Schumpeter’s Conceptions of Process and Order

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Abstract:
This paper scrutinises Schumpeter’s conceptions of process and reproduced order. In order to facilitate a detailed understanding of his position, his work is examined from different angles, in three successive ‘approximations’. The coherence, or mismatch, of Schumpeter’s conceptions is subsequently discussed. The paper argues that Schumpeter’s essay on social classes provides an ontologically grounded theory of process which is also a theory of reproduced order; and that this theory does not fit well with Schumpeter’s alternative conception of order as equilibrium. His methodological commitment to an orthodox notion of order as equilibrium is shown to be the source of pervasive tensions in his writings, here classified as ‘retroductive problems’ and ‘spurious problems’.

Keywords: Schumpeter, methodology, ontology, critical realism

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1. INTRODUCTION

‘I was trying … to answer the question how the economic system generates the force which incessantly transforms it’, Joseph Schumpeter writes in the preface to the Japanese edition of his *Theorie der wirtschaftlichen Entwicklung* (Schumpeter, 1937, p. 165). Recognising that, as an economist, he owes more to Léon Walras than to any other influence, Schumpeter nevertheless rejects the Walrasian conception that economic life is essentially a stationary process, which merely adapts itself to external influences. ‘It was not clear to me at the outset’, he adds, ‘that [my] idea and [my] aim [were] exactly the same as the idea and the aim which underly the economic teaching of Karl Marx. In fact, what distinguishes him … [is] precisely a vision of economic evolution as a distinct process generated by the economic system itself’ (*ibid.*, p. 166).

This vision of economic evolution is essential to understand the nature and workings of capitalism for, according to Schumpeter, all the typical phenomena of capitalism derive from that ‘source of energy within the economic system’ (*ibid.*), which recurrently revolutionises industrial structures. ‘Stationary socialism would still be socialism’, Schumpeter (1946, p. 198) submits, ‘but stationary capitalism is impossible, is, in fact, a contradiction in terms’. However, this process of economic self-transformation – the process of creative destruction – also gives rise to tendencies to the destruction of the institutional framework under which it operates. The capitalist process evolves a tendency to produce its own demise.

In this paper I scrutinise the specific conceptions of process and of reproduced order that underpin Schumpeter’s theoretical system and, in particular, his analysis of capitalism. Section 2 aims to identify those conceptions. Following Schumpeter’s own suggestion, I begin by distinguishing two levels in his analysis: on the one hand, the transformation of the economic sphere ‘from within’ which, under the institutional framework of capitalism, produces particular patterns of economic change; on the other hand, the reproduction and transformation of that institutional framework. I then attempt, through successive approximations, to clarify the concepts of process and reproduced order at those two levels. In Section 3 I go on to investigate the ontological status, as well as the coherence, or mismatch, of those concepts of process and reproduced order. Concluding comments appear in Section 4.
2. SCHUMPETER ON PROCESS AND ORDER

In *The Instability of Capitalism*, Schumpeter distinguishes between the capitalist **system** and the capitalist **order**. The capitalist system is defined as ‘an economic system characterised by private property (private initiative), by production for a market and by the phenomenon of credit, this phenomenon being the *differentia specifica* distinguishing the “capitalist” system from other species, historical or possible, of the larger genus defined by the first two characteristics’ (Schumpeter, 1928, p. 48). In turn, ‘when we merely mean to speak of the question of what may be termed the institutional survival of capitalism, we will henceforth speak of the capitalist *order* … the “system” may have an inherent tendency to destroy the “order” by undermining the social positions on which the “order” rests’ (*ibid.*, p. 49). In discussing the stability or instability of capitalism at these two levels, Schumpeter offers a convenient entry point into his conceptions of process and order: a first approximation, so to speak.

### 2.1 First approximation: the instability of capitalism

The part of Schumpeter’s 1928 paper that interests us now can be summarised into three propositions, though the second and the third receive much less attention. **First**, the workings of the capitalist system entail instability, but this instability, rather than accumulating, periodically ceases and restarts: business cycles are a necessary, rather than accidental, feature of capitalism. **Second**, the instability of the capitalist system does not cause an instability of the capitalist order. On the contrary, it is through this unstable economic process that the capitalist order reproduces itself in time. **Third**, the instability of the system tends to be more pronounced in competitive capitalism than in the trustified capitalism that has gradually evolved out of it. However, *this* evolution does tend to undermine the capitalist order. Let us briefly consider each proposition in turn.

As is well known, Schumpeter’s theory of economic development\(^1\) rests on the contrast between adaptive behaviour, facilitated by rules of conduct embodying knowledge that

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\(^1\) The translation of *wirtschaftliche Entwicklung* as *economic development*, as in the 1934 English translation of the second edition of Schumpeter’s famous book, is not ideal. As Esben
individuals need not consciously command; and entrepreneurship, which destroys old, and creates new, traditions and requires much more conscious rationality (see, e.g., Schumpeter, 1934, pp. 91-2). By development, Schumpeter actually understands ‘only such changes in economic life as are not forced upon it from without but arise by its own initiative, from within’ (ibid., p. 63). In other words, development is the carrying out of innovations, which is the function of entrepreneurs – a function which, by its nature, does not correspond to a profession or an enduring condition (see ibid., p. 78). How the process of development takes place depends on the institutional setting, and the characteristically capitalist method for financing innovation is through bank credit: through the ad hoc creation of purchasing power by private banks. Successful entrepreneurship is the essential source of profits, which tend to be temporary, as success makes it easier for others to follow the pioneers. And the appearance of new enterprise en masse, given that new products and processes are not typically introduced by old firms but compete with them, gives rise to the essential features of the business cycle – which, in its empirical form, are complicated and amplified by secondary waves, accidents, etc.. Cycles, then, ‘are essentially the form “progress” takes in competitive capitalism and could be discovered by the theory of it, if we did not know of them by experience’ (Schumpeter, 1928, p. 69)2. But,

‘by a mechanism at work in, and explaining the features of, periods of depression, a new equilibrium always emerges, or tends to emerge, which absorbs the results of innovation, carried out in the preceding periods of prosperity. The new elements find their equilibrium proportions; the old ones adapt themselves or drop out; incomes are rearranged; prosperity inflation is corrected by automatic self-deflation through the repayment of credits out of profits, through the new consumers’ goods entering the markets and through saving stepping

Sloth Andersen (2009, pp. 3-4) observes, economic evolution would have been a better choice and Schumpeter subsequently favoured the latter expression.

2 The term “progress” does not entail an unqualified approval of the process in question or of its results, which in any case cannot be measured in terms of GDP growth only. Schumpeter (1928, p. 49) actually remarks that the history of capitalism has undoubtedly been marked by catastrophes. For a welfare assessment of the process of creative destruction, attempting to reconstruct Schumpeter’s approach, see Schubert (2013).
into the place of ‘created’ credits. So the instabilities, which arise from the process of innovation, tend to right themselves, and do not go on accumulating. And we may phrase the result we reach in our terminology by saying that there is, though instability of the System, no economic instability of the Order.’ (Schumpeter, 1928, pp. 69-70)

Two features of this conception of the capitalist system stand out. First, as has already been underlined, the capitalist process is not merely adaptive. But innovation is a creative response in business. It depends on the entrepreneur and on the institutional arrangement (see De Vecchi, 1995, pp. 4ff.) – in the capitalist setting, entrepreneurial action is facilitated by the capacity of the banking system to create means of payment – as well as on other objective conditions. Still, ‘in capitalist society objective opportunities or conditions act through entrepreneurial activity’; which ‘is compatible with widely different views about its importance as an “ultimate cause”’ (Schumpeter, 1947, pp. 222-3; see also, e.g., Schumpeter, 1934, p. 61, fn. 1). Second, the ordering mechanism is an equilibrium mechanism. Given the influence of Walras noted above, one would expect Schumpeter’s concept of equilibrium to be close to the Walrasian notion – which indeed it is in some respects, as we shall see later on.

