

The Essential **JOSEPH  
SCHUMPETER**



by Russell S. Sobel and Jason Clemens

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## Dedication

The authors would like to dedicate this volume to their respective families who showed support and patience throughout the many days and nights required to complete this work. In addition, we would like to acknowledge the critically important and often unsung contributions of productive entrepreneurs around the world to whom Schumpeter devoted much of his career understanding.

# The Essential Joseph Schumpeter





## Chapter 1

# Who Is Joseph Schumpeter?

Joseph Schumpeter is one of the most accomplished economists of the twentieth century, although he is little known outside academic circles. Included among his many contributions is his path-breaking work on entrepreneurship—one of the quintessential characteristics of all market economies. His timeless phrase describing the entrepreneurial process as one of “creative destruction” is likely second only to Adam Smith’s “invisible hand” in its daily use in popular tweets, blog posts, speeches, and articles. This volume in the Essential Scholars series explores several of Joseph Schumpeter’s most important insights into entrepreneurship, business cycles, economic development, and the democratic process.

Schumpeter was born in 1883 in Triesch, a small town about 120 kilometres (or 75 miles) south of Prague in what today is the Czech Republic. The Schumpeters were a prominent family in the town, involved in several businesses. Like Adam Smith, Schumpeter lost his father at a young age. Soon after his father’s death, Schumpeter’s mother, Johanna relocated the family to Graz, an Austrian city about 225 kilometres (or 140 miles) outside Vienna. In 1893, Johanna married Sigmund von Keler, a retired general who was more than thirty years her senior. Keler was part of the Austrian nobility and his social standing meant that young Joseph Schumpeter would have access to some of the most elite educational institutions in the country. Shortly after the wedding, the family moved to Vienna where Schumpeter was immediately enrolled in one of the most prestigious preparatory schools, exposing him to rigorous coursework in mathematics, science, history, literature, and multiple languages.

At the time, the radical political and economic changes occurring throughout the Habsburg Empire were largely concentrated in Vienna. It was a flourishing intellectual center—an environment very formative to the young Schumpeter. In 1901, he entered the University of Vienna, which at the time was one of the top universities in the world, comparable to Oxford and Cambridge.

Schumpeter focused his coursework in the fields of law, economics, and history. Schumpeter's degree was actually in Civil and Roman Law since at the time it was customary for economics professors to be part of the Law faculty.

During college, Schumpeter was heavily influenced by several professors—including Friedrich von Wieser and Eugen von Bohm-Bawerk—both of whom trained under Carl Menger, a founding member of the Austrian School of Economics. Ludwig von Mises, one of the most acclaimed economists in the Austrian School, was Schumpeter's fellow student at the University of Vienna. Unlike Mises and many of his contemporaries at the University of Vienna, Schumpeter did not consider himself part of the "Austrian School" of economics. Schumpeter described himself as a conservative more than an "Austrian" in his brand of political economics. Indeed, Schumpeter openly acknowledged his admiration for Edmund Burke's "good order is the foundation of all good things".<sup>1</sup>

Schumpeter graduated in 1906 from the University of Vienna, having published three articles, all statistical in nature. They reflected Schumpeter's preference for a more mathematical, scientific approach to economics. Schumpeter's most famous student, Paul Samuelson, would take that ethos to another level when he became one of America's most prominent and influential economists in the 1950s.

Schumpeter struggled to find his path after graduating. He spent three years travelling to Germany, France, England, and the Middle East. Surprising many, Schumpeter quite suddenly married Gladys Ricarde Seaver, an English member of the aristocracy who was twelve years his senior. The need for employment is likely what brought Schumpeter and his new wife to Cairo where Schumpeter was qualified to practice law. It appears, however, that simultaneously Schumpeter decided that he ultimately wanted to be an academic economist. It is during this period that he penned and ultimately published *The Nature and Content of Theoretical Economics*, which was a sweeping assessment of economics with a particular emphasis on trying to bridge the divide between the major schools of economic thought at the time, particularly the Germans and Austrians.

Schumpeter returned to the University of Vienna in 1908 to begin the equivalent of today's Ph.D. studies, which were necessary to secure employment as a professor. Based on work in his already published book coupled with lectures

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1. Noted on page 34 of Thomas K. McCraw's biography of Schumpeter (2009).

and additional scholarship, Schumpeter was quickly approved and certified to teach. While Schumpeter had hoped to remain in Vienna, his mentors Bohm-Bawerk and von Wieser were only able to secure him a temporary position at the relatively new University of Czernowitz, near the eastern boundary of the empire. While at the University of Czernowitz, Schumpeter wrote what was considered at the time a breakthrough book on economic progress, titled simply *The Theory of Economic Development*. For the first time, Schumpeter introduced the central role of the entrepreneur in explaining economic progress. The book catapulted Schumpeter to prominence fairly quickly.

In 1911, Schumpeter left for the University of Graz, a more prestigious position in the town of his upbringing. After only two years in Graz, Schumpeter was invited to guest-lecture at Columbia University. Schumpeter's lectures and public presentations in the United States garnered strong, broad praise, with reviews that included terms like "brilliant" and "profound". It is during this period that the long separation from his wife ultimately led to a more formal separation, though the details about that split are limited.

Despite a general consensus that Schumpeter "lacked the tact and discretion necessary to succeed in public life" (McCraw, 2009: 94), he served during 1919 as Minister of Finance in the Austrian government. There is little doubt that, while Schumpeter's tenure in this political position was brief—he was removed less than a year later—, it was influential in his intellectual development regarding the role and limits of government action. Schumpeter then returned to the University of Graz but with little enthusiasm for the academy or research. Schumpeter himself referred to this period as the "gran rifiuto", an Italian phrase meaning "great waste" (McCraw, 2009: 94). In 1921, Schumpeter formally resigned from the University of Graz and began a new phase of his working career as a banker and professional investor, which would again greatly influence his intellectual views of the economy and in particular the role of the entrepreneur.

In 1921, Schumpeter was granted a licence to operate a bank in Vienna from his former colleagues in the government. The licence placed Schumpeter in a position to partner with Artur Klein, head of the Biedermann Bank, Vienna's oldest. Like many banks after World War I, the Biedermann Bank struggled. Klein's solution was to transition the bank from a partnership to a corporation and Schumpeter's licence was the avenue for that change. Schumpeter was granted chairmanship and presidency of the bank, which included a significant

salary as well as access to credit for personal investing plus a significant number of shares; indeed, Schumpeter was ultimately the second-largest shareholder in the incorporated bank.

While the next three years were incredibly challenging for the bank because of high inflation, which Schumpeter had predicted, he nonetheless was fairly successful in his investments and had accumulated significant wealth. That changed dramatically in 1924 when the Vienna stock market crashed and lost roughly three fourths of its value. Schumpeter lost much of his own personal wealth and accumulated debt. He was then forced to resign from the Biedermann Bank and reimburse all his credit lines, which forced him to take loans from friends that would take many years to pay off. Indeed, for almost a decade, Schumpeter committed almost all the earnings he made from writing and giving lectures to paying off his debts.

The following few years would be consequential for Schumpeter on a number of fronts. First, after several years of on-again, off-again courtship, Schumpeter proposed to Anna Josefina Reisinger. Schumpeter also decided to return to academics, accepting a position at the prestigious University of Bonn in Germany in October of 1925. For all the joy experienced by Schumpeter in 1925, the following year would be nothing less than devastating. In 1926, his mother died and then shortly thereafter both his wife and baby died during childbirth. During this period of grief, Schumpeter's academic production was unparalleled. He completed and published three academic articles along with several essays as well as re-thinking, re-working, and revising *The Theory of Economic Development*. Noted economist Oscar Morgenstern's review in the *American Economic Review* called it: "... one of the most stimulating and fascinating books that has been written on economic theory. It is, since it gives the first elaborate dynamic economics in the proper sense, very revolutionary" (1927: 281–282).

During his time in Germany, Schumpeter became more interested in, and involved with, popular public policy. He wrote numerous columns and articles analyzing public-policy problems and offering reform solutions, including issues such as tax rates, balanced budgets, wages and unemployment, the business cycle, the futility of protecting of existing industries, and of course the role and importance of entrepreneurship. The early 1930s established the foundation for Schumpeter's eventual permanent move to Harvard. He initially split his time between Harvard and Bonn, and eventually made the move full-time in 1932. Schumpeter became markedly more concentrated on his scholarship in

the late 1930s through to his death in 1950, writing three comparatively large books during this period: *Business Cycles* (1939), *Capitalism, Socialism and Democracy* (1942), and *History of Economic Analysis*, which was posthumously published in 1954.

Renowned Chicago economist Jacob Viner praised Schumpeter's *History of Economic Analysis*: "by a wide margin, the most constructive, the most original, the most learned, and the most brilliant contribution to the history of analytical phases of our discipline which has ever been made".<sup>2</sup> However, it is Schumpeter's *Capitalism, Socialism and Democracy*, published in 1942, that is by far his most popular and successful work. The book includes many insights from Schumpeter's previous works but is the most succinct, and perhaps most penetrating, analysis of the nature of capitalism. Schumpeter describes the mechanisms—entrepreneurs, innovation, and capital reallocation—that drive the "incessant" recreation of capitalism. It is this core dynamic of capitalism that led Schumpeter to use the phrase that perhaps best captures the uniqueness of entrepreneurial capitalism: "creative destruction".

