

Joseph Schumpeter, the Euthanasia of Capitalism



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1 Reading Schumpeter

About twenty years ago I presented a paper on Schumpeter's *Capitalism, Socialism and Democracy* at a conference of political scientists. I was struck by Schumpeter's prediction that capitalism would not survive and would open the road to socialism. I cannot find the paper in my backup some five computers ago, but if I remember well I then was particularly interested in Schumpeter's definition of democracy. Now I propose to take a second look at Schumpeter's book asking why Schumpeter thought that capitalism was coming to an end. Are we witnessing a slow and beneficial demise of capitalism? The answer to that question is closely related to Schumpeter's definition of capitalism and given that definition (Schumpeter was fond of definitions!) the answer to the question about the demise of capitalism is less spectacular than one might think.

Rereading Schumpeter it struck me that he was part of a school of economists which is different and in many ways an alternative to the work of Anglo-Saxon economists. This becomes evident from two issues and it is important to deal with them when we try to define Schumpeter's view of capitalism. As an Austrian by birth and upbringing he belonged to a school that was preoccupied by the problem of development and change and so naturally Schumpeter ab initio had intellectual ties to the German Historical School, to the historical sociology of Max Weber and to Karl Marx' economic theory. Schumpeter as a critic of the Historical School commented that they wrote history rather than developed economic theories (Schumpeter 1963, 804), but he accepted their perspective on development. And then of course he took part in a debate about socialisation (nationalisation) which in 1918 preoccupied both

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German and Austrian economists and that this conference is at pains to reconstruct (Streissler 1994).¹

Secondly, as the contributions of Francesco Forte and Günther Chaloupek make clear socialization was discussed as a serious issue for German and Austrian economists.²

Though I must answer the question what Schumpeter meant by the euthanasia of capitalism and whether it would occur on his conditions, there are four steps which lead up to that answer:

- 1. As Eduard März has made clear Schumpeter belonged to the Austrian school. And so he took part in the discussion on economic development and the role of the entrepreneur as the initiator of development. Under the influence of Nietzsche in particular he described him in his *Theorie der wirtschaftlichen Entwicklung* as the demiurge of development, not as inventor but as innovator.³
- 2. Schumpeter had a critical exchange with his teacher Eugen von Böhm-Bawerk on the nature of interest. Schumpeter stated that in a static economy ruled by perfect competition interest and profit were zero. Böhm-Bawerk thought this to be false. Given Schumpeter's bent of mind at the time he defined capitalism as a process of change. It was the entrepreneur who created profit and interest.⁴
- 3. Schumpeter took part in the debate of socialisation. Though he agreed with Otto Bauer that a complete socialisation of the economy would be ideal, as minister of finance (1919–1920) he warned that intervention 'on a massive scale' would be risky.⁵ Otto Bauer engineered his dismissal as minister, because of his caution. His standpoint on socialisation defined his view of socialism at the time.
- 4. März writes:

Here I will say only that during my last year at Harvard I came to feel that Schumpeter's striking reserve with regard to his own theory may ultimately have been caused by his feeling of its inadequacy. (März 1991, 167)

The fact that Schumpeter did not teach his development theory at Harvard indeed is striking considering that Schumpeter is regarded as the equal and the counterpart of Maynard Keynes. I do not think that he regarded the theory inadequate, but that it did no longer apply.

¹Streissler shows that all the characteristics of Schumpeter's economics such as the entrepreneur and the emphasis on development were being discussed in both countries since the beginning of the nineteenth-century and Schumpeter's teacher Friedrich von Wieser took part in that debate. I am not so sure about the influence of Hilferding (Streissler 1994, 132). As I read him, Schumpeter saw the entrepreneur as a private person (even hero perhaps) and he did not stress the link between banks and corporate business in the beginning of his career. Later on he took the link for granted.

²See Chaloupek (2019) and Forte (2019, this vol).

³März (1991, part 2, Chap. 3). Particularly para 3 "The intellectual roots of Schumpeter's *theory of the entrepreneur*", 54 ff.

⁴März (1991, 131). Schumpeter wrote a generous report on Böhm-Bawerk's work and praised the wide range of his vision. März calls it 'the best concise presentation of the main ideas of the Austrian school as developed by Böhm-Bawerk. See Schumpeter (1997a, 143–191). There is no mention of their disagreement in the obituary.

