

*17th International Conference of the European Association for
Evolutionary Political Economy, Bremen/Germany, November 2005*

The Influence of the German Historical School on Schumpeter

by:

Panayotis G. Michaelides *and* John G. Milios

Laboratory of Applied Economics
Department of Humanities, Social Sciences and Law
Faculty of Applied Mathematics and Physical Sciences
National Technical University of Athens
Zografou Campus, 157.80, Athens, Greece
pmichael@central.ntua.gr, jmilios@hol.gr

August 2005

The Influence of the German Historical School on Schumpeter

by:

Panayotis G. Michaelides *and* John G. Milios

Abstract

The present paper defends the thesis that Schumpeter formulated his research program and his main theses in accordance with the theoretical framework of the German Historical School, as expressed by major theoreticians such as Schmoller, Max Weber and Sombart. For instance, Schumpeter's notion of development could be viewed in the context of the Schmollerian theoretical approach. Next, we compare, briefly, Schumpeter's and Weber's central visions emphasizing the role of the "entrepreneur", the "circular flow" and the "protestant ethic" and the "spirit of capitalism" respectively. Finally, Schumpeter seems to follow Sombart in his "theoretical materialism", and there is general agreement between the two theoreticians that capitalism was on the decline. However, the strongest parallels are to be found with respect to forces driving the process, at the end of which Schumpeter expected a socialist system, while Sombart expected a mixed economy. Also, several similarities can be found in their respective theses about the evolution of the capitalist enterprise and the role of technology. The paper discusses, also, some of Schumpeter's main differences of approach as to the German Historical School and concludes that the latter shall inspire further research and developments in Schumpeterian economics.

1. Introduction

There is no doubt that Joseph Alois Schumpeter ‘was one of the greatest economists of all time’ (Haberler 1950, p. 1). Consequently, the issue of which theories or ideas might have influenced his thought becomes of great interest. The present paper examines the possible conceptual relationship between Schumpeter’s views and the basic approaches of the German Historical School.

In the words of Shionoya (2005, introduction) “Schumpeter was never considered even as working on its [the German Historical School] periphery”. However, this question has, this far, been either (effortlessly) rejected (Becker and Knudsen, 2002, p.387-388) or neglected in the relevant literature and with the exception of very few papers (for example: Shionoya 1987; Swedberg 1989; Chaloupek, 1995; Ebner 2000, Shionoya 2005) no systematic research seems to have been done on this important issue. In this paper we defend the thesis that certain elaborations of the German Historical School may be traced throughout Schumpeter’s works, while the influence of the Historical School on Schumpeter’s views is considerable.

The paper is organised as follows: section 2 provides an overview of the German Historical School; section 3 presents Schmoller’s program as the core of the German Historical School and its impact on Schumpeter’s theoretical system; section 4 investigates the influence of Weber’ work on Schumpeter, while section 5 discusses the impact of Sombart upon Schumpeter; section 6 concludes the paper.

2. The German Historical School: A Brief Overview¹

Before starting developing our argument on the way that the German Historical School might have influenced some of Schumpeter's views, we find it useful to devote a few lines to a brief presentation of the Historical School.

The German Historical School was formed in Germany in the second half of the nineteenth century and stemmed from the work of several economists, whose writings date from the late 1840s, as a reaction against both the Classical School of political economy and Marxian Economics. It ended by World War II, when Gustav Schmoller died. By then, most of its ideas have been absorbed by economists in general, and the school has ceased to exist.

The School has its roots in German economic Romanticism on the one hand and in Friedrich List's ideas 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 the entailing economic liberalism (Miliotis and Economakis, 2001).

The deeper reasons for these considerations lie in the social and economic situation of Germany during the nineteenth century (see what follows).

2.1 The Social Background of the German Historical School

The peace treaty, after the Napoleonic Wars, left Germany divided into thirty-three states, the majority of which were monarchical. In this framework, the Great Powers of Europe manipulated Germany in order to promote their own purposes: Britain wanted to see a strong Prussia thwarting France; Russia wanted for itself some parts

¹ The information is mainly drawn from the *Encyclopedia of International Economics*, (Economakis and Miliotis 2001: 686-7), *The Evolution of Economic Thought* (Oser and Blanchfield, 1975), the *History of Economic Theory* (Landreth and Colander, 1989), *A History of Economic Analysis* (Backhouse, 1987), as well as from Schumpeter's *History of Economic Analysis* (Schumpeter, 1954).

of Poland (i.e. the ones not seized by Germany or Austria), while Austria wished to keep Germany divided and Prussia weak.

The Napoleonic Wars had aroused nationalistic emotions and many Germans demanded constitutional reforms and unification. However, the democratic aspirations remained unrealized for about a century and were achieved, partly, under the World War I defeat circumstances.

Prussia constituted the largest, richest and most powerful German state and dominated the German speaking territory. Some foreign countries wooed Prussia as a very powerful ally. On the one hand, conservatives saw in Prussia a bulwark against democracy and socialism and, on the other hand, nationalists relied on Prussia to lead to a unified Germany. In this framework, Bismarck's social legislation, achieved the social peace that the monarchy has always aimed at and evoked patriotism among the Germans (Oser and Blanchfield, 1975, p. 199).

Obviously, several institutions of nineteenth-century Germany differed substantially from those of Britain. For instance, competition and freedom of enterprises were restricted in Germany. Also, mercantilist regulations persisted in Germany long after they had disappeared from Britain. Meanwhile, because of the large bureaucracy of the German economy, public administration was strongly developed. Apparently, the British theories were not applicable to the German case. Thus, the German Historical School defended the "German way" of economic organization by questioning the relevance of the classicist doctrines from Britain.

As a conclusion, the German nation to which belonged the intellectuals that that gave birth to the Historical School was weak and divided. Patriotism, nationalism, militarism, hard work and government intervention, were combined to

promote industrial growth, given that Germany, at that time, was far behind Britain in the development of industry.

2.2 The Principle Positions of the German Historical School

The German Historical School, expressing the needs of the less developed German industry, which suffered under British competition, had to theoretically support protectionism and hence the national peculiarities of Germany, as opposed to the ‘cosmopolitanism’ of the Classical School (matching the British industrial objectives for trade liberalisation). As a result, the analysis was focused on the clarification of the ‘historically concrete’ and the ‘nationally specific’. From this point of view, general laws appear to be of little significance; consequently, the abstract method of analysis is regarded to be useless, while historic evolution of social life is conceived as an inseparable whole.

In this framework, the basic characteristics of the Historical School are (Economakis and Milios, 2001):

- (a) First, the emphasis on the historical method of analysis and therefore the exclusive use of the inductive method in economic research.
- (b) Second, the rejection of theoretically drawn economic laws; the sole laws which can be inferred are ‘empirical laws’, drawn from historical monographs and statistical investigations.
- (c) Third, the necessity of a merger between economics and all other social sciences.

The German Historical School applied an ‘evolutionary’ approach to the study of the social formation. It emphasised development and growth. An analogy could be drawn to Darwin’s ‘evolutionism’ in biology. More precisely, the organism is born,

grows, decays and, finally, dies. Similarly, society changes and, therefore, what is relevant for one country, at a particular time, may be completely inappropriate for another country or another time. This argument has proved very useful for attacking classical economics as being suitable for Britain but not for Germany (Oser and Blanchfield, 1975, p. 199).

