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Working Paper

Capitalism, populism and democracy: Revisiting Samuelson's reformulation of Schumpeter

Serie Documentos de Trabajo, No. 796

Provided in Cooperation with:

University of CEMA, Buenos Aires

Suggested Citation: Ocampo, Emilio (2021) : Capitalism, populism and democracy: Revisiting Samuelson's reformulation of Schumpeter, Serie Documentos de Trabajo, No. 796, Universidad del Centro de Estudios Macroeconómicos de Argentina (UCEMA), Buenos Aires

This Version is available at:

<https://hdl.handle.net/10419/238421>

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**UNIVERSIDAD DEL CEMA
Buenos Aires
Argentina**

Serie
DOCUMENTOS DE TRABAJO

Área: Economía e Historia

**CAPITALISM, POPULISM AND DEMOCRACY:
REVISITING SAMUELSON'S REFORMULATION OF SCHUMPETER**

Emilio Ocampo

**Junio 2021
Nro. 796**

**www.cema.edu.ar/publicaciones/doc_trabajo.html
UCEMA: Av. Córdoba 374, C1054AAP Buenos Aires, Argentina
ISSN 1668-4575 (impreso), ISSN 1668-4583 (en línea)
Editor: Jorge M. Streb; asistente editorial: Valeria Dowding jae@cema.edu.ar**

Capitalism, Populism and Democracy: Revisiting Samuelson's Reformulation of Schumpeter

Emilio Ocampo^{*}

Abstract

In the 1970s and early 1980s Paul Samuelson reformulated the conditional prediction made by Joseph Schumpeter in *Capitalism, Socialism and Democracy* by replacing socialism with populism. According to Samuelson, “populist democracy” had attained its fullest development in the Southern Cone. He viewed Argentina as the paradigmatic case that proved his theory. Samuelson's thesis was that a strong electoral demand for equality and antipathy to business had hindered sustained economic growth. At the time, Samuelson also believed the advanced Western economies could follow the same path as Argentina. The Reagan and Thatcher revolution proved him wrong. However, the emergence of populism in Europe and the US in recent years makes his reformulation of *Capitalism, Socialism and Democracy* seem more plausible. The objective of this paper is to review and critique Samuelson's theory and to assess its relevance and usefulness today. Its main conclusions can be summarized as follows. First, Samuelson's theory is incomplete and therefore has limited power to explain current or past populist waves. Secondly, his analysis of the Argentine case was based on an erroneous interpretation of Argentine history. Third, despite being an outlier, Argentina's addiction to populism offers a cautionary tale.

Keywords: Samuelson, Schumpeter, Capitalism, Socialism, Democracy, Populist Democracy, Argentina, Chile, Uruguay.

JEL Codes: B20, B30, N16, O54, P48.

Revised on [23 June 2021](#)

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**Capitalism, Populism and Democracy:
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Emilio Ocampo

*Prognosis does not imply anything about the
desirability of the course of events that one predicts.*

Joseph A. Schumpeter (1942)

Sometimes nightmares do come true.

Paul A. Samuelson (1978)

1. Introduction

In several articles he wrote during the 1970s and early 1980s Paul A. Samuelson reformulated the prediction that Joseph A. Schumpeter, his teacher at Harvard, had made in *Capitalism, Socialism and Democracy* (1942). Although Samuelson's views during this period evolved, sometimes in contradictory ways, the core of his argument remained unaltered (for a thorough revision of Samuelson's evolving views on the subject see Boianovsky, 2021). Schumpeter's argument can be summarized as follows. First, if certain "observable tendencies" prevailed, capitalism would succumb due to forces engendered by its own success – "bureaucratization" of businessmen, a generalized hostility to business and the antagonism of intellectuals– and socialism would replace it. Second, democracy would survive. Basically, the capitalist democratic system would be replaced by a socialist democratic system.

Samuelson's reformulation of Schumpeter consisted in replacing: "capitalism" with the mixed-economy system prevailing in most advanced Western economies, and "socialism" with populism. The former would not collapse due to its success in delivering sustained GDP per capita growth but due to its failure in providing the levels of equality in income and wealth voters demanded. Capitalist democracy would be replaced by populist democracy. Samuelson considered the latter system characteristic of the Southern Cone countries and identified Argentina as the one in which it had reached its fullest development and its effects felt most intensely (Boianovsky, 2021, p.12).

In the late 1970s when the advanced Western economies were mired in stagflation, Samuelson argued that they could follow the same path as Argentina. The Reagan and Thatcher revolution proved him wrong. The fall of the Berlin Wall and Deng's reforms in China a few years later proved Schumpeter wrong (at least for now.) It is reasonable then to ask what is the point of reviewing their theories. The answer is simple: the emergence of populism in Europe and the US in recent years and the prospects of "secular stagnation" (Gordon, 2015) make Samuelson's theory plausible again.

The purpose of this paper is to review and critique Samuelson's reformulation of *Capitalism, Socialism and Democracy*. The structure of this paper is as follows. Section 2 summarizes the theory Samuelson loosely articulated in several articles and papers he wrote during the 1970s and 1980s. Section 3 critiques this theory by focusing on the case of Argentina, which Samuelson considered paradigmatic. Section 4 offers some tentative conclusions.

2. Samuelson's Reformulation of Capitalism, Socialism and Democracy

In *Capitalism Socialism and Democracy*, Austrian economist Joseph A. Schumpeter famously predicted that capitalism would inevitably succumb to socialism. More importantly, he explained it would not be due to "the weight of economic failure" but to its "very success" which would undermine "the social institutions which protect it and inevitably creates conditions in which it will not be able to live" (Schumpeter, 1942, p.61). In essence, Schumpeter argued that the demise of capitalism would likely occur due to four factors: the bureaucratization and obsolescence of management, the disappearance of "protective institutions", the unsparing hostility of intellectuals and the replacement of capitalist ethics by hedonism and a sense of entitlement (ibid., pp.423-24). He clarified that he was not a socialist and was not advocating or even predicting socialism ("I do not pretend to prophesy" he wrote). He simply took "observable tendencies" to their logical conclusion and recognized that the end result could be altered due to "factors external to the chosen range of observation" (ibid., p.422).

Schumpeter's argument can be summarized as follows: 1) Marx was wrong, capitalism doesn't lead to misery but to prosperity, 2) prosperity will engender non-economic forces that will undermine capitalism's foundations, 3) the most likely heir to capitalism is socialism, 4) the transition to socialism will not be revolutionary but democratic, 5) socialism is compatible with a minimalist definition of democracy as a competitive system to elect political leaders, and 5) from the perspective of productive efficiency, under certain "ideal" conditions, socialism could be equal (and even superior) to capitalism.

Until the early seventies, it seemed as if Schumpeter's pessimism about the prospects of capitalism had been unwarranted or at least exaggerated. In 1970 Paul A. Samuelson came to the rescue of his old master:

It is just twenty years since Joseph Schumpeter died. Although it is not my practice to tout profitable speculations, today I'd like to suggest that Schumpeter's diagnosis of the probable decay of capitalism deserves a new reading in our own time. The general reader cannot do better than begin with his 1942 *Capitalism, Socialism and Democracy* (Samuelson, 1970).

Schumpeter had been "wrong in his timing, so very wrong, But who can walk the streets of Princeton or Stockholm or Toronto and deny his prescience?" Samuelson wrote (Samuelson, 1971, pp.277-278). Thirty years had passed since the publication of Schumpeter's book and Samuelson wrote with a similar time horizon in mind. He analyzed "observable tendencies" and extrapolated them. He recognized that in the postwar period the mixed economy system had been a resounding success: "the third quarter of the twentieth century outshone any epoch in the annals of economic history" (1965, p.45). However, he was concerned about the future. How sustainable was the mixed-economy system that prevailed in Western democracies in the face of increasing social pressure? He could see "new forces developing in the wealthier nations" On one hand, "new demands for greater social responsibility are being made of business" while on the other, the "old demands—ever greater productivity and higher living standards for all—continue to be strongly pressed, perhaps even more so than at any time in the past" (Samuelson, 1972, p.176). What if governments (or voters) placed social demands on industry that industry couldn't meet without sacrificing productivity or innovation?

There is a dictum attributed to Lenin to the effect that we will ruin the capitalist system by debauching its currency. That is not a very intelligent way to hurt an economic system and advance the day of successful revolution. By contrast, there are few better ways to ruin a modern mixed economy than to insist on 40 to 70 per cent increases in money wage rates within a brief period of time. This, to a degree, has happened time and time again in the unhappy economic history of Latin America (ibid., p.176).