⁵März (1991, 152). Two years later he called 'full socialisation' 'no more than political phraseology'.

2 Reading Schumpeter

Since I wrote on John Stuart Mill I have been an enthusiastic reader of Schumpeter's *History of Economic Analysis*. That chunky, unfinished book, which his widow Elizabeth Boody put into order, is a marvel. Schumpeter had the empathic genius to approach an author by reconstructing his economic logic in a way the author's thought made sense. In fact Schumpeter distanced himself from his own work in such a manner that the reader could not be aware that Schumpeter was the great rebel in the camp of the economists while reading the *History of Economic Analysis*.⁶ It is only at the end of his book in part V, Chap. 5 (1170–1184) that he takes issue with Keynes as the modern exponent of equilibrium analysis. His remarks are of particular interest, because it defines Schumpeter's own position as that of an outsider in mainstream economics. I shall deal with the relationship of Keynes and Schumpeter in the next paragraph.

Apart from C.S. & D. (*Capitalism, Socialism and Democracy*) and his work on *Imperialism*⁷ I knew no more of Schumpeter's economic thought than my colleagues at the faculty of Economics in Groningen told me, namely that Schumpeter discovered the escape route for the law of declining profits by arguing that entrepreneurs made use of inventions to create monopoly-profits which would keep the engine of economic growth going.

Before I started to read Schumpeter in earnest I had the hope that we could stop economic growth by controlling and monitoring inventions, particularly their application and their effect on future economic growth and stop the applications when they use up scarce resources and have other negative effects on the global environment. However, Schumpeter never held the primitive theory that I was told and he took it as self-evident that the euthanasia of capitalism would and should not put an end to economic growth.

3 Schumpeter and Keynes

Schumpeter belonged to the intellectual tradition of List, Roscher, Schmoller, Wagner, but also Max Weber (a sharp critic of the Historical School) and Marx for which development is the key for understanding economics. Schumpeter's theory of development was close to that of Marx though I think that Schumpeter developed it independently and recognized the similarity of the Marxian model to his own. In its barest terms the theory was that capitalism unleashed creative forces

⁶James Tobin remarks that Schumpeter taught on the basis of the work of other economists while at Harvard and never referred to his own work. See J. Tobin in his "Foreword" to März (1991, x).

⁷On which März completely misses Schumpeter's point that whatever people thought at the time and how it influenced their behaviour it was completely irrational and against the current of international development which made for cooperation not war. See März (1991, part one, Chap. 4) "The Modern Theory of Imperialism".

that created new businesses and destroyed established trades. Schumpeter made the distinction between the entrepreneur and the manager (the *Wirt*). The manager is the caretaker of established business routine and the entrepreneur is after new combinations. The term ‘combinations’ is rather vague, but it has the advantage that it leaves open the way how the entrepreneur becomes the fixer of change. This change may be new products, new organisations or exploring new markets. In Schumpeter’s analysis inventions or the inventor play no prominent role. What is important is the application of new inventions whether the latter applies it himself or leaves it to an enterprising businessman. Monopolistic profits as an inducement to change also play no part in Schumpeter’s theory of economic development. It is good to keep this aspect in mind, because his lack of concern spells a weakness in his description of the fate of capitalism in C S & D. What, however, is fundamental in Schumpeter’s account of the rise of capitalism is that next to creating new combinations it destroys old ones and this destruction cannot be helped. The rise of capitalism has an aura of inevitability.⁸

In the last chapter of his “History of Economic Analysis” Schumpeter gave a critical account of Keynes *General Theory*. He called it a conservative and static view of the economic process (Schumpeter 1963, 1174). He added that Keynes’ followers, such as Paul Samuelson, turned it into a dynamic system of sorts (Schumpeter 1963, 1183). And Schumpeter was rather peeved by the success of the Neo-Keynesians, but he understood that this approach suited the politicians of the welfare state and the economists as their advisers very well.