Meanwhile, the Historical School gave emphasis to the community or the national economic framework, whereas classical economics was individualist. Then, society and the state rather than the individual occupy the centre of the stage. In this way, a ‘glorification’ of the state took place, which gave prominence to economic state intervention.

The economists of the German Historical School concentrated on the importance of the historical study of the economy. In this way, they criticised the abstract, deductive, and – as they thought – unrealistic and unhistorical character of classical and, of course, marginalist economics. Therefore, they conducted studies based on primary material, focusing on changing institutions. In this way, the School claimed that it managed to study all the forces behind an economic phenomenon and all the faces of economic behaviour.

Most members of the Historical School opposed theorising and denied that there are valid economic laws with the exception of the patterns of development that may be generalised into laws (Oser and Blanchfield, 1975, p. 201).

The economists of this School were reformers and believed that Political Economy has important ethical tasks as well. For instance, it should not only analyse motives of economic activity but also compare moral merit. Besides, they were of the opinion that the demands of justice and morality should be satisfied. The ‘common man’ was the focus of their analysis and the amelioration of conditions should be the

German state's task. In this way, the state would safeguard the well-being of the workers, while enjoying increasing loyalty. These advocates of the moderate social changes were called "Socialists of the Chair", a reference to their academic positions.

We may conclude, therefore, that the German Historical School served the German states and also themselves, as they enjoyed close relations with government officials.² Its members were critical of 'laissez faire' and clever enough to foresee that unrestricted free enterprises do not necessarily produce the best possible results for social welfare.

2.3 The 'Structure' of the German Historical School

German thinkers such as Johann Gottfried Herder, Adam Mueller and Friedrich List are sometimes regarded as the forerunners of the Historical School (Shionoya, 2005, p. 1). The Historical School is usually distinguished in 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). Some authors - for example Landreth and Colander (1989, p. 271) – include Friedrich List who is regarded as the founder of the School. However, strictly speaking, these economists did not form a School, as their approach to economic history was neither uniform nor very different from that of other economists.³

The leading figure of the 'Younger' Historical School was Gustav von Schmoller (1838-1917); another important writer was Lujo Brentano (1844-81).⁴

² Practically, the German government controlled most universities and Schmoller, who was known as the "professor maker", had under control most academic positions in Germany through his impact on the Prussian Ministry of Education. In this framework, his followers were placed in academic positions, while the adherents of the Austrian Marginalist School were excluded from most university positions (Oser and Blanchfield, 1975, p. 202).

³ At this point, it should be noted that the definition of a "school" is always problematic (Shionoya, 2005, introduction).

⁴ Other members of the 'Younger' Historical School are: Karl Buecher, Friedrich Knapp and Adolph Wagner (Shionoya, 2005, p.1).

Schmoller and his followers rejected the idea that a scientific economic theory existed already, with the argument that, until then, there had not been enough knowledge of economic history. They further criticised both the Classics' commitment to unlimited free economic competition and Marxist socialism; however, they were in favour of social reforms. Their effort to approach social life as an inseparable whole not only introduced moral issues into their analysis but led also to psychological considerations.

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. As Menger attacked the Historical School, Schmoller rejoined, and the famous *Battle of Methods (Methodenstreit)* followed.⁵

Arthur Spiethoff (1873-1957), Werner Sombart (1863-1941) and Max Weber (1864-1920) were the most eminent exponents of the 'Youngest' Historical School, which carried on the work of the 'Younger' School. Despite any differences from their predecessors and from one another, these writers remained faithful to the fundamental methodological principles formulated by Gustav von Schmoller.

The views of the German Historical School had a limited influence on economic thought outside of Germany. The School's most outstanding disciple in Britain was T.E. Cliffe-Leslie (1825-1882). There is a large bulk of books and essays written by authors who followed the principles of the Historical School. These works constitute a collection of valuable material in economic history. However, if all abstract notions are rejected and the analysis is restricted to the accumulation of heterogeneous facts, supposedly describing empirical 'laws', economics is reduced to

⁵ For a Marxist critique to both camps of the Methodenstreit see Bukharin (1919).

a collection of case studies, which disregards causalities in economic process. It ceases, therefore, to be a distinct theoretical discipline of social science.

3. Schmoller's Research Program and Schumpeter

Modern economic analysis has systematically neglected the works of Schmoller, the "towering figure" (Shinonoya, 2005, introduction) of the German Historical School, who sought a historical, ethical and institutional approach to the abstract theories and cared for its integration into a real multidisciplinary approach. This theoretical research program was named *Schmollerprogramm* by Schumpeter (Schumpeter 1954, ch. 4) as seems to have exercised significant influence on the latter in his attempt to unify economics with the rest of the social sciences. It is actually, Schmoller who gave meaning and direction to historical, ethical and institutional teaching in economics, at that time. For instance, Schmoller argued that ethics should not be based on general, abstract principles of moral philosophy but should rather be relevant for individuals and social policy issues in order to design institutions and organizations.

Schmoller's understanding of the research program originates from a concept inherited from the so-called 'Older Historical School', that economic processes consist of the interaction between, on the one hand, natural – technical, and on the other hand, psychological – ethical factors of society. Thus, it proceeded to the formulation of a historical – ethical approach which was, as seen, opposed to the theoretical approach of mainstream economics. Schmoller even remarked with pride, on the occasion of a speech at the University of Berlin: "Today's economics has reached a historical and ethical conception of nation and society contrary to rationalism and materialism" (Schmoller, 1897, p. 26).

As one would expect, in its methodological framework, the *Schmollerprogram* asks for economic phenomena to be analysed and interpreted in their own framework. More precisely, the research methodology consists of three basic steps: First, the observation and description of the economic phenomenon, second the definition and classification of this phenomenon and, third, the causal explanation of the phenomenon and the interrelations (Schmoller 1901, vol. 1, p. 12). Obviously, this situation implies a huge amount of empirical work.

Despite, Schmoller not rejecting the natural scientific method, his own research agenda is, as seen, based on the collection of historical data, originating in his view that economics deal with complicated phenomena where the formulation of a law is not always possible. In fact, the basic defect of the historical method of the German Historical School is this methodological view that a theory (or law) has to be a summary or generalization of empirical facts. Or, 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).

The main thesis of the German Historical School is not the complete rejection of theory, but the need for empirical research even before the theoretical formulation of a complicated economic phenomenon. However, Schumpeter’s own view on the subject does not diverge significantly; it actually manifests the core of the German Historical School:

“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. 1, p. 220).

Meanwhile, his goal “filling the bloodless theoretical schemata and statistical contour lines with live fact” (Schumpeter, 1939, vol. 1, p. 222) is also the goal of the German Historical School: “[Historical research] has given, for the first time, 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. 464-460).