During the following decade, Samuelson wrote several articles in which he refined and developed his theory. At that time, the Iron Curtain was still standing and nobody foresaw how in 1989 it would crash down abruptly. However after the oil shock of 1973, the advanced Western economies gradually fell into what seemed a permanent stagflation. "Has the modern evolution of capitalism, the mixed economy, run out its string of luck?" wondered Samuelson in 1976. "Is the realistic outlook for the final quarter of the century a more somber one?"

(Samuelson, 1976a, p.47). He thought Schumpeter's prediction no longer seemed far-fetched but not for the reasons Schumpeter had envisioned.¹ Its failure and not its success was the problem. According to Samuelson the problem with Schumpeter's original thesis rested on his definition of socialism:

Somewhere Schumpeter proposes a more useful broadening of the word "socialism" beyond its original connotation of state ownership of the means of production. He speaks of "an extension of the public sector at the expense of the private sector" as constituting an extension of socialism... I must repeat that Schumpeter's thought was confused. He really did not expect the mixed economy, whose evolution he correctly perceived, to be a well functioning and stable way of running the railroad of modern social living. The fact that Schumpeter was, on the whole, wrong in this regard for the third quarter of the century should not blind us to the possibility that some of the malfunctionings he feared may be looming up more closely ahead in the last quarter of this century (1980, p.63).²

"What capitalism is succeeded by is not necessarily 'socialism' in any of the conventional senses of the word," Samuelson explained (Samuelson, 1981a, p.19). Samuelson also thought that Schumpeter's had equivocated on the definition of capitalism (Samuelson, 1981a, p.13). Finally, he questioned Schumpeter's optimism about capitalism's ability to "deliver the goods." Contrary to what Schumpeter had argued capitalism's success was not the problem but its failure. But failure had to be redefined in non-economic terms. "If we broaden our definition of failure to go beyond the behavior of broad real aggregates of output and income, if we include failure of a market system to provide what electors deem a fair and equitable degree of equality of income and opportunity –if we do this, we can assert with propriety and confidence that often failure of capitalism is what can be expected to result in its demise" (Samuelson, 1981a, p.19).

In 1980 Lester Thurow, a colleague of Samuelson at MIT, published a best-seller in which he argued that the US economy had become "zero-sum game" and its political system was unable to resolve pressing problems such as inflation, unemployment and stagnation (Thurow, 1980, pp.8-9, 11). Samuelson dismissed this notion even before Thurow wrote his book. He considered it "a false philosophy of despair" (Samuelson, 1978, p.233). However, he believed that stagflation was "intrinsic" to the mixed economy system. He was convinced that slower

¹ In fact, in his best-selling textbook Samuelson predicted that under an optimistic scenario (or pessimistic depending on one's view) the GDP of the USSR could surpass that of the US by 1990 (1976b, pp.882-883).

² It is Samuelson who seems to be confused. As we shall see below, Schumpeter did in fact a definition of socialism that encompassed a populist system.

growth lied ahead due for Western economies due to higher energy prices, increased laziness and slower innovation (Samuelson, 1980, pp.71-74). Even in a non-zero sum game, Von Neumann and Morgenstern's basic theorem still applied: in a democracy, the poorer 51% would use the state "to gang up" on the richest 49%. Well-intentioned policymakers' attempts to interfere with market mechanisms could make matters worse. Samuelson believed there was no guarantee that growing electoral demands for government intervention and income redistribution would result in optimal policies and avoid "all other temptations that involve deadweight loss and distortion" (ibid., p.72). Falling into those temptations was characteristic of "populist democracy."

It may be commendable tot take from the over-rich and give to the needy poor. But in doing this, the welfare state all too often impairs the incentives of the poor to do the actions that will lessen their poverty. And the process of taking away superfluous income from the affluent classes inevitably in some degree blunts the incentives of those taxpayers to produce useful goods and services (Samuelson, 1984, p.504)

Basically, you can't have your cake and eat it too. Only the size of "deadweight losses", tradition and the economic power of the "plutocrats" could prevent the onset of populist democracy (Samuelson, 1981a, p.19). Following Olson (1982), Samuelson worried that the struggle between different interest groups would end up in deadweight loss for society as a whole, i.e., it could lead to a "Pareto inefficient" situation (Samuelson, 1984, p.504). Argentina seemed to Samuelson a paradigmatic case that showed the consequences of yielding to the populist temptation. He recognized that in 1945 Argentina had not been in the same situation as the advanced Western economies at the time of his writings. Samuelson believed that what had led to populist democracy in the former was not stagflation but "considerable" inequality under a *laissez-faire* system. The proximate cause of the problem in each case was different but the consequences were the same: a majority of voters demanding government intervention to alter the income and wealth distribution generated by market forces and such intervention being sub-optimal. In other words, liberal democracy would inevitably give way to populist democracy:

John Adams and Alexander Hamilton warned against democracy. So did Edmund Burke and Thomas Babington Macaulay. Universal suffrage, they prophesied, would inevitably mean that the poorest 51 per cent of the population would pillage the property of the frugal middle classes... The deadweight loss of inefficient and unresponsive representative government simply decimates the total social pie that we call real gross national product.

The pace of economic progress is brought to a veritable halt as the government fritters away the resources needed for producing new capital equipment and plant, and as inept regulation poisons the wellsprings of technological advance and entrepreneurial innovation. Workers are hurt along with owners of property, since any rise in real wages must come primarily from the accumulation of capital and the improvement of skills and managerial techniques. At best, it is only the politicians and bureaucrats who fatten and thrive under populist democracy (1979b, pp.53-54).

In essence, Samuelson reformulated Schumpeter's thesis by redefining certain terms and inverting its argument. He replaced capitalism with a mixed-economy system, socialism with populism and electoral democracy with Madisonian democracy. He then argued that what would bring capitalism down would not be its success in delivering GDP growth but its failure to provide voters with the degree of equality of income and wealth they felt they deserved.

Samuelson believed democracy could survive under populism. He used the term "populist democracy" to describe this system. According to Boianovsky (2021), Samuelson borrowed it from Robert Dahl's *A Preface to Democratic Theory* (1956). In his book Dahl contrasted "populist democracy" –in which majorities exercised unlimited power– to "Madisonian democracy", which limited the power of majorities and protected the rights of minorities with a system of checks and balances (Dahl, 1956, p.34).³ There was one country in the world where "populist democracy" had achieved its fullest development and suffered its consequences also to the fullest: Argentina. In Samuelson's view the inherent tension between economic and political power, could turn a Madisonian democracy into a populist democracy:

The same gasoline that classical economists thought ran the *laissez faire* system, namely self-interest, will in the context of democracy lead to use of the state to achieve the interest of particular groups. It is a theorem of von Neumann's theory of games that this should be the case. Long before Marx, John Adams and Thomas Macaulay warned that giving votes to all would mean that the poorest 51% of the population would use their power to reduce the affluence of the richest 49% (1981b, p.43)... Social equilibrium *a la* Queen Victoria or Calvin Coolidge is unstable. If all groups but one adhere to its modes of behavior, then it definitely pays the remaining persons to form a

³ In contrast with Schumpeterian democracy defined as a "competitive struggle" for votes.

collusion and use the state to depart from the *laissez faire* beloved by Ludwig von Mises and Fredric Bastiat (1980, p.70).

If one accepted this premise, Samuelson said, the most likely evolution of the advanced Western economies was not toward socialism in any of its variants but toward populism Latin American style, specifically the system that, in his view, prevailed in Argentina, Chile and Uruguay:

The shadow on the wall for all of us, I fear, is not the totalitarian revolution of a Lenin or Mao. It is not a relapse into the *laissez faire* of Queen Victoria or President Coolidge. Argentina, I dare to suggest, is the pattern which no modern man may face without crossing himself and saying: "There but for the grace of God." In 1945, no competent economist could have predicted that countries like Argentina or Chile would fail to grow mightily in the next quarter of a century. With temperate climates, they stood at the take-off point for rapid advance. Yet, even before correction for burgeoning population numbers, their rate of real GNP growth has been almost negligible. How was this miracle contrived? The time has long passed when we can continue to blame Argentinian stagnation on Peron. Uruguay, the one-time Switzerland of Latin America, had no dictator. Yet it managed to escape economic growth (1971, p.278).

