

The Soul of the German Historical School

Methodological Essays on
Schmoller, Weber and
Schumpeter

Yuichi Shionoya



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Introduction

This volume is a collection of my essays on Gustav von Schmoller (1838–1917), Max Weber (1864–1920), and Joseph Alois Schumpeter (1883–1950), published during the past fifteen years. These three intellectual giants are connected with the German Historical School of Economics in different ways. In the history of economics, the German Historical School has been described as a heterodox group of economic researchers who flourished in the German-speaking world throughout the nineteenth century. The definition of a “school” is always problematic. Even if the core of a certain idea were identified in the continuous and discontinuous process of the filiation and ramification of thought, it is still possible to trace its predecessors, successors, and sympathizers in different directions, creating an amorphous entity of a school. It is beyond question, however, that Schmoller was the leader of the younger German Historical School, the genuine school with a sociological reality.¹ Schmoller was indeed the towering figure of the Historical School at its zenith.

Although Weber and Schumpeter were both brought up in the German-speaking world under the influence of historical economics, their works are appreciated independently of the German Historical School, for they established their own system of thought that can be understood without reference to that school. Whereas Weber was sometimes counted as one of the members of the youngest Historical School (or its third generation) and declared himself repeatedly to be a student of the school, Schumpeter was never considered even as working on its periphery because he was in the vanguard of theoretical economists. However, Schumpeter’s aspiration to a universal social science was informed by the German Historical School, although he seldom revealed it when he addressed his Anglo-American audience after he left Germany for the United States in 1932. This collection treats Schumpeter, the apparent outsider of the German Historical School, as its key associate among the three addressed and approaches Schmoller and Weber through Schumpeter’s looking glass.

The unifying idea of the Schmoller-Weber-Schumpeter nexus in this book is to rationally reconstruct the methodological essence of the German Historical School led by Schmoller on the basis of Weber’s and Schumpeter’s works. Whereas Schmoller had devised a distinctive research program of economics as well as massive historical research that relied on a deep belief in historical economics, both Weber and Schumpeter, as the creative successors of the German Historical School, developed a characteristic methodology that contributed to the theoretical, if not actual, resolution of the *Methodenstreit* (the controversy on method between Schmoller and Carl Menger, or between

history and theory), and explored the unique field of economic sociology or *Sozialökonomik* that was methodologically designed for the synthesis of history and theory. By the synthesis of history and theory I mean the theoretical formulation of history, or “reasoned history” (*histoire raisonnée*)—to use Schumpeter’s favorite term—, or the “ideal-type construction of history”—to use Weber’s formula—, both of which are different from the mere collection, classification, summarization, and ad hoc explanation of historical data.

According to Weber and Schumpeter, the real challenge of the German Historical School to mainstream economics was not the dichotomy between theory and history, between nomothesis and idiography, between generality and specificity, between universality and individuality, between deductivism and inductivism, and so on. Rather, it was the need to analyze the overall picture of society, based on the conception of the whole man, from evolutionary and comparative perspectives. From these perspectives, other crucial concepts such as history, ethics, and institutions will follow.

This book focuses on the methodological aspects of the German Historical School because whereas its historical and theoretical work on economic institutions and its political and social advocacy were inevitably constrained by the historical context, its methodological contributions to the social sciences have been general and universal. Schmoller’s research program had proposed the methods and procedures by which a “historical-ethical approach” to economics could be substantiated in economic sociology. Schmoller’s defects, however, lay in the methodology for establishing a foundation of economic sociology. The contributions of Weber and Schumpeter in exploiting the potentialities of the German Historical School are found in their construction of the methodological foundation of economic sociology, which I contend could serve as the source of a future research paradigm in economics across time and space.

It is remarkable that the neo-Kantian philosophy (represented by Heinrich Rickert) as the basis of Weber’s methodology, on the one hand, and the early positivist philosophy (represented by Ernst Mach) as the basis of Schumpeter’s methodology, on the other, converged into similar methodological thought through their conscious orientation toward economic sociology. This methodological idea, combined with the scope and method of a universal social science, is called here the “soul of the German Historical School.” By the soul I refer to the Greek *psyche*, meaning the breath of life, which differs not only from the *nous* embodied in intellectual achievements but also from the *mind* embedded in the body or society. As, according to the Platonic conception, the soul is related to the general ideas and rational reconstruction of thought, it can transmigrate between bodies or societies. This book describes how the soul of the German Historical School was succeeded, reconstructed, and developed by Weber and Schumpeter at the peak of the school so as to crystallize the use of teleological holism and instrumentalist methodology as the tools needed to arrive at the big picture of society.

Why can Schumpeter be regarded as the key contributor to this project? Indeed, my knowledge of Schmoller and Weber is relatively limited compared to that of Schumpeter. But I find in Schumpeter's work three useful organizing ideas to reconstruct the soul of the German Historical School, the ideas that I suspect have been little known to both contemporary Anglo-American theoretical and historical economists.

The *first* idea is Schumpeter's interpretation of Schmoller's historical-ethical approach as the prototype of economic sociology in his article, "Gustav v. Schmoller und die Probleme von heute" (1926). This proved to be a noticeable declaration of the "first Schmoller renaissance" in the midst of the dismissive academic atmosphere of the inter-war period following the defeat of Germany and the demise of the German Historical School. Schumpeter was concerned with "*living* Schmoller and his *influential* message, not with what is combined with his rich personality and is today nothing more than a memory and monument."²

The *second* idea is his formulation of economic methodology as instrumentalism in his first book, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908), which is meaningfully compared to Weber's methodology of *verstehende* (interpretive) sociology. Schumpeter's instrumentalism is different from the caricatured notion of instrumentalism, which is the way most economists understand the term today. It is expected to apply to much broader fields of the social sciences.

The *third* is his idea of a universal social science in the last (seventh) chapter of his *Theorie der wirtschaftlichen Entwicklung* (1912), which was entitled "*Das Gesamtbild der Volkswirtschaft*" (The Overall Picture of the Economy). Since he deleted this chapter from the second and subsequent (including English) editions of *Entwicklung*, that idea has long remained unnoticed. This chapter, revealing for the first time the idea of Schumpeter's research program for a universal social science, presents not only a useful clue to understanding his wide-ranging work but also his alternative to the past major attempts to construct a universal social science. Incidentally, the chapter can be seen to compete with the last (fourth) book entitled "*Die Entwicklung des volkswirtschaftlichen Lebens im ganzen*" (The Development of Economic Life as a Whole) in Schmoller's *Grundriss der allgemeinen Volkswirtschaftslehre* (1900–1904).

Although these three critical works of Schumpeter's (1908, 1912, and 1926) had long been available only in German, it is a welcome development that one of them, the seventh chapter of the first edition of *Entwicklung*, was recently translated into English in the first volume of the series, "The European Heritage in Economics and the Social Sciences."³

I discuss each of the three ideas, which constitute the core blocks of this book, in Chapters 2, 5, and 7. Schumpeter also displayed a masterly skill in writing the history of economics; his penetrating analysis of the doctrine and method of the German Historical School is also utilized as the basis of this book.