Schumpeter was elected president of the American Economics Association in 1947, one of the most prestigious offices in the country for an economist, and he was the first foreign-born president of the Association. While Schumpeter's personal and professional lives outside of economics are characterized by great tragedy and failure, his economic scholarship is matched only by a few other great economists of the twentieth century.

There is general agreement that Schumpeter provided poignant and lasting insights into the nature of economic development and the role of the entrepreneur in the process of dynamic competition. Indeed, during the 1980s there was a pronounced increase in scholarly interest in Schumpeter's work as evidenced by the number of citations of his work surpassing citations of Keynes (Whalen, 2000). Schumpeter is rightly seen as one of the great and most accomplished economists of the twentieth century.

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2. Noted in McCraw (2009): 249.



## Chapter 2

# Entrepreneurship, New Combinations of Resources, and the Profit-and-Loss System

The carrying out of new combinations we call “enterprise”; the individuals whose function it is to carry them out we call “entrepreneurs”.

Joseph A. Schumpeter (1934), *The Theory of Economic Development*: 74.

Would orange slices go well on top of a pizza? How about pineapple? Do they go equally well with ham and turkey as the meat on the pizza? Does turkey even taste good on a pizza? If you have ever been to one of those make-your-own pizza restaurants, you already know there are many possible topping combinations you could, in theory, put on a pizza. With some mathematical formulas, it is possible to figure out exactly how many possible *combinations* you could make out of a certain set of ingredients; and the numbers get large quickly. If there were twenty different toppings you could use for your pizza, and you were to choose only three of them, how many possible pizza combinations do you think could you make?

The answer might surprise you. There are a remarkable 1,140 three-topping pizzas you could make from those 20 different ingredients! With 50 toppings to pick from, the number of three-topping pizzas you could make is 19,600! One of these combinations—which uses tomato sauce, cheese, pineapple, and ham—is known as the Hawaiian pizza, and it is currently the most popular type of pizza in Australia! The creation of the Hawaiian pizza is often credited to Sam Panopoulos, who first cooked one at the Satellite Restaurant in Ontario, Canada in 1962.

Sam provides a good example of what Joseph Schumpeter considered entrepreneurship—the discovery and commercial application of a new combination of resources. Every day entrepreneurs hunt for profitable new possible combinations of productive resources. To Schumpeter, being an entrepreneur was *not* synonymous with just owning, running, or investing in a business. What he thought distinguished entrepreneurs from other actors in the economy is their testing and experimentation to discover new possible combinations of productive resources in the pursuit of profit and success.<sup>3</sup>

In Joseph Schumpeter’s 1934 book, *The Theory of Economic Development* (TED), he writes:

As it is the carrying out of new combinations that constitutes the entrepreneur, it is not necessary that he should be permanently connected with an individual firm ... On the other hand, our concept is narrower than the traditional one in that it does not include all heads of firms or managers or industrialists who merely may operate an established business, but only those who actually perform that function.

...

But whatever the type, everyone is an entrepreneur only when he actually “carries out new combinations,” and loses that character as soon as he has built up his business, when he settles down to running it as other people run their businesses. This is the rule, of course, and hence it is just as rare for anyone always to remain an entrepreneur throughout the decades of his active life as it is for a businessman never to have a moment in which he is an entrepreneur, to however modest a degree. (TED: 75, 78)

From the quotations above it is clear Schumpeter did not view a traditional business owner or manager as an entrepreneur. Going further, Schumpeter even removes the concept of bearing risk from his definition of entrepreneurship:

The entrepreneur is never the risk bearer ... even if the entrepreneur finances himself out of former profits, or if he contributes the means of

---

3. In addition to the pure pursuit of profit, Schumpeter also clearly thought that entrepreneurs were motivated by personal forces such as “the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself” and “the joy of creating, of getting things done, or simply of exercising one’s energy and ingenuity” (TED: 93).



production belonging to his “static” business, the risk falls on him as a capitalist or as possessor of goods, not as entrepreneur. Risk-taking is in no case an element of the entrepreneurial function. Even though he may risk his reputation, the direct economic responsibility of failure never falls on him. (TED: 137)

In his work, therefore, Schumpeter stressed the function of entrepreneurs as disruptive innovators that propel economic growth and prosperity through time. In doing so, he also provides a clear distinction between “invention” and “innovation” that is best illustrated in his book *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process, Volume 1* (BC1): “the entrepreneur may, but need not, be the “inventor” of the good or process he introduces” (BC1: 103).

While *invention* is the creation or discovery of a new product or process, *innovation* is the successful introduction and adoption of a new product or process in the commercial marketplace. Innovation is basically the economic application of inventions. Let us consider some examples of this difference. The modern upright electric vacuum cleaner was *invented* in 1908 by James Spangler who was a department store janitor. But it was his cousin, William Hoover, who after seeing the idea bought the patent from Spangler and built the Hoover Company that then successfully *innovated* and commercially produced a worldwide brand and market for the product. Similarly, it was a milkshake-mixer salesman named Ray Kroc who is the innovator famous for commercially developing franchising and the worldwide McDonald’s brand after seeing Richard and Maurice McDonald’s restaurant in California. Finally, while Henry Ford did not invent the automobile, his innovation was the use of the assembly line and large-scale manufacturing that brought the price of the automobile within reach of the average family. In each of these cases, the innovator is different from the inventor, and it is the innovator’s role with which Schumpeter is concerned.

Perhaps an even more important factor in distinguishing invention from innovation is that most inventions never turn into innovations—that is, not all inventions are profitable business ideas. If you discovered a new way to turn tree leaves into gasoline at a cost of \$500 per gallon, it may be an invention but it would have a hard time competing in a marketplace where gasoline has a current price of under \$10 a gallon! Returning to our original example of pizza combinations, not all new pizza combinations (inventions) are tasty—rotten

egg, liver, and anchovy pizza, for example, would be one we would not much care for. And this turns our attention to the process by which we sort the good ideas from the bad ideas in the competitive marketplace.

How can we tell if we have stumbled onto a good new combination, such as Sam's Hawaiian pizza, or a bad one like the rotten egg, liver, and anchovy pizza? In a competitive market system, this sorting procedure is accomplished by the profit-and-loss system directed by consumers and resource owners. If the new idea is good enough that customers buy the product at prices sufficient to generate enough revenue to cover all costs of production, then the product is profitable—and production will continue into the future. On the other hand, if the new idea does not generate revenue sufficient to cover all costs of production, then losses, and going out of business are the result. I am sure that you have seen new restaurants in your town that are examples of both cases; those that open and succeed as well as new ones that open and fail.

The failures can be the result of either insufficient revenue, or costs that are too high. A business that might be profitable in a low-cost location, for example, may not be profitable if it locates in the area of town with the highest rental rates for space. Thus, which resources are brought to bear in the combination is of equal importance to the value of what is produced.

Profits and losses play an important role in an economy. As entrepreneurs sift through the many possible new combinations of resources, it is the profit-and-loss system that informs and guides this process of discovery. It is often a process of trial and error. Adding to the complexity of this process is that the target is an ever-changing one, with new opportunities arising and others disappearing with time. What was profitable yesterday may no longer be profitable today, and vice versa.

In fact, it is the potential for profit that provides the strong incentive for this type of trial and error by entrepreneurs to begin with. According to Schumpeter in his later, and perhaps most famous, book *Capitalism, Socialism, and Democracy* (CSD), “[i]n some cases, however, it is so successful as to yield profits far above what is necessary in order to induce the corresponding investment. These cases then provide the baits that lure capital on to untried trails” (CSD: 90). That is, the lure of profits is the incentive for entrepreneurial discovery and capital investment.

This is one reason that government policies that reduce the rewards from innovation can be harmful to economic growth and prosperity. When

regulations or taxes reduce the potential profitability of future innovations, fewer attempts are made to discover them. As Schumpeter notes in his book *The Economics of Sociology and Capitalism* (ESC):

Entrepreneurial profit proper ... arises in the capitalist economy wherever a new method of production, a new commercial combination, or a new form or organization is successfully introduced. It is the premium which capitalism attaches to innovation ... If this profit were taxed away, that element of the economic process would be lacking which at present is by far the most important individual motive for work toward industrial progress. Even if taxation merely reduced this profit substantially, industrial development would process considerably more slowly, as the fate of Austria plainly shows ... there is a limit to the taxation of entrepreneurial profit beyond which tax pressure cannot go without first damaging and then destroying the tax object. (ESC: 113–114)

While we shall return to Schumpeter's views of proper government policy in a later chapter, for now we simply point out that these policies can have large impacts on the rate of experimentation and discovery undertaken by entrepreneurs in the economy. To Schumpeter, this process was the key to economic growth and prosperity.

Entrepreneurship is important because it is the competitive behaviour of entrepreneurs in search of profits that drives this search for new possible combinations of resources that create more value. Some of these new combinations will be more valuable than existing combinations and some will not. In a market economy, it is the profit-and-loss system that is used to sort through these new resource combinations discovered by entrepreneurs, discarding bad ideas through losses and rewarding good ones through profits. A growing, vibrant economy depends not only on entrepreneurs discovering, evaluating, and exploiting opportunities to create new goods and services, but also on the speed at which ideas are labeled as successes or failures by the profit-and-loss system.