The history of the world would have been very different if in the 19th century a political leader in the advanced Western economies had followed the same policies that Perón followed in Argentina between 1946 and 1948:

If in the time of England's industrial revolution men had had the political power to try to rectify within a generation the unconscionable inequities of life, in which a privileged few live well off the sweat of the multitude, it is doubtful that the industrial revolution could ever have continued. The outcome would not have been a rational, planned economy with a Professor Tinbergen or Frisch at the helm. The outcome would have been legislated increases in money wages of as much as 40% per year. The outcome might well have been pretty much like that we have seen in those Latin American countries which have reached the brink of economic development while, so to speak, fully or overly developed in the political sphere (1971, p.277).

Although Samuelson partially exonerated Perón for Argentina's secular decline, he recognized that he had unleashed forces that had provoked it:

It is nonsense to continue to blame the dictator Peron for a stagnation in the Argentinian economy which has prevailed in the decades since he lost office. But it is not nonsense to infer that the populist imperatives upon which Peron so skillfully played have a pivotal role in explaining the miracle of Argentinian stagnation (1972, p.176).

Arthur Smithies, another student of Schumpeter, described Perón as a “*diabolus ex machina*” that was responsible for the divergence of economic performance of Argentina and Australia after WWII (Smithies, 1965, p.23). “Any sophomore could have told Peron that he was raising real wages far above the marginal product of labor at full employment. But unfortunately no sophomore had his ear”, wryly observed Smithies (*ibid.*, p.26). Friedman agreed: what changed Argentina was “the emergence of Mr. Peron and the Peronist movement” (1981).

Samuelson was so convinced of his argument that he reiterated it almost a decade later at a conference he gave in Mexico City about the prospects of the world’s economy at the end of the 20th century:

The human mind thinks in terms of overdramatic case studies. I suggest that to understand the future there may be a more useful paradigm than that suggested by Scandinavia, the Netherlands, or a typical mixed economy of Western Europe or North America. I am not proposing that we concentrate on the Yugoslavian experiment or on the pattern of an Eastern European economy such as Hungary or Poland. Instead I have in mind the Latin American example (1980, p.69).

In Samuelson’s view Argentina was the example *par excellence* of an economy whose stagnation did not result from “climate, race divisions, Malthusian poverty or technological backwardness.” Its problems were of a different nature. Argentine society, “not its economy, seems to be sick. Its political system does not function in a way conducive to productivity. And these sickness in sociology and government do impair the economic health of the Argentine economy” (1984, p.504).

At that time a foreign observer with limited knowledge of their history, could reasonably assume that Argentina, Chile and Uruguay suffered from the same malaise. The common symptoms were political instability, low economic growth and high inflation.⁴ The table below shows the averages for the last two variables for successive 5-year periods between 1960 and 1984. Until 1974, Argentina was experiencing the fastest economic growth but still

⁴ Brazil shared only two of these symptoms: political instability and high inflation.

trailed the global average by almost 1% per annum. Chile under the Allende regime, which unsuccessfully tried to implant an updated version of Marxism, was the first of the three countries to flirt with hyperinflation. In 1974 its annual inflation rate exceeded 600%. Argentina took the leadership in 1975-76 and had full-fledged hyperinflation in 1989-90. Although in a lesser degree than Argentina, Uruguay also experienced inflation, stagnation, military coups and political instability.

Inflation and Growth in The Southern Cone (1960-1984)

Period	Annual inflation rate			GDP per capita growth		
	Argentina	Chile	Uruguay	Argentina	Chile	Uruguay
1960-64	23.1%	25.3%	27.7%	2.2%	2.9%	0.2%
1965-69	22.6%	24.4%	73.8%	3.8%	2.6%	0.7%
1970-74	38.2%	258.7%	57.4%	2.8%	-0.4%	0.9%
1975-79	227.7%	140.6%	61.0%	0.2%	1.9%	4.1%
1980-84	268.0%	22.4%	44.2%	-1.7%	-0.9%	-2.5%

Source: World Bank, The Maddison Project and IMF.

According to Samuelson, in the Southern Cone countries development of electoral democracy had outpaced economic development. Or using Dahl's definition, populist democracy had gotten ahead of Madisonian democracy. In essence, Samuelson argued that in the Southern Cone countries a strong electoral demand for equality combined with a deep-rooted antipathy to business had aborted capital accumulation, which in turn had led to stagnation.

Although I am not an expert on Latin America, I cannot reject the suggestion that the slow growth of Argentina or of Uruguay (the one-time "Switzerland of South America") or of pre-Allende Chile is related to the fact that these societies are neither fish nor fowl, nor good red herring. They place social demands on industry that industry simply cannot effectively meet. Antipathy toward the corporation and the bourgeois way of life has served to hamstring performance (1972, p.176).

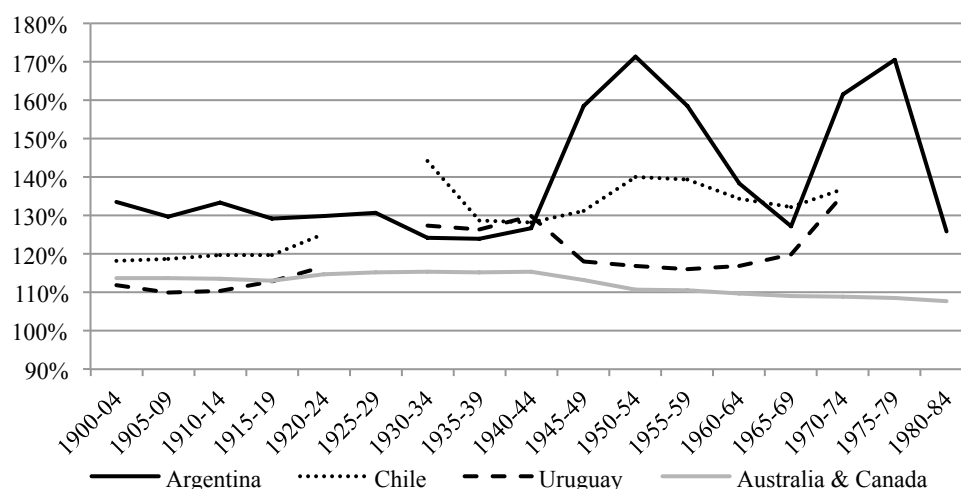
In Samuelson's view, populist policymakers in Argentina, Chile and Uruguay had attempted to rectify "the inevitable inequities of life" within a generation by massive income and wealth redistribution:

The southernmost countries of Latin America have fallen most markedly below their post-war potentials for development. The reasons do not seem to be narrowly economic. We cannot explain what has happened by appeal to Malthus's law of diminishing returns. There has been no exogenous shift in world demands peculiarly unfavorable to that region of the world. Their

sickness, Schumpeter would claim, is political and sociological rather than economic. It has to do with the breakdown of social consensus. It has to do with the workings out of the logic of populist democracy (1980, p.69).

Samuelson's hypothesis seems to be supported by the data. The V-Dem index of electoral democracy (IED) serves as proxy for the former while the index of liberal democracy (ILD) for the latter. The ratio IED/ILD is a proxy for the supremacy of "populist democracy" over Madisonian democracy. The chart below compares its evolution from 1900 until 1984 using data only for the years in which a legitimately elected president governed in each country. At least for this period, the ratio appears to be a good indicator of the prevalence of populism.⁵ In the case of Argentina it reached its maximum values in 1945-55 and 1973-75, when Perón was in power. In the case of Chile, during the presidency of Salvador Allende (followed closely by that of Ibañez del Campo in the 1950s). In contrast, on average, Uruguay consistently exhibited a relatively lower ratio reflecting a stronger democratic tradition.

Supremacy of Populist Democracy over Madisonian Democracy (1900-84)



Source: V-Dem Institute. Note: Only years in which electoral democracy was present are used to calculate the period average.

Even after the fall of the Berlin Wall, Samuelson remained convinced of his thesis that the political instability of capitalism arose out of its inability to provide what "electors deem a fair and equitable degree of equality of income and opportunity" (1981a, p.19). In 1997 he wrote an outline for a conference he planned to give in Buenos Aires in which he repeated his argument of how income and wealth inequality generated electoral demands that thwarted Argentina's growth after World War II:

⁵ Both the IED and the IDL reflect subjective assessments. In recent decades, the assessments are more questionable. For example, in 2020 the IDL increased in Argentina and decreased in Chile and Uruguay, which does not seem an accurate reflection of reality.

There was a history of considerable inequality of wealth between rich landowners and uneducated urban populations. Democracy, as elsewhere in Latin America, evolved in a *populist* direction... by promising the lower-income majority programs that would interfere with the verdicts of competitive markets (cited by Boianovsky 2021, p.25).