Let me explain briefly the content of each chapter. Chapter 1 describes the nature of the approach taken in this book as the rational reconstruction, rather than the historical reconstruction, of the German Historical School and Schmoller.⁴ I do not contend that the German Historical School had a single overarching vision of historical economics, but that one aspect of its scholarship can be reconstructed through artificial efforts of the human mind to mine the valuable groundwork for evolutionary and institutional thinking from its quarry. Of course, such a reconstruction must contribute to an understanding of the German Historical School as well as to the orientation of our contemporary research that must extend beyond the scope and method of mainstream economics.

Schmoller's idea of economic research originated from a simple notion, inherited from the older Historical School, that the economic process consists of the interactions between the natural-technical and the psychological-ethical factors of society, and proceeded to the formulation of the historical-ethical approach. However, his historical-ethical approach was diametrically opposed to the theoretical-economic approach of mainstream economics. A more balanced view might be that the relationship between natural-technical and psychological-ethical factors was the quintessence of the moral sciences in the eighteenth century, which I formulate as the evolutionary approach to the interaction between the "mind and society," and that the German Historical School is logically located within the framework of this approach.

Chapter 2, on a methodological evaluation of Schmoller's economic research program, analyzes the structure of his historical-ethical approach in terms of two axes: history versus theory and ethics versus economy. Schmoller's vision of economic research was concerned with the whole range of these controversial issues. According to Schumpeter, the combined vision of the development and unity of social life was the essence of the German Historical School. I suggest the use of instrumentalism and teleology to sustain the structure of Schmoller's historical economics or economic sociology.

Chapter 3 is intended to interpret Weber's methodological work for sociology as essentially equivalent to instrumentalism and to remove the barrier between sociology and economics. Importantly, Schumpeter's approach to economic sociology, starting from theoretical economics, differed from Weber's, which started from the overarching tool of sociology. The goal of my methodological investigation of the German Historical School is to help to discover, understand, and justify the approaches to economic institutions and their changes from the standpoint of Schumpeter and Weber.

Chapter 4 presents a summary view of Schumpeter's relationship with the German Historical School, covering the reconstruction of Schmoller's research program and Schumpeter's conception of economic sociology. Schumpeter's *Capitalism, Socialism and Democracy* (1942) was not a "pot-boiler," as he often called it, but a serious work of economic sociology focused on the evolution of institutions in terms of the consistency (or inconsistency) between economic machinery and value schemes, or the interactions between economic factors and noneconomic factors.

Chapter 5 is an interpretation of Schumpeter's *Wesen* as the application of Ernst Mach's philosophy of science to economics. If it is admitted that neoclassical economics emerged from the metaphor of mechanics, Schumpeter put the final touches on its system, laying the groundwork for its paradigm by ingeniously adapting the methodology of natural science to economics.

For Schumpeter, however, instrumentalist methodology was not confined to abstract economic theory. Insofar as economic sociology is also a theory, the same methodology can be applied to a broader perspective of economic and social change. I have examined the applicability of instrumentalism with regard to Schmoller and Weber in Chapters 2 and 3, respectively. Chapter 6 further explores the methodology of economic sociology in reforming the methodological foundation of the German Historical School.

Chapter 7 describes Schumpeter's research program for a universal social science or a comprehensive sociology, relying on the missing seventh chapter of the first edition of his *Entwicklung*. His program consists of three layers of economic research: economic statics, economic dynamics, and economic sociology. This represents half of the system of the moral sciences; in other words, it is a system of substantive theory that is distinct from a system of metatheory. Schumpeter the polymath also worked in the area of metatheory that includes the philosophy of science, the history of science, and the sociology of science; thus what he delivered throughout his life was much broader than what he planned in his missing seventh chapter. I call his broader system a "two structure approach to the evolution of the mind and society," as referred to in Chapter 1 of this book.

Although this book addresses the German Historical School through the looking glass of Schumpeter, it is untrue that he was concerned only with the tradition of that school. His intellectual background was influenced primarily by Léon Walras, Karl Marx, and Schmoller. In his preface to the Japanese translation of *Entwicklung*, he explained the aim of the book with special reference to Walras and Marx.⁵ Chapter 8 examines how Walras and Marx could coexist coherently within Schumpeter's thought; this is the question that has confounded Schumpeter scholars who have sometimes regarded him as somewhat schizophrenic. Whereas Schumpeter's conception of economic sociology that was inspired by Schmoller relates to the formal framework of socio-cultural development, his theoretical analysis based on the presumption of Walrasian and Marxian visions provides the substantive content for the workings of the economy and society.

Chapter 9 focuses on Schumpeter the historian of economic thought. Contrary to a commonplace view that he pursued the development of analytical economics along Walrasian lines, I elucidate how he assessed the attempts of economic sociology as they appeared in the historical literature in light of his research program for a universal social science. Whereas Chapters 2, 3, and 6 consider the relationship between economics and sociology from the methodological viewpoint, Chapter 9 examines that relationship from the perspective of the history of thought, covering Comte, Marx, Pareto, and Weber.

In Chapter 10 I discuss the supporting evidence on the role of instrumentalist methodology in Schumpeter's concrete work on business cycles, another example of his synthesis of theory and history. The evidence is his preface to the fourth German edition (1935) of *Entwicklung*, which supplements the previous chapters (Chapters 2, 3, and 6) on instrumentalism. It might be argued that the disagreement between Schumpeter and Simon Kuznets (a Schumpeter critic) on his work on business cycles is reminiscent of the *Methodenstreit*.

The genealogy of the Schumpeter family is appended as Chapter 11. When I visited Schumpeter's birthplace, Třešť, Czechoslovakia, in August 1989, this small town was governed by the communist regime just before its fall. I found that although Schumpeter himself was despised there as the puppet of capitalists, the history of his family had been indispensable to the town of Třešť for four hundred years even without Schumpeter the economist. I am deeply indebted to the staff of the town office and regional historians for decoding the historical record.

With the increasing acceptance of evolutionary and institutional thinking among contemporary economists, general interest in the German Historical School and Gustav von Schmoller in particular has risen steadily during the past decade.⁶ This can be called the "second Schmoller renaissance." Isaiah Berlin characterized the rise of German romanticism as a great turning point in the history of Western thought.⁷ The German Historical School, belonging to the tradition of historicism as part of German romanticism and idealism, wrought a radical transformation in the outlook of economics. Yet mainstream economics has never taken the impact of the romantic revolution on economics seriously; it is only in recent decades that economic thinking in the form of evolutionism and institutionalism is gradually returning to it. However, because the so-called neo-Schumpeterian evolutionary economics is largely confined to the problems of technological innovation, it cannot cope with the challenge of Schumpeter's socio-cultural development. Similarly, the so-called new institutional economics is an extension of neoclassical economic theory and thus unable to cover the subject matter of Schmoller's historical-ethical approach. I cannot but suspect that there is a strong divide between the Continental and the Anglo-American perspectives on the social sciences.

In editing the articles for this volume, I have not changed their content in principle. Rather, my revisions involved three nonsubstantive areas. First, as the original articles inevitably overlap somewhat, I tried to eliminate duplication as much as possible. Second, I used a consistent style for the text, notes, and references. Third, I tried to reduce grammatical shortcomings contained in the original articles.