Of course, it is extremely difficult, if not impossible to acquire information about the development of economic life historically and, consequently, a generalization acting as a theoretical formulation could never be attained, at least within a finite time. According to Schmoller (1911, pp. 467-468), the nature of theoretical formulations, are regarded as means for organizing thought, and not as an actual representation of reality, despite it being the absolute and ultimate aim of science.

Very significant in *Schmollerprogram* is the concept of *Volkswirtschaft*, originally translated as ‘popular economy’ and later as ‘national economy’. According to Ebner (2000, p. 357) it expresses the type of national economy which evolved from a particular “stage of development” in the historical process of evolution and is a special type of economic formation corresponding to Schmoller’s notion of the

evolution of developmental stages, where economic phenomena constitute special parts of a particular social formation.

As known, The *Schmollerprogram* is characterized by the attempt to provide a stage theory of economic development through an interaction between ethics and economics (Schmoller 1901, vol.1, pp. 53-57). Schmoller distinguished social systems in the family, the communities, and the firm. Of course, each system was based on a different organizational form. It is obvious, that contrary to the neoclassical self-interest model of maximizing behaviour of autonomous individuals in the economy, Schmollerian and historical economics emphasize on social organizations, such as the community in which individuals are free to share common interests and values on the basis of their background.⁶

According to Ebner (2000, p. 358), such organisations, the so-called ‘organs’, are at the core of the Schmollerian agenda and this Schmollerian procedure (Schmoller 1901, p. 100), which represents the observations and the formulation of definitions, is the basis for the elaboration of causal argumentations.

Schumpeter despite giving considerable credit, he does not fully agree with the view of the German Historical School that a national economy has its own aims and interests and cannot be split into independent individuals, or in his own word “stress hyperindividual components” (Schumpeter 1954, p. 812). He regarded as more acceptable the belief that individuals are, indeed, only *influenced* by the institutional aspects of society. He wrote:

“the individual economies, which together comprise the national economy, stand in intimate mutual relations with each other. These relations are far more important than the ones which economic theory describes and which influence the

⁶ This approach has inspired various contemporary researchers such as Alexander Gerschenkron (1962)

individual member of the economy. They enforce in fact upon the individual a behaviour which is of a different kind and which must be explained in a way which is quite different from the one which economic theory speaks” (Schumpeter 1914, p. 180). It is interesting to note that Schmoller had always supported the idea that comparative research could lead to unrevealing a significant amount of empirical regularities and could lead to the formulation of the historical laws of socioeconomic development.

According to Schmoller, economic institutions and organizations are not only technical but also psychological and ethical, meaning that the social context in which they act works only with ethical and moral values. In fact, even the religious and 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 comparative multi-factor approach to economic development emphasising the role of psychological factors (Ebner, 2000, p. 367). Thus, the economic life could only be understood by taking into account the psychological factors. However, this broader ‘psychological’ approach to capitalism is based on leadership (Schmoller, 1901, p. 413-415).⁷ Schmoller identifies the crucial role of the leading personalities as sources of change just like Schumpeter did (Schmoller, 1901, pp. 413-415). In this context, Schumpeter’s entrepreneurial innovation constitutes a special kind of leadership because the leader is the carrier of

⁷ In Schmoller’s (1903, p. 144) words: “Capital plays certainly a great role in the economy as well as in the modern firms of today, 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” (cited in Ebner 2000, p. 360).

innovation and is in contrast to the great majority of people who act routinely (see Michaelides and Milios, 2005). He even expanded this vision with regards to other aspects of social and economic life, such as science, politics, etc.

As for the development of (national) economies, Schmoller (1904, p. 465n) describes its cyclical character as a characteristic of the instability of modern societies caused (Schmoller, 1904, p. 673n) by the ‘moral powers’ (Ebner, 2000, p. 360). Schumpeter, too, argues for the discontinuous development and emphasizes the complex conditions that emerge (Schumpeter, 1926a p. 88n). However, Schumpeter (1954, p. 435) criticizes over-simplistic approaches such as “biological” or “behaviorist” economics, despite admitting that they were rightly introduced, in the first place, to economics from zoology⁸, because for a mechanical analogy does not apply to the extremely complex development of an economy and society (Schumpeter, 1934, p. xi).

Contrary to that, Schumpeter presented a more “endogenous” type of evolutionary forces (Michaelides and Milios, 2005). More precisely, Schumpeter’s vision of evolutionary changes in the economic and social stratum is that *the cause* of changes as well as *the response* to them is endogenous to the system. Thus, he emphasized the function of entrepreneurs because he was looking for an endogenous explanation of economic changes rooted in the system itself and not to external forces, at least, not in the general case. It is along this line of thought that he formulated the theory of *Business Cycles* as the impact of innovation through the response mechanism of the economic system.

In the 7th chapter of Schumpeter’s *Theorie der wirtschaftlichen Entwicklung* (Schumpeter 1912, ch. 7), the basic principles of development are presented following

⁸ For instance, Schumpeter said that if a study of the organs of a dog corresponds to the static situation, then research on the dog’s existence and so on corresponds to dynamics (Schumpeter, 1939, vol. 1, pp. 36-37).

Schmoller and it is their “institutional argumentation which constitutes the conceptual core of Schumpeter’s thought and simultaneously underlines his close relationship with the German Historical School” (Ebner, 2000, p. 369).

At this point, it should be noted that, although Schmoller’s historical – ethical work aimed at explaining the institutional aspects of capitalism, he admitted the value of neoclassical economics, within the framework of institutional analysis as is evident in his *Grundriss der allgemeinen Volkswirtschaftslehre*. Of course, it should also be noted that the ethical approach as a scientific method implies hypothetical assumptions, such as human behaviour motivated by various considerations such as morality, law and not driven by self-interest.

The vision of a historical and institutional approach to economic analysis can be found throughout Schumpeter’s writings. Schumpeter followed the *Schmollerprogram*, and introduced the concept of ‘economic sociology’ borrowing most of Schmoller’s ideas (Ebner 2000, p. 363). There, Schumpeter (1954, pp. 176-180) briefly presented six basic viewpoints on the German Historical School (see Shionoya, 2005, p. 19): “

- (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”.

Schumpeter emphasized on the combination of (1) and (2), instead of emphasizing on (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).

Friendly comments on the most eminent exponents of the ‘Youngest Historical School’, namely Spiethoff, Sombart and Max Weber, are repeatedly used by Schumpeter who was of the opinion that significant contributions to economics have been provided by the German Historical School, in general (Schumpeter, 1908, p. 617). This is the reason why he found in Schmoller’s research the “outlook of a universal social science” (Schumpeter, 1926b, p. 365).

He describes capitalist society as a whole, with interrelations between the various aspects of life, characterized by their static or dynamic character. However, Schumpeter was, practically, based on the dichotomy of human types, to distinguish between static and dynamic. As seen, he maintained that there exist a limited number of people able to destroy existing orders and introduce innovations, contrary to the great majority of people stuck to customary ways of doing things.⁹

As known, in his *History of Economic Analysis*, Schumpeter regarding the fundamental fields of economics (i.e. history, statistics, theory, and, later on, economic sociology) he chose economic history as the most preferable among them:

“if, starting my work in economics afresh, I were told that I could study only one [of the fundamental fields of economic analysis: economic history, statistics, or theory] but could have my choice, it would be economic history that I should choose” (Schumpeter 1954, p. 12).