From an economic standpoint then, business failure has a positive side; it gets rid of bad combinations of resources, freeing up those resources to be used in other endeavours, and provides information and signals to other entrepreneurs about that losing combination. A vibrant economy will have both a large number of new business start-ups and a large number of business

failures. In an economy where all entrepreneurs—even those with crazy ideas for new pizza combinations—can try them out in the marketplace, there will be a lot of mistakes.

However, Schumpeter points out that this process is not one of entrepreneurs simply chasing a target created by a given set of consumer wants. Entrepreneurs also play an important role in anticipating and driving those wants. As Schumpeter writes:

Yet innovations in the economic system do not as a rule take place in such a way that first new wants arise spontaneously in consumers and then the productive apparatus swings round through their pressure. We do not deny the presence of this nexus. It is, however, the producer who as a rule initiates economic change, and consumers are educated by him if necessary; they are, as it were, taught to want new things, or things which differ in some respect or other from those which they have been in the habit of using. (TED: 65)

Thus, as innovators, entrepreneurs often must anticipate what consumers may want that they currently do not have. They envision a different future. Instead of making a current product better or cheaper, true Schumpeterian entrepreneurs make an entirely new good or service that consumers may not have even imagined and educate consumers about the new product and its advantages. Schumpeter continues:

To produce means to combine material and forces within our reach ... To produce other things, or the same things by a different method, means to combine these materials and forces differently. In so far as the “new combination” may in time grow out of the old by continuous adjustment in small steps, there is certainly change, possibly growth, by neither a new phenomenon nor development in our sense. In so far as this is not the case, and the new combinations appear discontinuously, then the phenomenon characterizing development emerges. For reasons of expository convenience, henceforth, we shall only mean the latter case when we speak of new combinations of productive means. Development in our sense is then defined by the carrying out of new combinations. (TED: 65–66)

For Joseph Schumpeter, economic development is the result of innovation undertaken by entrepreneurs who discover new and more valuable combinations of resources. This search is both incentivized and guided by the profit-and-loss system. In addition to satisfying consumers' wants better and at lower cost, entrepreneurs also help consumers to discover new wants and preferences. But this process is disruptive. New goods and services enter markets and compete with existing ones, sometimes causing the old way of doing things to disappear.

Innovations such as the automobile and airplane were more than simply new combinations of resources satisfying existing consumer wants; they were leaps forward in economic progress. Such leaps are the key to economic development but they also threaten existing industries, as thousands of businesses and their workers in the horse-and-buggy industry soon discovered—and this process by which entrepreneurship threatens existing producers, and the consequences of that threat are the subject of our next chapter.



## Chapter 3

# Creative Destruction: Schumpeter's Perennial Gale

The fundamental new impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates ... that incessantly 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.

Joseph A. Schumpeter (1942), *Capitalism, Socialism, and Democracy*: 82–84.

If you could get into a time machine (perhaps a DeLorean) and travel back to visit a typical shopping mall in the 1980s, it would have been packed with shoppers. Had you interviewed a store owner about their worries for the future, they would have probably mentioned the fear of facing competition from new stores opening in that mall or from a new mall opening in the same town that might drive them out of business. Indeed, if you visited that same mall today most of the stores in that mall are probably closed and it is depressingly empty, with many vacancies. It turns out, of course, that it was not a new competing mall or other stores in that same mall that the owners should have been worried about driving them out of business ... it was the coming of the Internet, and Amazon in particular. But, of course, in the 1980s, there was no such thing as the Internet to worry about, nor did the store owners imagine such a thing would ever exist.

The Internet has not just taken business away from shopping malls. The traditional newspaper industry has been in rapid decline since 2010, as has traditional radio broadcasting. The printing of phone books (directories listing

the phone numbers of individuals and businesses) is now a thing of the past and hard-copy books and textbooks are probably next. Schumpeter stressed that it was the threat from the introduction of new goods and services that results in these types of fundamental changes that is the true nature of dynamic competition. This view stood in stark contrast to the competition depicted in textbook economics that focused on competition in price, quality, or location among rival firms producing similar goods in the same industry.

We tend to think of entrepreneurship as creative—the creation of something new. In Schumpeter’s words it is the creation of a new combination of resources. We also think of it as progress—something that makes the future better than the past: like the invention of the time-saving clothes dryer, microwave oven, or the rapid transportation afforded by the airplane. What we do not always remember is that it is destructive in that the old way of doing things often dies off as a result. Perhaps the most well-known contribution of Joseph Schumpeter is his discussion of this evolutionary process and the term “creative destruction” that he used to describe it in his 1942 book *Capitalism, Socialism, and Democracy* (CSD).<sup>4</sup>

Before continuing, let us consider more examples of Schumpeter’s process of creative destruction. Perhaps the most frequently used is the case of the automobile replacing the horse and buggy. Again, while we tend to think of how wonderful the introduction of the automobile was for the transportation needs of people, we tend to forget that it resulted in hundreds, if not thousands, of other businesses (in the horse and buggy industry) going out of business, and their employees and owners losing their jobs. This displacement was greater than you might imagine. People who raised the horses, workers who cut timber and made it into wagons, leather shops that made the harnesses and equipment, and blacksmiths who shod the horses and forged and repaired the metal fittings. There were individuals who owned small businesses, late in their careers, who suddenly found themselves and their businesses bankrupt, with few other employment options using their skills. There were sons and daughters who had planned to work in, and one day take over, the family business who now had to find a new career path, and maybe move to a new city. This is the destructive part

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4. The term “creative destruction”, while sometimes attributed to Schumpeter, was actually first used by a German economist and sociologist named Werner Sombart, in his 1913 book, *War and Capitalism*. Nonetheless, Schumpeter is the one who popularized the term and brought it to the forefront of economic theory in his writings about capitalism as an evolutionary process.



of the process—and it is likely visible in your town now as you drive by vacant buildings once occupied by retailers who have been driven out of business by the growth of online shopping or new retailers coming to town.

There is perhaps no industry in the private sector untouched by the process of creative destruction in the last two centuries, with the pace accelerating recently due to the Internet and cell phones. The old movie-rental industry, once dominated by Blockbuster Video, has been replaced with streaming movies on Netflix; vinyl records were replaced by cassette tapes and compact discs and these were replaced by music downloads, and now streaming music on demand. The cell phone has replaced digital cameras and video recorders, alarm clocks, portable music players, paper address books and pocket calendars, has resulted in watch sales plummeting, as well as caused a large decline in the use of old land-line home telephones, among many other things.

At this point, it is worthwhile to quote a longer version of Schumpeter's description of creative destruction to explore his view of the concept in more detail.

The essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process ... Capitalism, then, is by nature a form or method of economic change and not only never is but never can be stationary ... The fundamental new impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates ... the same process of industrial mutation ... that incessantly 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. It is what capitalism consists in and what every capitalist concern has got to live in ... Every piece of business strategy acquires its true significance only against the background of that process and within the situation created by it. (CSD: 82–84)

Note that Schumpeter's use of the term is specifically the way in which he understood the economic system of capitalism as an evolutionary process. Let us briefly discuss the distinction between evaluating something based on *outcomes* alone rather than evaluating the *process* that generates the outcomes.

Suppose you see that a recent basketball game had a final score of 108 to 75. That final score is the outcome of the game. The game itself is the process that generated that outcome. What information would you need to answer the question of whether the game was a fair game? Can you tell from the outcome alone if the game was fair? I think most of us would want to know if the teams were treated fairly in the game itself, in the officiating and rules under which the players competed. That is, we would assess the fairness of the outcome by asking whether it was generated by a fair process. A fair process can produce very lopsided outcomes. In contrast, one can have very equal outcomes (say, in a game with a final score of 76 to 75) while the process that produced that outcome was unfair, with cheating or unbalanced officiating.

Schumpeter himself was much more concerned with the market system as a process than any specific outcome it may generate at a point in time—and to him, this process is “never stationary” but is continuously ongoing—*perennial*. To Schumpeter it is also a major force in the economy and in economic development and progress that is reminiscent of a strong wind blowing—a *gale*. Thus, creative destruction is sometimes called “Schumpeter’s perennial gale”.

On average, roughly 700,000 new establishments open and another 600,000 fail each year in the United States. Similarly, workers become unemployed as they lose jobs at these failing firms, and in dying industries, and then become re-employed at new firms in new and growing industries. To Schumpeter it is this process of recycling labour and other productive inputs that is the result of entrepreneurs experimenting with new combinations of resources—the topic of our previous chapter.

Creative destruction is indeed central to Schumpeter’s theory of economic development—how market-based societies progress through time. In his 1934 book, *The Theory of Economic Development* (TED), he discussed the different types of changes he considered part of this process of creative destruction:

This concept covers the following five cases: (1) The introduction of a new good—that is one with which consumers are not yet familiar—or of a new quality of a good. (2) The introduction of a new method of production, that is one not yet tested by experience in the branch of manufacture concerned, which need by no means be founded upon a discovery scientifically new, and can also exist in a new way of handling

a commodity commercially. (3) The opening of a new market, that is a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before. (4) The conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists or whether it has first to be created. (5) The carrying out of the new organization of any industry, like the creation of a monopoly position (for example through trustification) or the breaking up of a monopoly position. (TED: 66)

Obviously, Schumpeter's view of this process included not just one new good (the automobile) replacing an old one (horse and buggy), but also included changes to production processes (like the assembly line or franchising), as well as the opening of new sources of supply or new markets.