Let us now turn to the second proposition. It is through the unstable economic process sketched above that the capitalist order reproduces itself in time. This is because the rise and fall of firms and industries is also a rise and fall in the social scale, and it is through this rise and fall that the bourgeois class renews and reproduces itself. Schumpeter touches, but does not elaborate, on this process in The Instability of Capitalism – he remarks that profits are the primary source of industrial fortunes, the rise and decay of which ‘is the essential fact about the social structure of capitalist society’ (Schumpeter, 1928, p. 67) – but he writes more, for instance, in The Theory of Economic Development (see also, e.g., Schumpeter, 1947, pp. 230-1):

‘The successful entrepreneur rises socially, and with him his family, who acquire from the fruits of his success a position not immediately dependent upon personal conduct. This represents the most important factor of rise in the social scale in the capitalist world. Because it proceeds by competitively destroying old businesses and hence the existences dependent upon them, there always corresponds to it a process of decline, of loss of caste, of elimination.
This fate also threatens the entrepreneur whose powers are declining, or his heirs who have inherited his wealth without his ability … An American adage expresses it: three generations from overalls to overalls … the upper strata of society are like hotels which are indeed always full of people, but people who are forever changing. They consist of persons who are recruited from below to a much greater extent than many of us are willing to admit.’ (Schumpeter, 1934, p. 156)

Here we have, then, a fragment of another conception of order, prima facie quite different from the equilibrium mechanism identified earlier: a fragment of a theory of social order, or of the reproduction of a class structure in time. And if we move on to the third proposition we find, in turn, elements of a theory of the process whereby this class structure passes away. Schumpeter remarks that competitive capitalism has evolved, or tends to evolve, into trustified capitalism. This implies that business cycles tend to become less marked. It also tends to undermine the entrepreneurial function and therefore the position of the bourgeois class and the institutional framework of capitalism – which, of course, is the topic of Capitalism, Socialism and Democracy (see Schumpeter, 1942, pp. 132-4; see also, e.g., Schumpeter, 1934, pp. 85-6):

‘Innovation is, in [trustified capitalism], not any more embodied typically in new firms, but goes on, within the big units now existing, largely independently of individual persons … Progress becomes “automatised”, increasingly impersonal and decreasingly a matter of leadership and individual initiative. This amounts to a fundamental change in many respects, some of which reach far out of the sphere of things economic … Capitalism, whilst economically stable, and even gaining in stability, creates, by rationalising the human mind, a mentality and a style of life incompatible with its own fundamental conditions, motives and social institutions’ (Schumpeter, 1928, pp. 70-2)

In sum, there seem to be different conceptions – certainly different conceptions of order – in Schumpeter’s analysis of capitalism. In the context of his analysis of the capitalist system, order is identified with the operation of equilibrium mechanisms: these mechanisms periodically reproduce the conditions of relative stability which render the emergence of a
new wave of innovations possible. As Schumpeter (1934, p. 244-5) puts it, ‘according to our theory there must always be a process of absorption between two booms, ending in a position approaching equilibrium, the bringing about of which is its function’. However, in the context of his analysis of the capitalist order, i.e., of the institutional framework of capitalism, the ordering mechanism seems to rest on the reproduction of the capitalist class structure over time.

Curiously, Alan Dyer (1988) has suggested long ago that Schumpeter has general (though perhaps flawed) theories both of social order and of social change – presented in his essay on social classes, *Die sozialen Klassen im ethnisch homogenen Milieu* (Schumpeter, 1927b) – of which *The Theory of Economic Development* and *Capitalism, Socialism and Democracy* would be applications\(^3\). In turn, Yuichi Shionoya (1990) has criticised this claim, stating that Schumpeter’s theory of social classes is not his general theory but its application and drawing attention to the seventh chapter of the original *Theorie der wirtschaftlichen Entwicklung* (Schumpeter, 1912), omitted in later editions and in the 1934 English translation. I shall now follow Dyer’s and Shionoya’s suggestions in turn, with a view to clarifying the nature of Schumpeter’s conceptions of process and reproduced order: first I focus on his theory of social classes, then on the ‘lost’ seventh chapter\(^4\).

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\(^3\) Schumpeter (1927b, p. 230) tells us that ‘the basic idea’ of this essay goes back to 1910, was presented in lectures in 1910/11 and 1913/14, and that he continued working on the subject until 1916. The preface of the original *Theorie der wirtschaftlichen Entwicklung* (Schumpeter, 1912) mentions that his reflections on crises started in 1905 (see Andersen, 2009, p. 100), and many ideas developed in that book are clearly intimated in *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (Schumpeter, 1908).

\(^4\) My purpose, then, is not to offer a critique of Dyer or Shionoya. Shionoya’s argument was later incorporated into his very influential book on Schumpeter (Shionoya, 1997), which is criticised in Graça Moura (2002). For a recent analysis with some elements in common with Shionoya, see Heinzel (2013). For a recent analysis of Schumpeter’s theory of social classes, see Festré and Garrouste (2008, pp. 374ff.). For English translations of the discarded seventh chapter, see Schumpeter (2002a, 2002b).
2.2 Second approximation: the theory of social classes

Schumpeter’s essay on social classes deals with classes as a ‘real social phenomenon’ (Schumpeter, 1927b, p. 280, fn. 2), rather than ‘a creation of the researcher, [which] owes its existence to his organizing touch’ (ibid., p. 232), as do the classes of economic theory. Schumpeter focuses primarily on two problems: the rise and fall of families within a given class structure – which involves a discussion of the rise and fall of families within a class, as well as of the movement across class lines; and the rise and fall of whole classes – i.e., the evolution of class structure. But the discussion of these problems involves a reflection on the nature of classes and on why they exist in every society.

Schumpeter argues that the rise and fall of families within a class cannot be explained independently of individual differences in behaviour. The effects of chance are usually not independent of behaviour and the automatic increment to an elevated position, though it may be important, has a limited explanatory value in that it already presupposes such a position. Those differences in behaviour are said to rest on individual differences in aptitude with regard to specific functions and ‘with respect to leadership, along lines that are in keeping with those functions’ (ibid., p. 274). Aptitude is not to be equated to moral value: ‘[f]rom many points of view – religious, aesthetic, moral – it may have to be evaluated in a negative sense. It may, in particular, be antisocial’ (ibid., p. 275). But a distinction must be made ‘between the social significance of a given mode of behavior and the social significance of the qualities that make such behavior possible’ (ibid.).

