The Viennese influence on Schumpeter

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Joseph Schumpeter was an exceptional man. The kind who is rarely born. Consider Keyne's famous dictum, " good economists are the rarest of birds", and rarer still when they benefit humanity and society in the way he did. There have been few men who have had so much to say on so many vital topics, and who said it with such clarity and freshness (Deutsch 1956).He was one of the leading economists of his generation and one of the great figures of Harvard University.

The nineteenth century was the first era of globalization. Trade barriers declined, transportation and communications costs fell, and productivity and output increased. This was the era of empires: the British, the Ottoman, and the Hapsburg in which Schumpeter was born. In the case of the Hapsburgs, running a multi-ethnic empire required a careful balance of underlying national and ethnic tensions; and the result of that balancing was a relatively open, liberal, and intellectually vibrant society. Schumpeter was surely shaped by turn-of-the century Vienna, just as Keynes was no doubt the product of England. But it was the period after 1914 - war, hyper-inflation, depression, protectionism, nationalism, totalitarianism, and then more war that ultimately affected Schumpeter and his thinking until his death. (Cain 1992).

To state its old world importance in Europe and the world, Vienna was once known as the first city of the Holy Roman Empire. In February 1867 the Austrian royals had to cede power to allow for a joint monarch system to prevent Hungary from leading a breakaway region - the so called Ausgleich (“compromise” in German) deal (Matlekovits 1898) - which was feared would lead to other regions on the outskirts of the Austrian empire also pushing for autonomy and/or independence (e.g. Czech, Romania and Poland). The *Ausgleich* which inaugurated the Empire's dualist structure in place of the former unitary Austrian Empire (1804-1867), was a result of the latter's declining strength and loss of power in Italy (due to war in 1859). This continued Hungarian dissatisfaction with rule from Vienna following Austria's suppression (with Russian support) of the Hungarian revolution of 1848-1849. The passive resistance of the Hungarian nation convinced the statesmen in Vienna that it was not possible to continue to govern Hungary despotically (Matlekovits 1898) and thus the creation of the Austro-Hungarian Empire.

In the closing years of the Hapsburg Empire, Vienna must have been one of the most pleasant places on earth, especially for those fortunate enough to have been properly born and properly endowed. Schumpeter was so born and so endowed and by all accounts he made the most of his opportunities. Although he became one of the most cosmopolitan of men,

the experience of those early years in Vienna never really left him. He remained to the end the cultivated Austrian gentleman of the old school who had seen everything and his interests and achievements were by no means limited to economics (Harris et al 1951). It was suggested that even his occasional wrong-headedness could be extremely stimulating and fruitful (Deutsch 1956).

Schumpeter was born in Triesch in Moravia (modern day Czech) in 1883 (A magical year for economics as it is the same year that Keynes was born), the only child of well educated middle class mother and hard working, yet uneducated father. When his father, a cloth manufacturer, died four years later, his mother moved to Graz (Austria) where he attended elementary school until the age of ten. His mother married a retired general with contacts within Vienna's social elite class, which was a young Schumpeter's passport to the inner circle of Vienna's elite society in the future. For Schumpeter this meant access to Austria's foremost school where he passed with flying colors (Giersch 1984). The fortunes of a rich and varied personal experience were favorable to Schumpeter.

Joseph Schumpeter was born at a time when Vienna, Austria and the Hapsburg empire were all on a downward slope from its glory days of the seventeenth and early eighteenth century. Vienna was still the political and

cultural capital of the Habsburg Monarchy; it was also its major financial centre. Important industries were located here as well, but the main centres of industrial concentration were in the Alpine provinces of Austria and in the northern districts of the Bohemian crown lands (Good 1977).

Schumpeter's family lived in this Vienna and it is here in that Schumpeter witnessed the rise of the modern state as a consequence of the preceding breakdown of the feudal state (Deutsch 1956). From 1893 to 1901 he was a day student at the Theresianim School, a well known and respected school which was favoured by the Austria's aristocracy and academics. At the Theresianum he received a thorough classical education including Latin and Greek which was supplemented at home by a study of modern languages (French, English and Italian). He was blessed with an extraordinary memory and retained his Greek language skills throughout his life; once, while in Cambridge he occasionally found the time to read together with Greek students the Greek classics in the original language. The milieu at the Theresianium in conjunction with what must have been a highly cultured atmosphere in the home of his mother, who herself spoke several languages, left a permanent imprint upon him and his personality. It was there that he acquired the agreeable, sometimes quaintly over polite old world manner, which, together with his natural charm, friendliness, and vitality, produced the man Schumpeter as he was known.

One should never under estimate the role that a man's direct personal upbringing and experiences can play in the formation of his intellectual make-up. Such a relation frequently exists, and in the case of Schumpeter it definitely does (Leontief 1950). The strongest single impression with which one was left after having spent an hour with him in the classroom or at a scientific meeting, or even better on a leisurely walk along the wooded shores of the lake near his Connecticut country home, was that of the astounding width of Schumpeter's intelligence and knowledge. He was equally at home in early Greek philosophy, English parliamentary history, Italian literature, and French Romanesque architecture. One can only wonder that if his life was unlimited, how much more he would have contributed to the science of economics and beyond?