Schumpeter's view of entrepreneurship as a disruptive process of creative destruction is often contrasted with the view of Israel Kirzner, another famous economist who is known for his contributions to our understanding of entrepreneurship. Unlike Schumpeter, Kirzner stressed the role of entrepreneurs in discovering profit opportunities, acting on them, and in the process closing arbitrage gaps that exist in markets, and bringing markets closer to the competitive equilibrium. However, these two views are better viewed as complementary. Schumpeter's entrepreneurs innovate and bring disruptions to existing markets, with the firms at the forefront earning above-average profits that subsequently draw imitation and entry from Kirzner's type of entrepreneurs, reducing excess profits through competition and bringing the new market toward equilibrium.<sup>5</sup>

Because the introduction of new goods and services often results in the failure or obsolescence of the old way of doing things, it generates conflict—enemies of the process itself. For example, throughout Europe and even America, taxi drivers have protested (sometimes violently) the coming of Uber and have been successful in getting governments to place restrictions on ride sharing. For a variety of reasons, both political and cultural, different cities, states, and countries have different levels of toleration for these disruptions and transitions. According to Schumpeter, this disruptive process of creative

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5. Readers interested in this distinction and Kirzner's views can find more details in Kirzner (1999).

destruction is the foundation of the economic progress of society through time. Thus, Schumpeter provides a road map to the policy environment conducive to economic development—jurisdictions that allow the process of creative destruction to unfold, rather than those that put up barriers to protect the *status quo*, are the ones that grow faster and have stronger economic progress and development.

## Chapter 4

# Contestable Markets and the Nature of Competition

The first thing to go is the traditional conception of the *modus operandi* of competition ... in capitalist reality as distinguished from its textbook picture, it is not that type of competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization ... which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives ... It is hardly necessary to point out that competition of the kind we now have in mind acts not only when in being but also when it is merely an ever-present threat. It disciplines before it attacks. The businessman feels himself to be in a competitive situation even if he is alone in his field.

Joseph A. Schumpeter (1942), *Capitalism, Socialism, and Democracy*: 84–85.

In the classic board game, Monopoly, the objective is to drive all of your opponents into bankruptcy by owning and developing blocks of colour-coded property until you are the only remaining player. Players collect rent from their opponents and can charge higher prices as they own more properties of each colour. The game is built on the idea that monopolies—one firm controlling a market—generally produce worse outcomes for consumers (higher prices, for example) than markets characterized by many business firms in competition with one another.

Our experiences in daily life tend to reinforce this negative belief about monopolies and markets dominated by one or a few large firms. Generally the prices, quality, and customer service are better when we deal with businesses such as clothing, groceries, or restaurants that are in highly competitive industries

than it is when we deal with businesses in markets with less competition such as electric utilities or cable television; or even government-owned bureaucratic monopolies like the post office.

A large part of any modern microeconomics principles class in high school or college is devoted to exploring and comparing the outcomes that occur under different market structures. These usually range from markets with lots of firms competing with similar products (competitive markets) to markets dominated by one (monopoly) or a few (oligopoly) firms. Since the days of Adam Smith, the key concern in thinking about the differences among market types is the level of competition among firms, which is thought to be a force that disciplines the behaviour of businesses. Put simply, when firms are in greater competition with other firms they tend to provide better prices, quality, and customer service, and be more innovative and efficient. As is best summarized by noted economist William Baumol in his presidential address to the American Economic Association,

standard analysis leaves us with the impression that there is a rough continuum, in terms of desirability of industry performance, ranging from unregulated pure monopoly as the [worst] arrangement to perfect competition as the ideal, with [desirability] increasing ... as the number of firms expands. (Baumol, 1982: 2)

At one extreme on this continuum of competition are markets or industries described as having “perfect competition” (lots of firms competing with identical products), while at the other are markets that are a monopoly (dominated by one firm). Generally, economists also consider two additional markets in the middle of the continuum often called “monopolistic competition” (lots of firms competing but with products or services that are differentiated from one another) and “oligopoly” (a few large rival firms). Each market has specific properties that identify and differentiate it.<sup>6</sup> But, for simplicity’s sake, as Baumol states, we can generally conclude simply that markets with more small firms are better (or more efficient) than those with fewer large firms.

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6. This footnote is for readers interested in a quick definition of these markets. In the model of perfect competition, firms are very small relative to the market, produce identical products (like eggs or wheat), and sell their products at a given market-determined price; and it is easy for new firms to enter and old firms to exit. Monopoly markets are dominated by a single

Joseph Schumpeter was one of the first economists to question this standard description and indeed viewed this traditional framework as being somewhat misleading. After discussing the widespread increase in prosperity and economic development that occurred throughout the last few centuries prior to his writing *Capitalism Socialism and Democracy* (CSD), he notes:

As soon as we go into details and inquire into the individual items in which progress was most conspicuous, the trail leads not to the doors of those firms that work under conditions of comparatively free competition but precisely to the doors of the large concerns ... and a shocking suspicion dawns upon us that big business may have had more to do with creating that standard of life than with keeping it down. (CSD: 82)

Schumpeter's view of actual economic history, which was formative of his views of how the economy actually worked, was more a picture of progress based on innovation that had been produced in reality by industries dominated by larger firms. Perhaps more importantly, Schumpeter examined these industries and observed disruptive innovations over time that continued to remake the industries themselves and the broader economy and, in doing so, produced a regular churning and replacement among these larger firms. In other words, it was not the same large firms that dominated these industries over time.

Schumpeter viewed actual cases of both perfect competition and monopoly as being rare: "If we look more closely at the conditions ... that must be fulfilled in order to produce perfect competition, we realize immediately that outside of agricultural mass production there cannot be many instances of it" (CSD: 78–79); and similarly, "it becomes evident immediately that pure cases of long-run monopoly must be of the rarest occurrence and that even tolerable approximations to the requirements of the concept must be still rarer than are cases of perfect competition" (CSD: 99).

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firm selling a product for which there are no good substitutes and generally protected from competition by some type of barrier (such as a license or patent) that prevents new rival firms from entering the market. Under monopolistic competition (sometimes termed "imperfect competition") firms produce products that are somehow differentiated from one another, by factors such as quality, location, and brand name (*e.g.*, restaurants). An oligopoly is a market with only a very small number of large rivalrous firms that can sometimes collude with one another (*e.g.*, a cartel).

In Schumpeter’s view, the most important aspect of the true competitive process was not really the count of the number of *existing* firms in the industry (which is the dimension on which the traditional continuum is built in microeconomics). Instead, it was whether it is easy for new firms to enter and compete with (and displace) existing firms. In other words, Schumpeter focused on the degree to which there were barriers in place for new firms to be created or existing firms to enter existing markets. If we return to the opening quotation for this chapter, we see Schumpeter eschewing the standard “traditional” or “textbook” notion of competition in favour of one in which it is the competition from new goods or technologies that matters. In fact, Schumpeter continues with the following passage:

the competition from the new commodity, the new technology, the new source of supply, the new type of organization ... [t]his kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less promptly; the powerful lever that in the long run expands output and brings down prices is in any case made of other stuff. (CSD: 84–85)

Thus, the ability of new firms, goods, and technologies to enter and compete with existing firms, and to displace them through the process of innovation and creative destruction through time—or at least the threat of it—was a much more important aspect of real-world competition and progress than textbook models of price competition between firms.

How then does Schumpeter rectify his conclusion with the accepted wisdom that competitive markets generally produce better outcomes than industries with fewer larger firms or monopoly? He justifies his position by differentiating between outcomes at a point in time compared to outcomes over a longer time. Schumpeter argues:

First, since we are dealing with a process whose every element takes considerable time in revealing its true features and ultimate effects, there is no point in appraising the performance of that process [at] a given point of time; we must judge its performance over time, as it unfolds through



decades or centuries. A system—any system, economic or other—that at every given point of time fully utilizes its possibilities to the best advantage may yet in the long run be inferior to a system that does so at no given point of time, because the latter’s failure to do so may be a condition for the level or speed of long-run performance. (CSD: 83)

In a nutshell, Schumpeter’s assessment leads him to conclude: “In this respect, perfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency” (CSD: 106).

Schumpeter’s alternative view is that entrepreneurial innovation creates temporary monopoly power, and profits, and the quest for such profits is the driving force behind the process repeating itself through time, producing long-run economic development as large firms replace one another in industries that are not really highly competitive at any point in time. Over the long term, it is these industries dominated by larger firms that create more progress and prosperity than the ones that are normally considered “perfectly competitive”.

In his book *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process, Volume 1* (BC1) he asks readers to

visualize an entrepreneur who ... carries out an innovation ... that his receipts will exceed his costs. The difference we shall call Entrepreneurs’ Profit, or simply Profit. It is the premium put upon successful innovation in capitalist society and is temporary by nature: It will vanish in the subsequent process of competition and adaption. (BC1: 105)

In some cases, however, it is so successful as to yield profits far above what is necessary in order to induce the corresponding investment. These cases then provide the baits that lure capital on to untried trails. (BC1: 90)

This ongoing process of entrepreneurs, in search of profits, creating new innovations that generate short-term monopoly power by displacing old firms was the real competitive force of progress in the economy over the long term. The real competition each business firm faced was the threat of being run out of business by something new—of being creatively destroyed, so to speak. Importantly, this means that for an existing business the competition to be worried about is the threat of new entrants:

It is hardly necessary to point out that competition of the kind we now have in mind acts not only when in being but also when it is merely an ever-present threat. It disciplines before it attacks. The businessman feels himself to be in a competitive situation even if he is alone in his field (CSD: 85).