At the Mexico City conference in 1980 Samuelson wondered if it was too far fetched “as we try to peer into the decades just ahead and do so against the backdrop of the 1970’s era of worldwide stagflation, to fear that many of our mixed economies will begin to suffer from their own version of the Argentinian sickness? (1980, p.68).” At the time Samuelson saw Pinochet’s imposition of monetarism as the “fascist solution” to the problem posed by “populist democracy.” He also believed the same type of political regime would be necessary for monetarism “to succeed in fighting stagflation in the U.S. and in the U.K” (Boianovsky, 2021, p.4).

3. A Critique of Samuelson’s Thesis

The Reagan and Thatcher revolutions dealt a big blow to Samuelson’s argument. A year before Reagan’s victory he predicted that “middle class backlash and taxpayer revolts will not achieve restoration of Herbert Spencer’s *laissez faire*” (1978, p.53). After the fact he considered it as a “rational and not an irrational reaction to America’s inflation and stagnation during the 1970s” (Samuelson, 1981a, p. 10). Then came the fall of the Berlin Wall and Deng’s reforms in China. It seemed then that Schumpeter’s prediction –both in its original form and as reformulated by Samuelson– had to be definitely discarded. What collapsed was not capitalism but socialism in most of its existing variants. For the advanced Western economies, the Argentine scenario Samuelson had fretted for over a decade seemed as far-fetched as the impending collapse of capitalism. Even in Argentina a Peronist president embraced free markets! Samuelson was also wrong about monetarism and Chile. He predicted that Pinochet regime (or what he described as a system as “Chicago economics imposed by force”) would never evolve into a democracy:

History records no known case where fascism succeeds even on its own economic terms for any sustained period. Alas, such systems cannot evolve into normal democracies... dictators dare not ease up on repression (1980, p.76).⁶

⁶ Treisman (2020) found that since 1800 only approximately up to one third of transitions from authoritarianism to democracy originated in a deliberate decision by incumbents. However, the percentage has declined in recent decades.

As it turns out, Chile did indeed evolve into a democracy and not due to a revolution but to a decision made by the dictator himself (under pressure from other members of the *Junta*.) And the governments that Chilean voters freely elected after 1990 did not give up on Chicago economics (partly as a result of the electoral system imposed by Pinochet.) As a result, Chile became the most economically advanced democracy in Latin America. The gains were not limited to the economy. Institutional quality improved and poverty levels fell. Samuelson later recognized these facts and “hailed Chile’s “excellent recovery from its socialistic venture and ensuing military fascism” (Boianovsky, 2021, p.28).

Populism and Inequality

Samuelson’s game theory argument was logically flawless but inadequate to explain current or past populist waves. Economic theory is a powerful tool but it cannot capture several important dimensions of populism (for a review of the literature on the subject see Ocampo, 2019.) Which doesn’t mean that his writings on the subject are worthless or irrelevant. Samuelson pioneered the economic analysis of populism. As pointed out by Boianovsky (2021), Samuelson’s emphasis on the political consequences of inequality in a democratic setting anticipated the Median-voter Theorem (see Romer, 1975 and Meltzer and Richard, 1981).⁷

However, Samuelson didn’t explore the full implications of his argument. If inequality was the main cause of populism it should have grown and developed more rapidly in countries such as Mexico or Brazil not in Argentina that had a large middle class. When it comes to populism what matters is not absolute inequality between rich and poor as Samuelson argued, but the inequality felt by the middle class, the largest block of voters in most democracies with some degree of development (and where the median voter resides.) An analysis of the evidence from OECD countries suggests that when the middle class feels it is closer to the poor than to the rich it forges an alliance with the former to vote in favor of redistributive policies (Lupu and Pontusson, 2011).⁸ This problem was particularly acute in countries such as Argentina that had become very prosperous in the lapse of two generations. As Huntington explained in his classic treatise, “not only does social and economic modernization produce political instability, but the degree of instability is related to the rate of modernization” (Huntington, 1968, p.45).

By focusing solely on inequality, Samuelson distanced himself from Schumpeter, whose argument about the demise of capitalism was “by no means wholly economic” (Schumpeter,

⁷ According to this theorem a widening gap between the income level of the median and the average voter will lead to higher taxes and income redistribution.

⁸ Income redistribution alone does not necessarily imply or generate populism (although populism always entails some form of income or wealth redistribution).

1942, p.384).⁹ Schumpeter had not considered inequality as a key factor that would drive a society to embrace socialism because he saw no reason to believe that “the distribution of incomes or the dispersion about our average would in 1978 be significantly different from what it was in 1928” (ibid., pp.65-66). However, he recognized that fostering “the association of inequality of any kind with ‘injustice’” was an important “element in the psychic pattern of the unsuccessful and in the arsenal of the politician who uses him” (ibid., p.254).

Collective Narcissism and Populism

Samuelson ignored another key factor that must be incorporated into any explanation of populism: extreme nationalism. Schumpeter had recognized the importance its as a political force when he observed “to exalt national unity into a moral precept spells acceptance of one of the most important principles of fascism” (Schumpeter, 1942, p.352) The same can be said about populism. Samuelson never even considered this “moral precept” as a factor in his theory of the rise of “populist democracy.” Which is surprising given that in his best-selling economics textbook he described Perón as a fascist dictator and explained that “fascist movements are always highly nationalistic” (Samuelson, 1976b, p.870).

According to Gellner (1983), nationalism can be considered as an ideology, a feeling and/or a movement. The last two derive from the first. The ideology holds as a basic principle the congruence between political and national unity. Nationalist feeling emerges from this principle: if it is violated it generates frustration and anger; if it is fulfilled, satisfaction and pride. A nationalist movement embraces nationalist ideology and is fueled and driven by nationalist sentiments.

The emotional and psychological basis of nationalism is collective narcissism, a concept originally introduced by Freud (1921) and later developed by Adorno (1963) and Fromm (1964, 1973). In recent decades social scientists have incorporated collective narcissism in their theories of populism (see for example Marchlewska et al (2018), Golec de Zavala and Keenan, 2021, and Golec de Zavala and Lantos, 2020). At the individual level, narcissism is a state that can be described “as a state of experience in which only the person himself, his body, his needs, his feelings, his thoughts, his property, everything and everybody pertaining to him are experienced as fully real, while everybody and everything that does not form part of the person or is not an object of his needs is not interesting, is not fully real, is perceived only by intellectual recognition, while affectively without weight and color” (Fromm, 1973, p.201). The narcissist must “protect” this perception of superiority, since both his sense of worth and his sense of identity are based on it. Any threat to it is considered an existential

⁹ It is true that Samuelson recognized the importance of sociological factors but he did not incorporate them into his theory.

threat. If a narcissist is ignored, criticized, defeated, he/she tends to react aggressively: the greater the wound to the ego, the greater the resentment it generates. A society exhibits collective narcissism when a majority (or a significant proportion of its members) have an exaggerated and unrealistic perception of national greatness or superiority, requiring permanent external validation or recognition. This perception is fed by an idealized interpretation of the origin of the nation. The conviction about national superiority does not sound at all unreasonable to those who suffer from this condition. On the contrary, it sounds like patriotism, faith and loyalty. Being shared by a majority, it can even seem perfectly valid and justified. That is to say, the consensus manages to transform a fantasy into reality, since for the common people reality is what the majority believes and not what results from rational analysis. Collective narcissism not only exalts national superiority but also denigrates everything foreign. It is particularly sensitive to any real or imagined aggression to this perception of superiority, which almost automatically provokes an openly hostile reaction. As Fromm explained, collective narcissism is one of “the most important sources of human aggression, and yet this, like all other forms of defensive aggression, is a reaction to an attack on vital interests” (Fromm, 1973, p.205).

Samuelson was right that Argentina’s evolution towards a “populist democracy” offered a cautionary tale to the US and other Western advanced democracies but it was not the one he derived from his emphasis on inequality and his erroneous interpretation of Argentine history. The common thread that links Trumpism with 1940s Peronism is threatened collective narcissism (for an analysis of the former see Federico and Golec de Zavala, 2018.)

The Rise of Populism in Argentina

Argentina is the only country that seems at *prima facie* to have proved Samuelson and Schumpeter (partially) right. Under the guise of “social justice”, in 1946 Perón replaced a relatively well-functioning capitalist system that had generated high levels of prosperity with a system in which the state (he) made all the important decisions concerning the allocation and remuneration of economic resources. The consequence was a decades long economic decline that continues today.