Keynes came from a tradition of economic thought which started with Adam Smith. For Smith an optimal circulation of goods and services led to an optimal national product. It is said that Smith enlarged the physiocratic vision of the circulation of resources (basically agricultural products) by adding trade as a value adding activity. Smith’s model of the ‘invisible hand’ was the beginning of equilibrium analysis in the British style. Of course neither Smith nor his successors would deny that a better circulation of goods would cause economic growth. That, however, was not the main focus of their concern and the ‘invisible hand’ would after growth lead to a new equilibrium on a higher plane. Economic growth in their view was like the man who slowly climbs a spiral staircase to riches.⁹

The problem that became manifest in the forties of the nineteenth-century was that busts started to follow booms and astute observers discovered a cyclical pattern in this phenomenon. This cyclical pattern gave urgency to equilibrium analysis. Keynes gave a new twist to the discussion by arguing that in times of depression equilibrium

⁸Schumpeter had the narrow view of the economist on change. The historian will refer to the Industrial Revolution with next to economic, drastic social and political changes, positive as well as negative. Not to confuse the argument too much I have left them out of my discussion, but is it not remarkable that Schumpeter left out any discussion of the changing role of the consumer in the rise of capitalism?

⁹This peaceful picture was of course spoiled by Ricardo’s conclusion that in the end the economy would stagnate, because population growth would lead to this stagnation. However, if you reject the Malthusian premises why should the economy not be able to grow in a more conventional manner? Schumpeter did not face this question.

would be reached but at a lower level which left part of the plants idle and many workers unemployed.

The supreme irony of Keynes' influence is that it fulfilled his prophecy that "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist" (Keynes 1964, 383). In this case Keynes was the defunct economist. He attempted to find a solution for the problem of underemployment, but his theory started to be used by post war governments to ensure a policy of full employment by investing in public works in times of recession and adopting restraint in times of bloom (except that no government accepted that part of the recipe). And in order to reach optimal results governments adopted a policy of mild inflation. So they followed the counsel of the Keynes of Bretton Woods to insure stable currency exchanges rather than the Keynes of the "General Theory" in which Keynes showed himself to be an enemy of any degree of inflation.

Comparing Keynes with Schumpeter as a theorist is also comparing two traditions of economic thought because a theory of development clashed with equilibrium analysis anyhow. It is not that Schumpeter did not believe in equilibrium—the first chapter of his *Theory of Economic Policy* starts with 'the circular flow of economic life', but for Schumpeter the equilibrium of perfect competition was a utopian image which was constantly disrupted by developments. He did not believe in managing the economy and was sceptical about the New Deal (abetted probably by his wife who was dead set against Roosevelt and what he stood for) (März 1991, 171). Reading his *Business Cycles* it becomes clear that he thought that the crisis of 1929 would be cured in the usual cyclical pattern. So theoretically and politically he was out of tune with the New Deal and again ironically (because he was elitist himself) more with the political and scientific elite than with the general public.

In 1946 Schumpeter wrote an obituary of Keynes. It is a warm and sympathetic account, but beneath the surface Schumpeter is sharply critical. Perhaps his most remarkable statement is that 'practical Keynesianism' cannot be exported outside England (Schumpeter 1997b, 275). That sounds bizarre given the success of Keynes in the United States. What Schumpeter meant was that Keynes' advice could only apply in a situation of "modern stagnation" (Schumpeter 1997b, 268). Keynes' short term advice to his countrymen was to save less and to invest more in an ailing economy.

Schumpeter used his vast knowledge of two centuries of economic thought to point out the insularity of Keynes' ideas. Nowhere does he appeal to his own theory of economic development. I shall have to come back to this remarkable fact at the end of my contribution.

Schumpeter made the distinction between crises caused by exogenous factors such as war or endogenous factors which belong to the character of capitalism. Endogenous crises have to be expected and accepted. And if you wanted to do something about them you should turn to the socialism of a planned economy. Schumpeter called Keynes a conservative, Schumpeter himself was on one side more conservative than Keynes—he was almost a Hooverite—but in his inexorable logic he was also prepared to adopt a radical solution as socialism.

4 The Theory of Economic Development

Let me report on Schumpeter's theory chapter by chapter. The book starts with the remarkable statement that the circular process is the fundamental fact of any economy. Fundamental means two things. Firstly it is common sense that anywhere in any economy people will want 'to truck and barter' to use Smith's expression. Secondly Schumpeter mentions it as an intellectual construct to indicate that under the conditions of perfect competition the economy is circular. It is Schumpeter's way of defining development; because the perfect equilibrium is utopian there always will be disruption of the equilibrium.¹⁰ The first statement also reveals another trait of Schumpeter as an economist. The economy is a matter of transactions. Léon Walras had a great influence on Schumpeter and here it shows. There is according to Schumpeter no absolute standard of value. Value is a product of transactions and prices are its indicator. That is a statement out of Walras' book. However, Schumpeter learnt 'the subjective theory of value' from Böhm-Bawerk. Value according to Böhm-Bawerk is the product of transactions. There is no objective standard of value such as gold or the quantity of labour.

