

Joseph Schumpeter and the German Historical School

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So far Schumpeter's affinities with the German Historical School (GHS) have been inadequately acknowledged or even unexplored in major accounts of Schumpeter's work. This essay argues that Schumpeter formulated some of his principal theses in accordance with the conceptual framework of the GHS. Schumpeter's affinity with the GHS is established by examining his writings and his relationship with major scholars such as Schmoller, Max Weber and Sombart. It is demonstrated that Schumpeter's works built heavily on GHS insights, and he even referred positively to the ideas of certain of its members. However, some obvious differences between Schumpeter and the GHS are observed. The paper concludes that the GHS should inspire further research in evolutionary economics.

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1. Introduction

Undoubtedly, Joseph Alois Schumpeter 'was one of the greatest economists of all time' (Haberler, 1950, p. 1) who made seminal contributions to economics and had a major impact on the development of the discipline in the twentieth century. However, some important aspects of his works remain less widely discussed.

For instance, Schumpeter's affinities with the German Historical School (GHS) have been inadequately acknowledged or even unexplored in recent decades, with the exception of a very few important contributions, e.g. Swedberg (1989), Streissler (1994), Shionoya (1997, 2005), Ebner (2000), Hodgson (2001, 2003), Becker and Knudsen (2002) and Kesting (2006). Given the presence of central elements of Schumpeter's vision in the GHS's works, it is surprising that so little attention has been paid to the GHS as an intellectual source for the flamboyant economist.

There is one main reason why studying the potential influence of the GHS on Schumpeter, Vienna's *enfant terrible* of economic theory, is of great interest. Given that Schumpeter ranks among the 'most important and enduringly influential economists of

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all time' (Hodgson, 2007A, p. 1) and had a major impact on the development of economics, the potential influence of the GHS on him is an important key for understanding Schumpeter's economic writings. Obviously, understanding the origins of these important ideas in Schumpeterian economics and re-evaluating the influences that shaped Schumpeter's work may be very useful for promoting dialogue between different schools of economic thought and clarifying several issues in the evolutionary approach.¹ In this framework, this essay focuses on the conceptual relationship between Schumpeter and three of the leading figures of the GHS, namely Sombart, Max Weber and Schmoller.

As is well known, Schumpeter's writings covered a very broad range of topics including the dynamics of economic development (*Theory of Economic Development*, 1912, and *Business Cycles*, 1939), the integration of economic, sociological and political perspectives with regard to the feasibility of capitalism (*Capitalism, Socialism and Democracy*, 1942) and the history of economic thought (*History of Economic Analysis*, 1954). This paper makes an attempt to interpret certain parts of Schumpeter's voluminous *oeuvre* in association with the writings of several prominent members of the GHS, such as Sombart, Max Weber and Schmoller, and approaches them through his own looking glass. Certain crucial ideas of Schumpeter's work are thus being identified as 'key elements' of his relation to the GHS.

In this context, a 'key element' of his relation to the GHS is Schumpeter's (1926B, p. 365) belief in a universal social science (*Universalsozialwissenschaft*) consisting chiefly of economic dynamics, economic statics and economic sociology. In his conception of *Universalsozialwissenschaft*, the conventional line of separation between separate disciplines had disappeared (Shionoya, 2005). Of course, this formed a system of substantive theory, which was, however, distinct from the system of methodology, and thus comprised about half of the Schumpeterian system: according to Shionoya (1997, p. 265) this broader system was the 'two structure approach' to the mind and society.

Our attempt intends only to provide an overview of the GHS's influence on Schumpeter, from the theoretical and methodological perspective, focusing on the writings of Sombart, Max Weber and Schmoller. As a result, in this paper, the connections between Schumpeter and the GHS are sometimes primarily substantive (as in the sections on Sombart and Weber) and sometimes primarily methodological in nature (as in the section on Schmoller), where the focus is on the *Schmollerprogramm*.

More precisely, we argue that Schumpeter shared with Sombart the view that capitalism is on the decline. Also, strong parallels are to be found with respect to forces driving the capitalist enterprise and the role of technology. Also, the paper compares Schumpeter's and Weber's central visions emphasising, on the one hand, the role of the 'entrepreneur' and the 'circular flow' and, on the other hand, the 'protestant ethic' and the 'spirit of capitalism', respectively. Finally, another idea is Schumpeter's interpretation of Schmoller's historical-ethical approach. Schumpeter's notion of development is viewed in the context of the Schmollerian theoretical approach of integrating theoretical and historical concerns.

Of course, we do not argue that these three theoreticians were the only prominent economists of the historical school that influenced the great Austrian thinker. For instance,

¹ On the impact of evolutionary economics see Dopfer (2005), Hodgson *et al.* (1994), Silverberg (1988), Witt (2003); on the impact of Neo-Schumpeterian Economics see, among others, Hanusch and Pyka (2006).

other important economists and members of the GHS, such as Schäffle (1831–1903) have influenced Schumpeter's thought (see Balabkins, 2003; Borchardt, 1961).¹

The paper is organised as follows: Section 2 provides a brief overview of the GHS; Section 3 discusses the impact of Sombart upon Schumpeter; Section 4 investigates the influence of Max Weber's work on Schumpeter; Section 5 presents Schmoller's programme and its impact on Schumpeter's research agenda; Section 6 concludes.

2. The German Historical School: a brief overview

The GHS was formed in Germany in the second half of the nineteenth century and stemmed as a reaction against both the Classical School of Political Economy and Marxian Economics. It lasted until the devastations of the Nazi period and World War II and went through several phases of development.

The School had its roots in German economic Romanticism, on the one hand, and in Friedrich List's ideas (List, 1856), on the other. From the former it took the negative position to abstract theoretical analysis; from the latter a method of economic study based on historical research; from both the opposition to the Classical views of individualism and economic liberalism.

The GHS is usually differentiated into the 'Older', the 'Younger' and the 'Youngest'. To the 'Older' Historical School belong mainly three writers: Bruno Hildebrand (1812–78), Wilhelm Roscher (1817–94) and Karl Knies (1821–98). The leading figure of the 'Younger' Historical School was Gustav von Schmoller (1838–1917); another important writer was Lujo Brentano (1844–1931). Schmoller and his followers rejected the idea that a scientific economic theory existed already because until then there had not been enough knowledge of economic history. The views of the 'Younger' Historical School on the method of economic analysis called forth a critique by Carl Menger, one of the major representatives of the Austrian School of Economics. In this way, the dispute between Schmoller and Menger opened the famous *Battle of Methods* (*Methodenstreit*), which lasted almost until the dawn of the last century.² Arthur Spiethoff (1873–1957), Werner Sombart (1863–1941) and Max Weber (1864–1920) were the most eminent exponents of the 'Youngest' Historical School. Despite some differences from their

¹ Schäffle's influence on Schumpeter's theory of innovation cannot be gainsaid, despite the fact that some authors (e.g. Loring, 1991, p. 104) argue that '[Schumpeter's] entrepreneur differed from those of other social scientists, including, among others, . . . Schäffle, an economist of the German historical school.' In spite of having shaped Schumpeter's thought, Schäffle's work exhibited primarily a sociological approach to the economic sphere (Schumpeter, 1954, p. 788). However, according to Schumpeter (1954, p. 788), Schäffle's major work in economics *Bau und Leben des Sozialen Körpers* was partly 'spoilt by its author's attempts to discover in the social body nerves and digestive organs'. And it was Schumpeter himself who did not put Schäffle in his list with the 'names of academic leaders that first arise in one's mind, when one thinks of German economists' of the period under survey (Schumpeter, 1954, p. 850), and possibly underestimated Schäffle's work and his own personal debt to Schäffle's theory of innovation by arguing that: 'economic analysis cannot be said to owe much to him' (Schumpeter, 1954, p. 850). However, regardless of what Schumpeter wrote about Schäffle (Schumpeter, 1954) we agree with Balabkins (2003, p. 216) that 'it is time to give Schäffle, a footnote in the growing literature about Schumpeter's innovator'. See also Hodgson (2003).