One of Schumpeter’s illustrations of his thesis is the nineteenth-century industrial bourgeoisie. ‘[T]he social logic or objective situation does not unequivocally determine how much profit shall be invested, and how it shall be invested, unless individual disposition is taken into account’, he remarks. ‘Yet when that is done, the logic is no longer inherent solely in the system as distinct from the individuality of the industrialist himself’ (ibid., pp. 242-3). To explain changes in the relative positions of industrial families, he proceeds, the crucial factors are not saving or efficient routine management. Rather, it is through innovation, which means breaking up custom and tradition and requires leadership aptitudes, that industrial fortunes are made and family position is enhanced.

As for the movement across class lines, Schumpeter argues that ‘class barriers are always, without exception, surmountable and are, in fact, surmounted, by virtue of the same qualifications and modes of behavior that bring about shifts of family position within the
class’ (ibid., p. 273); and he points out that the process by which class barriers are surmounted is the process by which the content of classes is formed in the first place. However, he also underlines that the class situation of an individual clearly conditions his/her behaviour (see ibid., pp. 238, 247); and that changes in class composition at times take place slowly and almost imperceptibly, ‘impeded by legal and other barriers which every class, for obvious reasons, seeks to erect’ (ibid., p. 248).

Once again, one of Schumpeter’s illustrations of his thesis is capitalism. He remarks that most industrial families have risen from the working and craftsman class, ‘because one of their members has done something novel, typically the founding of a new enterprise, something that meant getting out of the conventional rut. Because of the limited opportunities open to working-class families, this is virtually the only method by which they can make the great leap out of their class’ (ibid., pp. 253-4).

Finally, Schumpeter proposes to explain why class structures change, why it is that whole classes rise and fall\(^5\). He argues that the position of a class depends on the relative social significance of its function (or of other functions which its members are able to seize); and on the degree to which those functions are successfully performed (see ibid., pp. 256, 267, 272). And he adds that the relative social significance of a function is always determined ‘by the degree of social leadership which its fulfillment implies or creates’ (ibid., p. 273) – where social leadership means ‘to decide, to command, to prevail, to advance’ and ‘emerges only with respect to ever new individual and social situations’ (ibid., pp. 277-8)\(^6\).

However, class structure has, for several reasons, a tendency to endure: ‘[c]lasses, once they have come into being, harden in their mold and perpetuate themselves, even when the social conditions that created them have disappeared’ (ibid., p. 237). In fact, class structure is a matter of social value becoming firmly established (see ibid., p. 274), i.e., there is a process of

\(^5\) Schumpeter (1927b, p. 273) points out that ‘the factors which ultimately account for shifts in class position in historical time and for the existing class structure at any given point in time, also answer the question of why there exists such a phenomenon as class structure at all’.

\(^6\) ‘All the romance and gibberish surrounding this term [leadership] must be discarded’, Schumpeter (1927b, p. 277) warns: ‘the entire problem of the “great man” has no bearing on our subject.’
entrenchment. It is still the case that entrenched positions which constitute the class stratification of society ultimately rest on individual differences in aptitude. Clearly, though,

‘[e]very social situation is the heritage of preceding situations and takes over from them not only their cultures, their dispositions, and their “spirit,” but also elements of their social structure and concentrations of power … The social pyramid is never made of a single substance, is never seamless. There is no single Zeitgeist, except in the sense of a construct. This means that in explaining any historical course or situation, account must be taken of the fact that much in it can be explained only by the survival of elements that are actually alien to its own trends.’ (ibid., p. 236)

Now, is this a general theory of social order and social change, as Dyer (1988) proposes, of which the arguments in The Theory of Economic Development and in Capitalism, Socialism and Democracy are applications? Schumpeter’s essay offers an abstract account of how class structure is reproduced in time, as well as transformed, as a result of individual action, taken collectively. In this sense, it provides a theory of reproduced order which is also a theory of process. Since, according to Schumpeter (1927b, p. 259), class structure is reflected and objectified in institutions – at any point in time, however, institutions reflect, if perhaps only ultimately, different epochs and class structures – this theory can be regarded as an account of how an institutional framework is reproduced and changed in the course of history, through human action.

*Up to a point*, the argument in the Theory of Economic Development can indeed be shown to reflect this conception. As Schumpeter observes, individual action, even when it means doing something novel, is always conditioned by some rules of conduct: ‘the field of individual choice is always, though in very different ways and to very different degrees, fenced in by social habits or conventions and the like’ (Schumpeter, 1934, p. 91). But rules can be broken. While class membership is foreordained for the individual, stemming from membership in a given clan or lineage (see Schumpeter, 1927b, p. 238), individual behaviour is not determined by class membership. Whatever their class, under capitalism individuals can in principle act as entrepreneurs and ascend in the social scale, *because a certain institutional framework is in place* – banks have the power to create means of payment, which constitute the entrepreneur’s
capital. As Dyer (1988) underlines, capital is an institutional reflection of capitalist class structure, enabling its reproduction in time through the renewal of the capitalist stratum. Successful innovation is the essential source of profits, out of which interest is paid and credit repaid. Thus, ‘[e]conomically and sociologically, directly and indirectly, the bourgeoisie … depends on the entrepreneur’ (Schumpeter, 1942, p. 134). In short, the argument of The Theory of Economic Development can be seen as an account of the reproduction of the capitalist class structure, and of the institutions which reflect it, through innovative action, which transforms some rules of conduct and is rendered possible by those institutions.

In turn, the argument of Capitalism, Socialism and Democracy explains how this reproduction also yields tendencies to the transformation and demise of the capitalist order. Enterprise, through which the capitalist order reproduces itself, does not merely destroy some relatively minor rules of conduct. It propels a rationalist attitude which, moreover, tends to spread from the business sphere to all areas of social life. Both these processes undermine essential elements of the institutional framework of capitalism. On the one hand, innovation tends to become routinised and automatised – i.e., increasingly independent of leadership attributes – which renders the entrepreneurial function obsolescent: ‘[t]he perfectly bureaucratized giant industrial unit not only ousts the small and medium-sized firm and “expropriates” its owners, but in the end it also ousts the entrepreneur and expropriates the bourgeoisie as a class’ (Schumpeter, 1942, p. 134). On the other hand, the rationalist attitude destroys pre-capitalist traditions and ‘does not stop at the credentials of kings and popes but goes on to attack private property and the whole scheme of bourgeois values’ (ibid., p. 143).

In this light, it is apparent that Schumpeter’s conception shares some elements with the economic interpretation of history, to which he refers approvingly in his essay on social classes (see Schumpeter, 1927b, pp. 262, 282 fn. 22) and elsewhere (see, e.g., Schumpeter, 1949, pp. 294-6; Schumpeter, 1954, pp. 438ff.). But – apart from Hegelian phraseology, which Schumpeter dismisses as unimportant – there are significant differences with regard to Marx’s formulation in the preface to A Contribution to the Critique of Political Economy (Marx, 1859). One of them is signalled by Schumpeter when he writes that the economic interpretation of history ‘would at once become untenable and unrealistic - indeed, some easily demolished objections to it are explained from this fact - if its formulation failed to consider that the manner in which production methods shape social life is essentially influenced by the fact that the human protagonists have always been shaped by past situations’
(Schumpeter, 1927b, p. 237). Social structure does not simply follow from the conditions of production; instead, there is interdependence between both. A second difference is, of course, that Schumpeter rejects Marx’s theory of social classes, which he considers separable from the propositions constituting the economic interpretation of history and valid only for ‘agitatorial purposes’. I return to this topic in my concluding comments.