According to him economic sociology as “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. 369-370), while: “economic

⁹ Later on, these people ascend the ‘higher ranks’ of society and tend to form a social class.

sociology covers, first, the facts of economic behavior 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 characterized its goal as a “unified sociology or social science as the mentally (‘theoretically’) worked out universal history” (Schumpeter, 1926, p. 382).¹⁰ Apparently, the concept of *Verstehen*, i.e. the way of understanding “what things meant to people concerned”, (Schumpeter, 1954, p. 34) constitutes a significant part of Schumpeter's vision of economic sociology (Ebner, 2000, p. 366).

From these elaborations, it is clear that Schmoller and Schumpeter share a similar vision, constituting of an institutional analysis of modern capitalist society as a social formation. Of course, Schumpeter did not accept the *Schmollerprogram* exactly as it stood and introduced certain minor reconstructive comments.¹¹ Modifications to the Schmollerian agenda were pursued, as seen, by Max Weber, Sombart and Spiethoff, the so-called ‘Youngest Historical School’ (Schumpeter, 1954, p. 815) emphasizing the historical character of economic analysis.

4. Schumpeter and Weber

The purpose of this section of the paper is to compare Schumpeter and another member of the German Historical School, Max Weber, with respect to their central

¹⁰ Following Shionoya (2003), Schumpeter’s economic sociology consists of a set of sub-models: (1) theory of innovation, (2) theory of social classes, (3) theory of social leadership, (4) theory of ideology, (5) interaction between economic and non-economic areas.

¹¹ For example, he accepted Schmoller’s thesis on the importance of the historical perspective but emphasized the urge towards a construction of a theory rather than the simple observation, description, classification and explanation of the economic phenomena and interrelations. In his words: “While [historical description] does no more than make a catalogue of facts, a theory undertakes the transformation of facts, not for any far-reaching or mysterious purpose but only for a better summary of facts. A theory constructs a scheme for facts; its aim is to give a representation to an immense amount of facts and to achieve as simply and completely as possible what we call understanding” (Schumpeter, 1908, p. 42).

visions, in order to, possibly, identify any major similarities in the works of the two great theoreticians.

Max Weber (1864-1920) after establishing himself in Berlin's legal profession and publishing numerous scholarly works, he became professor of Political Economy and Sociology at Freiburg University and later at Heidelberg and Munich. His works aroused a lively controversy over the relationship between Protestantism and Capitalism. (Oser and Blanchfield, 1975, p. 213).

Weber's *Die Protestantische Ethic und der Geist des Kapitalismus* was published in two articles in the *Archiv für Sozialwissenschaft und Sozialpolitik* (1904, 1905). More precisely, the first article appeared in 1904 and the second in 1905 and was reprinted with new material, as a study in Weber's series *Gesammelte Aufsätze zur Religionssoziologie*.¹²

Weber's theses were often regarded as an attack on Marx's interpretation of history (MacDonald, 1965, p. 375). In the words of Bendix (1960, p. 52), Weber had showed that economic conduct was inseparable from the ideas with which men pursued their economic interests, and these ideas had to be understood on their own terms. Weber attempted to adjust his thesis in accordance with the German Historical School rejecting classical or Marxian economics.

At that time, Schumpeter was a student in Vienna, while the Austrian and German camps were strained because of the *Mehtodenstreit*. Chronologically, it coincided with a period in Schumpeter's life when he was formulating his own theoretical system (Haberler 1950; Smithies 1951; Faltello and Jovanovic, 1997; Michaelides and Milios, 2005).

¹² The appearance of these articles attracted attention: "On their first appearance they aroused an interest which extended beyond the ranks of historical specialists, and which caused the numbers of the *Archiv* in which they were published to be sold with a rapidity not very usual" (Weber, 1930, p.1: a foreword by H. Tawney).

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. 27-29). For Weber, this was not a realistic picture of the process of capitalist development. Until about the middle of the 19th century, he argued, modern industry had not displaced the putter-out, whose life was considered to be very comfortable (MacDonald, 1965, p. 375). We may imagine its 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. Personal canvassing of customers took place, if at all, only at long intervals. 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).¹³

¹³ However, this is not a critique of Marxist theory *per se*, but only of a mechanistic version of it which ignored the different forms of capital and identified capitalism with (high) industry. 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 is 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’ (LCW Vol. 2, pp. 434-35, emphasis added). Rubin (1929) stressed also that, under certain circumstances, “the manufactories were unable to oust and replace the domestic system on any significant scale” (Rubin, 1989, p. 156).

Weber viewed the capitalistic form of organization with capital, entrepreneurial activity and rational control over production. However, he also argued that capitalism, actually, reproduces 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).

In the above quotation, we may find expressed all the fundamental elements of Schumpeter’s famous ideas on the conflict between routine and innovation, characterizing capitalism’s circular flow:

“For our present argument 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. 40-41).

Schumpeter, thus, describes a completely stationary capitalist world where any element of change is absent and stationarity is the rule of economic reality. The author states that the mechanistic repetition of our acts is based on the accumulated experience of man. In his own words:

“all knowledge and habit once acquired becomes as firmly rooted in ourselves as a railway embankment in the earth” (Schumpeter 1949, pp. 84-85).

More precisely, this stationary situation is characterized by perfect competition, complete adjustment to the equilibrium situation, two social classes (workers and landowners), where money acts as a means of payment and no net saving of credit exists. Any changes in the economic stratum are continuous, undisrupted and absorbed by the system.

At any given time, the entrepreneurs take the same decisions. The income is paid to consumer goods already produced. Any supply is counterbalanced by its own demand at the expected level of prices which covers the unit cost. Money could be absent without deforming the economic phenomena in the economy. It is, thus, obvious, that the economic stratum could only alter under pressure.

Apparently, the Weberian type of “traditional capitalism” and Schumpeter’s circular flow describe, practically, the same thing. Even the respective expressions used by the two theoreticians indicate the idealist character of the situation. Weber wrote: “We may imagine [...]” while Schumpeter stated that “we may [...] visualize [...]” both of them expressing the ideal and refined situation about the economic circle.

After presenting the traditional picture, Weber goes on to introduce the “new” entrepreneur who intrudes into the routine’s tranquility. He wrote:

“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. What happened was, on the one contrary, often no more than this: 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 this connection, it was not generally in such cases a stream of money invested in the industry which brought about this revolution – in several cases – known to me the whole revolutionary process was set in motion with a few thousands of capital borrowed from relations but the new spirit, the spirit of modern capitalism, has set to work [...] 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. Often, - I know of several cases of the sort – regular legends of mysterious shady spots in his previous life have been produced” (Weber 1930, p. 68).

This aspect of capitalism became also Schumpeter’s centre of analysis, namely the innovator’s disturbance to the circular flow. Schumpeter stated:

“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. 82-83).

Schumpeter, just like Weber, believed that every socio-economic phenomenon came to an end and argued that society was not only willing to absorb the novelty but it was forced to do so by the dynamics of change. For instance, Schumpeter wrote:

“The matter then appears as follows. If anyone in an economic system in which the textile industry produces only with hand labor 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).