As already mentioned, Argentina played a central role in Samuelson’s reformulation of *Capitalism, Socialism and Democracy*. However, his over-simplified interpretation of Argentine history seems like an attempt to fit the facts to his theory. When Perón rose to power in 1943 Argentina was the richest country in Latin America, had by far the largest middle class in the region, its economy was close to full employment and real wage levels were higher than in 1939. It is true that growing inequality in the distribution of economic and

political power contributed to Perón's electoral success. Between 1933 and 1943, the top 1% increased its share in national income from 17% to 26%. This rise in inequality in the 1930s was not due to the concentration of land ownership in the hands of a few "oligarchs" as Samuelson believed. In reality, it owed more to industrialization. According to income tax records, in 1941 more "top bracket taxpayers derived their income from industry than from agrarian sources" (Weil, 1944, p.154). This is what Lewis and Kuznets would have predicted in a rapidly industrializing economy.

However, economic inequality alone cannot explain the rise of "populist democracy" in Argentina. Samuelson failed to take into account other decisive factors. First, in Argentina populist democracy is inextricably linked to Perón and the Peronist party, neither of which emerged out of the voting booth but out of an authoritarian proto-fascist regime. With the exception of Menem during the 1990s, the Peronist party has been the main "enabler" of populism.¹⁰

Second, the Argentine variant of populism was significantly different from the Chilean and Uruguayan ones: it was more virulent and persistent, two traits that can be traced back to its origins. As the editor of the leading financial weekly in Argentina explained in 1971 in response to one of the first of Samuelson's articles on the subject, "the fact is that on any careful analysis, Argentina is still crippled by the economic, social and political consequences of the Perón regime (*The Review of the River Plate*, 1971, p.509)." This is as true today as it was then.

Third, as Waisman (1989a, 1989b) has argued, the military coup that started Perón's political career was the reaction of an autonomous state elite –the army– to the dislocations produced by the Great Depression and the geopolitical realignments generated by WWII. This reaction was initially not channeled through democratic institutions but through a military coup orchestrated by a group of junior officers led by Perón. Their objective was to neutralize two threats to Argentina that they perceived as imminent and existential: a communist take-over (as it had happened in Spain in 1936) and the growing influence of the US in South America.¹¹ Extreme nationalism, a profound anti-liberalism, an admiration for Hitler and Mussolini and a euro-centric conception of international affairs fed this erroneous diagnosis. Regarding the first threat, despite the warnings of "vociferous intellectuals", communism was not a threat to the status quo (Weil, 1944, p.7).¹² There were no starving masses in Argentina

¹⁰ Since 1955, the Radical Party, which until the emergence of Peronism, was the largest in the country also attempted briefly and unsuccessfully to implement a "well-mannered" type of populism.

¹¹ A subsidiary objective was to prevent free elections from taking place.

¹² Weil was a wealthy German-Argentine who in his youth had been a hard core communist sympathizer and in the 1920s served as the Komintern's agent and liaison in Latin America. After a brief stint as advisor to the Finance Minister of Argentina he settled in the US. Weil was the main financial sponsor of the Frankfurt School.

in 1943 or 1945. A foreign journalist living in Buenos Aires at the time observed that “the Argentine nation is probably the best nourished in the world” (Greenup and Greenup, 1947, p.25). The *Los Angeles Times* correspondent noted that “food for home consumption is abundant and comparatively cheap” (Josephs, 1944, p.92). Perón himself had complained years earlier that Argentina’s main problem was an excess of well being and abundance, which conspired against the “virtuousness” of its people (Cloppet, 2018, p.140). As to the second threat, it had to a large extent been provoked by Argentina’s policy of openly confronting the US, particularly after December 7, 1941. For several years Argentina was the only country in Latin America that refused to break relations with Nazi Germany. The military regime confronted the United States even after it was obvious it would emerge victorious from WWII. This policy was “pure folly” and imposed heavy costs on the Argentine economy (Escudé, 2006, p.2). However, confronting the *yanquis* –and their alliance with Brazil– was the *raison d’être* of the June 1943 coup. The rise of Peronism owes more to wounded national pride than to income inequality. Although Perón’s anti-American policy was very costly to Argentina it was extremely popular.¹³

Fourth, in Argentina “populist democracy” did not emerge out of an electoral demand for redistribution. It was a deliberate strategy adopted by Perón to maintain power after the military regime that he had led for two years crumbled under political and social pressure. Perón reversed the course taken by European fascism and took Argentina from authoritarianism to electoral democracy. He was more powerful in the former than in the latter.

Interestingly, Samuelson failed to see the parallels between the political careers of Perón and Pinochet. As mentioned earlier, he didn’t believe a fascist regime could ever become democratic (or less authoritarian.) This is in fact what Perón accomplished in 1946.¹⁴ The chart below shows the evolution of the indices of electoral and liberal democracy for Argentina from 1922 until 1954. Although the absolute levels are questionable, they provide a reasonable approximation. The military coups of 1930 and 1943 (Perón was a minor player in the first and a leading one in the second) had a significant and lasting negative impact on the quality of liberal democracy. After the election of Peron in 1946, there was an initial improvement in the quality of electoral democracy (which never attained the pre-1930 levels) followed by a gradual decline. From a political standpoint, between 1942 and 1954 Argentina

¹³ Given the level of foreign direct investment, the democratic nature of its government and the convictions of most political leaders, in 1939 Argentina was the natural ally of the Allied Powers in South America. Instead, by embracing a false neutrality it left a space that was quickly filled by Brazil under the guidance of Souza Aranha. In 1940, US FDI in Argentina was 60% higher than in Brazil, and by 1955 it was 60% lower (Díaz Alejandro, 1970, p.266).

¹⁴ Once in power, Perón turned back to his roots and became increasingly authoritarian.

completed a full circle, transitioning from anocracy to authoritarianism to democracy and then back to anocracy.



Source: V-Dem Institute.

How did Perón accomplish this extraordinary transition? After Germany's surrender in April 1945, the days of the pro-Axis military regime were counted. Perón decided to take a political gamble and run for president. He had studied *Mein Kampf* and Le Bon's *Psychologie des Foules* and while in Italy had witnessed how Mussolini stirred the masses with rousing speeches and propaganda. He felt confident he could emulate *Il Duce* while avoiding his mistakes. Once the military regime announced that elections would be held, Perón took advantage of his significant political influence to prop up his presidential candidacy. He covered himself with the mantle of social justice, actively resorted to government financed handouts to labor unions and, more importantly, strident nationalism.

In his campaign Perón counted on two powerful allies: the Catholic Church and the US Department of State. The former viewed with sympathy a movement that supposedly followed Catholic "social doctrine" and proposed to adopt a "third way" equally distant from communism and liberal democracy. The Catholic Church hierarchy openly supported Perón in the 1946 presidential elections (Zanatta, 1999, pp.241-256).¹⁵ As to the US State Department, it unwittingly helped Peron whom it considered its worst enemy in the Americas. Spruille Braden, who after the end of WWII was appointed US ambassador in Argentina, tried to interfere publicly in domestic political affairs. According to his British counterpart, Braden came to Buenos Aires "with the fixed idea that he had been elected by Providence" to overthrow Perón and the military regime (Kelly, 1953, p.307). Braden's conduct during his

¹⁵ The relationship between Perón and the Church would later deteriorate and lead to his ouster in 1955.

brief stint in Argentina was completely counterproductive. Perón used the slogan “Braden or Perón” to great effect during his campaign. He tapped a deep-rooted resentment against the US, which for many Argentines was the main threat to their country’s greatness. Perón’s landslide election in February 1946 was a foregone conclusion (ibid., p.311.)

The memoirs of Sumner Welles, US Under Secretary of Inter American affairs during the period 1937-1943, help elucidate the popularity of Perón’s nationalism. Welles had started his career as a diplomat in Buenos Aires in the early 1920s and understood Argentine people and politics extremely well. Until his ouster from Foggy Bottom in 1943 he was in charge of FDR’s policy toward Latin America.

Argentina is a country which is in many ways unique. Throughout her independent life, she has been one of the richest agrarian nations of the world, with only a recent spurt towards industrialization, and yet more than two thirds of her nearly fourteen million inhabitants live in large cities. Her foreign trade has been the highest per capita of any country on earth. But of her exports only 10% have been shipped in normal times to the US and of her imports only some 15% came from this country. These facts help to explain why Argentina has always regarded herself as far closer to Europe than to the rest of the Western Hemisphere... There is no more vigorous and assertive people of the New World [than the Argentines], nor is there a more adult people in the Americas. Pride of nationality and faith in the destiny of the Argentine nation are so powerful that the second-generation Spaniards and Italians who comprise the bulk of recent immigrants are just as devout exponents of “*argentinidad*” –the privilege of being part of the life of Argentina– as are the descendants of the colonial pioneers. Like all Spanish Americans, the Argentine people are exceedingly individualistic. But beyond all others they are given to an exaggerated nationalism. This quality stems in part from the heritage of Spanish civilization which colors every aspect of Argentine life and in part from their belief in their special star as well as from their remembrance of the valor and determination with which in the earlier decades of their national history they successfully repelled all attempts at alien control, whether Spanish, French or British (Welles, 1946, pp.186-187).