2.3 Third approximation (from a different angle): the seventh chapter and equilibrium

But how exactly do Walras and equilibrium fit into this conception of order and change? Schumpeter actually offers a very clear argument as to why equilibrium is essential as a concept of order, which Richard Arena (2002, p. 42) appropriately calls the Magna Carta argument and which goes as follows (see also Schumpeter, 1908, pp. 33-4; Schumpeter, 1939, p. 41):

‘Economics, like every other science, started with the investigation of “local” relations between two or more economic quantities, such as the relation between the price of a commodity and the quantity of it that is available in a market … It was but slowly that the fact began to dawn upon analysts that there is a pervading interdependence between all economic phenomena … They were very far from realizing that this all-pervading interdependence is the fundamental fact, the analysis of which is the chief source of the additions that the specifically scientific attitude has to make to the practical man’s knowledge of economic phenomena; and that the most fundamental of all specifically scientific questions is the question whether analysis of that interdependence will yield relations sufficient to determine – if possible, uniquely – all the prices and quantities of products and productive services that constitute the economic “system” … [T]he discovery was not fully made until Walras, whose system of equations, defining (static) equilibrium in a system of interdependent quantities, is the Magna Carta of economic theory – the technical imperfections of that monument of constitutional law being an essential part of the analogy’ (Schumpeter, 1954, p. 242).

‘[F]rom the standpoint of any exact science, the existence of a “uniquely determined equilibrium (set of values)” is, of course, of the utmost importance, even if proof has to be purchased at the price of very restrictive assumptions; without any possibility of proving the
existence of uniquely determined equilibrium – or at all events, of a small number of possible equilibria – at however high a level of abstraction, a field of phenomena is really a chaos that is not under analytic control.’ (ibid., p. 969)

In other words, the separate treatment of a set of interdependent functional relations is justified only if they form a coherent whole – i.e., if, given ‘external data’, the workings of the ‘economic system’ bring about a certain pattern. It is in this sense that equilibrium is the foundation of an autonomous discipline of economics (see Shionoya, 1990). Indeed, because equilibrium is the only available notion of order when the ‘economic system’ is defined as a set of interdependent functional relations, this definition of the ‘economic system’ only makes sense if an equilibrium exists.

Now, this static equilibrium framework can, in Schumpeter’s view, encompass quantitative change but not the phenomena of development – which, however, are supposed to be endogenous to the economic sphere: ‘they are purely economic and ... their explanation is obviously among the tasks of pure theory’ (Schumpeter, 1934, p. 61). Whether these phenomena are indeed endogenous to an equilibrium system need not concern us now. The crucial point, rather, is that a purely economic theory of development is impossible unless development can somehow be articulated with the static equilibrium framework so that order emerges (see Shionoya, 1990, p. 321; Graça Moura, 2003, pp. 291-2). As Schumpeter explains in the seventh chapter of Theorie der wirtschaftlichen Entwicklung, there is no such thing as a dynamic equilibrium: equilibrium means static equilibrium (see Schumpeter, 1912, p. 489). This is the only conception of order available in the purely economic realm. Although statics cannot represent the whole economic process, ‘static laws are the basis of a scientific understanding of the economy’ (ibid., p. 471, as translated in Schumpeter, 2002b, p. 97).

There is much more in the seventh chapter, yet not enough for the purpose of understanding precisely how equilibrium relates to the conceptions of process and order presented in the essay on social classes. Thus, Schumpeter observes that the distinction between leadership and adaptive behaviour, or between development and statics, can be made in all areas of social life, not just in the economic realm. However, all these areas are actually the mutually interdependent parts of an organic whole (see Schumpeter, 1912, p. 546):
economic development also entails social changes of a non-economic type. That, however, is just one instance of a general phenomenon … achievements in any sector of social activity will end up having a shaping effect across all sectors of social life, and change the preconditions and conditions of human behaviour in all sectors … through the joint effects of relatively independent developments something emerges that seen from sufficient distance, looks like a uniform cultural development. We thereby untie things from rigid causal chains and give them back their life. And in this holistic understanding of cultural development the economy also has its particular place.’ (ibid., p. 547, as translated in Schumpeter, 2002a, p. 431)

The final stage of Schumpeter’s research programme, Shionoya (1990, pp. 322ff.) argues, is precisely the formulation of a theory of socio-cultural development, which analytically integrates the various areas of social life in order to reconstruct the overall social process; and it is here that Schumpeter’s theory of social classes would belong. From this perspective, economic development appears in a different light: ‘[w]hen the economic area is looked at in isolation, the innovating forces … appear to emerge from within the area; but when we take into account other areas as well, we find the innovating forces will become stronger or weaker in response to the situations in neighboring areas’ (Shionoya, 1990, pp. 323-4). This may well be so. Still, these observations do not constitute a satisfactory explanation of how Schumpeter’s static equilibrium framework is connected to his theory of socio-cultural development. There is no such explanation in the seventh chapter.

There exists, however, another complication which has to be mentioned presently (see Arena, 2002; Graça Moura, 2002, pp. 817-8). Despite Schumpeter’s repeated invocation of Walras, their understanding of equilibrium differs. Schumpeter opens his Theory of Economic Development with a description of the ‘circular flow of economic life’. In its simplest form, this represents a stationary process, which merely reproduces itself in time and which Schumpeter equates with general equilibrium. However, the workings of the circular flow do not rest on conscious rationality and optimisation. Schumpeter contrasts action within the circular flow, ‘which as such does not need to be reflected upon at all’ with entrepreneurial action, where there is ‘much more conscious rationality’, even if ‘many things must remain uncertain’ and ‘some can perhaps only be “guessed”’ (ibid., p. 85). Habit, he writes, ‘does not require to be continually renewed and consciously reproduced but sinks into the strata of
subconsciousness’ (ibid., p. 84). In short, the circular flow is based on custom and experience, in part inherited, on traditions and rules of conduct, which facilitate and constrain, but are not the same as, actual behaviour.

Nevertheless, Schumpeter insists that general equilibrium and his circular flow are equivalent. He argues that the assumption that action rests on conscious and rational efforts, rather than having descriptive merits, is useful ‘to bring out the rationale of economic behavior irrespective of the actual psychology of the households and firms under observation’ (ibid., p. 10). ‘The assumption that conduct is prompt and rational is in all cases a fiction’, he submits. ‘But it proves to be sufficiently near to reality, if things have time to hammer logic into men. Where this has happened, and within the limits in which it has happened, one may rest content with this fiction and build theories upon it’ (ibid., p. 80).

As Arena (2002, pp. 56ff.) demonstrates, this argument is flawed. Contrary to Schumpeter’s claims (1934, p. 42), routine behaviour, or action according to well-tried experience, cannot be generally regarded as equivalent to optimisation, or action with a knowledge of the best combination of present means under given conditions. But, moreover, conditions are not supposed to be given. The circular flow is supposed to encompass adaptive, though not revolutionary, change. And it is difficult to see how routine behaviour ensures a tendency to equilibrium once conditions change. Indeed, Schumpeter appears to concede that this cannot be generally so. He writes, for instance, that adaptation always offers difficulties – ‘[t]he mere knowledge of the changed state of affairs is not attained in most cases with the desirable promptness. To draw conclusions from the knowledge is again a big step, which meets many obstacles in unpreparedness, the lack of means, and so on’ – and that perfect adaptation is often ‘impossible’ (ibid., p. 33).

