there has been a long tradition of differentiating between the time of normality and crises in political thinking and in constitutional law (Slomp 2009). It is usually assumed in modern liberal and democratic theory that in the time of normality the rule of law must prevail and the latitude of political leaders is rather limited (Horton 2009; Ruscio 2004). Headship rather than leadership characterizes this ideal regime, where rulers have limited power and they are mostly occupied with the administration of laws.

Analogically to the classical/liberal view, the role of leadership is also reduced in democratic political thinking. In modern democracies government is responsive to the wishes of the people: political leaders transform citizens’ wants into public policy. Hence leaders do not have an autonomous role, they follow their voters. Not few, but many rule in a democracy. In the market analogy of politics incumbents take the median voters’ position, and equilibrium prevails. In times of normality exogenously given preferences of voters determine public policy.

In both the liberal and democratic traditions political leaders are transformed into administrators or bureaucrats at times of normality. A leaderless democracy emerges, using Max Weber’s term. Schumpeter challenges this static and reductionist view of politics and leadership and explores a dynamic concept of the political process in which political leaders gain a crucial role. This paper seeks to identify Joseph Schumpeter’s concept of political leadership and the politics of disequilibrium within the theory of competitive democracy.

Although the market metaphor and the economic analysis of politics as well as an instrumentalist definition of democracy bind together various authors (e.g. Schumpeter, Dahl, Downs) under the common label of elitist or competitive democracy in post-1945 political theory, this conventional approach conceals crucial differences and hides the problem of leadership (as agency) and disequilibrium in democratic politics (Körösényi 2009a). Joseph Schumpeter, the founding father of the concept of competitive democracy explores a theory that strongly diverges from most of the authors associated with this label.

The role one attributes to leadership follows from one's understanding of the political process. One of the novelties of Schumpeter's theory lies in his realist depiction of the democratic political process, in which he turns the conventional picture of the flow of democratic politics upside down. While classical democrats from the contemporary literature, like e.g. Gerry Mackie (2009) imagine a bottom-up process, Schumpeter introduces a top-down approach (cf. Körösényi 2009b). I will show that this inversion has its sources in his theory of economic development.

The paper is structured as follows. First, I will explicate Schumpeter's theory of economic development and entrepreneurship. Second, I will explore how Schumpeter applies his concept of innovation and development to politics and I will contrast his concept to the median-voter model of Anthony Downs. Third, I will pinpoint the limits of the market analogy in politics. Fourth, I will summarize the novelties of a Schumpeterian account of politics.

I. Schumpeter's theory of economic development

In *The Theory of Economic Development* Schumpeter (1959 /1911/) challenges the static equilibrium-model of neoclassical economics, since it does not give an explanation for economic growth and development. The argument is also restated three decades later in his *Capitalism, Socialism and Democracy (*1987 /1943/, cited as *CSD* in the following): he explains economic progress through innovation carried out by entrepreneurs. But, in Schumpeter's view, innovation and entrepreneurial activity have a strong disequilibrium impact,[2] they destroy perfect competition and create monopolist positions in the market (*CSD* 132). It is precisely perfect competition, a widely celebrated feature of the market in (neo)classical economics, that is incompatible with development, states Schumpeter in his revolutionary thesis. Perfect competition implies free entry into every (traditionally) existing industry and before Schumpeter it was thought that impediments to free entry would bring loss to the community.

> "But free entry into a new field may make it impossible to enter it at all. The introduction of new methods of production and new commodities is hardly conceivable with perfect – and perfectly prompt - competition from the start. And this means that the bulk of what we call economic progress is incompatible with it",

Schumpeter asserts (CSD 104-5). His explanation is that free entry would eliminate the profit of entrepreneurial activity and this way destroy the motive for innovation and progress. Therefore, from the perspective of progress, "*perfect competition is not only impossible, but inferior*", Schumpeter summarizes his shocking thesis that challenged the economic doctrine of the day (*CSD* 106). Although Schumpeter emphasizes the benevolent role of competition, he shows that *perfect*

[2] But "a new equilibrium always emerges, or tends to emerge, which absorbs the results of innovation carried out in the preceding periods of prosperity", Schumpeter (1989, 69) notes.

competition is an impediment to progress. Therefore, in the Schumpeterian argument both perfect competition and the lack of any competition have disadvantageous impacts.