Not only is practically every enterprise threatened and put on the defensive as soon as it comes into existence, but it also threatens the existing structure of its industry or sector almost as unavoidably. (BC1: 107)

The result of this ever-present threat of competition is that it forces existing firms to act competitively. They must continue to innovate and price competitively as long as the industry is open for rivals to potentially compete: “In many cases, though not in all, this will in the long run enforce behaviour very similar to the perfectly competitive pattern” (CSD: 85).

This idea that it is not the current number of firms in an industry, but rather the openness of the market to the entry of new competitors, that matters when assessing the desirability of market outcomes has been developed in more detail in modern theories of “contestable” markets associated with the work of William Baumol.<sup>7</sup> According to Baumol, “[a] contestable market is one into which entry is absolutely free, and exit is absolutely costless” (1982: 3). The outcomes in these markets are

freed entirely from their previous dependence on ... incumbents and, instead ... [depend on] the pressures of potential competition; [the outcome in these contestable markets] is, generally, characterized by optimal behaviour and yet applies to the full range of industry structures including even monopoly and oligopoly. (1982: 2)

Given these arguments, it is clear that the problem case is not one simply of an industry dominated by a single firm (*i.e.*, a “monopoly”) or several large firms, but rather the case of a firm or industry protected from the dynamic forces of competition. When government policies, for example, prevent new firms from entering and competing with (and/or displacing) existing firms, these

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7. See William J. Baumol (1982).

are the markets where outcomes are likely to be inferior. The threat of entry is the key to good outcomes, and government policies that lower or prevent this threat are harmful.

Schumpeter's work also has important implications for government anti-trust policy. Standard anti-trust policy that focuses on the current levels of competition within an industry entirely misses what Schumpeter viewed as the most important margin of competition, the threat of new firms and new goods. Retrospectively, we can see that almost all the major concerns about monopolization throughout the twentieth century eventually saw the supposedly offending companies creatively destroyed by new firms or technologies. Have you ever even heard of AOL's instant messaging monopoly, Myspace's digital monopoly in social media, Nokia's cell phone monopoly, or The Great Atlantic and Pacific Tea Company (A&P)'s monopoly on groceries? Probably not, because while at the time these were viewed as troubling monopolies arousing widespread calls for government intervention (that sometimes happened), they have all been displaced by creative destruction instead.<sup>8</sup>

The innovations of the cycling, dominant (large) firms, from Microsoft to Apple, to the displacement of Blockbuster by Netflix, or Uber taking on Yellow Cab and the taxi industry are examples of what Schumpeter viewed typified true competition. More importantly, this type of competition is responsible for a greater share of economic development through time than is the textbook competition that characterizes markets with many smaller firms producing identical products, such as the competition among wheat farmers (there are 20,000 wheat farmers in the state of Kansas alone!). Thus the "ideal" markets for true competitive innovation, discovery, and generating progress are not necessarily those markets most revered in economic theory as being "competitive". The most important implication for government policy is that it should not prevent or limit this type of competition by protecting firms or industries from new competition.

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8. For more examples and details, see Ryan Bourne (2019).



## Chapter 5

# Business Cycles: Understanding the Ebbs and Flows of the Economy

Capitalism is essentially a process of (endogenous) economic change ... The atmosphere of industrial revolutions—of “progress”—is the only one in which capitalism can survive ... In this sense stabilized capitalism is a contradiction in terms.

Joseph A. Schumpeter (1939), *Business Cycles*: 405.

The recurring periods of prosperity of the cyclical movement are the form progress takes in capitalistic society.

Joseph A. Schumpeter (1927), *The Explanation of the Business Cycle*: 30.

As was the case with many of Schumpeter’s contemporaries, he showed great interest in understanding the nature and causes of business cycles, that is, the ebb and flow of the economy from expansion and prosperity to recession, and at times, economic crisis and depression. Schumpeter’s work in the *Theory of Economic Development* (TED) coupled with his later two-volume masterpiece *Business Cycles* (BC1) focused on the broad issue of how and why economies progress. One of the many contributions of Schumpeter’s work in the field of business cycles was the introduction of innovation as a causal explanation.<sup>9</sup> A subtle aspect of his argument, but one that needs to be recognized, is that the business cycle or the fluctuation between expansion and contraction is natural or, as Schumpeter put it “like the beat of the heart” (BC1: *v*).

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9. For more information on Schumpeter’s view of the interconnectedness between progress and business cycles as caused by entrepreneurial innovation, please see Rosenberg and Frischtak (1983).

This evolutionary approach to understanding business cycles and their role in the general upward progress of economies placed Schumpeter in contrast to many of his peers during this time who believed economic fluctuations could and should be managed by the government. Schumpeter's views also put him at odds with the broad Austrian School of Economics, within which much of his training took place.

To understand Schumpeter's conception of the business cycle, we need to first recall his definition of innovation as given in *The Explanation of the Business Cycle* (EBC) :

... primarily changes in methods of production and transportation, or in changes in industrial organization, or in the production of a new article, or in the opening up of new markets or of new sources of material. (EBC: 30)

Schumpeter's explanation for business cycles, which again was rooted in his analysis of economic history and experience, starts with a major innovation by entrepreneurs. The initial innovation and the potential for monopoly profits spurs investment in factories, machinery, equipment, and perhaps additional research. It is critical for Schumpeter, however, that these investments and economic activity will cluster within the single branch of the economy in which the innovation occurs (EBC: 30). In other words, in the first phase of the expansion, the prosperity or economic development does not occur broadly in the economy but rather in one specific sector.

The investments and expanded economic activity in the sector have two important effects. One, it pulls resources into the sector from other parts of the economy. This includes raw materials, capital, labour, and—critically for Schumpeter—entrepreneurs begin to shift their attention and resources into this sector. As Schumpeter explained:

Why do entrepreneurs appear, not continuously, that is singly in every appropriately chosen interval, but in clusters? Exclusively because the appearance of one or a few entrepreneurs facilitates the appearance of others, and these the appearance of more in ever-increasing numbers. (TED: 228).

As more and more resources are reallocated to the sector experiencing expansion, the prices for resources, again including raw materials, capital, and labour begin to rise. Schumpeter described it as follows:

the swarm-like appearance of new combinations easily and necessarily explains the fundamental features of periods of boom. It explains why increasing capital investment is the very first symptom of the coming boom, why industries producing means of production are the first to show supernormal stimulation ... It explains the appearance of new purchasing power in bulk, thereby the characteristic rise in prices during booms, which obviously no reference to increased need or increased costs alone can explain. (TED: 230)

As the sector with the initial innovation expands and draws resources to it, prices outside the sector also begin to rise. Specifically, firms and entrepreneurs begin to invest in the additional sectors experiencing expansion because of the increase in demand from the sector that initially experienced the innovation breakthrough. These can include, for instance, providers of raw materials and suppliers of intermediate goods and services. As more and more firms, both within the sector initially affected by the innovation as well as those in other sectors of the economy affected by the expansion, bid on resources, including labour, and compete for investment, prices generally start to rise. During this phase, unemployment declines while wages increase, explaining the general prosperity experienced across the economy during expansions.

Another insight from Schumpeter that was well ahead of his time was the recognition of the role of diffusion of the initial innovation. Schumpeter envisioned a process whereby the initial innovation was replicated by other entrepreneurs within the sector but, during the course of the expansion, the benefits of the innovation begin to be diffused within the broader economy.<sup>10</sup>

To summarize, the expansionary phase of the business cycle for Schumpeter starts with an initial innovation that pulls resources, particularly entrepreneurs, into the sector within which the innovation occurs. As resources are pulled into

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10. For more on the role of diffusion in Schumpeter's concept of the business cycle, which is a key factor in his conception of the expansionary phase of economic cycles, please see Aghion, Akcigit, and Howitt (2013).

this sector and new firms develop, economic activity in related sectors also begins to expand. Ultimately, the prosperity in these directly and indirectly affected sectors drives economic expansion, lowering unemployment, increasing wages, and driving investment. As Schumpeter described it: “the release of secondary waves—the spread of prosperity over the whole economic system” (TED: 230).

As with the expansionary phase, Schumpeter explains the contraction or recessionary stage based on the initial innovation. Economic contractions and recessions were seen by Schumpeter as the economy’s reaction and adaptation to the innovation. As noted economist Alvin Hansen put it when assessing Schumpeter’s contributions to our understanding of business cycles, “depression is a process of adaptation to the change conditions ushered in by the boom” (Hansen, 1951: 129). The adaptation at the heart of Schumpeter’s concept of economic contraction relates to the competition between new and existing firms both within the sector initially affected by the innovation as well as the other sectors of the economy affected by it. Firms are forced to adapt to compete with new products, new processes, new markets, and other innovations. Such adaptation includes firms going out of business or perhaps being absorbed by more efficient firms, layoffs, and massive adjustments to new product and service markets.