This tension as to the meaning of equilibrium serves as a bridge to the next section. As we reach the end of our third approximation, the reader may feel that his/her understanding of Schumpeter on process and order remains fragmentary and precarious. It is unclear to what

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7 ‘[T]he necessity of making decisions occurs in any work’, Schumpeter (1934, p. 20) writes. ‘No cobbler’s apprentice can repair a shoe without making some resolutions and without deciding independently some questions, however small. The “what” and the “how” are taught him; but this does not relieve him of the necessity of a certain independence.’
extent the various elements of Schumpeter’s conception fit with one another, if they do. This is the topic to which we now turn.

3. PROBLEMS IN SCHUMPETER’S ANALYSIS

Let us take stock. There are two levels in Schumpeter’s analysis, or more specifically in his analysis of capitalism. One of these levels is the analysis of socio-cultural development as a whole. Schumpeter’s theory of social classes can perhaps be interpreted as the framework for this level of analysis, presenting the general features of a theory of process which is also a theory of order. The other level is the purely economic analysis of development. Here, too, Schumpeter’s conception of change seems to turn on the interdependence of institutions (e.g., capital) and individual action (or, more specifically, a type of individual action, creative response). However, his conception of order is hardly unequivocal. Schumpeter identifies order with equilibrium – and argues over a period of more than 40 years that general equilibrium is the Magna Carta of economics as an autonomous subject – but he also refers to the circular flow as a set of rules and traditions reproduced in time.

In this section I want to focus on problems with these conceptions of process and order, especially problems of coherence or mismatch. I first return to the issue which the seventh chapter of Theorie der wirtschaftlichen Entwicklung fails to clarify, i.e., how Schumpeter’s purely economic analysis coheres with its socio-cultural counterpart. A very simple argument suffices to show that they do not fit with one another. I go on to argue that semantic ambiguity surrounding Schumpeter’s notion of equilibrium is intelligible as a result of methodological preconceptions. I then turn to Schumpeter’s purely economic analysis of capitalism in more detail and discriminate two types of problems therein. Both relate to his conception of order as equilibrium. I cannot discuss Schumpeter’s socio-cultural analysis of capitalism in this paper; but I do not think that there are methodological problems there such as can be detected in his purely economic analysis.

3.1 Equilibrium as an ordering mechanism and as a metaphor

Let us provisionally take equilibrium, in the Walrasian sense, as the ordering mechanism in Schumpeter’s theory of economic development. Because it is not clear how the entrepreneur can be endogenous to a static equilibrium framework, let us eliminate this problem by
assuming that entrepreneurship is exogenous. So we have an equilibrium to start with, which is disturbed by a massive external shock – the appearance of entrepreneurs en masse – from which the system nevertheless is allegedly able to recover: tendencies to equilibrium eventually operate, or so Schumpeter claims. Let us accept this, too, for the time being.

Clearly, a model of this kind cannot be a first step towards the representation of socio-cultural development as a whole, or of economic development in the wider context of socio-cultural development (see Graça Moura, 2003, p. 292). In an orthodox equilibrium model, ‘action’ is fully determined once ‘data’ are given. Capacities or potentials are expressed as, or conflated into, actual outcomes. This is why it is difficult to sustain a meaningful notion of entrepreneurship in this context. But the distinction of these two realms, potentials and actions, is also essential to Schumpeter’s representation of socio-cultural development. The recognition of structure, at various levels, as a condition of action, which however it does not determine, renders creative responses in general both conceivable and explicable.

If Schumpeter’s conception of equilibrium is orthodox, then, it follows that the two levels of his analysis do not fit with one another (and, moreover, that there are problems within his purely economic representation). They presuppose incompatible worlds. Some of Schumpeter’s pronouncements obfuscate this tension because they seem to suggest that equilibrium is a shorthand expression – or perhaps a metaphor – for the relatively stable reproduction of rules of conduct through action. As remarked, Schumpeter often intimates that order lies at the level of rules or structures, which are distinct from, but conditions of possibility of, events or actions – e.g., when he portrays the circular flow as a system where individuals make (potentially different) decisions by relying on (and thereby reproducing) rules.

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8 The impression that the ordering mechanism in Schumpeter’s theory of economic development cannot be equilibrium in the literal sense is strengthened by its multiple-cycle extension (see, e.g., Schumpeter, 1939, pp. 161ff.; Schumpeter, 1935). Whereas in the single-cycle version innovation starts from (neighbourhoods of) equilibrium only, this cannot be generally the case with three superimposed cycles of different lengths.
Clearly, though, his understanding of equilibrium also draws on Walras. The problem, of course, is that it is untenable to argue that, in the context of the circular flow, individuals follow rules of which they may not even be consciously aware and that this produces (or tends to produce) a result similar to the one that would obtain if they were consciously optimising; or to argue that order involves the reproduction of rules of conduct in time and that this brings (or tends to bring) about the outcome that obtains in the Walrasian framework. The superimposition of these two views on order is, however, explicable as the product of ontological insights and methodological preconceptions. Not only is there considerable evidence that Schumpeter’s commitment to Walrasian equilibrium is not ontologically grounded but, as far as I can see, there is no other plausible explanation for his position.

Thus, the Magna Carta argument strongly suggests that the definition of the ‘economic system’ as a static equilibrium framework is primarily methodological. For Schumpeter, there exists no such static ‘economic system’. Rather, ‘[t]he social process is really one indivisible whole’ (Schumpeter, 1934, p. 3). Behind that definition of the ‘economic system’ is a particular conception of science, according to which scientifically interesting results, in economics and in every other science, are functional relations, or constant conjunctions of the form ‘whenever event x, then event y’ (see Lawson, 1997). In turn, these functional relations only constitute a system if there is an equilibrium.

In fact, Schumpeter explicitly acknowledges the ontological shortcomings of the Walrasian framework while implying that – for methodological reasons – they are of peripheral importance. A succinct example of this can be found in his discussion of tâtonnement in History of Economic Analysis. ‘Lest [the reader] should … turn away from Walras’ construction’, Schumpeter (1954, p. 1015) writes, ‘on the ground of its hopeless discrepancy from any process of real life, I wish to ask him whether he ever saw elastic strings that do not increase in length when pulled, or frictionless movements, or any other of the constructs

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9 Andersen (2009, p. 254) similarly observes that Schumpeter’s circular flow ‘is not only the non-evolutionary starting point for most of his subsequent evolutionary analyses, but also his bridge to standard economics’, adding that Schumpeter’s ‘vagueness’ reflects the fact that the circular flow is designed to serve at least four different, and partly conflicting, purposes – which is ‘a main source of his strange mix of economic orthodoxy and heterodoxy’ (ibid., p. 258). See also ibid., pp. 65-6, 134, 144, 319.
commonly used in theoretical physics; and whether, on the strength of this, he believes theoretical physics to be useless.’