Intellectually precocious, Schumpeter had written three outstanding books by the age of thirty: when presented with one of them by the proud young author, the aging Walras told Schumpeter to congratulate his father on an excellent piece of work, much to Schumpeter's indignation (Cain 1992). Schumpeter's life was wholly devoted to thinking, teaching and writing, although he was never merely a bookish sort of person. He always took a lively interest in public and world affairs and never hesitated to express emphatic opinions on current political issues.

When Bohm Bawerk resigned as Minister of Finance in 1904, he returned to academic life as a professor in the University of Vienna and conducted a famous seminar in 1905 and 1906, in which Schumpeter was an active participant. Another prominent Austrian economist present was Ludwig von Mise. It was made lively and at times stormy by the participation of a group of young Marxists who later became the theoretical and political leaders in the Austrian and German Social Democratic Parties. Otto Bauer was also often present at these seminars. He is credited with being a brilliant theorist and in 1918 became the intellectual leader of the Austrian socialists and leader of the new Austrian Parliament. He also seems to have been mainly responsible for Schumpeter's appointment as Minister of Finance of the Austrian Republic in 1919. It is here at these seminars though that Schumpeter was able to debate, argue and interact with notable socialists and Marxists, no doubt always critically analysing their arguments with his own knowledge that one day in the future he would be able to publish his thoughts on their theory's. Schumpeter's profound knowledge of Marxian theory and this intimate familiarity with the continental socialist movement as well as the psychology of the socialist leaders, lent colour and freshness to a long series of articles, culminating in his book, *Capitalism, Socialism and Democracy* in 1950. It's little doubt that Bohm Bawerk's seminars were inspiration for this book.

After the armistice, the German socialist government set up a socialization commission in Berlin with the purpose of studying and preparing for the nationalization of industries (Galenson 1949). Schumpeter received a call from three acquaintances he knew during his university days, Kautsky, Hilferding and Lederer, who were prominent members within the government, to join the commission. He then spent 3 months in Berlin in late 1918 working with this commission. The work seems to have consisted in the holding of seminar-like debates, not dissimilar to Bohm Bawerk's, to discuss socialization and the other economic problems. It is his association with this commission *(sozialisierungkommission)* that has often been taken out of context and used as proof of his socialist convictions. This is incorrect. The *sozialisierungkommission* was not entirely composed of socialists, rather it was a cooperation between men of high reputation as thinkers and practical men, and it is because of this that Schumpeter was asked and joined them (Cain 1992).

Then in February 1919 the first republican parliament was elected in Austria. The strictly Marxist socialists emerged as the largest party and a coalition government of the socialists and the Christian social party (a Catholic conservative party) was formed with Dr. Karl Renner, a left leaning socialist, as the leader. Neither of the two political parties was

eager to take responsibility for the almost insoluble and politically unrewarding task of grappling with Austria's finances, so they agreed to let a non-political expert try his hand at a seemingly hopeless job in an even more hopeless situation. Schumpeter accepted.

Schumpeter could not be called a successful finance minister by any conventional standard, but it is more than doubtful whether anybody could have been successful in the turbulent period which followed The Great War. Politically and economically the situation was chaotic. The war was lost, the old monarchy which Schumpeter had a certain affection for had collapsed and disintegrated and new states, frontiers and barriers to trade had arisen in the north, east and south of Vienna. The financial difficulties were tremendously complicated by the problems arising out of the dissolution of the Empire. The new Austria was saddled with a disproportionate share of the debt of the old state and had to take over a much larger number of civil servants, mostly returning army officers, from the old Empire than were required.

Schumpeter's downfall as Finance Minister was brought about not by the bleak situation he found himself in or the rampant inflation plaguing the country, but by the famous affair of the Alpine Montan-Gesellshaft, the largest iron and steel producer, and owner of the most important source of

iron ore in Austria. The socialists wanted to nationalize certain profitable industries and, naturally, the iron and steel industry was at the top of their list. In June and July of 1919 there was a great boom on the stock exchange, especially shares in Alpine Montan-Gesellshaft, and it was public knowledge that an Austrian banking house had begun buying up shares on behalf of an Italian consortium. This infuriated the socialists because they knew it would be extremely difficult to nationalize an industry in which there existed strong foreign ownership and investment. They accused Schumpeter of having permitted the deal in order to prevent the nationalization. Otto Bauer, once a somewhat silent supporter of Schumpeter, charged him with disloyalty to the government and national newspapers scolded him for making his own foreign policy without the knowledge of the cabinet. What had really happened was that the socialists found it difficult for a variety of reasons to carry out their programs and policies and were glad to find a scapegoat outside of their own factions, in whom they could blame their failure to keep their election promises to nationalize basic industries (Hardy 1945). This ended Schumpeter's short and indecorous political career and contributed to one of his only few failures in his lifetime.