It is the “creative destruction” of entrepreneurial innovation that Schumpeter saw as the fundamental characteristic of entrepreneurial capitalism. Specifically,

[t]he effect of the appearance of new enterprises *en masse* upon the old firms and upon the established economic situation, having regard to the fact ... that as a rule the new does not grow out of the old but appears alongside of it and eliminates it competitively, is so to change all the conditions that a special process of adaptation becomes necessary. (TED: 216)

More specifically, Schumpeter observed a number of factors that coalesced to explain the transition from an expansionary phase to contraction.<sup>11</sup> First, as noted above, many firms fail as their products and services are replaced as a result of the emerging products and services from the innovation. Second, the successes of the boom phase cause increases in prices of raw materials and potentially of

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11. For a thorough discussion of Schumpeter’s concept of the reason for recession, please see Dal-Pont Legrand and Hagemann (2007).



labour that dampen profitability expectations and thus investment. Third, the emergence of new firms and more competition in the sector originally affected by the innovation decreases the prices of the new products and services made available by the innovation, which again dampens additional investment. Fourth, Schumpeter observed that entrepreneurs could “overshoot” the opportunities in the sector and thus potentially overinvest. This last point is important as it is often overlooked but Schumpeter did in fact allow for entrepreneurs to make errors.

A real-world example may help to illustrate the dynamics Schumpeter envisioned as explaining the boom of the economy. A major entrepreneurial innovation along the lines that interested Schumpeter, such as the railway or electricity, is the development of the computer chip. It took a significant amount of investment and time for this technological innovation to influence the economy. In typical Schumpeterian style, investment and entrepreneurs flowed first to the technology sector. Many new firms were created to try to capitalize on the new technology. It attracted additional resources and skilled labour. Major clusters of activity formed in places like Silicon Valley, Boston, Massachusetts, and parts of Texas.

This cycle was amplified as the personal computer market began to emerge. Successful firms were pulling resources from other sectors of the economy. For instance, this portion of the technological sector was attracting more and more engineers and programmers. In addition, it was driving demand for the various inputs required to produce computers, including plastics, aluminum, wiring, screens, and so on. Eventually, however, there was a culling of the firms in the sector. Many firms failed while many others were absorbed by more successful firms. The expansionary aspects of this example of how an entrepreneurial innovation can facilitate or, as Schumpeter would argue, cause economic expansion, fits well historically. Indeed, a number of economists have noted how “persuasive” Schumpeter’s analysis is with respect to the expansionary phase of a business cycle (Hansen, 1951: 132).

A subject related to Schumpeter’s work on business cycles that was also quite popular at the time is the idea of long-wave economic growth. A number of high-profile economists were working on the idea that economies experience economic growth in waves. While not a critical insight in the same league as Schumpeter’s work on entrepreneurship, business cycles, or competition, it is nonetheless helpful to briefly survey his work in this area since it is an extension of his scholarship on business cycles.

At the time, there were several competing theories about waves of economic growth: Joseph Kitchin, a British Statistician, hypothesized that the waves were roughly three to five years and focused on inventory changes; a French economist, Clément Juglar, thought the waves were longer and explained by changes in fixed investment; noted American economist Simon Kuznets believed the waves were much longer, ranging between 15 and 25 years, and linked with infrastructure investment; and finally Nikolai Kondratiev, a Russian economist, envisioned even longer waves lasting between 45 and 60 years that were rooted in technological innovations (De Groot and Franses, 2005: 7–8). Schumpeter’s contribution to the work on long-wave theory of economic growth was to synthesize the work of these major economists into one overarching theory. Essentially, Schumpeter argued that all four waves existed within each other and that the larger process was rooted, as Kondratiev argued, in technological innovation. The shorter waves occurred within the longer Schumpeter-Kondratiev wave of long-term growth.

Using the previous example of the emergence of the computer chip as an entrepreneurial innovation, Schumpeter would have explained the following forty-plus years of economic growth as having been grounded in the original innovation of the computer chip. Shorter waves of growth within the larger, long-wave growth would have been based on building supply chains and the emergence of additional innovations based on the original computer chip, such as smart phones. In addition, the emergence and demise of competing firms within each of the shorter waves of growth would have been part of the ongoing adaptation process Schumpeter envisioned as both explaining part of the forces in the contraction but also key to the evolution of the economy.

While the accuracy and usefulness of conceptualizing long-wave growth is arguable, it is nonetheless illustrative of the central, fundamental position in which Schumpeter places entrepreneurial innovation in explaining economic progress. According to Schumpeter, economic growth and progress more generally occur when the benefits of new innovations such as the computer chip are diffused throughout the economy. However, he also explains contractions based on innovations, since they inevitably, or perhaps more accurately naturally, lead to the replacement of previously existing products and services and the firms that provided them by new products and services, and new firms. Schumpeter’s key insight that the economy expands and contracts in response to entrepreneurial innovation is an idea that continues to shape and influence modern economists and our understanding of progress.

## Chapter 6

# Democracy, Public Choice, and Government Policy

Nothing is easier than to compile an impressive list of failures of the democratic method, especially if we include not only cases in which there was actual breakdown or national discomfiture but also those in which, though the nation led a healthy and prosperous life, the performance in the political sector was clearly substandard relative to the performance in others.

Joseph A. Schumpeter (1942), *Capitalism, Socialism, and Democracy*: 289.

Joseph Schumpeter is largely known for his seminal contributions to our understanding of the role of entrepreneurs, innovation, and creative destruction in economic growth and development. However, Schumpeter's economic insights extend far beyond just his most well-known work on innovation. Another area where Schumpeter was well ahead of the economics profession and provided real insights is the nature of politics and the democratic process of collective decision making. The economic analysis of the process of politics and collective decision making is the focus of a modern field of economics known as *public choice*. While Schumpeter wrote prior to the formal origins of this field in economics, early scholars such as Anthony Downs did cite and attribute some of his ideas to Schumpeter's writings in *Capitalism, Socialism, and Democracy* (CSD).<sup>12</sup>

Schumpeter's ideas about the functioning of government were likely informed by his first-hand experience as the minister of finance of Austria. At

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12. In *The Economic Theory of Democracy*, Downs writes: "Schumpeter's profound analysis of democracy forms the inspiration and foundation for our whole thesis, and our debt and gratitude to him are great indeed" (1957: 29).

the time, and even today, much of the economic analysis of government intervention relied on a set of implicit (sometimes explicit) assumptions about the actors in the political sphere—that they are selfless, benevolent, leaders and bureaucrats worried only about the public interest, untouched by influence from interest groups. Indeed, much of the interventionist approach to macroeconomic policy championed by John Maynard Keynes implicitly relies on the wise actions of benevolent government actors who selflessly worry about the common good. Schumpeter knew from his own experience that these assumptions were incorrect.

Schumpeter understood that democracy was merely an alternative process for producing social and economic outcomes, and “it would not necessarily follow that the political decisions produced by that process from the raw material of those individual volitions would represent anything that could in any convincing sense be called the will of the people” (CSD: 254). Regarding the idea that government pursues some common good, Schumpeter argues:

There is, first, no such thing as a uniquely determined common good that all people could agree on or be made to agree on by the force of rational argument. This is due not primarily to the fact that some people may want things other than the common good but to the much more fundamental fact that to different individuals and groups the common good is bound to mean different things ... as a consequence ... the particular concept of the will of the people ... vanishes into thin air. (CSD: 251–252)

Schumpeter recognized that to understand democratic outcomes one must look to understand the motivations and different desires of the *individuals* involved in the process, be they the voters, elected politicians, or administrators and bureaucrats running government agencies. That is, to understand democratic outcomes one must understand the role of what he termed “Human Nature in Politics”. Thus, Schumpeter shared a common insight with the founders of the field of public choice, such as Nobel Laureate James Buchanan, who recognized that just because individuals step into the public sphere, they do not suddenly start acting for the common good—instead they continue to be self-interested actors concerned with their own goals and desires.

According to Schumpeter, democracy is best understood as follows: “it may be put into the nutshell of a definition ... the democratic method is that

institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for people's vote" (CSD: 269). According to Schumpeter,

as far as there are genuine group-wise volitions ... we are now able to insert them in exactly the role they actually play ... called to life by some political leader who turns them into political factors ... by working them up and by including eventually appropriate items in his competitive offering ... The incessant competitive struggle to get into office or to stay in it imparts to every consideration of policies and measures the bias so admirably expressed by the phrase about "dealing in votes". (CSD: 270, 287).

Thus, in the process of seeking election (or re-election) politicians must make promises to give benefits to narrow interest groups to earn their votes and political support (and campaign contributions). These groups "may consist of ... exponents of an economic interest or of idealists of one kind or another or of people simply interested in staging and managing political shows ... Human Nature in Politics being what it is, they are able to fashion and within very wide limits" (CSD: 263) shape the outcomes of the political process.

One such interest group is obviously those businesses being threatened by creative destruction who seek to get government to restrict competition. In his book, *Business Cycles* (BC1), Schumpeter states:

Such struggles for a share in profits that have been made are, however, less important for our subject than the struggles to conserve the stream of profit itself ... Taking industry as a whole, there is always an innovating sphere warring with an "old" sphere, which sometimes tries to secure prohibition of the new ways of doing things. (BC1: 106–108)

Schumpeter's arguments regarding the high level of influence that special-interest groups have in the political process and how this influence would grow through time within a democracy was an insight that would not be widely recognized in the academic literature until much later.<sup>13</sup>

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13. This idea is most widely associated with the work of Mancur Olson in his book, *The Rise and Decline of Nations* (1982).