² According to Hodgson (2001), the GHS, at least in its early years, made the mistake of laying too much emphasis on empirical fact gathered at the expense of more general principles, whereas Carl Menger seemed to neglect the specificity of empirical facts. For a review of the *Methodenstreit* see Hodgson (2001, p. 79n) who argued that the dispute 'was also about the legitimate boundaries of economics as a discipline' (Hodgson, 2007A, p. 3). See also Rieter (1994). For a Marxist critique to both camps see Bukharin (1919).

predecessors, they remained faithful, in general terms, to some of the principles formulated by Schmoller.¹

The GHS, expressing the needs of the less developed Germany, which suffered under British competition, had to support the national peculiarities of Germany, as opposed to the 'cosmopolitanism' of the Classical School. As a result, the analysis was focused on the clarification of the 'historically concrete' and the 'nationally specific'. Consequently, historic evolution of social life was conceived as an inseparable whole, and the abstract method of analysis was regarded to be useless. In other words, the GHS was based on the presumption that different socioeconomic phenomena may require theories that are, to some degree, different from each other (Hodgson, 2001).

The main characteristics of the Historical School were (Economakis and Milios, 2001):

- An emphasis on the historical method of analysis.
- The rejection of theoretically drawn economic laws, since the only laws that can be inferred are 'empirical laws', drawn from historical monographs and statistical investigations.
- The necessity of a merger between economics and all other social sciences.

The GHS applied an 'evolutionary' approach to the study of the formation of social structure. The economists of the GHS concentrated on the importance of the historical study of the economy. Therefore, they conducted studies based on primary material, focusing on changing institutions. In this way, the School claimed that it managed to study all forces behind an economic phenomenon.

3. Schumpeter and Sombart

At the time when he published *The Instability of Capitalism* (1928), Schumpeter was Professor at the University of Bonn. Just one year earlier, another prominent economist who believed that capitalism had entered a phase of stagnation, Werner Sombart, had published his *Der Moderne Kapitalismus*. In this book he dealt with the age of 'high capitalism' and put forward his theory of *Spätkapitalismus*.²

The parallels between Sombart and Schumpeter are many, and not only in the academic sense. Just like Joseph Schumpeter, Werner Sombart was born in a German-speaking environment as the son of an industrialist; he studied law and economics and visited several universities in Europe. In 1888, he received his PhD from Berlin under the direction of Gustav von Schmoller, 18 years before Schumpeter received his own from Vienna.

He started his career just like Schumpeter, i.e. as a lawyer and then moved to the academic world with a junior professorship at the University of Breslau. Sombart, at that time, became well acquainted with certain interpretations of Marxist theory to the point that Friedrich Engels called him the only German professor who understood *Das Kapital*.

¹ Spiethoff, Sombart, and Weber remained faithful only to *some* of the principles formulated by Schmoller. In fact, Sombart and particularly Weber launched a 'second battle on method', the so-called *Werturteilsstreit*, i.e. the question whether economists or other social scientists should make normative or value judgments, which was directed against Schmoller and the ethical approach of the GHS, and which led to major controversies in the *Verein für Socialpolitik* from 1909 onwards, being unsettled until the outbreak of WW II (for further reading, see Schumpeter, 1954, pp. 804–7).

² Sombart made use of a great amount of historical material and empirical data in order to support his views. In fact, his works could be viewed as the fulfilment of the last generation of the GHS. On Sombart see, among others, Backhaus (1996A), which constitutes the standard work on Sombart in the English language.

This is a parallel with Schumpeter, who for much of his adult life combined conservative politics with an admiration for Marxism (see also Rieß, 1996).¹

In 1902, Sombart's *magnum opus*, *Der moderne Kapitalismus*, appeared. In 1904 Edgar Jaffé, Werner Sombart and Max Weber became the editors of the *Archiv für Sozialwissenschaft und Sozialpolitik*.² In 1917, Sombart became professor at the University of Berlin and taught until 1940 at a time when Schumpeter taught at Harvard University.³ Throughout his lifetime, Sombart aimed at resolving the questions raised in the *Methodenstreit*, and bridging the gap between theoretical and empirical investigation (Hodgson, 2001).⁴ After, roughly speaking, 1930 Sombart is said to have moved to the political right (see, for instance, Harris, 1942, p. 807) and his relation to Nazism and anti-Semitism is heavily debated until today (see Brocke, 1987, 1996; Reheis, 1996).

In this paper, the connections between Schumpeter and Sombart are regarded as being primarily substantive in nature. Schumpeter's economic thought owed Sombart certain notions regarding the negative effects on the spirit of capitalism created by the 'automatisation' of production, which Sombart himself had developed in his conception of *Versachlichung* (reification) or *Vergeistung* (spiritual reification) of the modern enterprise.

Sombart's conception of *Vergeistung* of the big firm coincided with the effects of Schumpeterian 'automatisation'. Analytically, regarding the evolution of relationships between different enterprises, Sombart saw two trends (Chaloupek, 1995, p. 135n): (i) an increasing specialisation in the production of goods and services and (ii) an increase in the concentration of production in enterprises of increasing size. There Sombart saw the process of *Entseelung* (de-animation) and *Vergeistung* (spiritual reification), which he regarded to be a consequence of capitalism: 'rationalization goes hand in hand with reification in which individual animal spirits ('soul') are replaced by abstract concepts'. The evolution of capitalism was just a special case, which was transformed 'from a community of lively individuals tied to each other by personal relationships into a system of artfully designed interdependent work performances which are executed by functionaries in human shape' (Sombart, 1927, p. 895). Capitalist enterprise consisted of three (sub)systems: (i) administration, (ii) accounting and (iii) production called 'instrumental system' (Sombart, 1927, p. 901n).

Consequently, leadership—as expressed by the personality and function of the entrepreneur, which was the typical motor of economic development in capitalism for Sombart (see Prisching, 1996)—had been replaced by a bureaucratic apparatus. In this

¹ It is well known that both economists, Sombart and Schumpeter, had in common a critical relationship to the works of Karl Marx. Both of them sympathised, on the one hand, with social reforms and, on the other, were deeply aristocratic. The Marxian agenda emphasising the long-run development of the capitalist economy by focusing on the role of capital accumulation and technical progress was an important challenge for both Sombart and Schumpeter. This may partly explain the rivalry between the two great theoreticians. In fact, the relationship between Schumpeter and Sombart was characterised by hostility, particularly on the side of Sombart. For instance, it was Sombart who launched intrigues to avoid Schumpeter getting one of the vacant professorships at the University of Berlin in 1931–32 (Stolper, 1994). Also, Sombart was probably anxious concerning Max Weber's success and was always looking for an alternative to the latter's emphasis on the role of protestant ethics in the development of capitalism. Actually, Sombart's book *Die Juden und das Wirtschaftsleben* (1911), could be regarded as a pendant to Max Weber's work on the connection between Protestantism and Capitalism. The main difference is that Sombart put Jews at the core of his analysis of economic development. The authors would like to thank an anonymous referee for this comment.