Schumpeter (1989, 60) differentiates progress, i.e. qualitative development from pure quantitative change, that characterizes the equilibrium model of neoclassical economics. In the market model of neoclassical economics changes may occur due to *non*-economic forces outside the system - like expansion of the market, for example -, and they have a quantitative nature. But development means *qualitative* change, which occurs due to economic forces (like innovation) *within* the system, and "does not *follow*, but *creates* expansion" in Schumpeter's theory (1989, 63). "*By 'development', therefore, we shall understand only such changes in economic life as are not forced upon it from without but arise by its own initiative, from within*" Schumpeter says (1934, 63).

Innovation, the crucial element of this qualitative change creates something new, untried and irreversible. Innovations, as defined by Schumpeter (1989, 138), are "*changes in production functions which cannot be decomposed into infinitesimal steps. Add as many mail-coaches as you please, you will never get a railroad by doing so.*"[3]

In Walrasian equilibrium economics "*(E)conomic life is essentially passive and merely adapts to the natural and social influences which may be acting on it*", Schumpeter says (1989, 159). Changes have a quantitative nature and are caused by exogenous factors. In contrast, in Schumpeter's theory development is qualitative and has *endogenous* explanation. He draws on Karl Marx in his search for a "vision of economic evolution as a distinct process generated by the economic system itself" (Schumpeter 1989, 160). While neoclassical economics sees the market economy as a stationary process which *actually* does not change of its own initiative but only under the influence of events which are external to itself, such as population increase, natural catastrophes, wars and so on, Schumpeter aims to give an economic, i.e. endogenous explanation for economic processes. "*(t)here must be a purely economic theory of economic change which does not merely rely on external factors propelling the economic system from one equilibrium to another"*, he claims (1989, 166).

In the process of economic development Schumpeter attributes a crucial role to entrepreneurs. Entrepreneurs are actors who are not satisfied with the application of tested methods and the experiences of the past, but have a *vision* about the future.

> "(t)he function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention or more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on." (CSD 132).

[3] Schumpeter's (1989, 30) definition of innovation is the following: "By innovation I understand such changes of the combinations of the factors of production as cannot be effected by infinitesimal steps or variations on the margin. They consist primarily in changes in the methods of production and transportation, or in changes in industrial organisation, or in the production of a new article, or in the opening up of new markets or of new source of material". And another one: "What we, unscientifically, call economic progress means essentially putting productive resources to uses *hitherto untried in practice,* and withdrawing them from the uses they have served so far. This is what we call 'innovation'" (Schumpeter 1989, 63-64).

It is "the nature of the entrepreneur's function to act as the propelling force of the process" (Schumpeter 1989, 68). The function of entrepreneurs is distinct from the mere 'managerial' function: innovation, and not routine behaviour characterizes it. While traditional businessmen and managers react to existing demand for their standardized products, entrepreneurial activity "*creates an expansion of demand for its own*", for its *new* products. However, the real entrepreneurial act is not the invention of the new product in a technical sense. Innovation is to overcome the difficulties, the resistance of the environment: like convincing buyers, creditors; to combine the different elements of production in an appropriate, new way (Schumpeter 1989, 63-66).[4]

Distinguishing entrepreneurial activity from routine behaviour in business is an additional novelty of Schumpeter's approach. If there are disturbances in the market, e.g. cycles caused by outside factors, the market is characterized by passive adaptation. Most businessmen react in a predictable way, i.e. through adaptation by infinitesimal steps. This well-defined behaviour fits in with 'static' theory. It is a type of behaviour we have before our eyes in real life, notes Schumpeter (1989, 26-27), "*for this is the only way in which the majority of people do act and are capable of acting*". But there is another way of reacting, he adds: "People can also drop their attitude of passive adaptation, they can react by doing new things in a new way, incompatible with the fundamental arrangements that exist" (Schumpeter 1989, 27). Entrepreneurship means this new kind of attitude and behaviour; an entrepreneur gives a creative rather than an adaptive response to market disturbances. It can be derived from an outside impulse (e.g. external market shock), but if there is no outside impulse, "the 'impulse' would be *created* by our type" (Schumpeter 1989, 27).[5] Entrepreneurs are exceptional figures, because *"outside routine most people find it difficult and are often unable to act; those who can are rare and therefore not subject to competitive conditions, whence the phenomenon of profit"* (Schumpeter 1989, 33).[6] Others can copy their behaviour later, after new things have been successfully done: and innovation spreads through industries through this copying.[7]

The shift from equilibrium to disequilibrium, from a static to a dynamic model means a break with predictability in the world of economics. Innovation undermines the world of certainty and has a *disequilibrating impact* (CSD 132), since it disturbs the circular flow of the economic process, creates new data and changes the relation between consumers and producers – i.e. innovation produces

[4] In contrast, the equilibrium model narrows its focus to adaptation, a response to changes in the data (i.e. to a shift of preferences caused by exogenous factors), which drives the process back to equilibrium. Equilibrium analysis, therefore, assumes full adjustment carried out by traditional businessmen and managers. Since the process of equilibration is not treated as problematic, there is no room for the entrepreneur here (Loasby 1984, 78). That is the reason why neoclassical economics does not recognize either the crucial role of entrepreneurs or the problem of economic development.