Notes

- 1 J. A. Schumpeter, *History of Economic Analysis*, New York: Oxford University Press, 1954, p. 809.
- 2 J. A. Schumpeter, 'Gustav v. Schmoller und die Probleme von heute,' *Schmollers Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft*, 1926, p. 339.
- 3 Ursula Backhaus, 'The Theory of Economic Development,' in Jürgen Backhaus (ed.), *Joseph Alois Schumpeter: Entrepreneurship, Style and Vision*, Boston: Kluwer Academic Publishers, 2003.
- 4 For a recent work of the historical reconstruction of Schmoller, see Erik Grimmer-Solem, *The Rise of Historical Economics and Social Reform in Germany 1864–1894*, Oxford: Clarendon Press, 2003.
- 5 J. A. Schumpeter, 'Preface to the Japanese Edition of *Theorie der wirtschaftlichen Entwicklung*,' 1937, reprinted in R.V. Clemence (ed.), *Essays of J. A. Schumpeter*, Cambridge, Mass.: Addison-Wesley, 1951.
- 6 Helge Peukert, 'The Schmoller Renaissance,' *History of Political Economy*, Spring 2001.
- 7 Isaiah Berlin, 'The Romantic Revolution: A Crisis in the History of Modern Thought,' in *The Sense of Reality*, New York: Farrar, Straus and Giroux, 1996, pp. 168–70.

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1. Rational Reconstruction of the German Historical School: An Overview

Historicism in economics originated in Germany in the latter half of the nineteenth century. According to the accepted view in the history of economic thought, the German Historical School had three generations: the Older Historical School (Wilhelm Roscher, Karl Knies, Bruno Hildebrand); the Younger Historical School (Gustav von Schmoller, Lujo Brentano, Karl Bücher, Friedrich Knapp, Adolph Wagner); and the Youngest Historical School (Arthur Spiethoff, Werner Sombart, Max Weber) (Schumpeter, 1954, 807–820). Can one develop a unified picture of the German Historical School from these diversities? If so, in what sense and how?

I. Introduction

The German Historical School has been described as a criticism of British classical economics. In opposition to the universally valid economic theory, it asserted that economic principles should be inductively derived through the study of historical facts of different countries. However, that was an immediate moment; the root of the Historical School must be found in German romanticist, idealist, and nationalistic ideology that was a reaction to rationalism and enlightenment, of which classical economics was one of the products. Therefore, it is understandable that German thinkers such as Johann Gottfried Herder, Adam Müller, and Friedrich List are sometimes regarded as the forerunners of the Historical School.

Quentin Skinner (1969) discussed two approaches to interpreting texts in the history of ideas: one is to emphasize the total historical context in which any text is located; the other is to derive from the text universal propositions apart from the context of history. The two approaches may be called contextualism and textualism. In the same sense, Richard Rorty (1984) distinguished the methods of description in the history of philosophy as historical reconstruction and rational reconstruction: the former places the text in question in the context of the past and identifies what it wanted to say; the latter interprets the text from the standpoint of the present and specifies what it could have said in terms of ideas unknown to the original authors. The distinction between ‘meaning’ and ‘significance’ may also be attributed to the goals of the two methods of reconstruction, respectively.

The German Historical School can be reconstructed in terms of a historical as well as a rational context. According to the German perspective, the

organicist *Weltanschauung* was politically oriented toward industrialization of less-developed Germany and concerned with the building of an institutional framework on a national basis and thus could not accept British *laissez-faire* economics. But the importance of the German Historical School cannot be overemphasized in its historical role alone. The fact that its thought was partly implanted in other countries—e.g., England, the United States, and Japan—in its heyday and that some of its influence was revived in Germany after its decline reflects its universalizable elements. Despite divergences among the members of the school, its intellectual project can be generalized through an interpretation and reconstruction of the scope and method of economics; this suggests a new perspective that may provide an alternative to present-day mainstream economics. This chapter presents the framework for a rational reconstruction of the German Historical School, and explores the relevance of its thought to current evolutionary and institutional thinking.

II. Evolution of the Mind and Society

Social science observes social reality and constructs theory, which, in turn, becomes an object of observation. Social science is thus characterized by its duality: it addresses social reality and its achievement becomes an object of social science. These dual aspects of social science can be represented by the notion that the mind and society interact in a historical process.

In this sense, suppose that there are two objects of study in social science: society and the mind, or economy and economics, as far as economic science is concerned. The former relates to a whole group of real and organizational factors of society and the latter to spiritual and ideational factors of society. We will assume that the system of theory addresses society and that the system of metatheory addresses the mind. Theory in economics comprises economic statics, economic dynamics, and economic sociology, which differ in scope and method as they relate to an economic society. Metatheory, which considers the mind or thought, is a theory about theory and consists of the philosophy of science, the history of science, and the sociology of science. Thus the structures of theory and metatheory are parallel in the sense that in social science both society and the mind are analyzed at three levels: the static, the dynamic, and the social. The two structures can be interpreted as the system of theories for two different social areas: the mind and society. I call this concept of social science a two-structure approach to the mind and society (Shionoya, 1997, 262–65).

From this observation it can be inferred that just as a social study, whether historical or theoretical, focuses on social reality and attempts to make a subjective construction of the reality, so a study of theories is merely a subjective construction of those theories because they are part of social reality. Studies conducted in the past, which may be classified as culture, science, thought, or whatever, are now part of the social reality. An approach to

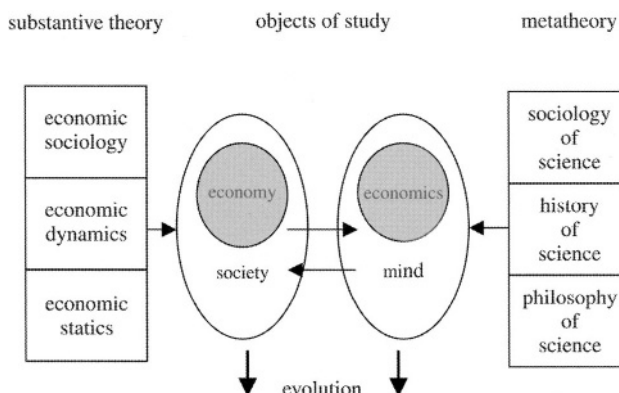


Figure 1. Two-structure approach to the mind and society (Source: Yuichi Shionoya, *Schumpeter and the Idea of Social Science: A Metatheoretical Study*, Cambridge University Press, 1997, p. 265.)

previous studies, whether an interpretation or a critique, is also either historical or theoretical.

Figure 1 summarizes the two-structure approach to the mind and society, which I developed through an inquiry into the work of Joseph Schumpeter. Contrary to the conventional view, I believe that Schumpeter should be regarded as one of the successors of the German Historical School because he attempted a rational reconstruction of that school, especially Schmoller's research program, in terms of economic sociology and made his own contribution from this perspective (Schumpeter, 1926). The framework of his approach thus will be useful in reconstructing the Historical School.

The left part of Figure 1 shows that substantive theory addresses social reality or the real aspects of society and attempts to subjectively construct the reality, where three levels are distinguished in theoretical or historical investigation. When the focus is on the economy, the levels of economics include economic statics, economic dynamics, and economic sociology. The right part of figure shows that metatheory is merely a subjective reconstruction of mind products or scientific theories, which consist of the philosophical, historical, and sociological investigation of thought and science. Rorty's distinction between historical and rational reconstruction is the first approximation that does not distinguish between types of metatheories.

The important conception underlying the two-structure approach is that interactions between the mind and society shape historical evolution and that the mind and society are two aspects of the same evolutionary process. In Schumpeter's view (1954, p. 137), this recognition is attributable to Giambattista Vico, the eighteenth-century Italian thinker. Because Vico is regarded as the first serious critic of Cartesian rationalism and the founder of nineteenth-century historicism, I argue that the evolution of the mind and society is key to understanding the German Historical School, which took ethics seriously as a determinant of social schemes in an evolving process.