² In 1922, Emil Lederer became the Managing Editor, with Joseph Schumpeter and Alfred Weber (Max's younger brother), as the Associate Editors. It should be noted that Schumpeter never edited the journal together with Sombart and Max Weber (who was already dead in 1922).

³ Wassily Leontief, the future Nobel Laureate was among his students in Berlin (Backhaus, 1996B).

⁴ For a discussion of Sombart's principal theses see Chaloupek (1996).

way, bureaucratisation went hand in hand with a growing perfection of methods leading to the reduction of economic fluctuations (Sombart, 1927, p. 680n). Production for profit gave way to the production for the population (Sombart, 1927, p. 1015). The case of the state operating the railways was given as an example. In this way, 'the community will extend its area of control. Free enterprise is replaced by semi-public entities' (Sombart, 1925, p. 26).

Sombart expected the consolidation of a nationalistic state with mixed economy, where pre-capitalist, capitalist and meta-capitalist elements coexisted (Sombart, 1927, p. 1012n). He also expected some kind of central planning (Sombart, 1927, p. 1012n).¹ His arguments against socialism were mainly concerned with rejecting Marxian teachings (Sombart, 1908, p. 79ff) and their inability to fulfil their promises (Sombart, 1924, p. 255n).

Sombart (1932) refused to accept a market-based socialism because the market mechanism was not essential for the working of an economy, and he supported a state-governed economy (Priddat, 1996). He argued that the Soviet-type economy was based on production in big industrial units and such a centrally planned socialism was doomed to failure. He believed that the definition of socialism should be based on the 'spirit of the principles which shape social structure', which should form the relevant criterion (Sombart, 1924, p. 6).

In a similar vein, Schumpeter argued that 'progress itself may be mechanized as well as the management of a stationary economy, and this mechanization of progress may affect entrepreneurship and capitalist society nearly as much as the cessation of economic progress would' (Schumpeter, 1942, p. 131). He expected this because functions in the economic process, which had been traditionally executed by individuals, had been taken over by an entrepreneurial bureaucracy:

It is much easier now than in the past to do things that lie outside familiar routine—innovation itself being reduced to routine. Technological progress is increasingly becoming the business of teams of trained specialists who turn out what is required and make it work in predictable ways ... thus, economic progress tends to become depersonalized and automatised. (Schumpeter, 1942, p. 132n)

Even more emphatically, he argued: 'The economic process tends to socialize itself—and the human soul' (Schumpeter, 1942, p. 219). Generally speaking, Schumpeter claimed that 'the modern corporation, although the product of the capitalist process, socializes the ... mind' (Schumpeter, 1942, p. 156). He argued that the 'bureaucratization of economic life' is stimulated by and within the large-scale corporation (Schumpeter, 1942, p. 206) and so allowed the transition to a 'bureaucratic apparatus' by establishing new modes of managerial responsibility that 'could only be reproduced in a socialist society' (Schumpeter, 1942, pp. 206–7).

The views of the two social theorists also converged as regards the concept of technology. For both, Sombart and Schumpeter, capitalism was essentially a process of rationalisation of economic life. Actually, Sombart shared Schumpeter's view that innovation was the fundamental driving force of the economic system. He wrote that capitalism 'has a mania for innovations ... either through elimination of competitors by the establishment of new enterprises based upon them, or—primarily—through introducing new, more profitable

¹ He wrote: 'For the future density of mankind and culture it makes little difference whether the economy is shaped according to the capitalist or socialist mold. What counts is that the way it works will be essentially the same: in both cases, the economy as a whole will be based on *Vergeistung*' (Sombart, 1927, p. 1016).

processes, capitalism soothes its innermost desire: to make an extra profit!’ (Sombart, 1927, p. 87).

Schumpeter, based on Sombart’s theses, which were published in 1909, extended them in order to provide a more complete picture of technological progress, emphasising the importance of processes as well as the introduction of new goods. He claimed that real economic growth and development depended primarily upon productivity increases based on ‘innovation’, a concept which covered five cases.¹ In this context, he used the term ‘technological progress’ to characterise these changes (Scherer, 1992, p. 1417), which accounted for the greater part of economic development. He clearly distinguished this process from growth due to the gradual increase in population and capital (Schumpeter, 1942, p. 65). Conclusively, there was general agreement between the two great theoreticians, Schumpeter and Sombart, that capitalism was declining due to bureaucratisation of the big enterprise, resulting from mechanisation of production.

Schumpeter recognised Sombart’s book as a major work in economics (Schumpeter, 1927, p. 199). Schumpeter even admitted that he was aiming at a ‘combination of Sombart and Edgeworth’ (Schumpeter, 1927, p. 214). It was, probably, this gap that Schumpeter attempted to fulfil in *Capitalism, Socialism and Democracy*, which was ‘greatly inspired by Sombart’ (Chaloupek, 1995, p. 129).²

According to Hodgson (2006A, p. 110), it was Sombart who influenced Schumpeter and it was even Sombart (1913, p. 207) who originally coined the term ‘creative destruction’.³ Appel’s view is even more emphatic, arguing that Schumpeter’s perspective in *Capitalism, Socialism and Democracy* was ‘taken almost entirely’ from Sombart’s writings (Appel, 1992, p. 260).⁴

Of course, it is important not only to delimit our analysis to some striking similarities, but also to refer to some significant differences between the views of the two great theoreticians. For instance, Sombart did not remain consistent throughout his lifetime with respect to whether the improvement of everyday life that was due to the development of capitalism constituted ‘progress’ in a general sense. Contrary to Sombart, Schumpeter was always, to a considerable extent, a believer in the ‘progress’ brought about by capitalist development.

Related to this situation is a disagreement between Sombart and Schumpeter. In Sombart’s view capitalism had lost its expansionary power and had entered a phase of stagnation. On the contrary, Schumpeter was of the opinion that capitalism, driven by its inherent expansionary power, constantly generated new periods of economic growth that revolutionised the economic structure from within, ‘incessantly destroying the old one, incessantly creating a new one. This process of ‘creative destruction’ is the essential fact about capitalism’ (Schumpeter, 1942, pp. 82–3). Thus, Schumpeter presented his theory on the demise of capitalism as the result of its success, which produced non-economic

¹ ‘1. The introduction of a new good ... or a new quality of a good. 2. The introduction of a new method of production ... 3. The opening of a new market ... 4. The conquest of a new source of supply ... 5. The carrying out of the new organisation of any industry’ (Schumpeter, 1942, p. 66).

² In his second edition of *The Theory of Economic Development*, Schumpeter praised Sombart’s exposition as ‘the highest aim after which ambition can strive today’ (Schumpeter, 1934, p. 90n).

³ For an interesting analysis of the origins of Schumpeter’s theory of economic development as ‘creative destruction’ see Prendergast (2006).