[5] "This kind of activity is primarily responsible for the recurrent 'prosperities' that revolutionize the economic organism and the recurrent 'recessions' that are due to the *disequilibrating impact* of the new products and methods" (CSD 132).

[6] This kind of attitude is a very rare, Schumpeter (1989, 28) adds "(B)ecause doing what has not yet stood the test of experience is no mere act of ordinary business practice…".

[7] An entrepreneur believes that "he is right, while everyone else is wrong" and sees an opportunity of profit in his superior perception (Loasby 1984, 79).

creative destruction. "Herein lies Schumpeter's fundamental departure from the standard modern analytical method: tastes, resources, and technology are themselves the products of the system, not the facts with which the system has to deal" as Brian Loasby (1984, 80) notes. In contrast to the assumed priority of consumers' preferences, Schumpeter (1959, 65) asserts that "*it is… the producer who as a rule initiates economic change, and consumers are educated by him if necessary; they are, as it were, taught to want new things*." Entrepreneurs create demand through supplying new products and changing consumer preferences.

The theory of entrepreneurship has an epistemological significance. In equilibrium economics businessmen are rational and use "*equilibrium routines*", i.e. "*individuals in their economic conduct simply draw conclusions from known circumstances…*" (Schumpeter 1934, 21). To put it another way, economic actors can be characterized by habitual behaviour, i.e. the continued application of rules, which, in Schumpeter's words, "*have stood the test of experience*" (cited by Loasby 1984, 78). The mechanics of the market are transparent in the equilibrium model: there are fixed assumptions about actors' behavioural attitude, all data is well known for the actors and the method of analysis is logical deduction. But new patterns of behaviour and new forms of organisation, which constitute new situations, are not deducible from the original by logical argument (which is the method of equilibrium analysis): they are invented, created by innovative entrepreneurs.[8]

Schumpeter's position on public good also has its origin in his critique of (neo)classical economics. In the equilibrium model common good is defined through market procedure and perfect competition; there is a tendency in the economic process towards an equilibrium (i.e. the common good). In the disequilibrium model, in contrast, the economic process is dynamic and open-ended. There is no direct and unambiguous relationship between institutions and outcome. "Progress" or development does not have any specific direction; it means "qualitative change" without claiming to achieve a higher "good", happiness, etc. Unlike in the model of perfect competition, there is no *invisible hand* that would produce social harmony and public good as an outcome. Hence, the common good has a contingent nature; it may be identified with progress, but progress may also create disequilibrium and recession (creative destruction). The exact nature or direction of progress is unknown for us; it cannot be forecasted through induction from past experience or deduction from the data of a static equilibrium model.[9] The refusal of certainty, habitual knowledge, complete information and predictability (of the economic process) has serious implications. Predictability is lost. Economic

[8] "This objection is based on the logical impossibility of induction, which can no more produce a new decision rule or new organisational arrangement than a new theory", Loasby notes (1984, 76). There is a shift of emphasis from information to imagination. It is an application of a post-Popperian theory of the growth of knowledge: "new methods of production, new products, new ways of making decisions, new organisational practices, are just as *conjectural* as new theories about the causes of cancer…(italics are mine – A.K.)", characterizes Loasby (1984, 76) Schumpeter's epistemology.

[9] Although Schumpeter shares the view of (neo)classical economists that individual self-interest is not *incompatible* with "the interest of all" (CSD 75), he refuses that individual self-interest *necessarily* has this impact. The benevolent working of an *invisible hand* is problematic in his account. The certainty of the common good is lost.

process may either have a tendency towards equilibrium or quite the opposite. It loses its definite direction and becomes susceptible to innovation and the creativity of entrepreneurs.[10]

While the neoclassical theory of, e.g. Marshall and Wicksell keeps the classical proposition that "*in the case of perfect competition the profit interest of the producer tends to maximize production*" (CSD 77), Schumpeter's theory of economic development reveals that economic *progress* could not be achieved in those conditions. In the case of perfect competition, only quantitative growth is possible, if it is induced by some exogenous stimulus (like population increase, etc.). Economic progress, however, is beyond this well-known, secure and predictable world of equilibrium-economics. We have seen above that perfect competition is inferior, since it destroys the motive for innovation and progress, which may take place in the condition of monopolistic competition or, to put it in another way, in the case of oligopoly (CSD 79; Schumpeter 1959). "*Practically every innovation… at first creates that kind of situation which is designated by the term Monopolistic Competition*", Schumpeter (1989, 167) notes.