Continuously, the entrepreneur begun to make profits:

“But now comes the second act of the drama. The spell is broken and new businesses are continually arising under the impulse of the alluring profit. A complete reorganization of the industry occurs, with its increases in production, its competitive struggle, its supersession of obsolete business, its possible dismissal of workers, and so forth” (Schumpeter 1934, p. 131).

So, the introduction of the “new” element is accompanied by a mentality, driving the economic climate to stagnation and decline. 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 defenses, to disperse the garrisons of its entrenchments [...] 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 life-cycle comes to an end because the atmosphere has changed. Thus, a strong personality and the leader’s characteristics are continuously being underestimated in favour of a bureaucratized system. Meanwhile, innovation has become routine and the bourgeoisie as a class, the means of reproducing the capitalist ideas, is constantly losing its self-esteem. 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).

Apparently, this vision of the capitalist system has several similarities with Weber’s theoretical schema. In other words, the dynamic entrepreneur who breaks into the circular flow, equipped with will, energy, and the ideas that pave the way of his success over the old firms is both Weber’s and Schumpeter’s favourite theme.

Of course, it is important not only to delimit our analysis to some striking similarities, but to also stress some important differences between the two theoreticians.¹⁴ So, while Weber saw in the innovator the ‘ideal type’ of the Protestant, Schumpeter, on the other hand, regarded him as the ‘extra-ordinary’ entrepreneur. Weber argued:

“The religious valuation of restless, continuous, systematic work in a worldly calling, as the highest means to asceticism, and at the same time the surest and most

¹⁴ Schumpeter was critical of Weber’s several methodological views. For a brief review of these points of disagreement see Shionoya (2005, p. 109n).

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).

Schumpeter’s view, stressing the innovative character of the entrepreneur rather than the religious personality could be considered as tool in explaining the rise and development of capitalism. Of course, it is more plausible to postulate the appearance of men of superior ability as causes of change, than the influence of Calvin (MacDonald, 1965, pp. 377-378). Schumpeter’s approach seems to explain better the conjunctural increases in innovations and waves of capitalist development.

Another significant difference in the work of the two theoreticians has to do with the dynamics of change. Analytically, Weber’s model of change was ‘static’, meaning that the Protestant leaders introduce their followers to asceticism and their followers pursue their capitalist careers in the usual, continuous way. However, for Schumpeter innovators make their appearance rather spontaneously, giving rise to waves of technical change.

So, an innovation refers to an economy adapted to traditional methods, forces it to readopt as a new period of “traditionalism” makes its appearance, but at a higher level of production and output. This gives Schumpeter’s approach a dynamic characteristic in which capitalism progresses in discontinuous steps, and each wave is followed by a period of quiet, signifying a new position of equilibrium. This is the

core idea of both his business cycle theory and his theory of the rise of capitalism (MacDonald, 1965, p. 378). In the words of Usher:

“The romantic idealists and the various historical sociologies identified change with the transitions from one stage to another. The discontinuities of history were, thus, restricted to long term movements dated in terms of centuries. In the *Theory of Economic Development*, change became a completely pervasive feature of social life” (Usher 1951, p. 127).

Despite these differences, we may conclude that Weber’s view of capitalist development signifying a break through a stationary condition, constituted the basis for Schumpeter’s view. In what follows, following MacDonald (1965, p. 379n) we will make an attempt to illustrate some minor similarities in the works of the two theoreticians:

First, both theories seem to be based on the theoretical construction of “thesis-antithesis”, which has been extensively used by a variety of thinkers among the Greek philosophers: for Weber the type of capitalist enterprise, followed by the Protestant ethic is set against the “traditionalist” enterprise, ruled by the Catholic ethic. Schumpeter, on the other hand, regards 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).

Second, the innovator is a man of unusual will and energy, and a man with no capital. Schumpeter wrote: “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 matches with Schumpeter’s emphasis on “the

capacity for making decisions” and the “vision to evaluate forcefully” (Schumpeter, 1955, p. 121).

Last is the rejection of hedonism as the motive power of entrepreneurial action and capital accumulation (MacDonald, 1965, p. 380). In the nineteenth century most economists viewed the entrepreneur as motivated by endless greed (see, for example, 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: “his 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 is 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 is consistent with the writings of Weber who noted that after the religious motivation is exhausted, other motives emerge “of later decadence” (Weber, 1930, p. 71). More precisely, 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 which often give it the characteristic of sport” (Weber, 1930, p. 182), which is similar to Schumpeter’s “dream and the will to found a private kingdom” (Schumpeter, 1939, p. 93).

Finally, it is important to note that Weber refers to the entrepreneur as an “innovator” (Weber, 1904) and that the innovation described fits, in general terms, Schumpeter’s definition, even emphasizing the absence of any particular element of

invention. Weber's emphasis is on the "unusually strong character" and the "highly developed ethical qualities". Weber's personality did "no more than turn peasants into laborers", adapt the quality of his product and introduce the principle of low prices and large turnover (Weber 1930, p. 68, see above).

Apparently, Schumpeter's famous sources of growth are first detected in Weber's writings. Schumpeter wrote: "Real economic growth and development depend primarily upon productivity increases based on "innovation"". More precisely, for Schumpeter this concept covered the following five cases: "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 1912, p. 66).

To sum up, we could say that according to Weber some extra-economic motive was necessary in order to accomplish the transition to capitalism and economic development, and the Protestant ethic fulfilled this goal. On the other hand, following MacDonald (1965, p. 382), Schumpeter started from, practically, the same basic position but emphasised the dynamics of the different economic acts carried out. The traditional capitalists behaved routinely, while the innovators were changing the routine themselves, a situation which accounts for capitalist development.

5. Schumpeter and Sombart

At a time when Schumpeter published his *The instability of Capitalism* (1928), he was a Professor at the University of Bonn. However, 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* which was the output of a long scientific work on the evolution of capitalism as a socioeconomic system. In

the book the author dealt with the age of ‘high capitalism’, from the decades of the 18th century to the first decade of the 20th century. It is in this book that Sombart put forward his theory of *Spätkapitalismus*, which attracted general attention.

Der moderne Kapitalismus signified for Sombart the completion of a long-life career. After, the publication of the first two volumes in 1902, Sombart published numerous articles presenting his views on capitalism. In his publications he made use of a great amount of historical material and empirical data in order to support his views. In fact, according to some researchers (for instance, Chaloupek, 1995, p. 128), Sombart’s book could be viewed as a fulfillment of the research agenda of the last generation of the German Historical School.

It is well known that both economists, Sombart and Schumpeter, had in common a critical relationship to the works of the great Karl Marx. Both of them sympathized, on the one hand, with social reforms and, on the other, were deeply aristocratic. However, while for Sombart the Prussian state was close to his ideal, Schumpeter was an admirer of the British culture. We agree with Chaloupek (1995, p. 128) that Schumpeter seems to have been, in general terms, consistent with his own theoretical system with very few internal contradictions, while Sombart did not seem to exhibit a considerable continuity since he moved from socialism to nationalism and Nazism towards the end of his life.