One reason special-interest groups are able to achieve the upper hand in the political process is the widespread ignorance of voters regarding political issues, which Schumpeter recognized explicitly as one source of the failures of the democratic process:

The reduced sense of responsibility and the absence of effective volition in turn explain the ordinary citizen's ignorance and lack of judgement in matters of domestic and foreign policy which are if anything more shocking in the case of educated people and of people who are successfully active in non-political walks of life than it is with the uneducated people in humble situations. Information is plentiful and readily available. But this does not seem to make any difference ... the typical citizen drops down to a lower level of mental performance as soon as he enters the political field. He argues and analyzes in a way which he would readily recognize as infantile within the sphere of his real interests. He becomes primitive again. (CSD: 261–262)

Modern public-choice theory helps us understand that, because their vote is unlikely to alter the outcome, voters have little incentive to become informed on political issues or to participate in the political process. Can you, for example, name the people who are the current elected representatives for you in your local and national government; or what issues are being voted upon today by these individuals? Most people cannot. If it makes you feel better, a viral video from 2013 showed a reporter from the *Harvard Crimson* asking students on campus what the capital of Canada was, and the vast majority of Harvard University students did not know it was Ottawa.<sup>14</sup> The point is that even smart people are smart enough to know there are some things that are not worth spending time to learn and remember. Our limited brain power is better spent on things that matter more to our daily lives.

When a large proportion of voters are not motivated to be informed and participate, this then gives well-organized subsets of voters and special-interest groups an upper hand in the political process to achieve their narrow ends at the expense of the general public.<sup>15</sup> Because of these limitations and

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14. To watch the entertaining video, see Zhang (2013): <<https://www.youtube.com/watch?v=r0fdYhgJleE>>.

15. Modern public-choice theory also suggests that the political process tends to be biased toward producing short-sighted outcomes that favour creating highly visible current benefits to interest groups, especially when the costs are far into the future and hard to discern, while being biased

failures of the democratic decision-making process, Schumpeter believed that there should be constraints on the scope of government action:<sup>16</sup>

The second condition for the success of democracy is that the effective range of political decision should not be extended too far ... in order to function properly that all-powerful parliament must impose limits upon itself ... a corresponding limitation of the activities of the state./ (CSD: 291–292)

In his book, *The Economics and Sociology of Capitalism* (ESC), Schumpeter provided additional insights into how government policies influence the incentives to produce and innovate, as well as a prognostication as to the future of the state under democracy. Schumpeter held concerns for the future of government (or as he called it “the tax state”) under democracy as more and more groups demand government social programs and spending, claiming if “the will of the people demands higher and higher public expenditures, if more and more means are used for purposes ... the tax state *can* collapse” (ESC: 116).

Schumpeter’s main concern at the time, however, was that government interference in the economy, particularly through tax policy, was having negative consequences on innovation and progress. He cites

that enormous treasure of energy which ... is wasted in the fight against the chains into which irrational legislation, administration, and politics have thrown the personality, which take the entrepreneur away from his organization, technical, and commercial tasks and which leave him merely the backstairs of politics and administration as the only path to success. (ESC: 129)

When government action takes too broad of a scope and interest groups have high levels of influence on the process, it encourages individuals (including

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against undertaking actions that create future benefits but that require current visible costs. More simply put, relative to markets, governments tend to place more weight on the aspects that are highly visible in the short term, rather than the long term. Schumpeter clearly agreed as democracy “forces upon the men at or near the helm a short-run view and it makes it extremely difficult for them to serve such long-run interests of the nation as may require consistent work for far-off ends” (CSD: 287).

16. This idea of imposing constraints (usually constitutional) on democratic action to avoid failure and misuse is at the foundation of most modern Western democratic systems.

entrepreneurs) to direct their actions toward the political process to secure favours and influence policy. Schumpeter points out that to the extent this happens it wastes enormous amounts of productive talent in a society.<sup>17</sup>

Schumpeter is clear about his concern over the extent to which high tax rates hampered growth by lowering the incentives to produce and innovate:

everyone works and saves for himself and his family ... What is produced is produced for the purposes of the private economic subjects ... In this world the state lives as an economic parasite. It can withdraw from the private economy only as much as is consistent with the continued existence of this individual interest ... In other words, the tax state must not demand from the people so much that they lose financial interest in production or at any rate cease to use their best energies for it. (ESC: 112)

Specifically regarding the taxation of entrepreneurial profit he states:

If this profit were taxed away, that element of the economic process would be lacking which at present is by far the most important individual motive for work toward industrial progress. Even if taxation merely reduced this profit substantially, industrial development would progress considerably more slowly ... there is a limit to the taxation of entrepreneurial profit beyond which tax pressure cannot go without first damaging and then destroying the tax object. (ESC: 114)

While economist Arthur Laffer is often associated with the idea that when tax rates get high enough they discourage so much economic activity as to lower tax revenue—and that in those situations lowering tax rates can actually raise more revenue—Schumpeter clearly held a similar view much earlier claiming that

there exists a level beyond which further tax increases mean not an increase but decrease of yield ... almost all countries have ... burdened some articles to such an extent that ... a tax reduction would lead to an increase in revenues. (ESC: 113)

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17. For readers interested in more details about this idea, known more broadly in the literature as “unproductive entrepreneurship,” see Sobel (2015): 48–50.



As with his work on entrepreneurship and innovation, Schumpeter also provided key insights into the nature and failures of the democratic decision-making process and how taxes can potentially harm the economy by lessening the incentives to innovate. Schumpeter's analysis of shortcomings of government action help us understand that the political process is simply an alternative mechanism for making decisions about the use and allocation of productive resources—and that as such it has its limitations and failures. Thus, the actions of the state should be subject to limits. Democratic government is not a means of somehow automatically producing outcomes that are in the best interest of society, or to be interpreted as a unified “will of the people”. The case for government intervention, even in situations where markets may not achieve the best outcomes, must be carefully considered as democratic government also has its failures rooted in the human nature of individuals or, as Schumpeter put it, “Human Nature in Politics”.



## Chapter 7

# Can Capitalism Survive?

Can capitalism survive? No. I do not think it can ... its very success undermines the social institutions which protect it, and “inevitably” creates conditions in which it will not be able to live and which strongly point to socialism as the heir apparent.

Joseph A. Schumpeter (1942), *Capitalism, Socialism, and Democracy*: 61.

Perhaps the most interesting aspect of Schumpeter’s lifelong work in economics was a similarity between his work and that of Karl Marx, the most noted socialist writer in history. What makes this similarity striking is that Schumpeter’s greatest insights relate to the role of the innovative entrepreneur at the heart of capitalism. Yet, despite this insight, Schumpeter, like Marx, believed that the economic system of capitalism would eventually be replaced by socialism as a result of forces from within. In *Capitalism, Socialism, and Democracy* (CSD) Schumpeter himself states: “My final conclusion therefore does not differ, however much my argument may, from that of most socialist writers and in particular from that of all Marxists” (CSD: 61).<sup>18</sup>

There are, however, two important differences between the analysis of Schumpeter and Marx with regard to the end of capitalism. First, while Marx

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18. In Thomas K. McCraw’s definitive biography of Schumpeter, *Prophet of Innovation* (2009), he argues that Schumpeter’s discussion of the socialism successfully replacing capitalism should be interpreted as, at least to some extent, sarcastic. McCraw writes: “As a whole, the organization of Schumpeter’s discussion of socialism has elements of a shell game. At first his argument seems designed to establish the viability of socialism and its likely replacement of capitalism. But there follows such a lengthy series of convoluted qualifications and assumptions as to raise doubts about his candor ... a careful reading leaves little question that his purpose has been to praise capitalism and condemn socialism. Even so, Schumpeter’s irony escaped many readers” (2009: 366–367).

personally desired socialism and believed it to be a superior economic system, Schumpeter did not, declaring: “Prognosis does not imply anything about the desirability of the course of events that one predicts. If a doctor predicts that his patient will die presently, this does not mean he desires it” (CSD: 61). Schumpeter was a firm believer in the power of private innovation and entrepreneurship and the benefits capitalism produced; ones that he believed were superior to the outcomes under socialism. Unlike Marx, Schumpeter did not *want* capitalism to be replaced by socialism, nor did he think this transition would be beneficial for the well-being of society.