⁴ ‘Without referring to Sombart ... [in *Capitalism Socialism and Democracy*] Schumpeter presented only what had already been written and said decades earlier in the German literature about ‘the future of capitalism’ and ‘it is remarkable that Schumpeter, who had so clearly distanced himself from the basic economic theory of Sombart, took over his ideas and perspectives on the development of capitalism almost completely’ (Appel, 1992, p. 260n).

factors that were inconsistent with it; these factors worsen the economic performance of capitalism (Shionoya, 2005, p. 53). In other words, capitalism was practically doomed to its *success* and not its *failure and stagnation*, as Sombart argued. In this context, economic expansion, which was related to the process of 'creative destruction' led to an improvement of material life (i.e. 'progress'), despite the fact that non-economic factors would eventually worsen its performance. Sombart, who in the early days was close to Schumpeter, later came to reject economic 'progress'.¹

Also, Schumpeter was critical of Sombart's lack of theoretical rigour in his works.² It is known that Schumpeter considered 'pure' theory as the most important analytical tool for the explanation and understanding of economic phenomena. Ultimately, Schumpeter seemed to advocate 'methodological individualism'³ (see Shionoya, 1990, p. 202), which gave priority to an atomistic view of society over a holistic one.⁴ Meanwhile, Sombart focused on the concepts of mind that were shaped by the reality of social life and its development (Chalpolepek, 1995, p. 141).

To conclude, we may say that, based on the available material and given the profound similarities in their respective theses and despite some apparent differences, the fact that Sombart was Schumpeter's senior by 20 years and the fact that he had published all of his important works before Schumpeter, are clear evidence that Sombart influenced the great Austrian theoretician. After all, it is Schumpeter himself who was sincere enough to admit this very fact (Schumpeter, 1927, p. 214).

4. Schumpeter and Weber

The purpose of this section is to compare Schumpeter's views with those of another prominent member of the GHS, Max Weber, with respect to their central visions. Consequently, the connections between Schumpeter and Max Weber in this paper are regarded as being primarily substantive in nature.

¹ He even came to hate 'progress' and called it a thing of witchcraft (*Hexensabbat*) (Sombart, 1927, p. 1010). It is probably his prejudices that drove him to argue that a movement back to agriculture (*Reagrarisierung*) could stop the process of 'Entseelung' and 'Vergeistung' (Sombart, 1927, p. 1019).

² Sombart had some respect for 'rational schemes' only to the extent that they turned out to be useful in his investigations and argued: '[I] disregard them, where they do not serve any purpose. I am unable to admire them just because they are artfully designed. On the contrary, they are a waste of effort' (Sombart, 1930, p. 303n).

³ For Schumpeter (1908, p. 91) who originally coined the term, *methodological individualism* 'just means that one starts from the individual in order to describe certain economic relationships'. Of course, according to Hodgson (2007B), methodological individualism is neither a universal principle of social science nor an obligatory rule for all social scientists. According to the same author, Schumpeter (1954, p. 888) invented the term 'sociological individualism' to describe 'the doctrine that the self-governing individual constitutes the ultimate unit of the social sciences'. Regardless of the fact that there is no broad consensus on the sense and usage of 'methodological individualism', the term 'sociological individualism' coincides with what many theoreticians, nowadays, describe as 'methodological individualism' (for further reading, see Hodgson, 2007B).

⁴ In his mature writings, Schumpeter had become dissatisfied with the individualistic approach set out in his early writings, and made a genuine attempt to broaden his initial conception (Prendergast, 2006, p. 261; Swedberg, 1991, pp. 172–3). Schumpeter pointed out that it was quite easy to overestimate the autonomy and importance of the (physical) individual who was, practically, dominated by social circumstances, which played a very crucial role (Schumpeter, 1995, p. 153). He even came to argue emphatically that: 'mankind is not free to choose ... things economic and social move by their own momentum and the ensuing situations compel individuals and groups to behave in certain ways whatever they may wish to do' (Schumpeter, 1942, pp. 129–30). In other words, Schumpeter's mature writings revealed a less individualistic approach (Prendergast, 2006, p. 261). We would like to thank an anonymous referee for this insightful comment.

Max Weber (1864–1920) published numerous scholarly works before becoming professor of Political Economy and Sociology at Freiburg University and later at Heidelberg and Munich. His works aroused a controversy over the relationship between Protestantism and Capitalism. Weber's *Die Protestantische Ethik und der Geist des Kapitalismus* was published in two articles in the *Archiv für Sozialwissenschaft und Sozialpolitik* (1904, 1905). At that time, Schumpeter was a student in Vienna, while the Austrian and German camps were strained because of the *Methodenstreit*. Chronologically, it coincided with a period in Schumpeter's life when he was formulating his own theoretical system (Faltello and Jovanovic, 1996; Haberler, 1950; Smithies, 1951).

Weber attacked Marx's view according to which the capitalist, armed with new techniques and driven by rationality, had swept away the old traditional methods, and had imposed on society his own *Geist* deriving from causalities immanent in the specific Capitalist Mode of Production (Weber, 1904, p. 27–9). For Weber, this was not a realistic picture of the process of capitalist development. Until the middle of the nineteenth century, he argued, modern industry had not displaced the putter-out, whose life was considered to be very comfortable. We may imagine the routine as follows:

The peasants came with their cloth ... to the town in which the putter-out's customers, for markets any distance away, were middlemen, who also came to him ... seeking traditional qualities, and bought from his warehouse, or ... placed orders which were in turn passed on to the peasants. ... The number of business hours was moderate; enough to lead a respectable life and in good times to put away a little. On the whole, relations among competitors were relatively good, with a large degree of agreement on the fundamentals of business. A long daily visit to the tavern, with often plenty to drink, and a congenial circle of friends, made life comfortable and leisurely (Weber, 1930, p. 66).¹

Weber viewed the capitalistic form of organisation in connection with capital, entrepreneurial activity and rational control over production. However, he also argued that capitalism reproduced a traditional element: 'the traditional manner of life, the traditional rate of profit, the traditional amount of work, the traditional manner of regulating the relationships with labour, and the essentially traditional circle of customers and the manner of attracting new ones' (Weber, 1930, p. 67).

¹ It should not be overlooked that Max Weber's analysis on the role of protestant ethics for the development of modern capitalism was also directed against Karl Marx and the latter's emphasis on the socioeconomic basis. However, this was not a critique of Marxist theory *per se*, but only of a mechanistic version of it which ignored the different forms of capital and/or the influence of non-economic, in the strict sense (politic, cultural, ideological), factors and identified capitalism with (high) industry. Concerning the different forms of capital, it is characteristic that in his 1893–1900 writings Lenin noted: 'Nothing could be more absurd than the opinion that working for buyers-up [putters-out, P.M.-J.M.] is merely the result of some abuse, of some accident, of some "capitalization of the process of exchange" and not of production. The contrary was true: [I]n the scientific classification of forms of industry in their successive development, work for the buyers-up belongs to a considerable extent to capitalist manufacture. *Work for the buyer-up is consequently a backward form of capitalism*, and in contemporary society this backwardness has the effect of seriously worsening the conditions of the working people, who are exploited by a host of middlemen (the sweating system), are disunited, are compelled to content themselves with the lowest wages and to work under the most insanitary conditions and for extremely long hours, and—what is most important—under conditions which render public control of production extremely difficult' (Lenin, Vol. II, pp. 434–35, emphasis added). Rubin (1929) stressed also that, under certain social (economic, political, cultural) circumstances, 'the manufactories were unable to oust and replace the domestic system on any significant scale' (Rubin, 1989, p. 156).

In this passage, we may detect most of the fundamental elements of Schumpeter's ideas on the conflict between routine and innovation, characterising the circular flow:

we may thus visualize an economic process which merely reproduces itself at constant rates; a given population, not changing in either numbers or age distribution ... the tastes (wants) of households are given and do not change. The ways of production and usages of commerce are optimal from the standpoint of the firm's interest and with respect to existing horizons and possibilities, hence do not change either, unless some datum changes or some chance event intrudes upon this world.