Chapter two on the 'Fundamental Phenomenon of Economic Development' introduces the entrepreneur as the creator of development. Schumpeter asks why the entrepreneur has this ambition to create new business ventures and the answer is power, ambition, prestige and first of all the will to create his own domain in the economy which he can control at its best. Schumpeter also asks whether the entrepreneur can function in a planned economy and he answers that this is an important question of 'taking seriously socialism and a planned economy'.¹¹

In his *Theorie* Schumpeter focuses on the entrepreneur. He is a kind of Nietzschean superman who creates and destroys. The period just after World War One was a grim period for Austria. It had to face life as the trunk of a great Empire. It had to settle disputes with neighbours that had become independent nations and it was saddled with great war debts. In this situation Schumpeter felt that the position of the entrepreneur as the great changer was in danger. He wrote in 1918:

Gradually private enterprise will lose its purposes as a result of economic development and the expansion of social sympathy this entails. (März 1991, 95)¹²

I do not think that he took the threat of socialism to the function of the entrepreneur seriously, however, but note his forecast of the future.

¹⁰Schumpeter's statement that under perfect competition—a statement which provoked a lot of criticism—the rate of interest will be zero obviously refers to this utopian situation.

¹¹"Several authors have written about the fact that Schumpeter omitted chapter seven in the 1911 edition of his "Theorie der wirtschaftlichen Entwicklung" from the English translation and a later German edition. It offered a vista of Schumpeter's original idea of a more comprehensive social development. He took up that theme again in his *Capitalism, Socialism and Democracy*." See the reprint of the Seventh chapter: Schumpeter, Joseph "Theorie der wirtschaftlichen Entwicklung. Siebentes Kapitel. Das Gesamtbild der Volkswirtschaft" (Backhaus 2003, pp. 5–59).

¹²März is quoting from Schumpeter's 'Die Krise des Steuerstaates'.

Chapter III on Credit and Capital emphasizes the importance of private capital and hence private credit for the entrepreneur being able to start new ventures. This emphasis on private capital means two things. First the owner of capital and not the entrepreneur bears the brunt of the risks involved in new undertakings. The entrepreneur must be able to operate without being hampered by considerations of conventional practices. Secondly the fear is that in a planned economy there will be strings attached to the giving of credit. Credit is important because it is the *conditio sine qua non* of development.

Chapter IV deals with entrepreneurial profit. Schumpeter uses the Marxian term surplus value, without accepting, however, Marx's notion that it is an indication of exploitation of the labour force. In this chapter Schumpeter introduces the notion of monopolistic profits. That idea attracted a lot of attention, as we have seen, but Schumpeter treats it rather casually. And quite rightly so, because the amount of surplus value does not only depend on the higher prices the entrepreneur can achieve, but also on a better organisation of the production and the rate of interest which will tend to be low in a situation of development.

We may pass Chap. V on "Interest on Capital" which for explaining the euthanasia of capitalism is a side issue. Chapter VI on 'the Business Cycles' brings us in the heart of Schumpeter's analysis of development. His treatment reveals unfinished business. Schumpeter describes the actions of the entrepreneur not only as disruptive of the old order, but as not being related to any regular phenomenon. As stones thrown in a pond they came haphazardly at times. How then does the interface between the intervention of the entrepreneur and the mechanism of the business cycle work? Schumpeter writes:

The ever growing familiarity – when applying economic analysis – with the cycle, together with the increasing formation of trusts, is the chief cause that genuine crises have become milder with each turning point in the economic process.¹³

Familiarity with the business cycle can help to dampen the crisis, but does not explain them. The question remains how the crises caused by new combinations can be fitted in the regular pattern of the business cycle. How can fitful phenomena as new combinations ever become part of a regular pattern? It is time we turn to Schumpeter's major and massive work on business cycles.