There are multiple statements to a similar effect, some of them more subtle (or, perhaps, more cryptic). In a sketch for a paper on The Meaning of Rationality in the Social Sciences (Schumpeter, 1991a), for instance, Schumpeter distinguishes ‘rational models’ built on the assumption of conscious or subjective rationality from those based on subconscious or objective rationality. Not surprisingly, he observes that social scientists have almost invariably overrated the range of conscious rationality in action. He adds that they have formulated their propositions on the basis of concepts foreign to the individuals whose behavior they were supposedly describing, and overlooked the fact that conscious motives ‘are largely “rationalizations” of impulses [one] either is unable to diagnose or unwilling to admit’ (ibid., p. 326). But he also states that many of these errors can be amended: models or results wrongly relying on subjective rationality can often be rephrased in terms of objective rationality. In the end, however, he appears to conclude against the ontological value of these ‘rational models’:

10 Schumpeter acknowledges, however, that it is essential to investigate the mental processes of the actors involved if a ‘rational model’ is to have explanatory value. A proposition, say, about the monopolist’s profit maximum is independent of the subjective rationality of individual monopolists, ‘only so long as we are interested in that proposition as such and nothing else. If, however, we apply it as an interpretative schema, it may occur to ask why it does or does not fit the facts of the particular case in hand. Taking the first alternative, subjective rationality on the part of the monopolist concerned would afford a very obvious explanatory hypothesis: the monopolist’s conscious calculations of his own pecuniary interest would then constitute a real force (“Realgrund” [real or ontological ground] as distinguished from “Erkenntnisgrund” [epistemological ground] – sorry, but for these things there are no perfectly adequate English terms). The value of that hypothesis might be inferred from the fact that if, for some reason or other, we do not feel justified in adopting it, conformity of behavior to the rational pattern becomes a puzzle, solution of which is both a laborious and a difficult task.’ (Schumpeter, 1991a, pp. 326-7)
‘the reform primarily associated with the name of Pareto, though it did much to reduce the hedonist stigma and though it reduced the emphasis on conscious rationality quite a lot, yet retained in service the objective rational schema. And this turned around the profit motive. We have, it is true, seen that it is not essential for the applicability of the hypothesis of rationality in action to assume any particular end. But in practice, it is almost necessary to construct a rational schema with a view to a single end – otherwise the construct loses its main raison d’être, simplicity. Hence the homo oeconomicus turned up again. Marshall obviously did not like him. But Pareto accepted him, comforting us with the assurance that another time we would consider the homo religiosus, the homo eroticus, and so on in turn. This, however, only shows up a very serious limitation. Even if I could – I cannot – visualize the laborious life of a pure homo eroticus, any attempt at combination of all those homines would only serve to show, by the absence of any rational rule of combination, that life is ontologically irrational, at least as much as “nature.”’ (ibid., pp. 336-7)

It would seem, then, that ‘rational models’ can only have a purely instrumental value – which accords well with Schumpeter’s definition of ‘theory’ as ‘mere instruments or tools framed for the purpose of establishing interesting results’ (Schumpeter, 1954, p. 14). But why should the results so established be interesting in the first place? Because of Schumpeter’s conception of science, according to which scientifically interesting results take the form of constant conjunctions or functional relations – and from which the Magna Carta argument follows.

### 3.2 Retroductive problems and spurious problems

I shall now focus on Schumpeter’s purely economic analysis of the capitalist process, distinguishing, for expositional convenience, two closely related types of problems. Both turn on his usage of equilibrium.

Retroduction is the form of reasoning that moves from observations of specific phenomena to hypotheses about their underlying causes or conditions of possibility (see Lawson, 1997, 2003). The core of Schumpeter’s Theory of Economic Development can be thought of as a retroductive argument. Schumpeter starts from a recurrent set of phenomena – the empirical manifestations of capitalist motion, in particular its wavelike character – and attempts to infer the conditions, or the specifically capitalist conditions, which give rise to these phenomena. I
call *retroductive problems* those that concern this reasoning. They turn on whether Schumpeter correctly identifies the essential causes of the economic process under capitalism. There is a long and distinguished line of criticisms of Schumpeter in this regard, and all the arguments that I present here can be traced back to François Perroux (1965), Paul Sweezy (1943), Allen Oakley (1990), and no doubt others. *Spurious problems*, in turn, are defined by Schumpeter (1954, p. 80, fn. 4) as those ‘that the analyst himself creates by his own method of procedure’\(^{11}\). I shall discuss under this heading whether Schumpeter’s argument, as constructed, allows him to accurately portray his own vision.

Schumpeter’s theory of economic development does not seek to present a complete theoretical explanation of the multiple causes of wavelike movements. His point is merely to demonstrate that cycles are a necessary rather than accidental feature of the capitalist process (see, e.g., Schumpeter, 1927a, p. 26, fn. 1, p. 32). He remarks that exogenous (for instance, political) disturbances, which are ubiquitous, are ‘an obviously important source of economic fluctuations’ (Schumpeter, 1935, p. 134)\(^{12}\). But the question he wants to address is whether,  

\(^{11}\) Schumpeter is talking about Max Weber and he adds: ‘For purposes of abbreviated description, we construct abstract pictures of social “systems” that we endow with a number of well-defined characteristics in order to contrast them sharply. This method of (logically) Ideal Types … has, of course, its uses, though it inevitably involves distortion of the facts. But if, forgetting the methodological nature of these constructions, we put the “ideal” Feudal Man face to face with the “ideal” Capitalist Man, transition from the one to the other will present a problem that has, however, no counterpart in the sphere of historical fact.’ (Schumpeter, 1954, p. 80, fn. 4).

\(^{12}\) Schumpeter observes that many outside factors, when considered on a higher plane and for a wider purpose, are ‘the direct outcome of the working of the capitalist machine’. They are explicable by economic circumstances, in turn ‘created by the working of the whole social system, of which the capitalist mechanism [is] a part’. Hence the distinction of an economic process and its institutional setting in general is, ‘in a sense, quite unrealistic. But if we do not make it, we shall never be able to say more than that everything depends on everything’ (Schumpeter, 1935, p. 136 and fn. 2).
even if the institutional and natural framework remain invariable, the economic process under capitalism provides *sufficient* conditions for the existence of cycles.

In order to establish this, as we know, Schumpeter starts from the circular flow, which does not encompass innovation. Since the business cycle ‘would be impossible in an economic world displaying nothing except unchanging repetition of the productive and consumptive process … [i]f there be a purely economic cycle at all, it can only come from the way in which new things are, in the institutional conditions of capitalist society, inserted into the economic process and absorbed by it’ (*ibid.*, p. 139). The argument then proceeds to introduce the specifically capitalist means of financing entrepreneurial ventures, through inflationary bank credit – as Schumpeter (1927a, p. 41) puts it, ‘the fundamental cause [of cycles], whilst in nature independent of the machinery of money and credit, could not without it produce the particular kind of effects it does’ – and to explain how innovations cluster and the boom comes about; how prosperity necessarily gives rise to a process of liquidation, readjustment, and absorption – i.e., recession – even if there are no errors; how speculative secondary waves, quantitatively more important than the primary innovation wave, intensify the amplitudes of cycles and can lead to depressions; and how the economic system eventually returns to a ‘neighbourhood of equilibrium’, which makes it possible for enterprise to resume.