No other than ordinary routine work has to be done in this stationary society, either by workmen or managers. Beyond this there is, in fact, no managerial function—nothing that calls for the special type of activity which we associate with the entrepreneur ... Such a process would turn out, year after year, the same kinds, qualities and quantities of consumers' and producers' goods; every firm would employ the same kind and quantities of productive goods and services; finally, all these goods would be brought and sold at the same prices year after year. (Schumpeter, 1939, pp. 40–1).

Schumpeter described a stationary capitalist world where any element of change was absent and stationarity was the rule of economic reality. The author stated that the mechanistic repetition of acts was based on the accumulated experience of man (Schumpeter, 1934, pp. 84–5): This stationary situation was characterised by perfect competition, complete adjustment to the equilibrium situation, where money acted as a means of payment and no net saving (or credit) existed. Any changes in the economic stratum were undisrupted. The entrepreneurs took the same decisions. The income was paid to consumer goods already produced. Any supply was counterbalanced by its own demand at the level of prices which covered the unit cost. Money could be absent without deforming the economic phenomena. Apparently, the economic stratum could only alter under pressure.

After presenting the traditional picture, Weber went on to introduce the 'new' entrepreneur who intruded into the routine's tranquillity:

Now at some time this leisureness was suddenly destroyed, and often entirely without any essential change in the form of organization, such as the transition to a unified factory, to mechanical weaving, etc. ... Some young man from one of the putting-out families went out into the country, carefully chose weavers for his employ, greatly increased the rigour of his supervision of their work, and thus turned them from peasants into labourers. On the other hand, he would begin to change his marketing methods ... At the same time he began to introduce the principle of low prices and large turnover. There was repeated what everywhere and always is the result of such a process of rationalization: those who would not follow suit had to go out of business. The idyllic state collapsed under the pressure of bitter competitive struggle, respectable fortunes were made, and not lent out at interest, but always reinvested in the business ... And what is most important is ... the new spirit, the spirit of modern capitalism ... Its entry on the scene was not generally peaceful. A flood of mistrust, sometimes of hatred, above all moral indignation, regularly opposed itself to the first innovator. (Weber, 1930, p. 68)

This aspect of capitalism became Schumpeter's centre of analysis, namely the disturbance to the circular flow (Schumpeter, 1942, pp. 82–3).

Schumpeter, just like Weber, believed that every socioeconomic phenomenon came to an end and argued that society was forced to absorb the novelty. In this context, the innovative entrepreneurs began to make higher profits and new businesses were arising under 'the impulse of the alluring profit'.¹ Through this overthrow of traditional mentality capitalism became dynamic:

¹ For instance, he wrote: 'If anyone in an economic system in which the textile industry produces only with hand labour sees the possibility of founding a business which uses power-looms, feels equal to the task of overcoming all the innumerable difficulties, and has the final decision, then he, first of all, needs purchasing power. [H]e borrows it from a bank and creates his business' (Schumpeter, 1934, p. 129, 131).

Capitalism . . . is by nature a form or method of economic change and not only never is but never can be stationary . . . revolutionizes the economic structure *from within*, incessantly destroying the old one, incessantly creating a new one. This process of 'creative destruction' is the essential fact about capitalism. (Schumpeter, 1942, pp. 82–3)

However, Schumpeter further developed this idea of changing entrepreneurial mentality by stating that the introduction of the 'new' element is accompanied by a 'destructive' mentality, ultimately driving the economic climate to stagnation, an idea closely related with Hilferding's analysis of a 'latest, monopolistic, phase of capitalism' (Michaelides and Milios, 2005).¹ Schumpeter wrote:

The capitalist process . . . eventually decreases the importance of the function by which the capitalist class lives . . . it tends to wear away protective strata, to break down its own defences . . . capitalism creates a critical frame of mind which, after having destroyed the moral authority of so many other institutions, in the end turns against its own; the bourgeois finds to his amazement that the rationalist attitude does not stop at the credentials of kings and popes but goes on to attack private property and the whole scheme of bourgeois values' (Schumpeter, 1942, p. 143)

In this way, the capitalist lifecycle came to an end because the atmosphere had changed. Thus, the leader's characteristics were being undermined in favour of a bureaucratised system. Meanwhile, innovation had become routine and the bourgeoisie as a class constantly lost its self-esteem.²

Apparently, Schumpeter's vision of capitalist dynamic change had several similarities with Weber's theoretical schema. In other words, the dynamic entrepreneur who broke into the circular flow, equipped with will, energy, and the ideas that paved the way of his success over the old firms was both Weber's and Schumpeter's favourite theme.

In what follows, we make an attempt to illustrate some further similarities in the works of the two theoreticians. First, both theories seem to be based on the theoretical construction of 'thesis–antithesis', used by the ancient Greek philosophers: for Weber the type of capitalist enterprise, followed by the Protestant ethic was set against the 'traditionalist' enterprise, ruled by the Catholic ethic. Schumpeter, on the other hand, regarded his theory as 'characterized by three corresponding pairs of opposites', i.e. the circular flow versus the developing economy, 'statics and dynamics' and the entrepreneur versus the mere manager (Carlin, 1956; Michaelides and Milios, 2005).³

Second, the innovator is a man of unusual will and energy, and a man with no capital (MacDonald, 1965, p. 380): 'What have the individuals under consideration contributed to this? Only the will and the action' (Schumpeter, 1939, p. 132). The 'unusually strong character' and the 'clarity of vision and the ability to act' (Weber, 1930, p. 69) of Weber's innovator matched with Schumpeter's emphasis on 'the capacity for making decisions' and the 'vision to evaluate forcefully' (Schumpeter, 1955, p. 121).

¹ Rudolf Hilferding had been a fellow student of Schumpeter in Böhm-Bawerk's seminar in Vienna in 1905. For Hilferding's influence on Schumpeter see Michaelides and Milios (2005).

² He wrote: 'The perfectly bureaucratized giant industrial unit not only ousts the small or medium-sized firm and "expropriates" its owners, but in the end it also ousts the entrepreneur and expropriates the bourgeoisie as a class which in the process stands to lose not only its income but also what is infinitely more important, its function' (Schumpeter, 1942, p. 134).

³ Concerning the 'three corresponding pairs of opposites' a qualification has to be made with regard to the first two. After having read Frisch's very first article on *Statics and Dynamics in Economic Theory* Schumpeter substituted the terms 'statics' and 'dynamics', which played a fundamental role in his theoretical system, by the terms 'circular flow' and 'development' in his 1934 English edition of *The Theory of Economic Development*, as he explained in the Preface. We would like to thank an anonymous referee for this comment.

Finally, both theoreticians seem to have rejected hedonism as the motivating force behind entrepreneurial action and capital accumulation. In the nineteenth century, especially after the 'marginalist revolution' most economists viewed the entrepreneur as motivated by endless greed (e.g. Veblen, 1898, p. 389). However, Weber saw the case 'where a man exists for the sake of his business instead of the reverse' (Weber, 1930, p. 70), an attitude resulting from the effect of a sense of duty. For Schumpeter also: '[the entrepreneur's] conduct and his motive are "rational" in no other sense. And in no sense is his characteristic motive of the hedonist kind . . . typical entrepreneurs retire from the arena only when and because their strength is spent and they feel no longer equal to the task' (Schumpeter, 1939, p. 92).