The move from perfect competition to an oligopolistic one changes the nature of innovation and entrepreneurship. Innovation becomes part of a strategic game, a rivalry among a few large firms. Schumpeter says that "in the general case of oligopoly there is in fact no determinate equilibrium at all and the possibility presents itself that there may be an *endless sequence of moves and countermoves*, as an indefinite state of warfare between firms" (CSD 79).

Table 1. The status and nature of knowledge in the two models

	Equilibrium	**Disequilibrium**
Direction of process	There is a tendency in the economic process towards equilibrium (i.e. the common good)	The economic process is open-ended, it has no specific direction
Nature of the process	Predictability	Unpredictability
knowledge	Deduced (or learned through induction from experience)	Invented (innovation depreciates habitual knowledge)
Behaviour of actors	equilibrium routines (habitual behaviour)	Innovation
Epistemology	Positivism (deduction / induction)	Popperian conjecture
Common good	The common good is well defined through market procedure (equilibrium) /perfect market, perfect competition/	The common good has a contingent nature, it may be identified with progress; but progress creates disequilibrium; and the exact nature or direction of progress is unknown, unpredictable
Definite knowledge, truth	-market process does lead to definitive truth (i.e. equilibrium / public good)	-market process does not lead to definitive truth; it provides an environment for the testing of *conjectures* (e.g. disequilibrium / common good) -innovation depreciates habitual knowledge
game-theoretical analogy	Equilibrium: data is given => rational calculation (i.e. parametric situation)	Disequilibrium: data can be changed by competitors (i.e. strategic situation)

[10] Unlike in the equilibrium model of neoclassical economics, in Schumpeter's developmental model the "market process does not lead to definitive truth; it provides an environment for the testing of conjectures" of economic actors (Loasby 1984, 76-77), and reveals the ambiguity of knowledge. Habitual knowledge can be made temporary and depreciated by innovation.

The thesis about the benevolent impact of perfect competition is undermined by the Schumpeterian account of the market. To sum up the switch from the equilibrium to the developmental model (see table 1): there is a shift from predictable optimality (common good) to the contingent nature of development. By *contingent* nature I mean that progress depends, first, on the innovative activity of entrepreneurs, second, on the specific quality of this innovation, and third, on the nature of the strategic game which characterizes oligopolistic competition. Common good may be identified with progress, but progress creates disequilibrium, and we do not have ex ante knowledge about the exact nature or direction of progress. In addition to that, development does not mean that people are "happier" or "better off" than they were earlier (CSD 129).[11]

II. Schumpeter's theory of democracy

In contrast to the unrealistic, normative concept of the classical doctrine, Schumpeter envisages a descriptive-analytical, realistic account of contemporary democracy, in which political leaders and parties play the crucial role. Democracy is a method of leadership selection, where the competition for leadership gives the dynamic of the political process. But Schumpeter's theory is much more than just this procedural account of democracy. His *Capitalism, Socialism and Democracy* (1987 /1943/) is an application of his *The Theory of Economic Development* (1959) onto politics. And it has implications which are rarely taken into consideration in the literature.

Schumpeter's description of leadership in a democracy is a political equivalent of the role of entrepreneurship in the capitalist economy. Political "development", therefore, is produced by the political innovation of leaders and, although competition is a necessary condition, perfect competition would destroy the conditions of political progress. Schumpeter's argument challenges the idea of equilibrium in politics in the same way as his theory of economic development undermines the equilibrium model of neoclassical economics. His approach is unfolded later in a systematic way by William Riker in his concept of heresthetics (Riker 1983; 1986; Körösényi 2010).

In the following part of this essay I will try to expand a Schumpeterian account of the political market and political development, drawing on his remarks and insights in the three famous chapters and elsewhere in his *Capitalism, Socialism and Democracy* (1987 /1943/). As Schumpeter contrasts the innovative activity of entrepreneurs to the neoclassical equilibrium model of economy, in the following I will contrast Schumpeter's (1987, /1943/) concept of political leadership to the static model of democracy exposed later by Anthony Downs' *An Economic Theory of Democracy* (1957).[12]

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[11] Economic progress might be in the interest of all, but it is beyond the well-known, secure and predictable world of equilibrium-economics and it does not necessarily produce more happiness (CSD 129; Schumpeter 1959).