Attempts to explore the interactions between the mind and society are illustrated, among others, by Karl Marx's distinction between the substructure and superstructure of society, Weber's association between the Protestant ethic and capitalism, and Schumpeter's thesis that capitalism will fall because of its moral failure resulting from its economic success. These attempts are understood in light of the two-structure approach that models the research program of the German Historical School.

Schumpeter summarized six basic perspectives of the German Historical School: (1) the unity of social life, (2) a concern for development, (3) the organic nature of society, (4) the plurality of human motives, (5) individuality rather than generality, and (6) historical relativity rather than universality (Schumpeter 1914, 110–13). Of these perspectives, Schumpeter attached much importance to the combination of (1) and (2), contrary to the standard view of historicism, which emphasized the combination of (2) and (5), as was evident in the work of Ernst Troeltsch and Friedrich Meinecke. In a historical process, according to my interpretation of Schumpeter, all aspects of society change through multifarious interactions; this entails endogenous development or evolution because all social factors are included in the process. Interrelationships between the mind and society represent a simplified model of this process and are the object of economic sociology, in which historical individuality is incorporated into an appropriate theoretical schema such as typology or stage theory. I will now discuss how the German Historical School is restructured as a theoretical scheme that deals with an evolutionary process by means of the historical-ethical method.

III. Historical-Ethical Method

Schumpeter argued that the German Historical School was developed as a genuine school under Schmoller's leadership (Schumpeter 1914, 100–101; 1954, 809–14). This is how Schumpeter interpreted the rational reconstruction of the Historical School. Schmoller called his method 'historical-ethical' (Schmoller 1897, 26): this sloganistic advocacy of method is merely a rational reconstruction of the school that would serve as a strategy for its integration and development in the future. Elsewhere I have examined Schmoller's research program in greater detail and argued that much of his program should be revised from the viewpoint of rational reconstruction (Shionoya, 1995).

On the basis of this dual method, the Historical School opposed not only British classical economics but also contemporary German and Austrian neoclassical economics. The latter confrontation included the *Methodenstreit* between Schmoller and Carl Menger and the *Werturteilstreit* between Schmoller and Max Weber. Although it is commonly believed that Schmoller lost both battles, such an outcome was not necessarily the result of rational investigation. To discover clues to a rational reconstruction of the German

Historical School, let us analyze the meaning and significance of the historical-ethical method in economics separately.

1. Empiricism versus rationalism

In the *Methodenstreit* the historical method, or empirical and inductive method, was diametrically opposed to the abstract, theoretical, and deductive method, and the relative superiority of the two methods was the bone of contention. But even for Schmoller the historical method was not simply directed to the accumulation of historiography and historical monographs; rather, it aimed to gather materials to ultimately build a broader theory for the institutional framework of the economy and its historical changes.

In hindsight it is pointed out that the real issue in the *Methodenstreit* was not methods as such but problems to be pursued: *utility and price* or *institution and evolution*. Neoclassical economists focused on the former, whereas historical economists addressed the latter. A method's validity and effectiveness depends on the problems: for the Historical School, the method based on *history and ethics* was advocated to deal with the problem of *institution and evolution*. In later years, in recalling the *Methodenstreit*, Schmoller acknowledged the relationship between methods and problems (Schmoller 1911, 479).

Even the controversy was not inevitable. Although Schmoller's historical-ethical method mainly focused on explaining the institutional foundations of the economy, he admitted the value of the neoclassical analysis of utility and price within the framework of institutional analysis. His comprehensive, two-volume *Grundriss der allgemeinen Volkswirtschaftslehre* (1900–04) was an attempt to develop a system of economics on the basis of historical knowledge; in other words, he intended to integrate two economics. Whether he succeeded or not is another story. The study begins with the 'anatomy' of the institutional framework involving ethics, then argues the 'physiology' of economic circulation in terms of price and income, and concludes with his observations on the development of society as a whole.

Schmoller held that the development of human recognition takes place as the alternation of rationalism and empiricism (Schmoller 1888, 147); instead of making a rash generalization on a poor empirical basis, one should engage in empirical research before launching into the theoretical treatment of historical materials, insofar as the major object of economics is the evolution of economic institutions in a historical process.

The lesson of the *Methodenstreit* is the recognition that new theories would be formulated through feedback between theoretical and historical approaches. To permit continuous feedback, we should make explicit the research task for which cooperation between theory and history will be most necessary and feasible. The need for as well as the difficulty of such cooperation will increase as one goes up the layers from economic statics to economic dynamics to economic sociology (see figure 1). Schumpeter (1926)

defined Schmoller's historical method as the prototype of economic sociology, the theoretical discipline for the development of institutions in terms of interactions among individuals. Schumpeter later coined economic sociology as the generalization, typification, and stylization of history by means of institutional analysis and located it as one of the four disciplines in economics beside theory, history, and statistics (Schumpeter 1954, 20).

The fundamental defect of the historical method in the German Historical School was the methodological view that theory or law must be a summary or generalization of empirical facts. Since it is extremely difficult to acquire information about the total historical development of economic life, a theoretical formulation based on the historical method would never be attained within a finite time. The School's opposition to simple and unrealistic assumptions in theoretical economics was also derived from this naïve empiricism. When Schmoller (1911, 467–68) considered the nature of concept formulation, he argued that concepts are an auxiliary means to organized thought, not a perfect copy of reality, admitting nominalism instead of realism. But because he believed that the ultimate goal of science was still realism, he suffered from the serious contradiction between nominalism and realism.

To utilize feedback between theory and history, one should not wait until extensive data are collected in order to endow concepts with as rich an empirical content as possible. From nominalism it is only a step to instrumentalism, the view that theories are not descriptions but instruments for deriving useful results and are neither true nor false. Instrumentalism asserts that assumptions or hypotheses are arbitrary creations of the human mind and need not be justified by facts, and that theories deduced from assumptions are not descriptive statements in themselves but instruments for understanding and explaining facts. Although a collection of historical facts is welcome, economic sociology based on the historical method should be formulated on the methodology of instrumentalism.

Schumpeter, adapting instrumentalist methodology to economic sociology, carried out a wide range of investigations mainly in terms of the interactions between economic and noneconomic phenomena, treating noneconomic elements as a set of social institutions surrounding the economic area (Shionoya, 1997, 193–222). It should be noted that Max Weber also tried to develop a solid foundation for economic sociology by linking economic phenomena with political, legal, and religious phenomena (Swedberg, 1998). His methodology of ideal type was a version of instrumentalism specifically applied to the historical method (Shionoya, 1996). In addition to the work of Schumpeter and Weber, it is possible to add Werner Sombart's threefold approach of economic spirit, order, and technology to see what the rational reconstruction of the German Historical School has produced: all three scholars contributed to the development of an economic sociology that was based on the substantiation of the historical method as it applied to the interactions between economic and noneconomic areas.

2. Morality versus self-interest

The second distinctive feature of the German Historical School is its emphasis on the ethical method. Although it seems generally accepted that Schmoller was also defeated in the *Werturteilstreit*, that is not a valid interpretation. It is indeed true that ethical value judgment was denied by Weber's thesis of value freedom in science. But this means neither that social science should not deal with value judgment, nor that Schmoller's ethical method should be rejected simply because it is value laden.