As minister of finance in the Austrian government Schumpeter was confronted with the problem of planning the economy by the state and with socialism or 'socialisation' as it was called in his circle. His colleague Otto Bauer was in favour of complete socialisation or complete control of the economy by the state. Schumpeter regarded this as an interesting option, but as we have seen he counselled caution and advised the government to start with a partial socialisation (März 1991, 153).

His idea of capitalism *anno* 1913 (the year his *Theorie* was published) was clear cut. In fact the entrepreneur was the only true capitalist. He had, as we have seen,

¹³The German quote reads as follows: "Die immer steigende Vertrautheit der Praxis mit dem Zyklus ist denn auch zusammen mit fortschreitender Vertrustung der Hauptgrund dafür, dass die eigentlichen Krisenerscheinungen von Wendepunkt zu Wendepunkt ... schwächer werden" (Schumpeter 1936, 367).

a critical exchange with Böhm-Bawerk about his idea that in equilibrium of perfect competition interest is zero, but he agreed with Böhm-Bawerk that it is the entrepreneur who creates profit. Without exploring ‘new combinations’ profits turn into managerial wages. So capitalism *anno* 1913 is the business of single individuals. Schumpeter saw the new development of “trustification”. Not socialism but the big corporations would change the nature of capitalism. In World War Two Schumpeter became convinced that corporate business controlled the economy, but in 1913 that was a distant possibility.

In 1913 Schumpeter regarded capitalism to be the business of private persons. Socialism at that stage was neither a threat nor an option.

5 Schumpeter on Business Cycles

According to Swedberg Schumpeter’s *Business Cycles* was not well received. Kuznets was very critical of the book. Swedberg para phrases Kuznet’s opinion as follows:

Kuznets says that his reading of the book has left him with ‘some disturbing doubts’ about Schumpeter’s analysis. These doubts, he says, centre on three key propositions in *Business Cycles*: that innovations come in bundles; that there are four phases to the business cycles [equilibrium, recession, depression and recovery]; and that three cycles go on simultaneously. (Swedberg 1991, 134)

As to bundles I am repeating Kuznets’ criticism. Why indeed should inventions which are at the core of the innovative process come in regular patterns which match business cycles? The other two critical points are of interest to me, because they demonstrate that Schumpeter changed his view on the relationship between crisis and business cycles. In his *Theorie der wirtschaftlichen Entwicklung* innovation creates crises in the regular pattern, now—probably under the influence of his massive empirical work on the subject—innovations become the *cause* of the business cycles and the crises (depressions) become part of the regular pattern. The fact that the Juglar fits into the pattern of the Kondratieff and the Kitchin within the Juglar confirms the notion that *when the economy is left to its own devices without being disrupted by war or government intervention cycles follow a regular pattern*. Kuznets was also critical of Schumpeter’s method of computing indexes. Given Kuznets’ massive reputation as a statistician I am prepared to believe him, but I would echo Schumpeter’s criticism of the Historical School: his massive description of data does not provide us with an explanation of the business cycle as a phenomenon.¹⁴ The orthodox explanation relying on the functioning of credit, on speculation (the hog’s cycle e.g.) and Keynes’ sophisticated analysis of Say’s law at least makes sense of the *regularity* of business cycles.

¹⁴They are at best, to quote J. Mill’s *System of Logic* ‘an empirical law’ such as the registration of the tides. Only the attraction of the moon and the movement of the moon provide us with an understanding of the phenomenon.

One message of Schumpeter's compound cycle is that there was no crisis (not even the crisis of 1929) which took the cycle out of step. There would be a recovery in the long run. That message is important for interpreting Schumpeter's C.S. & D. There would be no standstill in the economy, because of the demise of his prophecy of capitalism and its transition to socialism, provided that socialism was managed properly.