In his second edition of *The Theory of Economic Development*, Schumpeter praised Sombart for the exposition of the European Economy as “the highest aim after which ambition can strive today” (Schumpeter, 1934, p. 90n). However, this happened fifteen years before Schumpeter published his book on the prospects of the capitalist system in 1942. Also, at that time Schumpeter published two essays on the German Historical School, i.e. one on *Gustav von Schmoller und die Probleme von*

heute (1926), and another one on Sombart's third volume immediately after its publication, indicating that Schumpeter was very eager to read it and, after doing so, very well aware of the arguments presented in the book.

Despite some minor critical remarks, the Austrian economist recognized Sombart's book as a major work in economics, considering it to be a thorough investigation of historical process (Schumpeter 1927, p. 199). Even, Schumpeter himself admitted that he was aiming at a "combination of Sombart and Edgeworth" (Schumpeter, 1927, p. 214), expressing on the one hand his deep respect to the face of Sombart and, on the other hand, the lack of theoretical rigour. It is, probably, this gap that Schumpeter attempted to fulfill in *Capitalism, Socialism and Democracy* which was "greatly inspired by Sombart" (Chaloupek, 1995, p. 129).

Before proceeding to a closer look at the two economists' views, we should stress the fact that Sombart was Schumpeter's senior by twenty years. The early version of Sombart's *Der moderne Kapitalismus*, was published in 1902, i.e. ten years before Schumpeter's *Theory of Economic Development* and his last volume on the future of capitalism was published in 1927, just one year before Schumpeter presented his own "prediction of its [...] demise" (Samuelson, 1981, p. 5).

As known, Schumpeter enjoyed his great reputation after the publication of his *Capitalism, Socialism and Democracy* which was written in the 1930s – just a few years after the publication of Sombart's last volume – and was published in 1942. Appel's view on the subject is even more emphatic since he argues that Schumpeter's perspective in *Capitalism, Socialism and Democracy* was "taken almost entirely" from Sombart's writings (Appel, 1992, p. 260).

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 basic functions in the economic process which had been traditionally executed by individuals had been taken over by an entrepreneurial bureaucracy, separated from the ownership of the enterprise (see Chaloupek, 1995, p. 134; Michaelides and Milios, 2005).

“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 automatized” (Schumpeter, 1942, p. 132n).

Or, even more emphatically: “the economic process tends to socialize itself – and the human soul. By this we mean that the technological, organizational, commercial, administrative and psychological prerequisites of socialism tend to be fulfilled more and more” (Schumpeter, 1942, p. 219).

The British banking sector of economic activity could be used as one of the examples where in Schumpeter’s point of view automatization is accomplished (Chaloupek, 1995, p. 135): “In commercial banking, concentration and bureaucratization seem to have done full work. The big concerns could be made to absorb as much of independent banking as there is left to absorb and then he merged with the Bank of England into a National Banking Administration, which could also absorb saving banks, building societies and so on without any customer becoming aware of the change except from his newspaper” (Schumpeter, 1942, p. 230). In the same line of argument, he added: “life has gone out of these forms and an administrative rationalization of what is actually being done could easily eliminate them” (Schumpeter, 1943: 122n).

Generally speaking, Schumpeter claimed that “the modern corporation, although the product of the capitalist process, socializes the [...] mind” (Schumpeter, 1942, p. 156). Furthermore, he argued that the “bureaucratization of economic life” is stimulated by and within the large-scale corporation (Schumpeter, 1942, p. 206) and so allows 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). So he regarded socialism as “an institutional arrangement that vests the management of the productive forces with some public authority” (Schumpeter, 1942, p. 113).

Schumpeterian “automatization” is practically the same thing that made Sombart develop his theory of *Versachlichung* (reification) or *Vergeistung* (‘spiritization’ or spiritual reification) of modern enterprise. Regarding the evolution of relationships between different enterprises, Sombart sees two trends (Chaloupek, 1995, p. 135n): (a) an increasing specialization in the production of goods and services and (b) an increase in the concentration of production in enterprises of increasing size.

There Sombart sees the process of *Entseelung* (de-animation) and *Vergeistung* (spiritual reification), which is a consequence of the inner logic of capitalism: “rationalization goes hand in hand with reification in which individual animal spirits (‘soul’) are replaced by abstract concepts. The evolution of capitalism is just a special case, which is 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 consists of three (sub)systems: (a) the system of administration, (b) the system of accounting and (c) the system of production called

“instrumental system” (Sombart, 1927, p. 901n). Consequently, leadership has been replaced by a bureaucratic apparatus. In this way, bureaucratization goes hand in hand with a growing perfection of methods leading to the reduction of economic fluctuations (Sombart, 1927, p. 680n). Production for profit gives way to the production for the population (Sombart, 1927, p. 1,015). The case of the state operating the railways is 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). It is obvious that the way Schumpeter viewed the evolution of modern enterprise was influenced by Sombart.

Sombart presented a nationalistic state with mixed economy, where pre-capitalist, capitalist and meta-capitalist elements coexist (Sombart, 1927, p. 1,012n). He also expected some kind of central planning (Sombart, 1927, p. 1,012n).¹⁵

Somewhere between personal desire and historical necessity 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. 1,016).

His arguments against socialism are mainly concerned with rejecting Marxian teachings (Sombart, 1908, p. 79ff) and their inability, according to the writer, to fulfill their promises (Sombart, 1924, p. 255n). Also, 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:

“Nothing could be more mistaken than defining the planned economy by monistic economic forms such as state economy, socialized enterprise, state

¹⁵ According (Krause, 1962, p. 53) Sombart was not a socialist but just thought the way to socialism was inevitable.

capitalism and collectivism. Monism is the cause of failure of utopian reforms, because the utopian doctrinaires are blind to reality. Soviet socialism would be doomed to failure, if its leaders are not willing to change course” (Sombart, 1932, p. 18).

However, Sombart did not seem to be able to analyze the problem in terms of ‘technical arguments’, the use of which he criticized. Instead, he believed that the definition of socialism should be based on the “spirit of the principles which shape social structure”, that would be the relevant criterion (Sombart, 1924, p. 6). Sombart (1932) refused to accept a market based socialism because he argued that the market mechanism was not essential for the working of an economy, and he supported the idea of state-governed economy (Chaloupek, 1995, p. 140; Priddat, 1995).

The views of the two social theorists are also converging, as regards the concept of technology. For both, Sombart and Schumpeter, capitalism is essentially a process of rationalization of economic and social life. Actually, Sombart shares a similar to Schumpeter’s view that innovation is the fundamental driving force of the economic system.

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

In his theses on innovation and technological progress, Sombart refers to the introduction of new production processes, and not of new products. “Rationalization concerns business as a whole. It extends to 1. production: here the most “rational” methods are introduced which initiates and promotes technologies based on scientific principles. The organization of enterprise and the use of labor force are also

rationalized. 2. The process of sale and distribution of goods is subjected to the same principles” (Sombart, 1909, p. 716).