To avoid misunderstandings about the German Historical School and to attempt its rational reconstruction, it should be noted that the ethical method as a scientific method implies a hypothetical assumption in economic theorizing. It assumes that human behavior is motivated by various considerations other than self-interest, including morality, law, and customs. If this were the expression of value judgment, the assumption of the self-interested man in mainstream economics, which was ridiculed by Thorstein Veblen as a 'lightning calculator of pleasures and pains' (Veblen 1919, 73) and by Amartya Sen as a 'rational fool' (Sen 1977), would have been condemned as a sort of value judgment commending egoism. In fact, Schmoller did not advocate any subjective value judgments, but dealt with the evolution of the historical process in which ethical values are developed as a matter of facts and tried to explain the reality in terms of broader human motives. In his view, values in the form of law, morality, and custom are embedded in institutions and play a leading role as the determinants of evolving institutions and of consequent economic performance.

Schmoller asserted that the ethical approach not only aims at the recognition of moral facts that are embedded in social institutions but also is conceived in a teleological form (Schmoller 1911, 437). The nature of teleology in Schmoller is quite important in appraising his ethical method but has been little noticed. From the Kantian teleological perspective, society is assumed to have certain ends that are explained as if human actions and social systems might work spontaneously and reciprocally to achieve those ends based on the teleological relationship between ends and means. If a society can be regarded as a unified entity with its own ends—in other words, if holism can be assumed—, a teleological inquiry is useful to make an estimate of the world about us in terms of the relationship between ends and means. Since moral values are to govern society as a whole, teleology is effective in the study of institutional organizations embodying ethics.

The principle of teleology cannot be used for cognitive purposes in the strict sense; it can be employed only by reflective judgment to guide an investigation of an organic entity. Schmoller regarded teleology as a heuristic device that supplements an empirical study when historical knowledge is insufficient. Teleology assumes that individuals behave as if they would purposefully serve the ends of the whole. For Schmoller, the leverage for this purpose was ethics of justice. The teleological ends would be realized in an evolutionary process based on interactions between ethics and institutions. Schmoller's teleology

relates to methodological holism and has nothing to do with the justification of a specific ideology.

The ethical method thus has two functions in historical economics: first, ethics is understood empirically as a determinant of human behavior and social systems; second, it is assumed methodologically as a teleological principle of social inquiry. In restructuring the German Historical School, the combination of teleological holism and instrumentalist methodology will provide the historical-ethical approach with a legitimate foundation. In other words, the status of ethics in the Historical School should be interpreted as a value premise, not as a value judgment.

IV. Institution and Evolution

The German Historical School is characterized by the unique attempts of the stage theory of economic development. Schmoller in particular tried to formulate a stage theory of institutions in terms of the interactions between economy and ethics (Schmoller 1900–04, vol. 1, 53–57). He distinguished social systems in the family, the regional community (village, city, and state), and the business firm. Each system is based on a different organizational principle: sympathy, kinship, and love for the family; neighborhood, nationalism, law, and coercion for the regional community; contract for the firm. What Schmoller meant by the ethical determinants of institutions relates to these principles. Contrary to a self-interest model of economy, historical economics pays attention to a community in which individuals share common values and the public interest in pursuing economic activities on the basis of their culture, history, and traditions.

From autarkic family economy or tribal economy there developed two types of organizations. On the one hand, organizations of the regional community such as village economy, city economy, territorial economy, and national economy were formed for the purpose of controlling economic life and serving the public interest at different levels of the regional economy. On the other hand, business firms were developed as organizations to pursue profits, and the private enterprise system entailed various institutional arrangements such as the division of labor, markets, social classes, property ownership, and so on.

Schmoller's scheme of development in stages from village economy to city economy to territorial economy to national economy was based on the idea that the institutions of community are the carriers of social policy to control the free play of firms in the marketplace. His stage theory was concerned with the evolution of institutions brought about by the interactions between ethics and economy, between spiritual-social and natural-technical factors. It basically differed from the notions of the Older Historical School that relate to the natural-technical aspects of the economy.

1. Economics of latecomers

The idea of institutional evolution stressed by the German Historical School has relevance to contemporary thinking in economics and ethics. Several factors are involved in the idea of institutional evolution: first, Germany was a latecomer to the process of industrialization inaugurated by Great Britain; second, the industrialization process is quite diverse across countries; third, a latecomer depends on institutional factors rather than on *laissez-faire* to catch up advanced countries; fourth, institutional development is explained not so much by the free choice of autonomous individuals in markets as by the sense of community and coordinated actions based on shared values.

These themes are integrated in Alexander Gerschenkron's thesis of economic backwardness, which denies the uniformity of economic development among countries and recognizes a differentiated pattern of development that is systematically accounted for by relative degrees of backwardness (Gerschenkron 1962). Gerschenkron's thesis represents neither a universal proposition nor a descriptive, unique history of economic development but rather an intermediate schema, i.e., a typology. If all economic phenomena were characterized by perfect uniformity, there would be no reason to talk about institutions for which certain economic phenomena were typified; only one meaningful institution would exist. On the other hand, if all economic phenomena were *sui generis*, one could not categorize them according to a particular type or group; there would be such an infinite variety of behavioral patterns that it would be useless to consider types.

The concept of institution is essential to historical research in two senses: first, in the cognitive sense, institution makes a typological observation possible despite the seemingly infinite complexity of history; second, in the practical sense, institution is a strategic device of latecomers for catching up to advanced countries through a differentiated growth path based on the degree of economic backwardness. Thus the institutional approach of the German Historical School is not a uniquely historical product but is generalized in the economics of latecomers. Furthermore, to meet the demands of the German Historical School their stage theories should be replaced with typological theories that admit a differentiated growth path instead of maintaining a standard stage sequence.

2. Communitarian ethics

What constitutes the strategy of latecomers in terms of institutional devices is communitarian ethics. The current debate in ethics and political philosophy between liberalism and communitarianism is, I argue, a reproduction of British classical economics and German historical economics (Shionoya, 2004). Community is characterized by common social practices, cultural traditions, and shared values; it is something more than a society of free and autonomous individuals. Communitarians emphasize the social

embeddedness of individuals in contrast with liberalism, which stresses individual rights and conceives of the individual as the ultimate source of values.

The controversy between liberalism and communitarianism is not a genuine conflict of values as there was no genuine conflict of methods in the *Methodenstreit*, in which different models of man were disputed between theorists and historians. The two doctrines deal with morality of a different scope: liberalism is concerned primarily with a universal principle of justice to be observed by free and equal citizens, whereas communitarianism assumes the existence of a limited community and is concerned with the common good to be shared with the members of the community. Communitarianism is a version of virtue ethics that should prevail in a community as an institution. Since virtue ethics represents normative values such as excellence, it might fit into the framework of teleological arguments for the evolution of institutions.

V. Conclusion

In conclusion, the rational reconstruction of the German Historical School suggests that a lot of tasks must be performed to provide an alternative paradigm to the mainstream with regard to the method, scope, and underlying value premises of social science. Our attempt of the rational reconstruction intends only to offer an overview of the German Historical School from the methodological perspective. Substantive contents should be worked out in various ways at the frontiers of economic research. The relevance of the German Historical School to contemporary ideas demonstrates its challenging potentiality. Let me summarize the skeleton of our observations.