But how exactly is it demonstrated that innovation, financed by credit, is *the essential cause* – ‘both necessary and sufficient’ (*ibid.*, p. 28) – of business cycles and indeed of all specifically capitalist phenomena? In order to see the ‘essence’ of development clearly, Schumpeter claims, it is convenient to abstract from certain empirical features (see, e.g., *ibid.*, pp. 25-6). As we know, the circular flow is supposed to represent ‘economic life from the standpoint of the economic system’s tendency towards an equilibrium position, which tendency … may be described as an adaptation to data’ (Schumpeter, 1934, p. 62). But this equilibrium position, ‘never attained, continually “striven after” (of course not consciously), changes, because the data change’ (*ibid.*); and there can also be growth. Schumpeter submits, however, that growth, or changes in data, only call forth processes of adaptation, and therefore should be abstracted from, even if they are often a condition of development. He recognises, moreover, that every process of development irreversibly affects future development, changing its shape. Still, in order to avoid circular reasoning (see, e.g., Schumpeter, 1935, p. 139), he makes the ‘first’ cycle arise out of a position without development. In short, his argument starts from *an*
equilibrium position deprived of all specifically capitalist features, since these features only arise in the process of development.

Once capitalism is in motion, though, the economy is a credit economy, where interest exists, as do profits and savings. What, then, is the precise nature of the equilibrium which, allegedly, tends to be periodically re-established – and how exactly does a tendency to equilibrium operate in such an economy? Why should this equilibrium be of the same nature as the pre-capitalist equilibrium position from which Schumpeter’s argument starts? What has it got in common with the Walrasian conception invoked at the outset? These questions are not persuasively answered. Schumpeter does recognise the problems that he needs to face. He observes that ‘we must drop the assumption, made for convenience of exposition, that our wave is the first of its kind’ (Schumpeter, 1939, p. 157). He adds that ‘we must insert growth. Saving, in particular, we cannot longer disregard, because sources and motives are supplied by our process strong enough to make it quantitatively significant’ (ibid., p. 158). He also wants to take into account that ‘credit creation spreads from its “logical” source, financing of innovation, throughout the system … and … becomes an instrument for financing business in general’ (ibid., p. 159), and that innovation opens up investment opportunities to other industries. And, he promises, ‘we now drop the assumption of perfect competition altogether, as well as the assumption, made at the threshold of this chapter, that there is perfect equilibrium at the start’ (ibid., p. 160). Notwithstanding these proclamations, Schumpeter’s exposition of the circular flow in The Theory of Economic Development may give the impression that the differences between him and Walras on money are tenuous. But they are not. For Schumpeter, capitalism is necessarily a credit economy, capital is a fund of purchasing power, and interest is a monetary phenomenon – which, incidentally, is why, for him, general equilibrium excludes interest (see Schumpeter, 1934, p. 46, fn.1). Schumpeter’s very controversial theory of interest – or, more precisely, his theory of Produktivzins (see ibid., pp. 157-8) – is, however, impossible to discuss here (see, e.g., Perroux, 1965; De Vecchi, 1995, pp. 38ff., 151ff.). Neither is it necessary to do so. In the present context, it suffices to bear in mind this: if the argument that a tendency to Walrasian equilibrium operates is untenable in the context of Schumpeter’s circular flow, it is a fortiori so in the context of capitalist development (see Arena, 2002, pp. 59-60).
the fact is that he does not present an argument on the workings of capitalism that actually incorporates these changes.

It is therefore tempting to concur with the criticism that Schumpeter is not really elucidating the capitalist process but merely describing the effects of adding innovation, financed by credit creation, to a pre-capitalist (or non-capitalist) setting. In other words, his retroductive argument would not seem to be adequately constructed: it does not quite enable him to convincingly identify (demonstrate) the essence of the capitalist process. And from here, of course, it is but a small step to propose an alternative starting point for the explanation of the capitalist process, embodying another (perhaps no less contestable) conception of what is essential. Sweezy, for example, assumes a capitalist class in the circular flow, with exclusive control over produced means of production; which

‘implies a different view of profits and accumulation from that of Professor Schumpeter. For him profits result from the innovative process, and hence accumulation is a derivative phenomenon. The alternative view maintains that profits exist in a society with a capitalist class-structure even in the absence of innovation. From this standpoint, the form of the profit-making process itself produces the pressure to accumulate, and accumulation generates innovation as a means of preserving the profit-making mechanism and the class-structure on which it rests. A different view of the business cycle is also implied’ (Sweezy, 1943, p. 96)

It may be the case, then, that Schumpeter’s theory of economic development does not correctly represent the essence of the capitalist process. But his commitment to Walras also engenders a somewhat different type of problems, which may be termed spurious. Independently of whether Schumpeter’s vision is correct or not – it may of course be the case that it is correct even if Schumpeter does not succeed in establishing this – it is easy to see that the construction of his argument does not facilitate the presentation of, and even distorts, that vision.

I have observed that Schumpeter’s conversion of the circular flow into an equilibrium makes it difficult to visualise the emergence of the entrepreneur ‘from within’ the economic system, for in an equilibrium framework capacities are identified with the results of their exercise. But the picture of entrepreneurship that surfaces does not do justice to Schumpeter’s conception in
another sense. Whereas in the realm of the circular flow, the individual is held ‘in iron fetters fast in his tracks’ (Schumpeter, 1934, p. 6), his/her behaviour fully determined by ‘data’, the entrepreneur appears to operate in an environment the structure of which is largely unspecified\(^\text{14}\). The circular flow is institutionally characterised by private property, division of labour, and competition; bank credit is subsequently added to allow for the emergence of capitalism. But, except for this, the argument proceeds as if there is no structure to guide or constrain entrepreneurial activity. This, of course, can easily read like an overstatement of the entrepreneur’s powers or abilities, which finds support in passages of the original Theorie der wirtschaftlichen Entwicklung\(^\text{15}\) but is at odds with Schumpeter’s conception of innovation as a creative response – i.e., with the recognition that objective factors have as much claim to being considered causal as the action they condition (see, e.g., Schumpeter, 1991b, p. 409). Nor does it cohere with many other of his assertions on the nature of entrepreneurship, e.g., the remark that his conception, like actual life, ‘does not draw a sharp line between what is and what is not “enterprise”’ (Schumpeter, 1947, p. 223; see also, e.g., Schumpeter, 1927a, p. 27); or his related observation that the ‘new thing’ carried out by the entrepreneur may ‘of course’ be very trivial (ibid., p. 28, fn. 1): ‘It need not be Bessemer steel or the explosion motor. It can be the Deerfoot sausage. To see the phenomenon in the humblest levels of the business world is quite essential’ (Schumpeter, 1947, p. 223).

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\(^{14}\) Along similar lines, Oakley (1990) argues in great detail that Schumpeter fails to give due weight to the fact that there is a structure to production.