Although Sombart was of the opinion that human needs and wants grow fast as material culture expands (Sombart, 1927, p. 86), he did not believe that the means for satisfaction of wants could change considerably. Thus, Sombart seemed to underestimate the potential change of goods and services produced for human consumption, and also the power of such changes to induce further changes in consumption patterns and social habits (Chaloupek, 1995, p. 137).

Consequently, Schumpeter based, partly, on Sombart’s theses published in 1909, he seems to have extended them in order to provide a more complete picture of technological progress emphasizing the importance of processes as well as the introduction of new goods. Schumpeter criticized traditional price theory for its misleading focus on perfect competition:

“[I]n capitalist reality as distinguished from its textbook picture, it is not [perfect] competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) – competition which commands a decisive cost or quality advantage [...] This kind of competition is much more effective than the other” (Schumpeter, 1942, pp. 84-85)

Also, he claimed that real economic growth and development depend primarily upon productivity increases based on “innovation”. More precisely, for Schumpeter this concept covered the following five cases: “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).

In this context, he used the term “technological progress” to characterise these changes (Scherer 1992, p. 1417), which account for the greater part of economic development. He clearly distinguished this process from growth due to the gradual increase in population and capital. He wrote:

“The slow and continuous increase in time of the national supply of productive means and of savings is obviously an important factor in explaining the course of economic history through centuries, but it is completely overshadowed by the fact that development consists primarily in employing existing resources in a different way, in doing new things with them, irrespective of whether those resources increase or not” (Schumpeter, 1942, p. 65).

Conclusively, there was general agreement between the two great theoreticians, Schumpeter and Sombart, that capitalism was declining. More specifically, whereas following Schumpeter this fact was due to a tendency towards stagnation, Sombart stated that capitalism’s failure is attributed to its success and not its failure. Obviously, we agree with (Chaloupek, 1995, pp. 148-149) that strong similarities in the respective views expressed by the two great economists are to be found as regards the forces driving the entrepreneurs and the transformation process at the end of which Schumpeter expected a socialist system, whereas Sombart expected a mixed economy.

6. Conclusion

The present paper defended the thesis that the German Historical School represented an indispensable dimension of Schumpeter’s views. In other words, Schumpeter

formulated his research agenda and his main theses in accordance with the theoretical context of the German Historical School, as presented by major scholars, such as Schmoller, Max Weber and Sombart.

More precisely, Schumpeter's notion of development was viewed in the context of the Schmollerian theoretical approach integrating theoretical and historical concerns. Further, the paper compared briefly, Schumpeter's and Weber's central visions emphasizing the role of the 'entrepreneur', the 'circular flow' and the 'protestant ethic' and the 'spirit of capitalism, respectively. Finally, Schumpeter seemed to follow Sombart in his 'theoretical materialism', while there was general agreement between the two theoreticians that capitalism, as an economic system, was declining. However, strong parallels were found with respect to forces driving the process, at the end of which Schumpeter saw a socialist system, while Sombart expected a mixed economy. Also, several similarities can be found in their respective theses about the evolution of the capitalist enterprise and the role of technology.

As a final conclusion we may say that future research on the subject would be of great interest. The potential German Historical influences behind, for example, Schumpeter's views on the epistemological foundations of economics is a fine example for future investigation.

References

Appel, M. (1992), *Werner Sombart: Theoretiker und Historiker des modernen Kapitalismus*, Marburg: Nmetropolis-Verlag.

Backhouse, R. (1987), *A History of Modern Economic Analysis*, Oxford: Basil Blackwell.

Becker, M.C. and Knudsen, T. (2002): Schumpeter 1911: Farsighted Visions of Economic Development, *American Journal of Economics and Sociology*, Vol. 61, No. 2, pp. 387-403.

Bendix, R. (1960), *Max Weber: An Intellectual Portrait*, New York: Doubleday.

Carlin, E. (1956), Schumpeter's Constructed Type-The Entrepreneur, *Kyklos*, IX, pp. 27-40.

Chaloupek, G. (1995), Long Term Economic Perspectives Compared: Joseph Schumpeter and Werner Sombart, *The European Journal of the History of Economic Thought* 2:1, Spring, pp. 127-149.

Cramer, D. L. and Leathers, C. G. (1988), Schumpeter and Galbraith: A comparative Analysis on the Modern Corporate Economy, *History of Economics Society Bulletin* 10, (Spring), pp. 47-56.

Ebner, A. (2000), Schumpeter and the 'Schmollerprogramm': integrating theory and history in the analysis of economic development, *Journal of Evolutionary Economics*, 10, pp. 355-372.

Economakis, G. E. and Milios, J. (2001), Historical School, German, *Encyclopedia of International Political Economy*, London – New York: Routledge, vol. 2, pp. 686-687.

Faltello, R. and Jovanovic, M. 1997. 'Rudolf Hilferding und Das Finanzkapital', (http://www.agmarxismus.net/vergrnr/m07_2hil.html), cited also in *Trend-online Zeitung* 10/01 (<http://www.trend.partisan.net/trd1001/t141001.html>).

Haberler, G. (1950), Joseph Alois Schumpeter: 1883-1950, *Quarterly Journal of Economics* 64, pp. 333-72.

Krause, W. (1962), *Werner Sombarts Weg von Kathedersozialismus zum Fachismus*, Berlin: Ruetten and Loening.

Landreth, H. (1976), *History of Economic Theory*, Boston: Houghton Mifflin Company.

Landreth, H. and Colander, D. (1989), *History of Economic Theory*, Boston: Houghton Mifflin Company.

Lenin, V. I. (1893-1900), *Collected Works [LCW]*, Volumes 1, 2, 3. Moscow: Progress Publishers 1977.

List, F. (1856), *National System of Political Economy*, Philadelphia (translation by G.A.Matile).

MacDonald, R. (1965), Schumpeter and Max Weber – Central Visions and Social Theories, *Quarterly Journal of Economics*, August, 79 (3), pp. 373-396.

Michaelides, P. and Milios, J. (2005), Did Hilferding Influence Schumpeter?, *History of Economics Review*, Vol. 41, Winter, pp. 98-125.

Milios, J. and Economakis, G. (2001), Historical School, German, *Encyclopedia of International Economics*, Vol. 2, Routledge Publishers, 2001, pp. 686-687.

Oser, J. and Blanchfield, W. (1975), *The Evolution of Economic Thought*, Harcourt Brace Jovanovich, Inc.

Priddat, B (1995), Werner Sombart;s late economic thinking: back to physiocracy, in J.Backhaus (ed.), *Werner Sombart Social Scientist*, Vol. 2, Marburg: Metropolis-Verlag.

Rubin, I. I. (1929), *A History of Economic Thought*. London: Pluto Press 1989.

Samuelson, P. A. (1981), Schumpeter's Capitalism, Socialism and Democracy, in A. Heertje (ed.), *Schumpeter's Vision: Capitalism, Socialism and Democracy after 40 Years*, New York: Praeger.

Schmoller, G. von (1897), *Wechselnde Theoriesn und festehende Wahrheiten im Gebiete der Staats – und Socialwissenschaften und die heutige deutsche Volkswirtschaftslehre*, Berlin: W. Buexenstein.