[12] It was David Miller (1983) who first differentiated between Schumpeter's and Downs' models of competitive democracy. In contemporary literature there are further applications and explications of this comparison. John Medearis (2001) makes a few important points using the differentiation of equilibrium and disequilibrium

Downs' median-voter model draws on the equilibrium model of neoclassical economics, and assumes perfect competition of the candidates. Perfect competition encourages pure office-seeker candidates to adapt their policies to the position of the median-voter. If there is a shift of voters' preferences, candidates adjust their positions mechanically to the new median position. Any candidate wins, his or her policy is predictable: equilibrium routine prevails and the public good is also achieved. The law of policy-making for office-seeker candidates is determined by a "*political function*" which describes the relation between quantities (numbers) of citizens and various policy–positions along a left-right ideological spectrum. Political competition is about the more accurate and faster adjustment to the (median-) policy-position, determined by the political function.

Schumpeter (*CSD*), in contrast, challenges this image of the political market. It is true, that in the Schumpeterian political market there may also be a shift in the policy-preferences of citizens, followed by an adjustment of candidates' programs: politicians are motivated to adjust their positions to the shift in exogenous conditions, like in the median-voter model. But, in addition to this kind of simple political *change*, Schumpeter takes the political process as a political equivalent of economic *development*. Political development is, in his account, an endogenously driven process in which the starting point of the process dynamic is not the shift of citizen preferences; the process is moved by the innovative activity of political entrepreneurs, i.e. political leaders. Like entrepreneurs, political leaders also engender *qualitative* political change. Instead of policy adjustment which characterizes the equilibrium-model, Schumpeter's attention is focused on this endogenously driven qualitative change.

Political innovation means using a new political "*production function*" and supplying new policies rather than an adjustment to the median-voters' position (or providing old policies with a different composition of elements). However, as the consumer market is diverted from equilibrium by the innovation of entrepreneurs in his theory of economic development, political innovation of leaders also produces disequilibrium in the political market.

But what does innovation mean in politics? Drawing on his definition of innovation in the economy[13], a Schumpeterian account might be as follows. By political innovation we understand (i)

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models of the political market. His account of Schumpeter's theory of the political market, however, is misleading. Medearis claims that we have to differentiate between Schumpeter's two conceptions of democracy, the well-known elite and a (for political scientists) hidden or unnoticed transformative conception of democracy. The elite model (taken from *CSD*) is pictured as an equilibrium model which is, working within bourgeois capitalism, deprived of political innovation and political entrepreneurship. The notion of political innovation is narrowed to an anti-capitalist, socialist ideological change and systemic transformation from capitalism to socialism. This is, however, a false interpretation of chapter 22-23 of Schumpeter's *CSD*. The major point of my paper is to show that Schumpeter's concept of the political market is built on his theory of economic development including innovation and disequilibrium. My approach is close to the works of Andrew Hindmoor (2004; 2008). He adapts Schumpeter's critique of general equilibrium theory and argues that the use of the equilibrium method precludes the analysis of policy innovation. Unlike the static equilibrium model of Downs, where political space is exogenously given, Hindmoor (2004) argues that politicians or parties, by using Schumpeterian innovation, can (re)construct the political space and through this the "orderings" of policy-positions.

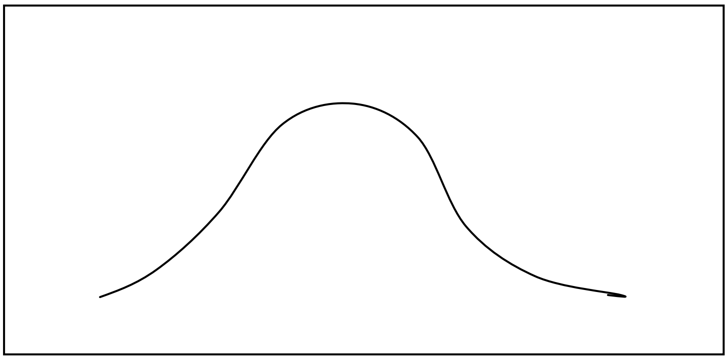
[13] See footnote 2 above.

changes in the combinations of the factors of policy-making and politicking "*as cannot be effected by infinitesimal steps*"; or (ii) changes in the methods of policy-making; or (iii) changes in political organization; or (iv) changes in the production of a new policy; or (v) the opening up of new electoral markets; or (vi) the opening up of new political resources or sources of political support; or (vii) providing a new ideological or interpretative frame to judge the political situation. The real entrepreneurial agency is not the invention of a new political product, or policy in a technical sense. What is innovative is to overcome the difficulties, the resistance of the environment, to gain support within his own rank and file (party, activists, supporters), among those who finance the campaign; in the media; and finally, to gain support among the voters, which is the most crucial condition.