Also, there was the famous 'dream and the will to found a private kingdom', the 'will to conquer', 'the joy of creating' that point to 'another psychology of non-hedonist character' (Schumpeter, 1939, p. 93). This thesis was consistent with Weber's analysis, in which he noted that after the religious motivation was exhausted other motives emerged (Weber, 1930, p. 71). Weber wrote: 'In the field of its highest development, in the United States, the pursuit of wealth . . . tends to become associated with purely mundane passions' (Weber, 1930, p. 182), a thesis that refers to Schumpeter's 'dream and . . . will to found a private kingdom' (Schumpeter, 1939, p. 93).

It is important to note that Weber referred to the entrepreneur as an 'innovator' (Weber, 1904) and that the innovation described fitted Schumpeter's definition, even despite the absence of any particular element of invention. Weber's emphasis was on the 'unusually strong character' and the 'highly developed ethical qualities'.

To sum up, according to Weber some extra-economic motive was necessary in order to accomplish the transition to modern capitalism and economic development, and the Protestant ethic fulfilled this goal. Similarly, Schumpeter emphasised the psychological and ethical dynamics of the different economic acts carried out. The capitalists behaved routinely, while the innovators took the initiative to change the routine themselves, a situation which accounted for capitalist development.¹

Of course, some obvious differences between Weber and Schumpeter are to be observed.² In this context, whereas Weber saw in the innovator the 'ideal type' of the Protestant, Schumpeter saw the creative entrepreneur.³

Another important difference in the work of the two great theoreticians has to do with the dynamics of change. Analytically, on the one hand, Weber's model of change was 'continuous', in the sense that the Protestant leaders introduced their followers to ascetism and their followers pursued their capitalist careers with intensity and rationalism. On the other hand, for Schumpeter the picture was 'discontinuous', since innovators made their appearance rather spontaneously, giving rise to waves of technical change and economic development. In other words, an innovation referred to an economy fully adapted to

¹ We cannot avoid mentioning as another possible source of Schumpeter's vision the influence of Clark (1907).

² Schumpeter was critical of Weber's methodological views. For a brief review of these points of disagreement, see Shionoya (2005, p. 109n).

³ Weber argued: 'The religious valuation of restless, continuous, systematic work in a worldly calling, as the highest means to ascetism, and at the same time the surest and most evident proof of rebirth and genuine faith, must have been the most powerful conceivable lever for the expansion of that attitude toward life which we have called the spirit of capitalism. When the limitation of consumption is combined with this release of acquisitive activity, the inevitable practical result is obvious: accumulation of capital through ascetic compulsion to save. The restraints which were imposed upon the consumption of wealth naturally served to increase it by making possible the productive investment of capital' (Weber, 1930, p. 172).

traditional methods, forced it to readopt itself at a higher level as a new period of 'traditionalism' ensued, but at a higher level of output. This gave Schumpeter's approach a dynamic character in which capitalism progressed in discontinuous steps.

5. Schumpeter and Schmoller

Modern economic analysis has neglected the works of Gustav von Schmoller, the 'towering figure' (Shionoya, 2005, introduction) of the GHS, who sought a historical, ethical and institutional approach to economics and cared for its integration into a multidisciplinary approach. After World War II many economists considered Schmoller a 'dead dog' (Kempski, 1964, p. 200) and it was argued that 'Schmoller is forever condemned and castigated' (Recktenwald, 1965, p. 342).¹

However, Schumpeter named Schmoller's theoretical research programme *Schmollerprogramm* (Schumpeter, 1954, ch. 4) as it seems to have exercised a significant influence on him. It is Schmoller who gave meaning and direction to historical, ethical and institutional teaching in economics, at that time.² As a result, the connection between Schumpeter and Schmoller was primarily methodological in nature. In its methodological framework, the *Schmollerprogramm* asked for economic phenomena to be analysed and interpreted in their broader social framework. Although Schmoller did not reject the natural scientific method, his own research agenda was based on historical data, because he believed that economics deals with complicated social phenomena where the formulation of a pure economic law was not always possible.³

Schumpeter's own view on the subject did not diverge significantly; it actually expressed the core of the GHS:

since what we are trying to understand is economic change in historic time, here is little exaggeration in saying that the ultimate goal is simply a reasoned (= conceptually clarified) history, not of crises only, nor of cycles or waves, but of the economic process in all its aspects and bearings to which theory merely supplies some tools and schemata, and statistics merely part of material. It is obvious that only detailed historic knowledge can definitely answer most of the questions of individual causation and mechanism and that without it the study of time series must remain inconclusive and theoretical analysis empty. (Schumpeter, 1939, Vol. I, p. 220)

Meanwhile, his goal of 'filling the bloodless theoretical schemata and statistical contour lines with live fact' (Schumpeter, 1939, Vol. I, p. 222) was also the goal of the GHS: '[Historical research] has given ... a proper complement to an isolating abstraction by showing how to regard the results of the abstraction as part of a coherent whole. Thus, what used to be faded abstraction and dead schema has recovered blood and life' (Schmoller, 1911, pp. 464–465).⁴

However, it is extremely difficult to acquire all information about the historic development of economic life and, consequently, the formulation of laws could never be

¹ On Gustav Schmoller, see Brinkmann (1937), Ritzel (1951) and Hodgson (2006B).

² Schmoller's understanding of the research program originates from a concept inherited from the 'Older Historical School' according to which economic processes consisted of the interaction between natural-technical and psychological-ethical factors of society (see Schmoller, 1897, p. 26).

³ In the words of Schumpeter: 'the school professed to study *all* the facets of an economic phenomenon; hence *all* the facets of economic behaviour and not merely the economic logic of it; hence the *whole* of human motivations as historically displayed, the specifically economic ones not more than the rest for which the term "ethical" was made to serve' (Schumpeter, 1954, p. 812).

⁴ Schumpeter, throughout his lifetime, criticised the *Battle of Methods* and argued that 'both sides are mostly right' (Schumpeter, 1908, p. 6).

achieved, at least within a finite time. According to Hodgson (2001, p. 115), we may say that Schmoller departed from a correct methodological point; however, he 'did not show in detail how [institutional and cultural] factors affected the outcomes. For all his concern with causal explanation, Schmoller did not paint an adequate picture of how an explanatory theory could be built, or of how its core concepts could be right'.

As is known, the *Schmollerprogram* was characterised by the attempt to provide a stage theory of economic development through an interaction between ethics and economics (Schmoller, 1901, Vol. I, pp. 53–7). Schmoller distinguished social systems in the family, communities and the firm. Of course, each system was based on a different organisational form. Contrary to the neoclassical self-interest model of maximising behaviour of autonomous individuals in the economy, Schmollerian and historical economics emphasised organisations in which individuals were free to share common interests and values on the basis of their background.¹

In this framework, according to Schmoller, economic institutions and organisations were not only technical but also psychological and ethical, meaning that the social context in which they acted worked only with ethical and moral values. In fact, even the moral system of economic life could not be understood without the knowledge of the historical development of customs, laws and morals: 'Economic behaviour and economic institutions [should be derived] from psychological power in general, from sentiment and instinct, from ethical ideas, and economic behaviour should be grasped in the framework of morals, custom and law' (Schmoller, 1911, p. 448).