Francis Herron, an American journalist that visited Argentina in 1942, also noted the natives’ extreme national pride, a strong belief in their superiority vis-à-vis the rest of Latin America,

and a profound dislike of the United States.¹⁶ These feelings subsist today despite Argentina's failure. In the annual *Latinobarometro* surveys since 2000, on average, the country exhibits the strongest negative view of the United States among eighteen Latin American countries.¹⁷ National pride and anti-Americanism figured prominently in Peron's rhetoric and dictated his economic and foreign policies from 1943 until 1953. During their 12 years in power the Kirchners followed an antagonistic foreign policy and also fostered an anti-American feeling. Increasingly frustrated collective narcissism is still a powerful political force in Argentina.

Samuelson agreed with Schumpeter that a general atmosphere inimical to business and businessmen was an important factor in undermining capitalism. Perón tapped to his advantage a cultural bias against capitalism that, as Herron's observations prove, preceded him:

Argentine society depends upon governmental paternalism. Government, not individuals or individual enterprise, creates the great utilities of the nation, influences the educational system, and directs the development of the country. Enterprise in the Argentine is something which the people believe must be "fomented" by government... Foreign capital is regarded as predatory, and whether it be of English, United States or German origin it is not popular... In a country where individual enterprise is uncommon and where success is difficult to achieve, wealth can most easily be obtained by a quick stroke at the expense of others. Hence a capitalist is not esteemed. He is considered to be a schemer, an opportunist, at times even a thief. A capitalist is not admired; he is more hated than admired. A capitalist is not regarded as one who promotes civilization; he is thought of as a plunderer. If he does good, it is regarded as a simulation, and the good he does is presumed to be for the ulterior purpose of placing himself in a position so that he can make another profitable deal at the expense of others. This conception of the capitalist has been inherited from the Spanish colonial system (1943, p.155-156).¹⁸

Finally, one factor that Schumpeter emphasized but Samuelson neglected –the influence of hostile intellectuals– was also present in Argentina. Perón imbibed a strain of illiberalism that combined nationalism, Catholicism and authoritarianism and had gained strength in the 1920s and 1930s (see Ocampo 2020a and 2020b).

¹⁶ During the first half of the 20th century governing elites perceived the US as a threat to Argentine superiority.

¹⁷ Anti US sentiment in Argentina is higher than in Colombia, Dominican Republic, Guatemala, Mexico and Panamá, countries that at some point were attacked and/or occupied by the US military.

¹⁸ Perón tried to enlist the support of the business establishment but failed. This failure pushed him to rely more on the support of the unions (Horowitz, 1980).

Populism and Socialism

By combining insights from history, economics and sociology Schumpeter provided a better – though still incomplete– explanation of what happened in Argentina after 1945 than his pupil. In fact, Argentina is the only country that proved him right. This statement does not require any definitional alteration. In a postscript to *Capitalism, Socialism and Democracy*, Schumpeter defined socialism as “that organization of society in which the means of production are controlled, and the decisions on how and what to produce and on who is to get what, are made by public authority instead of by privately-owned and privately-managed firm” (Schumpeter, 1942, p.421). Let’s compare this definition with a description of the economic system prevailing in Argentina in 1955:

During the past ten years Argentina has become a clear-cut case of a managed economy. The Government itself comprises by far the outstanding power group and has developed an elaborate system for implementing its plans for guiding industrial or other economic developments into desired paths... The large landowners, who once constituted the principal economic and political pressure group of Argentina, are no longer of much influence, although they have not been disturbed in the ownership of their properties. The Government itself, and the bureaucracy which composes it has replaced them as the prevailing There is close government control of many types of economic activity; and the official rather than the landlord or the businessman is at the helm (Department of State, 1955, pp.3,51).

Peronism fits well into Schumpeter’s definition of socialism from which it follows that Argentina proved his theory. Although Schumpeter did not explicitly anticipate populism per se, he was close. In fact when arguing against the postulate of voting rationality, he mentioned, in support of his thesis, the writings of Gustave Le Bon, whom he considered “first effective exponent of the psychology of crowds” (p.257). According to Schumpeter, Le Bon had shown “the realities of human behavior when under the influence of agglomeration—in particular the sudden disappearance, in a state of excitement, of moral restraints and civilized modes of thinking and feeling, the sudden eruption of primitive impulses, infantilisms and criminal propensities—he made us face gruesome facts that everybody knew but nobody wished to see and he thereby dealt a serious blow to the picture of man’s nature which underlies the classical doctrine of democracy and democratic folklore about revolutions.” Although Schumpeter believed Le Bon’s inferences did “not fit at all well the normal behavior of an English or Anglo-American crowd” he thought it would be a mistake to ignore the political implications of mass psychology:

The phenomena of crowd psychology are by no means confined to mobs rioting in the narrow streets of a Latin town. Every parliament, every committee, every council of war composed of a dozen generals in their sixties, displays, in however mild a form, some of those features that stand out so glaringly in the case of the rabble, in particular a reduced sense of responsibility, a lower level of energy of thought and greater sensitiveness to non-logical influences. Moreover, those phenomena are not confined to a crowd in the sense of a physical agglomeration of many people. Newspaper readers, radio audiences, members of a party even if not physically gathered together are terribly easy to work up into a psychological crowd and into a state of frenzy in which attempt at rational argument only spurs the animal spirits” (ibid., p.257).

Schumpeter knew the limitations of his theory. A few months before his death, he wrote in a letter that “if I had to write this book over again, I would have to add several other factors that have of late impressed me as proof positive that our society is developing toward socialism at an increasing speed” (cited by Swedberg, 1992, pp.358-359).

Schumpeter: An Intellectual Forefather of Peronism?

Ironically, even though Argentina under Perón came closest to proving *Capitalism, Socialism and Democracy* right, it did so by applying the ideas that Schumpeter preached in the last years of his life (see Solterer, 1950 and Waters, 1961 and Swedberg, 1992).¹⁹ In Schumpeter’s view, neither bolshevism nor democratic socialism offered an answer to the problems of the postwar era. Instead, particularly in Catholic countries where the Vatican’s influence was strong –such as Argentina and many other countries in Latin America– he recommended the “third way” between *laissez-faire* and socialism offered by corporatism (McGrath, 2007, p.427). At a conference he gave in Montreal in 1945, Schumpeter argued that “corporatism of association would eliminate the most serious of the obstacles to peaceable cooperation between worker and owner” (cited by Swedberg, 1991, p.405). Four years later, in a postscript to *Capitalism, Socialism and Democracy*, he proposed a “reorganization of society on the lines of the encyclical *Quadragesimo anno*, though presumably possible only in Catholic societies or in societies where the position of the Catholic Church is sufficiently strong, no doubt provides an alternative to socialism that would avoid the ‘omnipotent state’ ” (Schumpeter, 1942, p.422).

¹⁹ Interestingly, Peronist “intellectuals” and policymakers have never acknowledged any influence by Schumpeter. Perón himself claimed to have been inspired not only by “Christian socialism” but also by the policies of Franklin D. Roosevelt and the ideas of Harold Laski.

Issued by Pope Pius XI in 1931, when fascism still enjoyed some respectability, *Quadragesimo Anno* condemned both communism and capitalism and proposed a “third way.” This document updated Catholic Social Doctrine (CSD), first developed by Leo XIII in *Rerum Novarum* published in 1891. In the economic sphere, Pius XI advocated the type of corporatism that Mussolini had successfully implemented in Italy.²⁰

According to Schumpeter, *Quadragesimo Anno* “recognizes all the facts of the modern economy. And, while bringing a remedy to the present disorganization, it shows us the functions of private initiative in a new framework. The corporate principle organizes but it does not regiment. It is opposed to all social systems with a centralizing tendency and to all bureaucratic regimentation; it is, in fact, the only means of rendering the latter impossible.” Schumpeter explained that “the corporate principle organizes, but does not regiment. It is opposed to all systems with a centralizing tendency and to all bureaucratic regimentation.” Corporatism was not simply “the vision of an ideal” he clarified. The Pope, he wrote, “was showing us a practical method to solve practical problems which, through the impotence of economic liberalism to solve them, call for the intervention of political power” (Swedberg, 1991, p.404). In *History of Economic Analysis* (1954) Schumpeter didn’t spend more than one paragraph on CSD. He described Pius’ encyclical as a “normative program” rather than “a piece of analysis”, he identified Heinrich Pesch, a German Jesuit priest, as *Quadragesimo Anno*’s intellectual forefather and defined corporatism as a “definite scheme of social organization that, making use of the existing elements of group wise co-operation, visualized a society—and a state—operating by means of self-governing vocational associations within a framework of ethical precepts” (Schumpeter, 1954, p.732).