Schmoller, G. von (1901, 1904), *Grundriss der allgemeinen Volkswirtschaftslehre*, 2 vols, Leipzig: Duncker und Humblot .

Schmoller, G. von (1903), Werner Sombart, Der Moderne Kapitalismus, in B. vom Brocke (ed.) *Sombart's 'Moderner Capitalismus'*, Munich; Deutsher Taschenbuch-Verlag, pp. 135-46 [1987].

Schmoller, G. von (1911), 'Volkswirtschaft, Volkswirtschaftslehre und – methode', in J. Conrad *et al* (eds.), *Handwoerterbuch der Staatswissenschaften*, 3rd ed., vol 8, Jena: Gustav Fischer.

Schumpeter, J. (1908), *Das Wesen und Der Hauptinhalt der Theoretischen Nationalökonomie*, Berlin: Duncker and Humblot.

Schumpeter, J. (1924), Epochen der Dogmen und Methodengeschichte, in: *Grundriss der Sozialoekonomik*, Bd 1,2, Aufl. Mohr, Tübingen.

Schumpeter, J. (1926a), *Theorie der Wirtschaftlichen Entwicklung*, 2 Aufl., Berlin: Duncker und Humblot.

Schumpeter, J. (1926b), Gustav v. Schmoller und die Probleme von heute, *Schmollers Jahrbuch fuer Gesetzgebung, Verwaltung und Volkswirtschaft im Deutschen Reich*, 50, pp. 337-388.

Schumpeter, J. (1927), Sombarts Dritter Band, *Schmollers Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft im Deutschen Reiche* 51: pp. 349-69.

Schumpeter, J. (1934), *The Theory of Economic Development*, Cambridge: Harvard University Press.

Schumpeter, J. (1939), *Business Cycles: A theoretical, Historical and Statistical Analysis of the Capitalist Process*, New York: McGraw-Hill.

Schumpeter, J. (1949), *The Theory of Economic Development*, Cambridge: Harvard University Press.

Schumpeter, J. (1952), Sozialistische Moeglichkeiten von heute, in J.A. Schumpeter, *Aufsätze zur oekonomischen Theorie*, Tuebingen: J.C.B. Mohr-Verlag, pp. 455-510 [1921].

Schumpeter, J. (1954), *History of Economic Analysis*, Oxford University Press, New York.

Schumpeter, J. (1971), The Instability of Capitalism, in N. Rosenberg (ed.), *The Economics of technological Change*, Harmondsworth: Penguin Books, pp. 13-42 [1928].

Schumpeter, J. (1987), Sombarts Dritter Band, in B. vom Brocke (ed.) *Sombart's 'Moderner Kapitalismus'*, Munich: Deutscher Taschenbuch Verlag, pp. 196-219 [1927].

Shionoya, Y. (1990), Instrumentalism in Schumpeter's Economic Methodology, *History of Political Economy* 22 (summer): pp. 187-222.

Shionoya, Y. (1991), Schumpeter on Schmoller and Weber: A Methodology of Economic Sociology, *History of Political Economy* 23, pp. 193-219

Shionoya, Y. (1997), *Schumpeter and the Idea of Social Science: A Meta-theoretical Study*, Cambridge University Press.

Shionoya, Y. (2001), Rational Reconstruction of the German Historical School: An Overview, in Y. Shionoya (ed.), *The German Historical School: The Historical and Ethical Approach to Economics*, Routledge, pp. 7-18.

Shionoya, Y. (2005), *The Soul of the German Historical School*, New York: Springer.

Smithies, A. (1951), "Memorial: Joseph Alois Schumpeter, 1883-1950", in *Schumpeter, Social Scientist*, (ed.) Seymour Harris, Cambridge: Harvard University Press.

Sombart, W. (1897), Ideale de Sozialpolitik, *Archiv fuer soziale Gesetzgebung und Statistik*, X: pp. 1-48.

Sombart, W. (1908), *Sozialismus und soziale Bewegung*, Jena: Gustav Fischer-Verlag.

Sombart, W. (1909), Der Kapitalistische Unternehmer, *Archiv fuer Sozialwissenschaften und Sozialpolitik*, XXIX: pp. 689-758.

Sombart, W. (1913a), *Der Bourgeois*, Munich and Leipzig: Duncker and Humblot (English Translation (1967) [1915], *The Quintessence of Capitalism*, New York: H. Fertig.

Sombart, W. (1913b), *Luxus und Kapitalismus*, Munich and Leipzig: Duncker and Humblot.

Sombart, W. (1913c), *Krieg und Kapitalismus*, Munich and Leipzig: Duncker und Humblot.

Sombart, W. (1916), *Der Moderne Kapitalismus, Vol. 1: Einleitung – Die vorkapitalistische Wirtschaft – Die historischen Grundlangen des modernen Kapitalismus*, Munich and Leipzig: Duncker and Humblot.

Sombart, W. (1924), *Der proletarische Sozialismus*, 2 vols., Jena: Gustav Fischer – Verlag.

Sombart, W. (1925), Prinzipielle Eigenart des modernen Kapitalismus, in *Grundriss der Sozialoekonomik, IV, Abteilung/ 1. Teil*, Tuebingen: J.C.B. Mohr-Verlag.

Sombart, W. (1927), *Das Wirtschaftsleben im Zeitalter des Hochkapitalismus*, vol. III/1,2, *Der moderne Kapitalismus*, Munich and Leipzig: Duncker and Humblot.

Sombart, W. (1930), *Die drei Nationaloekonomien*, Munich and Leipzig: Duncker and Humblot.

Sombart, W. (1932), *Die Zukunft des Kapitalismus*, Berlin: Buchholz and Weisswange.

Sombart, W. (1934), *Deutscher Sozialismus*, Berlin: Buchholz and Weisswange.

Spiethoff, A. (1932), Die Allgemeine Volkswirtschaftslehre als geschichtliche Theorie, Die Wirtschaftsstile, *Schmollers Jahrbuch fuer Gesetzgebung, Verwaltung und Volkswirtschaft im Deutschen Reich* 56: p. 51-84.

Spiethoff, A. (1952), The Historical Character of Economic Theories, *The Journal of Economic History* 12: p. 131-9.

Swedberg, R. (1991), *Joseph A. Schumpeter: His Life and Work*, Oxford: Polity Press

Usher, A. P. (1951), "Historical Implications of the Theory of Economic Development", in *Schumpeter, Social Scientist*, (ed.) Seymour Harris, Cambridge: Harvard University Press.

Veblen, T. (1898), Why is Economics Not an Evolutionary Science?, *Quarterly Journal of Economics*, XII, July.

Weber, M. (1904), Die Protestantisches Ethic und der Geist des Kapitalismus (Teil A), *Archiv für Sozialwissenschaft und Sozialpolitik*, XX, pp. 1-55.

Weber, M. (1905), Die Protestantisches Ethic und der Geist des Kapitalismus (Teil B), *Archiv für Sozialwissenschaft und Sozialpolitik*, XXI, pp. 1-110.

Weber, M. (1930), *The Protestant Ethic and the Spirit of Capitalism*, New York: Charles Scribner's Sons.