Just like Schmoller, Schumpeter urged for a multi-factor approach to economic behaviour and development emphasising the role of psychological factors (Ebner, 2000, p. 367). However, this broader 'psychological' approach to capitalism was based on leadership (Schmoller, 1901, p. 413–15).² Schmoller identified the crucial role of the leading personalities as sources of change just like Schumpeter did (Schmoller, 1901, pp. 413–15). In this context, Schumpeter's entrepreneurial innovation constituted a special kind of leadership because the leader was the carrier of innovation and was in contrast to the great majority of people who acted routinely.

As for economic development of (national) economies, Schmoller (1904, p. 465n) described its cyclical character as a characteristic of the instability of modern societies (Schmoller, 1904, p. 673n) caused by the 'moral powers' (Ebner, 2000, p. 360). Schumpeter, too, emphasised the complex conditions that emerged in the framework of the process of discontinuous development (Schumpeter, 1926A, p. 88n). Schumpeter presented a more 'endogenous' type of evolutionary forces, compared with Schmoller's analysis. More precisely, Schumpeter's vision of evolutionary changes in the economic and social stratum was that *the cause* of changes as well as *the response* to them was endogenous to the system. Thus, he emphasised the function of entrepreneurs because he was looking for an endogenous explanation of economic changes.

Consequently, Schumpeter argued against the assumption of a uniform development of nations. His own approach stressed that social conditions emerged from historical

¹ Schumpeter did not fully agree with the view of the GHS that a national economy has its own aims and interests and cannot be split into independent individuals, or in his own words 'stress hyperindividual components' (Schumpeter, 1954, p. 812). He regarded as more acceptable the belief that individuals are only influenced by the institutional aspects of society (Schumpeter, 1914, p. 180).

² 'Capital plays certainly a great role in the economy ... but this is going to be explained only psychologically, by the men of a particular time, race, group of nations, and their spiritual powers, furthermore by the psychic results of these powers, the ideas and moral systems of the time, customs and law, institutions of the time' (Schmoller, 1903, p. 144).

individuals in historical time (Schumpeter, 1926A, p. 88n).¹ This argument implied that Schumpeter's notion of economic evolution depended on the basic principles of socio-cultural development, as outlined in the seventh chapter of the first edition of Schumpeter's *Theorie der wirtschaftlichen Entwicklung* (Schumpeter, 1912, ch. 7). In that chapter, the principal notion of Schumpeterian economics, i.e. the notion of entrepreneurship, was discussed in the context of cultural change. This analysis resonated with the Schmollerian vision of development and it is this institutional argumentation that constituted the conceptual core of Schumpeter's thought and simultaneously underlined his close relationship with the GHS.² At this point, it is interesting to note that Schmoller had always supported the idea that comparative research could lead to unravelling a significant amount of empirical regularities and could lead to the formulation of the historical laws of socioeconomic development and individual economic behaviour.

The vision of an institutional approach to economic analysis can be found throughout Schumpeter's writings. Schumpeter seemed to follow the *Schmollerprogram* when he introduced the concept of 'economic sociology'.

Schumpeter (1914, pp. 176–80) briefly presented six basic viewpoints on the GHS:

(1) a belief in the unity of social life, (2) a concern for development, (3) an organic and holistic view of society, (4) a recognition of the plurality of human motives, (5) an interest in concrete, individual relations rather than the general nature of events, and (6) historical relativity. (Shionoya, 2005, p. 19)

Schumpeter emphasised the combination of (1) and (2), instead of giving emphasis to (2) and (5), which was historicism's common practice. Of course, he agreed with (3) and (4) in their moderate forms and abandoned (5) and (6) because they rejected the possibility for a general viewpoint (Shionoya, 2001).

¹ The process of evolution was defined as follows: 'Social phenomena constitute a unique process in historic time, and incessant and irreversible change is their most obvious characteristic. If by Evolutionism we mean no more than recognition of this fact, then all reasoning about social phenomena must be either evolutionary in itself or else bear upon evolution' (Schumpeter, 1954, p. 435).

² The 'seventh chapter' of Schumpeter's *Theorie der wirtschaftlichen entwicklung* was regarded by Shionoya (1997) as the cornerstone of the Schumpeterian system. However, it has been at the centre of debates recently. In 1926—at a time when Schumpeter published his *Gustav von Schmoller und die Probleme von heute*—he eliminated Chapter VII on *The Economy as a Whole* (*Das Gesamtbild der Volkswirtschaft*) from the second German edition of *Theorie der wirtschaftlichen Entwicklung*. In the preface to the second German edition of *The Theory of Economic Development* (1926), Schumpeter made an attempt to explain why he dropped it. There he tried to inform the readers of a change in the character of his work. In another formulation, Schumpeter omitted this chapter because it contained a 'fragment of cultural sociology' and he wanted to concentrate on 'pure economic theory' (see also Stolper, 1988, p. 68). Schumpeter probably felt that the readers would be distracted from pure economic theory and would concentrate on those aspects of cultural sociology, which were contained in the chapter. In other words, Schumpeter was afraid that his readers or colleagues would perceive the seventh chapter as an *alternative* to pure economic theory. Meanwhile, he refrained from being associated with the economists that were opposed to theorising. Also, to Schumpeter, the criticism of Eugen von Böhm-Bawerk (his teacher at a 1905 seminar in Vienna) was considered an important factor for dropping it. Böhm-Bawerk stressed the need for economic theory to be based on empirical research because both, theory and research, reinforce each other. In this framework, theories need to be improved so as to lead to a better understanding of empirical reality, whereas the systematic analysis of empirical reality leads to 'better' theories. Böhm-Bawerk called this process of refinement *Tatsachenforschung* (Backhaus, 2002, p. 91). Finally, this decision was taken after Schumpeter's experience as a finance minister and bank chairman which, according to Mathews (2002, p. 2), made him much more cautious. For a relevant discussion of Schumpeter's intentions in the second edition see Shionoya (1997, p. 164). See also Backhaus (2003). Of course Schumpeter returned to the topic later. For instance, in his *Capitalism, Socialism, and Democracy* (1942), he made an attempt to deliver an 'integrated' theory of development containing sociological elements as well. However, for instance, Backhaus (1979, 2002, p. 92) convincingly argued that other authors have probably better reached this goal than Schumpeter himself.

According to Schumpeter, economic sociology was ‘a special field which, owing to the nature of its object, is not only a detailed and material-collecting discipline but also a theoretical discipline’ (Schumpeter, 1926B, pp. 369–70), that ‘covers, first, the facts of economic behaviour from which economists forge certain assumptions and, second, the institutions that characterize the economic organization of the societies to be studied’ (Schumpeter, 1954, p. 544). He characterised its goal as a ‘unified sociology or social science as the mentally (‘theoretically’) worked out universal history’ (Schumpeter, 1926B, p. 382).

Finally, there is no doubt that some differences between Schmoller and Schumpeter can be seen. For instance, the core of Schmoller’s approach consisted of an ethical segment, pointing at the process of change and emphasising the feasibility of policy reconciling market dynamics and social justice. This view was rejected by Schumpeter’s thesis on profit motives in the ethical sphere.

Also, institutional aspects such as customs and habits accounted for the creation of the leading personalities as sources of change in Schmoller’s agenda. In this context, he pointed at the individuals of political leadership but also to entrepreneurial leaders. In other words, Schmoller identified the crucial role of the leading personalities as sources of change just as Schumpeter did. However, for Schumpeter these leading personalities of the business world made their appearance discontinuously, giving rise to waves of technical change and development and did not depend on typical routine customs and habits. This gave Schumpeter’s approach a very ‘dynamic’ and ‘random’ character as compared with Schmoller’s view.