We could see that a Schumpeterian account of political innovation undermines perfect competition and the equilibrium-model of politics. What is really Schumpeterian in this respect is to acknowledge that leadership (innovation) and *perfect* competition are incompatible. The law of *"the more competition, the more efficient working of the market"* is not valid beyond a certain limit. True, the lack of competition means a monopolist position of a single political actor, i.e. a political dictatorship; and long-lasting monopoly might have a negative impact on innovation and progress. But too much competition has disastrous impact as well: it destroys oligopolies, destabilizes the political process and weakens the motivation of strong/large political actors (parties) for innovation (see Figure 1). In a Schumpeterian account, the idea of perfect competition is undermined by the oligopolistic nature of leadership contest and party competition in democratic politics (Santoro 1993).

Figure 1. Competitiveness and the political public good function: relation between the level of competition and the efficiency of the market

efficiency of the market
in approaching public good



Competitiveness: lack of competition – oligopolistic competition – perfect competition

Let me explore shortly the meaning of perfect competition in the political market. Formulating it in a Schumpeterian way, it means: (1) free entry into the political market; (2) more frequent elections; (3) well-informed and competent citizens with determinate political preferences; (4) more competition produces more efficient working of the market, i.e. higher level of responsiveness of government policy to the citizens' preferences of the day. (5) In a two-party system, where the median-voter model prevails, it means that policy-products become more homogeneous; (6) the median position provides an equilibrium point which is equivalent to the Public Interest; and (7) perfect competition eliminates leadership as a specific role and autonomous activity.

In the following, I will review each of the above listed elements of perfect competition and I will also try to show what kinds of means political actors use to defend politics against the perils of perfect competition. Large political entrepreneurs have strong motivation and a common interest to set up barriers against free competition and to establish an oligopolistic political market. Let us see each element of perfect competition in politics.

First, perfect competition includes free entry into the political market. Free entry of new competitors would eliminate the result of political investment into the new political "production function" by actors who entered into the market earlier. Hence free entry undermines motivation for political investments and destroys political progress. In addition to this, free entry may also increase the number of rival parties or candidates in the competition, and the proliferation of parties would be an impediment for a stable government, therefore it would weaken governability. In order to reduce these negative impacts, institutional and other barriers are set up against free entry: e.g. there is no permanent entry, but only periodic entering to parliament at times of general elections; restrictive electoral rules; newcomers have to pay high costs for entering into the political market (costs of organization and political advertising, etc.).

Second, perfect competition means more frequent elections, while the time lag between elections means monopolistic advantages for the governing parties. More frequent elections (elections at any time) may destabilize government and public policy. Political investment needs time to make its profit therefore a time-lag is required between elections to keep regimes more stable. The political elites impede frequent elections since rare elections increase their autonomy from voters' control. It is not a coincidence that in most countries there are usually 4-5 years between general elections. If winners did not have a guarantee to be in office for a certain period of time, candidates would lose motivation to make any political investment into the campaign. More frequent elections would reduce the stake of winning elections or they would increase the risk of any investment made into a political enterprise.

Third, perfect competition assumes a perfectly informed and competent citizenry with determinate political preferences. The condition of perfect information, however, is not as desirable as it first looks. In this imaginary world, as Anthony Downs (1957, 55-60) shows in his economic theory of democracy, an incumbent cannot win the elections again, therefore she loses motivation to keep her promises, to keep the rules of the game, to be honest - since she loses the elections, anyway. In the more realistic world of Schumpeterian politics, however, citizens are poorly informed and lack technical competence to evaluate the incumbent's policy (see his famous infantilism argument /CSD, 262/), while political leaders have an interest to keep citizens ignorant since it widens the room for their political manoeuvring.

Fourth, more competition produces more efficient working of the market, i.e. a more accurate and faster adjustment to the (median) policy-position. Higher responsiveness, however, reduces the political autonomy of leaders, endangers leaders' realization of policy-goals and long-term public interest. Hence leaders have an interest to liberate themselves from the pressure of public opinion and high competitiveness.

Fifth, in a two-party system, where the median-voter model prevails, perfect competition means that policy-products become more homogeneous; this is equivalent to product homogenization in the economic market. But product homogenization means an impediment to innovation, to quality change (hence to progress), since in this case public policy is matched to existing public opinion. If there is a homogenization in the essential characteristics of products, political leaders will try to differentiate their own product (i.e. policy) from that of their rivals through other means like framing, advertising, etc. Innovative leaders, however, try to break the tendency of product homogenization and supply new products on the political market.