What happened between 1939 and 1942, between the carefully phrased apolitical analysis of *Business Cycles* and his commitment to socialism (so at least it seems). Swedberg mentions that Schumpeter felt isolated and frustrated by the reception of *Business Cycles* and the situation created by the World War. He felt neglected by his colleagues in the Harvard department who, most of them, enthusiastically embraced Keynes' *General Theory*. He was unhappy about events in Europe and he was rather peeved by the popularity and success of Roosevelt's New Deal. Did his state of mind influence his theory about the transition of capitalism to socialism? I do not think so. Considering that the second edition of C.S. & D. appeared in 1947, three years before Joseph McCarthy started his campaign against socialists of any kind and an opinion about Marxian economics became almost impossible to express, that is a marvel, but his book was so remote from actual politics that professionals could see it as an interesting excursion into theoretical economics and the general reading public could appreciate it without drawing any political conclusions, 'subversive' or not. J. Edgar Hoover, the great witch-hunter and head of the F.B.I. wanted both Joseph and Elizabeth being prosecuted, but he got nowhere. Elizabeth was questioned, Joseph never was (Swedberg 1991, 273, note 34).

The introductory chapters in volume one of *Business Cycles* make it clear that Schumpeter was fully aware that capitalism had changed in the course of the twentieth century. Capitalism had become a collective affair in which the board of a company (and eventually the shareholders) became responsible for business ventures, while new inventions were cooked up in their laboratory. It is a pity that Schumpeter did not ask himself to what extent corporate business dominated the economy as a whole. I think, however, that the perfect fit of the business cycles as he constructed them convinced him that this domination was total.

6 Capitalism, Socialism and Democracy

Swedberg gives the following summary of Schumpeter's argument in C.S. & D.: 'The central theme' of Schumpeter's book is 'the role of institutions in the economy' (Swedberg 1991, 152–153). In part II, 'Can Capitalism Survive?', following Swedberg, Schumpeter claims that the very development of capitalism undermines the system on which it is based. In part III: 'Can Socialism Work?', the answer is that socialism can provide an alternative to capitalism. That answer has two aspects. First can it provide the same kind of welfare as the capitalist system and two can it maintain at the same time the democratic values we cherish? That question Schumpeter answers in part IV: 'Socialism and Democracy' as follows: Socialism can guaran-

tee democratic values as long as socialism is prepared to give citizens the freedom to pursue their own interests. And that is of course a big if, particularly because Schumpeter assumes that central planning would be the main feature of socialism.

Part I on 'The Marxian Doctrine' is a brilliant analysis of Marx' thought, but why is it relevant in Schumpeter's analysis? Swedberg makes it clear that Schumpeter accepted Marx' prediction that capitalism is doomed and socialism is its alternative. Schumpeter wrote his book during the war in which Marxism in the United States was discussed in freer terms than later was possible. Schumpeter discovered that according to Marx the labour theory of value would not necessarily be the only cause of the ruin of capitalism and that would possibly leave room for a milder transition than revolution.¹⁵

Swedberg's inventory is correct, but too bland to my taste. His assessment misses the peculiarity, not to say crankiness, of Schumpeter's definition of capitalism. Surely the entrepreneur as innovator is not solely responsible for the working of modern capitalism. The bureaucratic character of corporate business is in itself an innovation and Schumpeter completely ignores the role of the state in a mixed economy. For him it is either capitalism or socialism. He does not contemplate a mixture of the two and yet the osmosis of state and business is a characteristic of modern life. About Marx little needs to be added to Swedberg's report, except perhaps Schumpeter's emphasis on 'ripeness', the need for which, Schumpeter wrote, Marx also mentioned. "Ripeness" means that the transition from capitalism to socialism only makes sense when capitalism in terms of institutions, attitudes, progress in the economy is far enough to be replaced by socialism.

Schumpeter asked "can capitalism survive". He answered: "No I do not think it can" (Schumpeter 1942, xiii). To understand what he meant, it is crucial to mention his rather narrow definition of capitalism. Capitalism in his view is the product of private entrepreneurs who use credit from private financiers. So basically Schumpeter is saying that with "trustification" when big corporations take over the role of the private entrepreneur and when state intervention in the economy becomes a daily fact of life we create the conditions for a transition to socialism. Schumpeter's view, formulated during World War Two was perhaps a plausible assumption. In the United States during the war there was a planned economy in which big business and government cooperated. And yet there was no room for socialism in the United States. Roosevelt acted with flair and took emergency measures, but to call the New Deal a blueprint for socialism would have dismayed him.