First, the style of economics as was advocated by Gustav von Schmoller for the German Historical School is conceived as an attempt to address the evolution of the mind and society. In the history of economics, this overall approach is comparable only to the work of Marx, Weber, and Schumpeter.

Second, to deal with this problem, which naturally went beyond the scope of mainstream economics, the German Historical School proposed the innovative, historical-ethical method and emphasized empiricism against rationalism and morality against self-interest. This does not mean the denial of theory but the demand for a new theory.

Third, based on this method, the German Historical School endeavored to develop the economics of institution and evolution, which provided the “anatomy” of the institutional framework and its evolution in contrast to the “physiology” of a static economy. The economics of evolutionary institutions entailed the political and moral implications for the catching up strategy of latecomers and the role of communitarian ethics.

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2. A Methodological Appraisal of Schmoller's Research Program

I. Historical and Ethical Approach

Speaking on the occasion of his inauguration as rector of the University of Berlin in 1897, Gustav von Schmoller (1838–1917) remarked proudly: “Today’s economics has reached a historical and ethical conception of nation and society contrary to rationalism and materialism” (Schmoller 1897, 26). He affixed the label “historico-ethical” to his German Historical School (Schumpeter 1954b, 812). Although both historical and ethical factors have been expelled from the scope of mainstream economics, there always has been some sort of yearning for those factors behind the seeming scientific objectivity of economics. In this article I analyze the structure of the historical-ethical approach in Schmoller’s economics in order to derive its relevance in modern times.

As Joseph Alois Schumpeter related, economics grew from two distinct roots: the philosophical speculation of *Weltanschauung* and the discussion of current practical affairs, or, briefly, “philosophy” and “policy” (Schumpeter [1914], 21; 1954a, 9–11). By the first root Schumpeter meant the philosophers’ ideas on society that originated with Aristotle and were brought to completion as “moral philosophy”; by the second he meant “popular economics,” which was molded by merchants and officers in their ordinary business life and coined mercantilism and cameralism, respectively.

Although economic thought had been brought up initially by “philosophy” and “policy,” it was established later as a science by getting rid of them. Thus economics refrained once and for all from indulging in the speculation of *Weltanschauung* without observations of reality, on the one hand, and from recommending practical policy without recognition of the interrelationship among individual economic affairs, on the other. Specifically, economic science was established by growing attempts in seventeenth- and eighteenth-century Europe to discover the mechanism of economic phenomena on the basis of empirical facts. Thus British classical economists first found in the emerging capitalist economy an orderly mechanism with regard to the formation of prices and income. As the two sources of economics, we can say, philosophy stimulated ethical inquiries into a microeconomic order through the topics of justice in exchange, virtue in trade, legitimacy of interest and so on, and policy provided the task of finding a macroeconomic order through the topics of money, prices, balance of trade, and the like. Classical economics, in this way, jettisoned ethical and political elements to bring into relief an economic mechanism with regard to both micro and macro aspects.

The fact that a scientific system of economics was established and the scope and methods were defined for its system means that the conception of economy as the object of study was fixed in a certain way. Establishment of a scientific system is usually followed by development and elaboration within that system, on the one hand, and by criticism and controversy from outside the system, on the other. Neoclassical economics and Marxism were examples of the internal development and elaboration of classical economics, and the German historicism was a case of external criticism and controversy.

The German Historical School advocated a historical perspective that had never played a paradigmatic role in economic thinking, and it claimed that the economy can be properly conceptualized only from that perspective. For its proponents, the historical approach was a challenge to the theoretical approach of classical economics. Their emphasis on historical research was based on a new conception of economics, a policy-oriented economics: they were politically opposed to both *laissez-faire* economics and Marxian economics. For them, Schumpeter's notion of the two sources of economics, i.e., philosophy and policy, should not be jettisoned as being of no more use; rather, it should be made full use of as the basis for a new direction of economics.

It was believed that philosophy and policy, if placed in a historical perspective, could positively contribute to the formation of a different type of economics, because both moral values and political programs were now the objects of empirical and objective historical studies. It is important to realize that in the mind of the German Historical School, philosophy and policy were combined from a historical viewpoint. The new economics of the German Historical School, paradigmatically opposed to classical theoretical economics, did not simply consist in the devotion to an immense amount of historical facts. It claimed the two prescientific levers, i.e., philosophy and policy, as the guiding stars for historical research. Thus Friedrich List anticipated the fundamental approach of the German Historical School: "Political economy is based on *philosophy, policy, and history*.... History mediates between two-sided inquiries of philosophy and policy" (List [1844] 1930, 41).

The German Historical School generally emphasized the importance of historical research in reconstructing economics, but it was Gustav von Schmoller, the leader of the younger German Historical School and of the *Verein für Sozialpolitik*, who explicitly combined ethics and history. For Schmoller, ethics gave meaning and direction to historical research in economics. Ethics, the knowledge of a guide for action, must not only be based on a general, abstract principle of moral philosophy, but it must also be applicable to individual, concrete cases of social policy for designing institutions or organizations. In other words, ethics integrated the two separate roots of economics, i.e., philosophy and policy, and the integration was attempted from a historical perspective.

Schmoller maintained that the basic condition of human culture, of which economy is a part, is a religious and moral system and that economic life cannot be understood without the knowledge of the historical development of

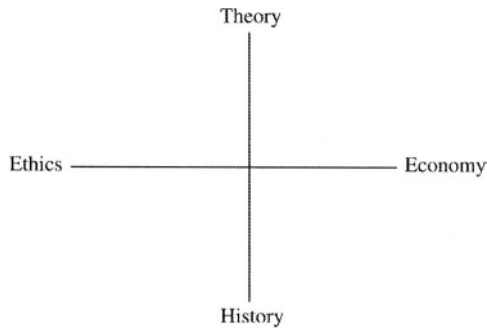
three norms: customs, laws, and morals. Economic institutions or organizations are not only natural and technical but also psychological and ethical in the sense that the social framework does not work without a consensus of ethical values even if that were technically feasible. In fact, the norms constitute the institutional framework of a society (Schmoller 1900, vol. 1, 1–75).

In discussing the past development of moral philosophy as a source of economics, Schmoller found in the speculative endeavors of *Weltanschauung* not so much visions leading to the discovery of an economic mechanism by the British classical economists, as morals leading to the foundation of social institutions in which the economic mechanism was found to function. In discussing another source of economics, namely the development of thought on practical problems in mercantilism and cameralism, Schmoller favored these practical doctrines rather than the abstract theories of their successors, namely the British classical economists, because the former depended on real experience. In other words, he found a framework policy for nation-building more important than macro- and microeconomic relations within a given framework. It should be emphasized that he expended the utmost effort to clarify practical policy in history rather than the doctrines of contemporary statesmen and scholars. Schmoller took both philosophy and policy seriously as the sources of a newly emerging historical economics by combining them under ethical as well as historical perspectives, and focused the aim of historical economics on the development of an institutional framework that conditioned the macro- and microeconomic mechanism. In this sense, the specification of Schmoller's work as "historical-ethical" indicates his unique position in the history of economics.