Perón always emphasized the strong connection between Peronism and the CSD. In fact, he considered his “doctrine” as “the Christian social doctrine, which is the only one that has known how to unite the material with the moral in extraordinary harmony. He has known how to put the body in agreement with the soul, and in societies he has known how to harmonize the dominant with the dominated” (Perón, 1947, p. 65).

It is unclear whether Schumpeter considered Peronism as a practical implementation of *Quadragesimo Anno* (he never identified any country as having done so.) However, it is hard to imagine he would have approved of Perón’s political methods or policies. In *Capitalism, Socialism and Democracy* he noted that “democratic phraseology has been instrumental in fostering the association of inequality of any kind with ‘injustice’ which is so important an element in the psychic pattern of the unsuccessful and in the arsenal of the politician who uses

²⁰ However, in another encyclical –*Non abbiamo bisogno*– the Pope condemned fascism for its “pagan worship of the State.” Mussolini was an atheist but he maintained a relatively amicable relationship with the Vatican.

him” (Schumpeter, 1942, p.254). It is more likely he had his compatriot Dolfuss or Portugal’s Salazar in mind, i.e., a “benevolent” non-demagogic authoritarian system.²¹

Schumpeter failed to realize that corporatism was not a viable alternative to democratic capitalism but instead would accelerate the decline of both capitalism and liberal democracy. Since he died in 1950 he would have had plenty of opportunity to assess the disastrous effects of Perón’s policies (two of his brightest students did). Interestingly, Samuelson never delved into this aspect of Schumpeter’s thought in the many articles he wrote about the subject.

Chile and Uruguay are Different from Argentina

Although Argentina proved one of Samuelson’s arguments it refuted another. Shortly after the conference Samuelson gave in Mexico City in 1980, Argentina, as well as most other countries in South America, gradually returned to democracy. In the Southern Cone Argentina led the way in 1983, Uruguay followed two years later and Chile in 1990. Except for the latter, which under the Pinochet regime successfully pushed for structural reforms, the 1980s were a “lost decade” characterized by high inflation and negative economic growth.

In Argentina’s first elections since 1973, a center-left coalition led by Raul Alfonsín soundly defeated the Peronist party raising hopes that the country would be able to overcome the legacy of populist democracy and military regimes. However, the new administration adopted the same economic policies that under Peronism had led to the stagnation of the Argentine economy: protectionism, fiscal profligacy and nominal wage increases divorced from productivity.²² The inevitable consequence of this policy mix was growing inflation. By mid-1985 consumer prices were increasing at 30.5% a month. Alfonsín changed tack and launched the Austral Plan, a hybrid stabilization plan that combined heterodox and orthodox measures. A change in expectations led to an initial success but by October 1987 the monthly inflation had exceeded 20%. The absence of structural reforms and growing fiscal deficits in a context political weakness pushed Argentina into a full-fledged hyperinflation for the first time in its history. In the 1989 election, a Peronist candidate, Carlos Menem, won by a landslide having campaigned on a classic populist platform. To everybody’s surprise Menem he embraced free markets and privatizations. In January 1991, he appointed Harvard trained economist Domingo Cavallo as economy minister. A few months later, Cavallo launched the Convertibility Plan, which established a fixed parity between the peso and the dollar and prohibited the Central Bank from financing the treasury. The plan also contemplated the deregulation of the economy, lower tariffs and the privatization of all state-owned companies.

²¹ His fellow Austrian Ludwig von Mises had briefly served as economic advisor to Dolfuss.

²² Despite Alfonsín’s attempt to seduce them, labor unions remained loyal to Peronism and actively sought to destabilize his government.

During the 1990s it seemed as if the Southern Cone had finally escaped from the populist curse: all three countries achieved high economic growth and relatively low inflation under democratic government.

	Annual Inflation			Annual GDP per capita growth		
	Argentina	Chile	Uruguay	Argentina	Chile	Uruguay
1981-90	787.0%	20.5%	62.5%	-2.4%	1.5%	-0.1%
1991-99	22.3%	9.5%	38.1%	3.2%	4.5%	2.5%

Source: IMF World Economic Outlook.

The turnaround for Argentina was notable: from 1992 until 2000, it had one of the lowest inflation rates in the world and its economy boomed. More importantly, a Peronist government was responsible for these results. However, the bonanza did not last. By the end of the decade an appreciating peso, cumulative fiscal imbalances at the provincial level, a heavy debt load and the effect of several international crises had undermined investors' confidence in the convertibility of the peso. In December 2001, the IMF withdrew its financial support triggering a massive economic and political crisis. President De la Rúa and Cavallo resigned and a new government controlled by the Peronist party repealed the Convertibility law, devalued the peso and defaulted on Argentina's public debt. During 2002 GDP contracted by 11.7%, the worst recession since 1914.

In early 2002, thanks to China's extraordinary economic growth, a new commodity super-cycle was underway. The sharp rise in the price of soybean and its byproducts, which accounted for a third of the country's exports, supported Argentina's recovery and, thanks to export taxes, also increased treasury revenues. Nestor Kirchner, a Peronist, became president in 2003 but despite traditional populist rhetoric, he initially maintained fiscal and current account surpluses. However, by the end of his mandate, he and his wife Cristina Fernandez, who succeeded him in December 2007, convinced themselves, just like Perón had in 1946 and 1973, that agricultural commodity prices would remain high forever. Populism came back with a vengeance. After several years of net fiscal surpluses, an anomaly in Argentina's history, the Kirchners increased primary expenditures from 13% to 24% of GDP. Social programs and subsidies to urban consumers accounted for most of the increase in public spending. The classic Peronist recipe of redistributive fiscal profligacy and monetary expansion lasted until mid 2012, when commodity prices started to decline.

Fiscal unsustainability is a typical feature of populism. Even though in the 1990s under Menem's government Argentina had pioneered the establishment of fiscal rules in Latin America, compliance was never strong and grew increasingly weaker. Another feature of populism is the pro-cyclicality of the fiscal stance. A recent IADB study found that among

developed and emerging economies, between 1980 and 2016 Argentina had the highest correlation between GDP and both total primary and discretionary public expenditures (Izquierdo, Pessino and Vuletin, 2019, pp. 23, 27). A third, and even more troubling, feature of populism is economic unsustainability, in turn generated by the distortive effects of a large, expensive and inefficient public sector.

Since 2010, Argentina not only had significantly larger deficits than Chile and Uruguay but also significantly higher public revenues and expenditures. The IADB study also revealed that Argentina had the highest levels of spending at all levels of government in Latin America (Izquierdo, Pessino and Vuletin, 2019, pp.49, 91). The cost of the Argentine welfare state is comparable to that of OECD countries with much higher GDP per capita. Public sector employees represent 20% of the labor force and their remuneration, at 14% of GDP, is the highest in the region (*ibid.*, pp. 56-57). Losses due to waste and inefficiencies in government spending amounted to 7.2% of GDP in Argentina (the highest in the region), compared to a 4.4% average for Latin America, 3.7% for Uruguay and 1.8% for Chile (*ibid.*, pp. 63-64). In contrast, despite rising prices for their main commodity exports, Chilean and Uruguayan policymakers resisted the populist temptation and reinforced their commitment to fiscal and monetary discipline.

Since the beginning of the 21st century, Chile has been Latin America's "poster child" of successful free market reforms. Thanks to Central Bank independence and disciplined fiscal policy Chile has enjoyed the highest credit rating in the region. Unfortunately, there is a significant risk that the political crisis that started in October 2019 may end up undermining the "Chilean miracle", particularly if an upcoming referendum favors a constitutional reform. In Uruguay successive governments have consistently maintained a primary fiscal surplus (even those of a leftist ideology).²³ Uruguay's Central Bank has also remained independent from the Executive branch and follows the sole statutory mandate of price stability. As a result, Uruguay is rated investment grade and has been able to tap international bond markets at very favorable spreads.