The authors that Forte and Chaloupek discuss next to Schumpeter are Hilferding, Rathenau, Pribram and Stolper. For them planning the economy was one of their

¹⁵I made the same discovery years ago. In the so-called "Grundrisse" there is a passage in which Marx admits that capitalism could escape the declining rate of profit. He writes: "In dem Maße aber, wie die grosse Industrie sich entwickelt, wird die Schöpfung des wirklichen Reichtums abhängen weniger von Arbeitszeit und dem Quantum angewandter Arbeit, als von der Macht der Agentien, die während der Arbeitszeit in Bewegung gesetzt werden und die selbst ... in keinem Verhältnis steht zu unmittelbaren Arbeitszeit, die ihrer Produktion kostet, sondern vielmehr abhängt von all-gemeinen Stand der Wissenschaft und dem Fortschritt der Technologie oder der Anwendung dieser Wissenschaft auf die Produktion" (Marx 1939, 592, cited in Holthoon 1982, 27).

targets. Next to that they paid attention to the role of intermediate groups such as trade union, other trade organizations and political parties. There was a strong corporatist element in their thought, which as far as I can see it is lacking in Schumpeter's C.S. & D.

It is not clear from the book to what extent socialism Schumpeter-style would plan the economy. Did he adopt the model of British Labour to nationalize the railroads, the coal industry and the utilities or did he go for the Soviet model of an economy planned to include all human activities? I suspect he had the latter alternative in mind.

Particularly in a totally planned economy the test of socialism then becomes whether power wielded by the state can be combined with a real say of the people (that vague but necessary term) within socialism. For Schumpeter democracy was a *conditio sine qua non*. Without democracy there could be no socialism. The problem with democracy, however, is that if you have it you can lose it, if not, you will not easily get it.

Schumpeter stated that a government by the people is as impractical as Rousseau's utopia. As to democracy we should substitute that idea by a government approved by the people. And he argued that there should be a governing class of politicians that should compete for the favours of interested parties. That idea is a look alike of Jefferson's 'representative democracy' except for the fact that in Jefferson's age the federal state and separate states had very little power while the socialist state that Schumpeter envisaged was Leviathan. Schumpeter of course believed in the rule of law though he does not mention this necessary brake on power, but we may well question whether that brake can function in an all powerful state.

We are now able to understand what he meant by the demise of capitalism and the transition to socialism. It is the second stage of the relation between capitalism and socialism as he saw it *annis* 1939–1943. Capitalism was 'ripe' to make the transition. There was still a long way to go before socialism could meet the challenge of any modern economy, but the transition was on the books.

People in the well-established democracies do not have to worry about Schumpeter's vision of the future *anno* 1950, because the transition did not happen and the soviet-style socialism broke down under Gorbachov.

7 In Retrospect

Wisdom of hindsight comes cheap. Schumpeter was completely wrong about America's future. When he thought that the transition to socialism was imminent he was witnessing the osmosis of state and civil society. That left enough room for capitalism to create economic growth on its own conditions. Even the individual entrepreneur did not disappear given Bill Gates and recently Mark Zuckerman who established their own business empires. That he was wrong is not an important conclusion, but why did he miss the obvious fact that the American Republic would be the last country where one could expect socialism to be victorious? That is an intriguing question. I can only guess what the answer is, but I think that Schumpeter knew very littler

about his host country. He lived rather isolated in the least American part of the country. No, in C.S. & D. he was thinking back to Austria in 1918 and the debate on socialisation. Then the situation was not ripe for socialism, now it was in his opinion.

A reflection on Schumpeter's position at Harvard brought me back to that puzzling fact that according to Swedberg he never taught his own *Theory* to his students and I have also quoted März's explanation of this strange fact: Schumpeter felt that his theory of development was inadequate. I think a better explanation is that he regarded his theory as no longer relevant to explain economic development.¹⁶ If so, that creates a paradox, because at that post war threshold in time a theory of development was needed more and more. Capitalism was in full swing, but capitalists, bankers, politicians and economists were not in control of tempestuous developments. Schumpeter was the first economist pointing out that the entrepreneur creates, but also destroys. At present we are in the situation that the negative aspects of economic growth loom large. One might wish that Schumpeter had paid more attention to the destructive aspect of entrepreneurial activities.

In the development of Schumpeter's thought there are two trajectories. First there is his *Theory of Development* which led to the euthanasia of capitalism and then there is the historian of economic ideas. In this field Schumpeter's achievement is unsurpassed. It must be the bias of the historian of ideas which makes me prefer Schumpeter's second trajectory.