It is this combination of historical and ethical in Schmoller's approach that Friedrich Meinecke innocently called "an ingenious compromise between German idealism, its ethics, in particular, and positivism and empiricism in Western Europe" (Meinecke 1933, 148–49). The weight of the challenge of Schmoller's historical-ethical approach is illustrated by two controversies created by two aspects of that approach: the *Methodenstreit* between Schmoller and Carl Menger and the *Werturteilstreit* between Schmoller and Max Weber. Schmoller was criticized doubly for banishing theory because of extreme concern about historical research and ethical evaluation. If Schmoller had simply lost these two disputes, most of his essentials would have been denied. In fact, although these disputes appeared to be settled temporarily, the issues that manifested themselves in these debates are perennial. Here lies a reason why Schmoller's approach is now being reconsidered after fifty years of complete neglect.¹

But the pretension of scientific objectivity by the use of historical research for the purpose of concealing an ideological standpoint is no longer maintained, even if it had some practical effects on Prussian civil servants. What is the real ingenuity in the historical-ethical approach of Schmoller? In the following sections I divide the history-ethics relationship into a methodological relationship between theory and history, on the one hand,

Figure 1. Analysis of Historical-Ethical Approach



and a substantive relationship between ethics and economy, on the other. In other words, I assume the vertical theory-history axis and the horizontal ethics-economics axis to visualize a broad perspective of the historical-ethical approach, as indicated in Figure 1.

II. Theory and History

The *Methodenstreit* between Schmoller and Menger with regard to the relative importance of the theoretical method and the historical method in economics ended without a resolution. The antagonism between them is typically shown by their following exchanges of abuses: according to Schmoller, Menger only knew and confined himself to “a corner of the large house of our science” and took it for “the whole house” or “the best and fanciest salon in the house” (Schmoller 1888a, 293–94). In response, Menger asserted: “Schmoller’s view is compared to that of a navvy who wants to be regarded as an architect because he carried some stones and sand to the construction site” (Menger 1884, 46). Each of them relegated the other to such a lowly place in the total body of economics that they could not arrive at a reconciliation.

Most current economists would agree with Schumpeter’s appraisal of the *Methodenstreit*. In his *History of Economic Analysis*, he wrote: “In spite of some contributions toward clarification of logical backgrounds, the history of this literature is substantially a history of wasted energies, which could have been put to better use” (Schumpeter 1954b, 814). This rather negative assessment seems to include different reasons why the debate was a history of wasted energies. Schumpeter himself gave two different reasons on different occasions.

First, in his first book *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908), Schumpeter insisted that because historical and theoretical methods are concerned with different problems, different interests, different categories of hypotheses, and different goals, it is useless to quarrel about the relative importance of the methods. Confronted with the danger of

economics especially in the German-speaking world, he strongly advocated the separation and differentiation of history and theory on the ground of instrumentalist methodology (Shionoya 1990). According to instrumentalism, theories are not descriptions but instruments for deriving useful results; they are neither true nor false. From this methodological standpoint, a specific method can only claim usefulness for the treatment of a specific problem. Although instrumentalism guarantees the peaceful coexistence of history and theory, Schumpeter in *Wesen* tried to clarify the epistemological foundation of theoretical economics in support of Menger. Theoretical economics was defined as a static theory of exchange, and dynamic problems such as capital formation, credit, interest, profit, and crisis, together with all the problems of political, social, and cultural development were relegated to descriptive historical research. The proposal to suspend hostilities in the *Methodenstreit* was a practical expedient and agreed with the circumstances in which instrumentalism was originally devised as an arbiter of unsettled controversies in the natural sciences.

Second, after the publication of *Theorie der wirtschaftlichen Entwicklung* (1912) Schumpeter turned to a discussion of the cooperation of history and theory in order to deal with the dynamic problems of economy. In this case, the controversy between history and theory is useless for a different reason. Both inductive and deductive methods, or empirical and abstract methods, are required for what might be called a joint research between theory and history. In his 1926 essay on Schmoller, Schumpeter called the joint research *economic sociology* and interpreted Schmoller's research program as an approach to this discipline (Schumpeter 1926).

It does not make sense to argue in general terms, as has often been done in assessments of the *Methodenstreit*, that inductive and deductive methods, or empirical and abstract methods do not contradict each other but should cooperate with each other and that for this reason the dispute between these methods is meaningless. This argument does not resolve the *Methodenstreit*. As a matter of fact, the cooperation could not be expected either in Schmoller's field of detailed historical studies or in Menger's field of abstract theoretical studies. The *Methodenstreit* was a misnomer; the real issue was over the scope of economic science. The difference in method only reflected the difference in the scope of the subject matter. Historical science dealing with the concrete individuality of socioeconomic phenomena at large and theoretical science dealing with general concepts for limited, isolated economic phenomena demand completely different methods. It is crucial to find a field where cooperation between history and theory is necessary and feasible. Schumpeter characterized economic sociology as "a special field which, owing to the nature of its object, is not only a detailed and material-collecting discipline but also a theoretical discipline" (Schumpeter 1926, 369–70). He held that the subject matter of this discipline was institutions generally and social classes and business cycles in particular.

But Schumpeter did not accept Schmoller's research program as it stood. He demanded rather radical changes in its scope, methods, and methodology in

order to develop its strengths and limit its weaknesses. It will be illuminating to examine Schmoller through the looking glass of Schumpeter's view of economic sociology, which Schumpeter locates in the toolbox of economic analysis together with theory, history, and statistics (Schumpeter 1954b, 12). Discussed next are (1) the formal aspect, (2) the substantive aspect, and (3) the methodology of Schmoller's research program.

1. The formal aspect

The formal aspect of the research program of Schmoller's economics consists of three steps: (i) the observation and description of economic phenomena according to time and space, (ii) the definition and classification of the phenomena by a coordinated system, and (iii) the causal explanation of the phenomena and recognition of their interrelations (Schmoller 1900, vol. 1, 12; also Schmoller 1911, 455). This program indicates an apparently endless scenario of empirical research. Although Schmoller does not exclude from economics the natural scientific method, general concepts, and regularity, his own research program is confined to the collection and summarization of historical data; he emphasizes the importance of accumulating monographs on historical studies. This was rooted in his basic recognition that economics must deal with complicated and various phenomena and that it is not sufficiently advanced to allow the use of deductive-abstract methods and the formulation of laws. The claim of the German Historical School is not the denial of theory in general but the need for more empirical studies before the theoretical formulation of wide and complicated phenomena in the historical perspective can be undertaken productively.

Comparing empiricism with rationalism, Schmoller held that the development of human recognition takes place as the alternation of empirical and rational methods; he insisted that instead of making a rash generalization on a poor empirical basis, one should engage in empirical research before beginning the theoretical treatment of historical materials (Schmoller 1888b, 147–50). His principle was: "When laws don't exist, we must be content with the broad observation of reality, the classification of these materials, and the inquiry of causes" (Schmoller 1888a, 283–84). These three tasks are nothing more than the three steps described above as the formal aspect of Schmoller's research program; thus, what is meant by the causal explanation in the third step is not based on theories deduced from assumptions but on ad hoc conjectures.

Schmoller's *Grundriss der allgemeinen Volkswirtschaftslehre* (2 vols, 1900–04) was an attempt to develop a theoretical system of economics on the basis of historical knowledge, and economists were surprised to see that he undertook a theoretical work so soon. Although its theoretical content is meager, the book indicates that the German Historical School does not deny theoretical formulation.