The divergence of Argentina's economic path from that of its neighbors is partly explained by differences in institutional quality.²⁴ These differences are in turn explained by the prevalence of populism in Argentina since the beginning of the 21st century.

²³ The deterioration of the country's fiscal stance in recent years is explained by a growing deficit of the public pension fund system.

²⁴ Compliance and enforceability are both weaker in Argentina, i.e., the country exhibits a high degree of institutional anomie (see Ocampo, 2021b).

Comparative Indicators of Institutional Quality

Indicator	Average 2006-2018			As % of Argentina	
	Argentina	Chile	Uruguay	Chile	Uruguay
1) Economic Freedom	49.7	77.8	68.9	156%	139%
2) Liberal Democracy	61.8	82.6	82.7	134%	134%
3) High Court Independence	68.3	79.2	82.0	116%	120%
4) Legislative Constraints on the Executive	76.1	94.6	89.4	124%	118%
5) Rule of Law	38.3	75.6	62.8	197%	164%
6) Control of Corruption	42.5	77.3	75.7	182%	178%
7) Voice and Accountability	57.9	71.0	72.2	123%	125%
8) Political Stability	50.7	59.3	68.2	117%	135%

Source: Heritage Foundation (1), V-Dem Institute (2-4), and World Bank (5-8).

These institutional quality indices are positively correlated to predominant beliefs and ideologies. Among the three countries Argentina exhibits the highest level of skepticism about the aims of government: a significantly larger percentage of respondents believes that public policies are mostly designed to benefit powerful interest groups. Although relatively fewer Argentines identify themselves as having a leftwing ideology than Chileans and/or Uruguayans, they exhibit a stronger anti-capitalist and anti-free trade mentality. Argentines also express a significantly stronger anti-US sentiment. This suggests that this mentality is deeply ingrained in society and to some extent independent of the professed ideology. According to the 2014-2018 World Values Survey (which doesn't include Uruguay) the percentage of respondents who believe government ownership of business should increase was 52% in Argentina and 39% in Chile. Interestingly a higher percentage of Chileans identified themselves as leftists (47% versus 39% of Argentines). When asked to choose between freedom and equality, the results were the opposite: surprisingly 62% of Argentines chose the former and 58% of Chileans the latter.²⁵ The following table summarizes the results of two surveys –*Latinobarómetro* and *WVS*– that assess the level of support for a free enterprise system in the three countries and the notion that the economy is a zero-sum game.

Percentage of Respondents that have Beliefs Inimical to Free Markets

Country	Don't believe a market economy is good for the country	Don't believe free trade is good for the economy	Believe one can only get rich at the expense of others
	(1)	(2)	(3)
Argentina	29.6%	9.1%	42.2%
Chile	26.1%	3.8%	39.2%
Uruguay	21.5%	2.2%	31.1%

Source: *Latinobarómetro* (average 2000-18) and World Values Survey (2010-2014). Between parenthesis is % of Argentina.

²⁵ The relatively strong anti-free market sentiment in Chile presages economic and political instability (see Newland, 2019; and Newland and Ocampo, 2020).

To understand why Peronism emerged in Argentina a comparison with Uruguay is helpful. Both countries share a common history and culture and between 1870 and 1930 underwent a similar economic and institutional evolution, sheds light on the origins of Peronism. As former Uruguayan president José Mujica once explained Argentina and Uruguay are like twins that grew out of the “same placenta” but Argentina is “simply Peronist and that is not an ideology, it is a gigantic feeling that a considerable part of its people have” (Telam, 2014).

The two countries trajectories started to diverge during the 1930s. Argentina went from a military coup in 1930 to another thirteen years later with a brief semi-democratic interlude with voter suppression. In Uruguay the trajectory was the opposite. A coup in 1933 was followed by a full return to democracy in 1942. During WWII, instead of embracing a vernacular version of Nazi-fascism, confronting the United States and closing its economy as Argentina did, Uruguay stuck to democracy, joined the new international economic order and sought an alliance with the US. The contrast between the economic performance of both countries was remarkable: between 1945 and 1955 Uruguay’s annual per capita GDP growth rate was 4.5% while Argentina's was 1.5%.

There are two typically Argentine cultural traits that were not present in the same degree in Uruguay: collective narcissism and messianic *caudillismo* (fascination with strongmen.) Two other institutional factors present in Argentina and not in Uruguay also facilitated the emergence of Peronism: a high concentration of economic resources in the hands of an elite and the enormous influence of the Army and the Catholic Church in national politics. Regarding the former, during the period 1870-1938 both GDP per capita and inequality and poverty indices were higher in Argentina. Regarding the second, it is enough to compare the increase in military spending between 1930 and 1946: 247% in Argentina and 11% in Uruguay. Not only was the army more prominent in Argentina, but its officers were trained and indoctrinated by German military instructors (which would have political consequences during the First and Second World Wars). Regarding the political power of the Catholic Church, it not only had a higher percentage of worshippers in Argentina (93% versus 70% in Uruguay in 1950) but also much greater political influence. This difference was institutionally ingrained: Argentina’s constitution included financial support from the state and required the president to profess the Catholic faith, while the Uruguayan did neither. Secularism, which at the end of the 19th century had gained ground in both countries, lost ground in Argentina after 1918, when the effect of the Russian Revolution. However in Uruguay it has remained strong until the present day. The economic power of the Catholic Church derived not only from public financing but also by huge donations from rich landowners. During the 1930s and 1940s Argentine politics were increasingly dominated by the alliance of the Catholic Church

and the Army. Perón can be considered the “bastard child” of this unholy union (Zanatta, 1999, p.7).

4. Conclusion

In the 1970s, when the Western democracies were mired in stagflation, Samuelson reformulated Schumpeter’s prediction about the demise of capitalism by redefining socialism as populism. Samuelson believed the latter system had attained its maximum development in Latin America, more particularly in the Southern Cone. In his view, Argentina was the most extreme example of the populist paradigm. Samuelson feared the advanced Western democracies could follow Argentina’s path as electoral demands for redistribution generated deadweight losses.

Due to his limited knowledge and understanding of Argentine history, Samuelson based his analysis on mistaken assumptions. Consequently, he reached the wrong conclusions. First, was not an endogenous electoral response. Perón chose “populist democracy” as the best option to achieve the goals of the 1943 military coup. Second, Samuelson incorrectly identified “considerable inequality” of income and wealth as the key factor that explained the rise of Perón. In reality, the rise in income inequality during the 1930s owed more to industrialization than to the land ownership regime. Third, other factors such as elite fragmentation and threatened collective narcissism had a decisive influence on Perón’s rise.

Samuelson relativized Perón’s responsibility for Argentina’s trajectory since 1945. There is no doubt that Peronist revolution had a decisive impact on the evolution of the Argentine economy in the second half of the 20th century. Peronism not only degraded the country’s institutional fabric but it also depreciated its civic culture, setting off a vicious cycle of stagflation, political instability and frustration. Which brings us to Samuelson’s third mistake: equating Argentina’s “populist democracy” with that of Chile and Uruguay. The evidence suggests there is something different about the Argentine case that made populism not only more virulent but also path-dependent. That something is Peronism.

Schumpeter’s unadulterated theory provides a better –though also incomplete explanation of what happened in Argentina in the postwar era. Ironically Argentina proved him right by following his recommendations: adopting “third way” corporatism and Catholic social doctrine.

Until recently, it seemed as if Samuelson’s reformulation of *Capitalism, Socialism and Democracy* would meet the same fate as the original (Argentina being the only exception.) The resurgence of populism in Europe and North America in the 21st century suggests that it

may not, but in a different way from the one envisioned by Samuelson or Schumpeter. Despite its incompleteness and mistaken prediction, the logic of Samuelson's analysis of the welfare state and of populist democracy has value. He deserves credit for pioneering the economic analysis of populism.

Argentina's case may seem too exceptional and too idiosyncratic culturally and historically to offer any guidance to the world's democracies. But it does. First, threatened collective narcissism is a powerful political force that can be harnessed by an opportunistic, unscrupulous and charismatic politician. Second, a Madisonian democracy –however imperfect– cannot remain immune to the temptations of populism if the right to vote is restricted in the face of economic stagnation and growing inequality. Third, what matters is not absolute inequality but how equidistant from rich and poor the middle class perceives itself. Finally, structural problems require structural solutions. The costless, simplistic and arbitrary solution proposed by populism, be it of the right-wing or left-wing variety, can only contribute to increase collective frustration and trigger an intractable vicious cycle.

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