Sixth, in perfect competition the median position provides an equilibrium point which is equivalent to the Public Interest, according to the assumption of this model.[14] The switch from the equilibrium to the Schumpeterian developmental model undermines the positive relation between the competitiveness of the market and the approaching of an optimum (common good), as we have seen above (Figure 1). Unlike in Downs' static equilibrium theory, higher competitiveness does not make the rival parties or candidates move necessarily closer to the median-position, but motivates them to shape voters' preferences; to manipulate the electoral agenda; to exclude issues from the agenda and to apply other means of collusion; to manipulate the frame of reference or the dimension of judgement; to (re)interpret the political situation and thereby (re)define the public interest; to evoke the segmentation of the political market, securing their own constituency. Unlike the pure office-seeker politicians of Downs' model who follow public opinion, political entrepreneurs (and monopolists or oligopolists) shape public opinion in order to achieve their own policy-goals (CSD 154-155; Santoro 1993). Without manipulation neither the emergence of a monopoly or oligopoly, nor qualitative change (progress) is possible in Schumpeter's account. Therefore political leaders themselves do have a crucial role in shaping the perception of the public interest or public good (cf. Körösényi 2009a; 2009b).

Finally, perfect competition is an impediment to leadership, innovation, therefore to political change and progress. According to Schumpeter, it is competition for *leadership*, and not *perfect* competition that is a precondition of achieving the interest of all – but it does not guarantee it.

[14] We know that the Public Interest does not necessarily coincide with the median position. Even the classical democrat Gerry Mackie, who challenges Schumpeter's view arguing that "we design democratic institutions in the hope that they will best *approximate* the common good", contends that the common good cannot be *defined* as the output of an actual democratic decision, since the will of all might err (Mackie 2009, 131). Democratic decisions do not necessarily produce the best outcome. Schumpeter pinpoints exactly this *gap* between the outcome of the democratic decision-making process and the concept of the common good.

Let me return to the question of the common good. As we have seen above, Schumpeter challenges the popular belief that democracy - either because of carrying out the will of the people or because of its superior institutional design - *necessarily* provides the common good. (1) He assumes that unlike in the model of perfect competition, there is no *invisible hand* which would provide equilibrium in politics. (2) He claims that there is no direct and unambiguous relationship between institutions and outcome, as we have seen in his economic theory. (3) He argues that no uniquely determined common good exists that all people could agree on by rational argument (CSD 130). Common good is vulnerable to the contingencies of the political process. However, Schumpeter contends at the same time that the *good of the people* can sometimes be achieved (CSD 134).

Schumpeter, setting up a descriptive-analytical definition of democracy, never denies the notion of public interest (although Gerry Mackie and other critics accuse him with that).[15] What he objects to, is first the derivation of common good from aggregating individual preferences, second, the metaphysical (quasi-mythic) notion of the common good (*volonté general*), third, the assumption that common good is a reasonable and unambiguous notion in every situation, fourth, that there is a sort of equilibrium or consensus state of affairs in competitive democracy which produces or reveals the common good. Schumpeter is a methodological individualist, a forerunner of Public Choice Theory. Common good or, using Schumpeter's term, the "interest of all" might be a *side-effect* of competitive leadership in his account. Although Schumpeter shares the classical view that individual self-interest is not *incompatible* with "the interest of all" (CSD 75), he refuses that individual self-interests *necessarily* have this benevolent impact. In Schumpeter's theory competitive democracy is an institutional mechanism for leadership selection and for *political change* but the nature of the change depends on the contingencies of politics. There is no institutional guarantee that policy innovation and its implications in a democratic regime necessarily serve the common good or the interest of the people.

[15] Mackie (2009, 134) accuses Schumpeter with intellectual and moral *incoherence,* saying that Schumpeter, on the one hand attacks the notion of common good, but on the other hand appeals covertly to the notion of common good (cf. Bellamy 1991, 502; Held 1987, 179).

Table 2. Two theories of the political market

	Downs	**Schumpeter**
1. Nature of the political market	Equilibrium	Disequilibrium
	Perfect competition	Imperfect (oligopolistic) competition
	Invisible hand *=> Public Good*	*Unintended consequences, perverse effects* *=/=> Public Good*
2. Pol process driven by	Exogeneous factors (voters' preferences)	Endogeneous factors (**leaders'** actions)
Key actors	voters	Leaders
Changes in the process are	quantitative	Qualitative
Behavioural rule of actors	Fixed (unchanging production function)	Not fixed (innovation: new production function)
3. Outcome is	predictable	Unpredictable
Common good or optimum is	Unambiguous: defined by median position	open / ambiguous: a *posteriori* notion
4. elected officials are	Managers	Leaders

III. The limits of the market analogy of politics

Although Schumpeter introduces the market metaphor of politics, he himself calls attention to the limits of the analogy. The political market works differently from the economic one.