\(^{15}\) Andersen (2009, pp. 36, 67ff.) considers elite theory one of the main sources of Schumpeter’s vision and theory, remarking that ‘[t]he emphasis on the innovative deeds of the elite gives Schumpeter’s early formulation of his theory of economic evolution many of the characteristics of a hero epic’ (ibid., p. 68). Nicolò De Vecchi (1995, p. 21), on the other hand, argues that it is wrong to bracket Schumpeter with elitist authors. De Vecchi is right if we consider the mature version of Schumpeter’s theory of economic development, although elite theory may have been an inspiration of the original version. Similarly, Schumpeter (1927b, p. 230) tells us that his thinking on classes started from racial theories yet, in fact, race plays no part in his theory of social classes – despite a few regrettable sentences (see ibid., p. 277; Schumpeter, 1954, pp. 791-2).
Of course, Schumpeter’s aim in *The Theory of Economic Development* is to provide a theoretical account of the workings of capitalism – an account of the mechanism of change rather than of the history of capitalism. His discussion is pitched at a certain level of abstraction. But this cannot justify that the structure of the environment where the entrepreneur operates is left indistinct – that, e.g., Schumpeter’s insights on the technological and economic interdependence of innovations, on the trajectory of technical change, or on diffusion, remain occasional, scattered observations. With insufficient elaboration on that sort of mechanisms, it is not surprising that Schumpeter does not deliver an entirely persuasive argument as to why innovators appear in swarms (see, e.g., Kuznets, 1940, pp. 262-3; Festré, 2002, p. 136; Andersen, 2009, pp. 221ff.). And without a convincing argument on this, of course, he does not have a theory of the business cycle: there is neither a limpid explanation of the upward phase nor a demonstration of the recurrent operation of a tendency to equilibrium in any of his writings.

These writings are, of course, dazzling as well as profound. They contain almost too many perspicacious observations on the capitalist process. But, to repeat, these observations are not always integrated into the core of Schumpeter’s argument – nor could they be, given his methodological preferences.

4. CONCLUDING COMMENTS

‘His writings have been stimulating by their visionary, ambitious, often pioneering character, but also by the unclarified details they left’, Christoph Heinzel (2013, p. 252) writes of Schumpeter. This is also my opinion. In Schumpeter’s analysis of the capitalist system, his conception of order does not quite cohere with his ideas on innovation or business cycles, which accounts for tensions in his writings, including a degree of semantic ambiguity surrounding the notion of equilibrium. Schumpeter’s commitment to Walras is nevertheless intelligible given his conception of science, a conception which was neither especially adventurous nor outdated in Schumpeter’s time. To reiterate, his admiration for the Walrasian system does not originate in an acceptance of its implicit ontology – Schumpeter just thought that its ‘logical schema’ was right ‘in principle’, even if its assumptions were ‘very far from reality’ (Schumpeter, 1939, p. 98) – but in a misguided belief about its usefulness as a protocol for expressing scientific results. Incidentally, this is why it is a misunderstanding to regard Schumpeter’s position on equilibrium as a reflection of his belief that the
appropriateness of methods depends on the nature of the subject matter. This realist position is often stated by Schumpeter (see, e.g., Schumpeter, 1908, p. xiv). But it is definitely not at the root of his Walrasian inclinations.

Of course, Schumpeter did not have appropriate analytical tools at his disposal, as Andersen (2009) and others insist; and consistency or detail were not always his main concerns. It is still the case that he consistently adhered to a conception of science founded upon ‘exact methods’, although he was aware that his vision could not be comprehensively formulated in mathematical-deductivist terms.

For those unimpressed by the equilibrium paradigm, the challenge, then, is to reconstruct – or rethink, or revise – Schumpeter’s visionary conception, i.e., to correct the distortions that are due to his deductivist commitment. For such a reconstruction, an essential element is, I think, Schumpeter’s general conception of process and order as put forward in his theory of social classes, which is ontologically grounded and to which I now briefly return.

The most general conception of process and reproduced order is Tony Lawson’s transformational model of social activity (see, e.g., Lawson, 2003, pp. 35ff.), according to which social structure is a real and relatively autonomous condition of human action; and human action, in turn, continuously reproduces and transforms social structure. Schumpeter’s conception can perhaps be seen as a particular version of this model. In his essay on social classes, however, Schumpeter focuses on class structure, not on social structure as a whole – though he often uses the expressions ‘class structure’ and ‘social structure’ as synonyms and, as noticed above, in his view institutions reflect class structures, if only ultimately. Moreover, he is fundamentally interested in creative responses, not so much in other modes of action, and in the ways in which they reproduce and transform rules of conduct at different levels. Through innovation, which leads to changes in some rules of conduct, capitalist institutions reproduce themselves in time; in turn, the orientation of creative responses to the business sphere is stimulated by the institutional framework of capitalism.

As remarked, this conception of process and reproduced order is complemented with a theory of the causal interdependence of the various levels of social life: a variant of the economic interpretation of history, which Schumpeter insulates from Marx’s theory of social classes. The latter is said to be blemished by an ideologically warped definition of classes and class antagonisms (see, e.g., Schumpeter, 1954, p. 440). Schumpeter's version of the economic interpretation of history is expressed as the conception that the forms of production have an
immanent tendency to change and ‘are the fundamental determinant of social structures, which in turn breed attitudes, actions and civilizations’ (Schumpeter, 1942, p. 12), with the qualification that there is interdependence between conditions of production and the social structure. I.e., ‘[s]ocial structures, types and attitudes are coins that do not readily melt’ (ibid.), and ownership of means of production does not always causally determine class.

In a sense, then, Marx’s theory of history is deprived of its Marxian specificity – including, of course, of its teleological quality. Marxian elements remain, but they are now part of a very different vision. Thus, as De Vecchi (1995, p. 164) reminds us, there is a close affinity – via Emil Lederer, to whom Schumpeter (1919, p. 217, fn. 24) refers – between Schumpeter’s conception of “rationalisation” and the Marxian notion of alienation:

‘These new types were now cast adrift from the fixed order of earlier times, from the environment that had shackled and protected people for centuries … They were severed from the things that had been constant year after year, from cradle to grave - tools, homes, the countryside, especially the soil. They were on their own, enmeshed in the pitiless logic of gainful employment, mere drops in the vast ocean of industrial life, exposed to the inexorable pressures of competition. They were freed from the control of ancient patterns of thought, of the grip of institutions and organs that taught and represented these outlooks in village, manor, and guild. They were removed from the old world, engaged in building a new one for themselves – a specialized, mechanized world. Thus, they were all inevitably democratized, individualized, and rationalized … Trained to economic rationalism, these people left no sphere of life unrationlialized, questioning everything about themselves, the social structure, the state, the ruling class.’ (Schumpeter, 1919, p. 190)

But “rationalisation” is now part of the vision that the capitalist system performs reasonably well – and ‘for the masses’ (see, e.g., Schumpeter, 1942, p. 67) – even if there is scope for improving it. Capitalism, however, ends up facing the limits of capitalist rationality, which ‘does not do away with sub- or super-rational impulses. It merely makes them get out of hand by removing the restraint of sacred or semi-sacred tradition’ (ibid., p. 144). ‘[O]ur inherited sense of duty, deprived of its traditional basis, becomes focused in utilitarian ideas’ (ibid., p. 127); and utilitarianism and its surgical proclivity are myopic and misguided.
Not everyone will find this vision compelling, of course. But even those that do not will, I think, agree that it deserves serious reflection.

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