Appendix

At a late stage in preparing the Heilbronn papers of 2018 for publication Ursula Backhaus pointed out to me that I had missed a publication of a much earlier conference entitled "Joseph Schumpeter. Entrepreneurship, Style and Vision" (Backhaus 2003). That volume reprinted the seventh, concluding, chapter of his "Theorie der Wirtschaftlichen Entwicklung" in German with a translation in English, which Schumpeter omitted from later publications of the text. Such is the penalty of contributing a paper to a conference and per force not attending it.

Rereading the chapter I was pleased to note that Schumpeter in chapter seven referred to the "leadership personality" (Schumpeter, Backhaus 2003, 110) or entrepreneur who invents and organizes new combinations. The omission of this person and his role is additional proof that Schumpeter dismissed this role in later publications. As I pointed out in my original publication: corporate business, according to Schumpeter, took over the role of the entrepreneur and encapsulated it in its business system. The role of big business almost naturally led to control by the State of planning the economy as Schumpeter explained in his *Capitalism, Socialism and*

¹⁶Forté remarks that Schumpeter switched from emphasizing the role of the individual entrepreneur in the 1911 edition of the *Theorie der wirtschaftlichen Entwicklung* as the major factor of economic development to a view of the decline of capitalism under the influence of corporate business in later publications.

Democracy. And the irony of Schumpeter's forecast was that corporate business was causing the euthanasia of capitalism.

Schumpeter was, as noted, dead wrong in his prediction. The U.S.A.—and not only the U.S.A.—was unwilling to adopt this encompassing model of State control and as I pointed out the entrepreneur as individual never disappeared from the scene. Schumpeter should have stuck to his view of destruction and innovation in the economic process. In this respect the seventh chapter is indeed worth rereading as becomes clear from the contributions of Helge Peukert and Mark Perlman.

Peukert points out that Schumpeter rejected the view of 'moving equilibria and organic growth in classical theory'. And she goes on:

Instead, he tries to show that they [the classical economists] were empirically and theoretically wrong and that discontinuous change is always the elementary and major fact of capitalism. (Peukert 2003, 223)

Indeed, as the seventh chapter makes clear Schumpeter advocated an analysis of the economy as a dynamic process without taking into account a notion of development or progress. Schumpeter writes:

It follows from the entire outline of our line of reasoning that there is no such thing as a dynamic equilibrium. Development in its deepest character constitutes a disturbance of the existing static equilibrium and shows no tendency at all to strive again for that or any other state of equilibrium. (Schumpeter and Backhaus 2003, 76)

The economic process is one of the old combinations and their destruction.¹⁷ So Schumpeter was neither a follower of the Classical nor of the Historical school. To which school did he then belong? Perlman's answer is that Schumpeter did not belong to any school. He studied Schumpeter's "Epochen der Dogmen- und Methodengeschichte" (1914) with care and noted that Schumpeter deplored the rivalry between the schools. Perlman concludes:

At best it was a brave way to end the book; at its worst it suggested that he was so much above the fray that he could dismiss persuasively the pettiness of the great names.¹⁸ (Perlman 2003, 173)

As all historians of economic thought Perlman is a great fan of Schumpeter's incomplete masterpiece, his *History of Economic Analysis*. In it Schumpeter described with much empathy the works of the competing schools and there is room for a thorough analysis as a piece of historical analysis.

Obviously that analysis cannot be undertaken here, but it is clear that Schumpeter regarded himself above the schools and perhaps he still dreamt of a dynamic counterpart to Walras' static model. However, this way of pinpointing Schumpeter's position leaves one question unaccounted for. How does this neutral position as expressed in the *History of Economic Analysis* relate to his prediction that capitalism will

¹⁷This leaves it an open question how the original equilibrium came into existence. It appears that Schumpeter regards static equilibrium as routines rather than equilibria.

¹⁸I am not sure whether Perlman applies the 'worst' to Schumpeter or to the pettiness of the great names.

be replaced by State-control of the economy? The answer is a typical Schumpeter answer: it does not. When dealing with economics straight he left out all political implications. This view shows the strength and the weakness of his view. The History of Economic Analysis is an excellent platform for making the statement that the world at large has as yet no control over the economic forces that human activities engender. At the same time he underestimated the power of politicians to shape these forces by non-economic means.

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