Second, while both Marx and Schumpeter believed there was an inevitable transition of capitalism into socialism, they disagreed on the causes. Marx believed capitalism would produce inequalities, monopolies, and economic failures that would lead to a revolt of the “exploited” working class (the “proletariat”) against the wealthy, capitalist class (the “bourgeoisie”) that owned the means of production. In stark contrast, Schumpeter understood from his analysis of history that capitalism greatly benefitted the working class:

Queen Elizabeth owned silk stockings. The capitalist achievement does not typically consist in providing more silk stockings for queens but in bringing them within the reach of factory girls in return for steadily decreasing amounts of effort. (CSD: 67)

Schumpeter clearly dismisses Marx’s argument in an essay published in a 2008 collection of his writings, *Essays on Entrepreneurship, Innovations, Business Cycles, and the Evolution of Capitalism* (EOE):

In Marx ... it is necessary to separate the arguments ... and the answer itself. All his arguments, but in particular the one that asserts that labour will be goaded into revolution by steadily increasing misery, can be proved to be untenable. But this does not dispose of the answer itself, because it is possible to arrive at a correct result by faulty methods. (EOE: 207–208)

So while he agreed with Marx’s conclusion that capitalism *would* be replaced by socialism, he firmly disagreed with the cause of the transition. Schumpeter instead believed that capitalism would be destroyed by its very

economic *success* as it produced an intellectual class that would subsequently work to undermine the systems of private property and private contracting that underpin the economic system of capitalism. Contributing to this transition, Schumpeter also believed that entrepreneurship and innovation would become bureaucratic within big firms and carried out as a routine matter based on specialists:

We observe ... the individual leadership of the entrepreneur tends to lose in importance and to be increasingly replaced by the mechanized teamwork of specialized employees within large corporations ... [and] that the capitalist process by its very success tends to raise the economic and political position of groups that are hostile to it ... shifting of economic activity from the private to the public sphere, or, as we may also put it, toward increasing bureaucratisation of economic life. (EOE: 207–208)

While clearly saying Marx’s theory was “open to serious objections” he agreed with Marx that there was a tendency toward “industrial combination” and “the emergence of largest-scale concerns”, “cartels”, “trusts”, and “big business” (EOE: 197). In Schumpeter’s view, this resulted in an erosion of the function and status of the entrepreneur in society:

Innovation is, in this case, not any more embodied *typically* in new firms, but goes on, within the big units now existing, largely independently of individual persons ... as a matter of course on the advice of specialists ... Progress becomes “automated”, increasingly impersonal and decreasingly a matter of leadership and individual initiative. (EOE: 70–71)

In Schumpeter’s view, the continual flow of product innovation becomes something people take for granted, and these innovations become entrenched in the routine operation of large firms. Progress is no longer so visibly attributed to innovative entrepreneurial individuals. The sizeable political and social class of small merchant entrepreneurs and their employees who directly felt vested in the economic system of capitalism and property ownership are replaced by emotionally unattached employees, managers, or shareholders of large bureaucratic firms. Thus, the entrepreneur falls from being on top of the pyramid of

society. In the process, individuals lose sight of capitalism as the true historical source of their prosperity and of its long-run benefits. They instead focus on using expanded government control to alleviate short-run economic concerns and social shortcomings as they see them, without realizing the harmful long-run secondary effects.

While Schumpeter believes the automation of the entrepreneur's role, as well as what he viewed as the "rationalizing" of the human mind, play a role in the downfall of capitalism, it is the lack of intellectual and political supporters to protect the institutions of private property and contracting that play the major role. To better understand this part of his argument requires understanding the defining features of capitalism according to Schumpeter:

A society is called capitalist if it entrusts its economic process to the guidance of the private businessman. This may be said to imply, first, private ownership of nonpersonal means of production, such as land, mines, industrial plant and equipment; and, second, production for private account, *i.e.*, production by private initiative for private profit. (EOE: 189).<sup>19</sup>

Afforded a leisurely life away from the business sector, the intellectual class of academics, journalists, and bureaucrats turn on the very institutions that underpin the economic system that brought this luxury—private ownership and free markets. In this manner, Schumpeter says Marx "greatly overrated the bourgeoisie's ... will to resist gradual changes that are contrary to its interest ... its scheme of life" (EOE: 208). Rather than Marx's view of the workers turning on the bourgeoisie supporters of capitalism, in Schumpeter's view the bourgeoisie themselves turn on capitalism.

Far from being a transition that might occur in the distant future, Schumpeter worried this transition to socialism was already underway: "Capitalism is ... in so obvious a process of transformation into something else, that is not the fact, but only the interpretation of this fact, about which it is possible to disagree" (EOE: 71). He provides examples of

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19. Schumpeter also stressed that "the institution of bank credit is so essential to the functioning of the capitalist system that, though not strictly implied in its definition, it should be added to the other two criteria" of private ownership and private production for private profit as defining characteristics of the capitalist system (EOE: 189).

how far the process of transformation has advanced already... Government control of the capital and labour markets, of price policies and, by means of taxation, of income redistribution is already established and needs only to be complemented systematically by government initiative in indicating the general lines of production (housing programs, foreign investment) in order to transform, even without extensive nationalization of industries, regulated, or fettered, capitalism into a guided capitalism that might, with almost equal justice, be called socialism. Thus, the prediction of whether the capitalist order will survive is, in part, a matter of terminology. (EOE: 209)

Schumpeter's view that the transition away from capitalism was underway with a growing influence of government was largely consistent with, and informed by, the current events at the time of his writing with the major expansion in the size and role of the US federal government during the New Deal programs that followed the Great Depression, and the economic controls imposed during World War II. He saw these same trends occurring in his home country of Austria, and other western countries. Schumpeter saw a coming government budgetary crisis (of the "tax state" as he called it) resulting from "expansion of the sphere of social sympathy" (ESC: 131) as "the will of the people demands higher and higher public expenditures" (ESC: 116) to finance social transfer programs on top of the debt accumulated from World War II.

Schumpeter also foresaw the growing influence of large-scale business firms in the political process, in attempts to use the power of government to "fight the threatening attack" posed by creative destruction; they, in the process, "can and will fight progress itself" (CSD: 96). "Taking industry as a whole, there is always an innovating sphere warring with an 'old' sphere, which sometimes tries to secure prohibition of the new ways of doing things" (BC1: 106–108). Government, shaped by the social structure, becomes a "handle, as it were, which social powers can grip in order to change this structure" (ESC: 108), and "the state ... enlarges ... deep into the flesh of the private economy" (ESC: 110–111). Schumpeter had serious concerns that high levels of taxation associated with the expansion of government size were already eroding the incentives to innovate and produce: "almost all countries have shot way beyond the mark in this or that case of indirect taxation and have burdened some articles to such an extent that the fiscal interest of the state itself has been hurt" (ESC: 113).

This gradual transition toward more and more government control and economic intervention in Schumpeter's view is aided by democracy and the march of "democratic socialism". According to Schumpeter, "democratic methods have become an element of the moral credo of the average American ... I do expect a slow progress in regulation, which will only cease when there is nothing unregulated left" (ESC: 313). It will consist of "extending the democratic method, that is to say the sphere of 'politics', to all economic affairs" (CSD: 299). "In any case, that democracy will not mean increased personal freedom" (CSD: 302).

It is clear that Schumpeter viewed a movement away from capitalism and toward socialism as resulting in less personal freedom, as well as lower levels of economic prosperity, in the long run. This is not surprising as Schumpeter is widely known for his writings illustrating the benefits and essential role of private-sector entrepreneurship in the capitalist, free-market system. Schumpeter noted this transition was "not by economic necessity" and would result in a "sacrifice of economic welfare, into an order of things which it will be merely matter of taste and terminology to call Socialism or not" (EOE: 72). Thus, while Schumpeter, like Marx, believed that the economic system of capitalism had built-in features that would lead to its demise and replacement with socialism, the two authors had not only different rationales but also different prognoses for the impact it would have on the well-being of the individuals in society.

Schumpeter's careful study of economic history, his practical knowledge from his time working in government, and his experience from living in different countries gave him an impressive understanding of how Western, capitalist societies would likely evolve in the decades after his writing. His writings foreshadowed the growing ability of special-interest groups to control the political process, the rise of large firms using the power of government to protect their interests from competitive pressures, the increased bureaucratization of innovation through large-firm concentration, the rise of the regulatory state with extensive controls on private business, and the growing levels of fiscal debt and taxation. As with the movement toward socialism, however, he felt the net result of these changes were harmful to freedom and prosperity.

Schumpeter's concern, which has manifested itself to a large extent, was that in intellectual circles eventually capitalism would be on "trial in front of judges who have the death sentence ready in their pockets ... the condemnation



of capitalism and all of its works is a foregone conclusion—virtually a requirement of the etiquette of discussion ... Any other position is held as not only crazy, but as anti-social” and this bias would prevent people from understanding the true economic and cultural accomplishments of capitalism.<sup>20</sup>

While a transition to socialism to the full extent Schumpeter described has yet to manifest itself, there is no question that government intervention and influence over the economy in Western countries has continued to grow rapidly, and that public and intellectual attitudes toward political platforms based on some variant of “democratic socialism” seem to have become more positive (and views about capitalism more negative), particularly in academic circles and institutions of higher education. In this light, Schumpeter’s writings are best viewed as a warning about where these countries are at now and could be headed if this trend continues as people lose sight of what generated the progress they now enjoy. As Schumpeter noted, “any pro-capitalist argument must rest on long-run considerations” (CSD: 144–145).

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20. The evidence that this intellectual turn has started to unfold is best witnessed by Schumpeter’s biographer noted Harvard scholar and Pulitzer-Prize-winning author, Thomas McCraw, in his statement that this argument is one that “many people who have spent time in universities will quickly recognize, regardless of their politics”. These quotations are taken from page 641 of Thomas K. McCraw’s *Prophet of Innovation* (2009), which is based on a translation of pages 161–162 of Schumpeter’s (1948) article, Capitalism and the Intellectuals, in the *German Journal for European Thought*.



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Prof. Lawrence B. Smith

Dr. Vito Tanzi

## Past members

Prof. Armen Alchian\*

Prof. Michael Bliss\*

Prof. James M. Buchanan\* †

Prof. Friedrich A. Hayek\* †

Prof. H.G. Johnson\*

Prof. F.G. Pennance\*

Prof. George Stigler\* †

Sir Alan Walters\*

Prof. Edwin G. West\*

\* deceased; † Nobel Laureate