



## Joseph Alois Schumpeter (1883-1950 )

"Can **CAPITALISM** survive? No. I do not think it can." Thus opens Schumpeter's prologue to a section of his 1942 book, *Capitalism, Socialism and Democracy*. One might think, on the basis of the quote, that Schumpeter was a Marxist. But the analysis that led Schumpeter to his conclusion differed totally from **KARL MARX**'s. Marx believed that capitalism would be destroyed by its enemies (the proletariat), whom capitalism had purportedly exploited, and he relished the prospect. Schumpeter believed that capitalism would be destroyed by its successes, that it would spawn a large intellectual class that made its living by attacking the very bourgeois system of private property and freedom so necessary for the intellectual class's existence. And unlike Marx, Schumpeter did not relish the destruction of capitalism. "If a doctor predicts that his patient will die presently," he wrote, "this does not mean that he desires it."

*Capitalism, Socialism, and Democracy* is much more than a prognosis of capitalism's future. It is also a sparkling **DEFENSE** of capitalism on the grounds that capitalism sparks **ENTREPRENEURSHIP**. Indeed, Schumpeter was among the first to lay out a clear concept of entrepreneurship. He distinguished inventions from the entrepreneur's innovations. Schumpeter pointed out that entrepreneurs innovate not just by figuring out how to use inventions, but also by introducing new means of production, new products, and new forms of organization. These innovations, he argued, take just as much skill and daring as does the process of invention.

**INNOVATION** by the entrepreneur, argued Schumpeter, leads to gales of "**CREATIVE DESTRUCTION**" as innovations cause old inventories, ideas, technologies, skills, and equipment to become obsolete. The question is not "how capitalism administers existing structures, ... [but] how it creates and destroys them." This creative destruction, he believed, causes continuous progress and improves the standards of living for everyone.

Schumpeter argued with the prevailing view that "perfect" **COMPETITION** was the way to maximize economic well-being. Under perfect competition all firms in an industry produce the same good, sell it for the same price, and have access to the same technology. Schumpeter saw this kind of competition as relatively unimportant. He wrote: "[What counts is] competition from the new commodity, the new technology, the new source of **SUPPLY**, the new type of

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organization ... competition which ... strikes not at the margins of the **PROFITS** and the outputs of the existing firms but at their foundations and their very lives.”

Schumpeter argued on this basis that some degree of **MONOPOLY** is preferable to perfect competition. Competition from innovations, he argued, is an “ever-present threat” that “disciplines before it attacks.” He cited the Aluminum Company of America as an example of a monopoly that continuously innovated in order to retain its monopoly. By 1929, he noted, the price of its product, adjusted for **INFLATION**, had fallen to only 8.8 percent of its level in 1890, and its output had risen from 30 metric tons to 103,400.

Schumpeter never made completely clear whether he believed innovation is sparked by monopoly per se or by the prospect of getting a monopoly as the reward for innovation. Most economists accept the latter argument and, on that basis, believe that companies should be able to keep their production processes secret, have their trademarks protected from infringement, and obtain patents.

Schumpeter was also a giant in the history of economic thought. His magnum opus in the area is *History of Economic Analysis*, edited by his third wife, Elizabeth Boody, and published posthumously in 1954. In it Schumpeter made some controversial comments about other economists, arguing that **ADAM SMITH** was unoriginal, **ALFRED MARSHALL** was confused, and **LEON WALRAS** was the greatest economist of all time.

Born in Austria to parents who owned a textile factory, Schumpeter was very familiar with business when he entered the University of Vienna to study economics and law. He was one of the more promising students of Friedrich von Wieser and **EUGEN VON BÖHM-BAWERK**, publishing at the age of twenty-eight his famous *Theory of Economic Development*. In 1911 Schumpeter took a professorship in economics at the University of Graz. He was minister of finance in 1919. With the rise of Hitler, Schumpeter left Europe and the University of Bonn, where he was a professor from 1925 until 1932, and emigrated to the United States. In that same year he accepted a permanent position at Harvard, where he remained until his retirement in 1949. Schumpeter was president of the American Economic Association in 1948.

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#### **Selected Works**

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