Conclusively, Schumpeter did not accept the *Schmollerprogram* exactly as it was and introduced reconstructive comments.¹ However, modifications to Schmoller’s agenda were pursued by the members of the ‘Youngest Historical School’ (Schumpeter, 1954, p. 815). Friendly comments on Spiethoff, Sombart and Max Weber were repeatedly used by Schumpeter who believed that significant contributions to economics had been provided by the GHS (Schumpeter, 1908, p. 617). Actually, he found in Schmoller’s approach the ‘outlook of a universal social science’ (Schumpeter, 1926B, p. 365).

At this point, it should be noted that to proceed to a review of all theoreticians of the GHS that might have influenced Schumpeter would be impossible in just one essay, even if such an essay could be far longer than the present one. Therefore, what we have presented in this paper is, undoubtedly, a highly selective review. In this context, our analysis has focused on the influences of Sombart, Max Weber and Schmoller on Schumpeter’s research agenda, because they are among the most eminent economists to constitute the core of the GHS (Schumpeter, 1954; Shionoya, 2005) and their writings have striking similarities (as well as differences) with Schumpeter’s *oeuvre*.

6. Conclusions

Given the presence of central elements of Schumpeter’s vision in the GHS’s works, it is surprising that so little attention has been paid to the GHS as an intellectual source for Joseph Schumpeter. This essay argues that Schumpeter formulated some of his principal theses in accordance with the conceptual framework of the GHS as represented by Schmoller, Max Weber and Sombart.² Despite some obvious differences between

¹ For example, he accepted Schmoller’s thesis on the importance of the historical perspective but emphasised the urge towards the construction of a theory rather than simple observation, description, classification and explanation of economic phenomena (Schumpeter, 1908, p. 42).

² It is worth mentioning at this point that Gustav von Schmoller, Max Weber and Werner Sombart are regarded as historicists who developed theory in contrast to the more empiricist historicists, such as Wilhelm Roscher (Hodgson, 2005, p. 341).

Schumpeter and the GHS, the parallels are undeniable, and the matching of certain concepts impressive.

More precisely, Schumpeter followed Sombart in his 'theoretical materialism' and there was general agreement between the two theoreticians that capitalism was on the decline. Also, strong parallels were found with respect to forces driving the evolution of the capitalist enterprise and the role of technology. Next, the paper compared Schumpeter's and Weber's central visions emphasising the role of the 'entrepreneur', the 'circular flow', the 'protestant ethic' and the 'spirit of capitalism', respectively. Finally, Schumpeter's notion of development was viewed in the context of the Schmollerian theoretical approach of integrating theoretical and historical concerns.

At this point one faces another important issue: Schumpeter's attitude to the GHS seems to have shifted remarkably. More precisely, in his pre-1920 works Schumpeter worked mostly in a Walrasian context, and especially in his very important *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908). In this book, Schumpeter was mainly concerned with theoretical economics and their methodological foundations. This book was mainly addressed to the members of the GHS (Schumpeter, 1908, pp. xxi, 554) to convince them of the usefulness of the theoretical approach.

Throughout his lifetime Schumpeter (1908, 1914, 1954) criticised the famous *Battle of Methods*. He argued that 'both sides are mostly right' (Schumpeter, 1908, p. 6) and even strived for a solution. In other words, he argued that both methods had a place in economics. In this context, Schumpeter, in his *Wesen und Hauptinhalt*, tried to convince the members of the GHS about the usefulness of theoretical analysis (Schumpeter, 1908, p. 561n). However, in the same book Schumpeter also advocated the testing of new theories with empirical evidence, otherwise the strength of the theory was doubtful.¹ It is in this sense that the GHS (especially Schmoller, Max Weber and Sombart) seems to have influenced Schumpeter's late works.

Perhaps a more appropriate way to formulate this argument would be to refer to Walras. It is well known that Schumpeter was a great admirer of Walras. In his *History of Economic Analysis* he wrote: '[S]o far as pure theory is concerned Walras is in my opinion the greatest of all economists' and suggested that Walras's work 'will stand comparison with the achievements of theoretical physics' (Schumpeter, 1954, p. 827). Yet, while his early works were Walrasian in nature, his later works seem less Walrasian (see Schumpeter, 1954, p. 12). A principal manifestation of this change was held to be Schumpeter's revised assessment of the role of market competition in the process of innovation (see Nelson, 1977, pp. 134–5). Moreover, Schumpeter's change of his earlier views could also be associated with a shift in philosophical orientation (Klein, 1977, p. 133). However, regardless of the fact that Schumpeter changed some of his earlier theses and of whether he was inconsistent (da Graça Moura, 2002) or not (Shionoya, 1997), it should be made clear that, as a great admirer of Walras, Schumpeter (1941, p. 239) never actually rejected the Walrasian framework of analysis. In fact, in his *History of Economic Analysis* he praised it highly (Schumpeter, 1954, p. 827).²

At this point, one must face an issue raised by Backhouse: 'When forgotten precursors of later ideas are found, the main interest is often in why they were neglected, as much as in

¹ This is probably the reason why the *Methodenstreit* interests economists who have been discussing it for more than a century (Hodgson, 2001).

² For an analysis of Schumpeter's work divided into 'phases' see Kesting (2006). See also Shionoya (1997) who provided an interesting analysis of Schumpeter's writings. For a critique to Shionoya (1997) see da Graça Moura (2002).

the ideas themselves' (Backhouse, 1985, p. 5). Put another way, why is the GHS's contribution to the formation of Schumpeter's ideas systematically neglected in the literature, whereas other influences are persistently stressed?

In our view, it is because after World War II, most German-speaking economists went into an eclipse. Part of the explanation lies with the 'mathematisation' of economics. As a consequence, the German—non Marxist—tradition in economics was practically represented by Schumpeter, a fact that made him appear unique. Schumpeter played a role in this process, by not emphasising the significant contribution of German economics (Reinert, 2002). In other words, Schumpeter's originality in the Anglo-Saxon world was probably the product of ignorance of the approaches on which he built. According to Appel's (1992, p. 260n) emphatic argumentation, most Schumpeterians (of the Anglo-Saxon world), would be surprised by an approach that describes Schumpeter's writings as a reworking of a German debate that had taken place decades earlier, when Schumpeter referred neither to the debate itself nor to its protagonists.

According to Toye (2006, p. 830) 'There are different kinds of debt that a young economist incurs in the course of his education and apprenticeship. Some are personal, accumulated through receiving mentoring, friendship and academic patronage, and some are intellectual, accumulated through inspiration, intellectual guidance and assimilation of the other's ideas'. Undoubtedly, Schumpeter owed intellectual debts to Schmoller, Max Weber and Sombart. In other words, in conclusion we may say that Schmoller, Max Weber and Sombart seem to have exerted a certain influence upon the formation of Schumpeter's theses.

This connection between Schumpeter and the GHS may be very useful for promoting dialogue between different schools of thought and for understanding current economic issues. Without doubt, these influential theoreticians were not the only prominent economists to have influenced Joseph Schumpeter. As has been acknowledged in the literature, the great Austrian theoretician was apparently influenced by other prominent economists such as Karl Marx and various Marxist theorists. The potential Marxian influences behind Schumpeter's move towards history are a fine example for further investigation.

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