First, the political market is necessarily oligopolistic unlike the economic one. In the circular flow of the economic process you can be, but you do not *have to* be an entrepreneur. To be an entrepreneur is something special, rare; it is not a necessity. You can live and prosper by behaving according to your past experience and customs. In politics, however, there is a stronger pressure to invent "new combinations", since the nature of rivalry is different. Since in politics there is necessarily an oligopolistic competition, the loser is motivated to introduce a new combination, an innovation in order to defeat his rivals. Politics becomes a strategic game.

Second, there are stronger monopolistic elements in the political market. It means that unlike in the consumer market, there is no permanent feedback from citizens (political consumers), only at the distinct events of regular elections (cf. CSD 263).[16] Between elections there is a (usually four years) long period, and during this period the monopolist position of the incumbent political party or politicians is secured.

Third, citizens' political competence is weaker then consumers' competence. One of the sources of Schumpeter's top-down depiction of democratic politics is psychological, contained in his famous *infantilism* argument (*CSD* 258-261). The limits lie in the differences between consumers' and voters' capacity for autonomous choice. Citizens' political competence is weaker than consumers' competence to make the appropriate choice. Unlike in the "little field" of their everyday life, such as that of the consumers in the market, ordinary people are not capable of reasonable choice in the "wider

[16] In economic terms, political competition is similar to bidding for a long-term government contract (licence).

field" of politics. However, what is the wider, political field for ordinary people is the narrower, little field for political leaders. Politics is the sphere of politicians' everyday activity, where they are familiar with the rules, conventions and other realities of life. Therefore there is a wide gap between the competence and autonomy of politicians and ordinary citizens in Schumpeter's account of politics, which is the other explanation for the crucial role of leadership in a democracy.

IV. Summary and conclusions

Finally I will try to summarize the findings of my paper. First, it was highlighted that Schumpeter's theory of democracy is an application of his concept of the *entrepreneur* and his theory of *economic development* into the world of politics. Through the systematic application of the market and the entrepreneur metaphors, Schumpeter develops a few shocking theses on democratic politics.

Second, it was argued that in contrast to the picture of market competition presented by neoclassical economics and its application to politics by Anthony Downs, Schumpeter sets up a *disequilibrium* theory of democratic competition. Although Schumpeter is the father of the market analogy of politics, the Schumpeterian account of political innovation undermines the *equilibrium* theory of democratic competition in general, and the median voter theory in particular.

Third, it was explored why Schumpeter's disequilibrium theory and theory of development lead necessarily, both in an analytical and a normative sense to a theory of oligopolistic competition in democratic politics. The emergence of oligopolies and cartels in politics are not deficiencies of the political market, but inevitable consequences of political competition and the innovative activity of political entrepreneurs.

Fourth, it was explored that the ambiguous relationship Schumpeter assumes between private motivation and public good is due to his break with (neo)classical economics. The benevolent social impact of an *invisible hand,* which coordinates individual actors in a harmonious way, is not unproblematic in his account. "Progress" or development does not have any specific direction; it means "qualitative change" without claiming to achieve a higher "good" or happiness. Schumpeter is especially sceptical about progress in public affairs, which differentiates him from most of the literature of the post-1945 democratic elitist consensus. In his theory, common good lost its unambiguous nature and its exogenous character; it can be, at best, an incidental by-product of political competition. Perfect competition, however, does not necessarily produce public good in his view. The switch from the equilibrium to the developmental model undermines the positive relation between the competitiveness of the market and the approaching of an optimum.

Fifth, the role of political leadership was analysed. The role of leadership is not limited to times of unexpected change or crises in Schumpeter's account but it is a function of the everyday working of competitive democracy. I concluded that the nature of political leadership in his approach requires agenda setting, framing and shaping of voters' preferences. Hence, manipulation is not an alternative to but a constitutive part of leadership.[17]

Finally, the limits of the market analogy were highlighted. Schumpeter views entrepreneurship as a vital and productive force within an economy but much less so in the polity.

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[17] Unlike what Hanna Pitkin assumes (1967, 233), manipulation is not just an instrumental means of politicians but also a constitutive element of political leadership. This crucial element of Schumpeter's democratic theory, namely the blurring of the distinction between the concept of manipulation and leadership, has important normative implications (e.g. the decline of accountability see Körösényi 2010, 298-300).

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