Schumpeter was known for his broad minded and accepting approach to any situation in which he found himself. In 1919 Schumpeter and Max

Weber met in a Viennese coffee house, a popular meeting point for academics in the city, to discuss the Russian revolution. Schumpeter thought it was wonderful: now socialism was no longer a possibility to be argued about in theory but an experiment to be observed in reality. Weber was outraged at this cavalier attitude and stated that Russian communism would be a catastrophe, a laboratory full of corpses. Schumpeter sarcastically defended his position until Weber rushed out shouting, “I can’t stand any more of this”! (Roskamp 1995). Schumpeter had the ability, somewhat lost today, of learning from his rivals. He belonged to a more civilized era and whilst capable of being an ideologist, he was also capable of meeting those who opposed him under a flag of truce to examine the consequences of the analytical points being made. Further proof to this statement lies in the fact that in the 1940’s, when he was working on his monumental *History of Economic Analysis,* his principal assistant was Paul Sweezey, then the most controversial academic Marxist in the United States. Schumpeter’s willingness to rise above partisanship in his intellectual life seems unbelievable to many today, who often regard factional allegiances and ideologies as almost our highest virtue. Schumpeter was a staunch individualist. He loved to "epater les bourgeois," that is, to express shocking minority views even at the risk of isolating himself from the mainstream of political and economic thinking (Giersch 1984).

After holding a number of academic positions at Vienna, Graz, Czernowitz and Bonn, and failing to obtain a chair at Berlin, Schumpeter “in a mood of resignation”, accepted an offer to join the economics department at Harvard University (1932 – 1950), eventually replacing F.W. Taussig in the graduate course in economic theory, the famous EC11 class. ‘Schumpy’, as the students called him, would according to the then young Paul Samuelson, arrive for his afternoon class immaculately attired and deliver his lectures with sweeping gestures (Turner 1993).

Despite all this, Schumpeter's academic life was hardly a series of continuous triumphs. He laboured vainly for years to produce a book on monetary theory that would satisfy him. *Business Cycles* was cautiously received on publication in I939; its main themes were often obscured by detail and the attention of the academic community in America and Britain was now centered on Keynes's General Theory, something the proud and irritable Schumpeter found hard to swallow (Cain 1992). The essence of his book from the economist's point of view is that the capitalistic system is dynamic, adaptive, and marked by entrepreneurship and innovations. The system is evolutionary but at the firm's level subject to discontinuities and breaks. The concepts of a static equilibrium and the steady state, though enormously helpful as organizing theoretical tools, are not very useful for

the analysis of economic reality, something Schumpeter was fond of. (Roskamp 1995). It is also in this book that Schumpeter termed the original German word, Entrepreneurial spirit, which is now mentioned so often in contemporary economics and management.

In accordance with his social background Schumpeter was inclined to see the world from an elitist perspective. He regarded clusters of talented people as the driving force behind economic and political history: entrepreneurs who push forward society's technological frontier; a nobility to protect the capitalist system by performing the political functions which are alien to the commercial outlook of the bourgeoisie; and the intellectuals who help to destroy capitalism by undermining its ethical basis (Giersch 1984).

It is well-known that Schumpeter postulated an "inevitable de-composition of capitalist society" (Schumpeter 1950). "Can capitalism survive?" he asked pointedly. "No, I do not think it can" (1950, p. 61). Capitalism's prospective demise is not perceived to emanate from "its breaking down under the weight of economic failure..." Instead, "its very success undermines the social institutions which protect it, and 'inevitably' creates conditions in which it will not be able to live and which strongly point to socialism as the heir apparent" (1950, p. 61). In short, the "paradoxical

conclusion" is not the result, but the process: "capitalism is being killed by its achievements" (1950, p.61). Was Schumpeter that much of a visionary thinker that just as he describes the entrepreneur's actions in his *Business Cycles* of having the foresight to leave a market when the "swarm of incompetence" arrives, wass he able to foresee a future where capitalism ends and government intervention in markets is the norm? Alternatively, was he predicting the downfall of capitalism just as he witnessed the downfall of the old world order in Europe? Just like an unsustainable political and social system in Austria, he saw capitalism as unsustainable and untenable once discontent grew within the lower classes. His mind was truly ahead of its time.

Schumpeter believed that capitalism's potential was unbounded: an unending dynamic process of change and creative destruction driven by entrepreneurship and leading to an even higher standard of life. He favored "selective lending to companies in industries with high growth potential. "The strong ones, or those that can become strong, are to be strengthened, but the weak ones are not to be nursed." (Giersch 1984). As conditions for public assistance, he argues, the companies must be forced to adopt innovative practices (Schumpeter 1950). Schumpeter's most important contribution remains his theory of entrepreneurship. But *Capitalism, Socialism, and Democracy* is significant for the way it attempts

to place that theory in the larger currents of social thought. This is another sign of Schumpeter's work and how he tried to tie economics into sociology, using examples which would thoroughly explain his positioning and reasoning behind his theory (Hardy 1945).

Another man of Schumpeter's ability and intellect may not be immediately forthcoming, but what scholars of today can do in the meantime is remember how when someone of that calibre does come about, to allow them the intellectual freedom to theorise about not the past and present but also the future. The future of society lies within the boundaries of democratic states which will only encourage future economists to be as brave and free spirited as Schumpeter was. Schumpeter was indeed a great economist and an exceptional man.

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