2. The substantive aspect

It is the substantive aspect of Schumpeter's research program that determines the content of the program. This aspect relates to a set of specific visions and preconceptions, as a presupposition of empirical research, on how to perceive the subject matter. In his early work on the history of economic doctrines and methods Schumpeter summarized six basic viewpoints of German Historical School: (1) a belief in the unity of social life and the inseparable relationship among its component elements, (2) a concern for development, (3) an organic and holistic view of society, (4) a recognition of the plurality of human motives, (5) an interest in concrete, individual relations rather than the general nature of events, and (6) historical relativity (Schumpeter 1914, 110–13; 1954a, 176–80). We can hope for no better analysis of the methodological characteristics of the Historical School than this. Of these viewpoints, Schumpeter gave unqualified approval to (1) and (2); he agreed with (3) and (4) at least in their more moderate forms; and he abandoned (5) and (6) because they rejected *a priori* the possibility of a general and universal viewpoint.

The greatest significance of the historical method for Schumpeter was the recognition that historical materials reflect the development phenomenon, indicate the relationship between economic and noneconomic facts, and thus suggest how the disciplines of social sciences should interact. This recognition of the development and unity of social life is the combination of viewpoints (1) and (2), the essence of the German Historical School as Schumpeter understood it. For this reason Schumpeter found in Schmoller's research program the "outlook of a universal social science" (Schumpeter 1926, 365). It is well known that Schumpeter admired Marx, but he admired Schmoller for the same reason. He highly praised those scholars who had a grand research program covering the historical development and intertwinement of social aspects as a whole. Marx was one of them; another was Schmoller. Schumpeter offered the name "unitary Social Science" to Marx's vision of social evolution in the same sense in which he called Schmoller's program a "universal social science" (Schumpeter 1954b, 441). But Schumpeter noticed an important difference between Marx and Schmoller. He was critical of Marx's economic interpretation of history. He lumped together attempts at reducing a whole historical process to the action of one or two factors as a simple hypothesis of the "Comte-Buckle-Marx kind" and contrasted them with Schmoller's pluralist approach to which he was quite sympathetic (Schumpeter 1954b, 811).

While viewpoints (1) and (2) of the German Historical School relate to the scope of subject matter, (3), (4), (5), and (6) concern their methods. Schumpeter recognized a purely scientific value in the claims of (3) and (4), which are distinct from the assumptions of neoclassical economics, those of methodological individualism and of utility maximization. As to (3), i.e., the organic and holistic view of society, Schumpeter denied the alleged contention of the Historical School that a national economy has its own aims and

interests and thus cannot be split into an agglomeration of independent individuals, the view basically influenced by the philosophy of value in German historicism. Instead, he considered more acceptable the belief that individuals do not live in a vacuum but are conditioned by the institutional and cultural factors of a society. He interpreted Schmoller's view as follows:

the individual economies, which together comprise the national economy, stand in intimate mutual relations with each other. These relations are far more important than the ones which economic theory describes and which influence the individual member of the economy. They enforce in fact upon the individual a behaviour which is of a different kind and which must be explained in a way which is quite different from the one of which economic theory speaks ([1914] 1954a, 180).

This viewpoint is related to (4), i.e., the recognition of the plural motives of individuals. Rejecting the assumption of maximizing behavior of autonomous individuals, Schmoller emphasized that customs, laws, and morals constitute the institutional framework of a society and that the behavior of individuals is partly formed by institutions.

Referring to viewpoints (3) and (4), Schumpeter described the direction of research in the German Historical School that was labeled "historico-ethical": "the school professed to study *all* the facets of an economic phenomenon; hence *all* the facets of economic behavior and not merely the economic logic of it; hence the *whole* of human motivations as historically displayed, the specifically economic ones not more than the rest for which the term 'ethical' was made to serve, presumably because it seems to stress hyperindividual components" (Schumpeter 1954b, 812). It is viewpoints (3) and (4) that the old institutional economics after the Historical School emphasized, whereas the new institutional economics based on neoclassical economics denies them.

Schumpeter did not show much interest in viewpoint (5), i.e., the issue of individuality versus generality, and (6), i.e., the issue of relativity versus universality of social knowledge. Although the position of historicism used to be bound up with an interest in individuality and relativity, Schumpeter argued, historical interest should not prevent the possibility of general and universal knowledge. He found that (5) and (6) were not fruitful issues; thus he was critical of neo-Kantian philosophy, which, he said, went too far into these issues. Surprisingly, he found that Schmoller stuck to neither the individuality nor the relativity of historical phenomena:

he recognized ... how essentially similar the causal nexus in social science and natural science is; he also described the explanation of social phenomena in the form of cause and effect and in the form of laws ... as the aim of scientific effort. Indeed we find even the far-reaching proposition that all perfect science is "deductive." ... This proposition implies the acknowledgment that such a state of the science is possible in principle—even if in actual fact it should remain unattainable for us. It also

implies a complete rejection of the specifically historical belief in the "incalculable" and essentially "irrational" nature of social events. Schmoller goes further here than most of the theorists would have been prepared to do ([1914] 1954a, 170–71).

A different methodology for bridging the gap between theory and history was required. Max Weber's methodological work, consisting of the concepts of "understanding" (*Verstehen*) and of "ideal types," was a solution to the problems concerning viewpoints (3), (4), (5), and (6) (Shionoya 1992).

3. The methodology

Economic sociology, in Schumpeter's view, belongs to a category of theory and is subject to the instrumentalist methodology (Shionoya 1991). This methodological standpoint will serve as a test for Schmoller's research program. According to Schmoller, a theory or law must be nothing more than a summary or generalization of empirical facts. Since it is extremely difficult to grasp the complexity of the total historical developments of economic life, he insisted, we have not yet acquired what can be called a law or a theory. Schmoller's notion of theory involves a requirement that a theory should start from realistic assumptions that ought to be derived from an extensive observation of reality. It follows that this procedure would be valid only for a complete science as an ideal. He always maintained that "all progress of induction brings us deductively useful propositions and the most completed science is generally deductive" (Schmoller 1911, 478). In Schmoller's long-run view, by the continuous efforts of detailed empirical research and comprehensive summary, economists will approach an indisputable truth that is accepted by all" (Schmoller 1897, 9–10).

Instrumentalism, in contrast, asserts that assumptions or hypotheses are arbitrary creations of the human mind and need not be justified by facts, and that theories deduced from assumptions are not descriptive statements in themselves but instruments for understanding and explaining facts. Therefore, a theory is neither true nor false; it proves useful if it can cover an increasing amount of facts. Instrumentalism facilitates deductive attempts even when a sufficient amount of empirical data for a given area of study has not been collected according to the Schmollerian standard. Theory is not only a convenient device for summarizing, systematizing, and deducing a given body of observable facts but also a guide for exploring and predicting unknown facts. Whereas Schumpeter's instrumentalist methodology provided a prescription for the suspension of hostilities between history and theory when it was applied to the *Methodenstreit*, it could advise cooperation between history and theory when applied to Schmoller's research program. One does not need to engage in the never-ending process of data collection in order to develop realistic assumptions; instead, one should have a feedback process between theory construction and fact-finding in order to achieve a "unified

sociology or social science as the mentally ('theoretically') constructed universal history" (Schumpeter 1926, 382).

Schmoller remained a naïve empiricist; he did not have a coherent methodological approach. When he considered the nature of concept formation, he argued, while admitting nominalism instead of realism, that concepts were means for constructing thought, not perfect copies of reality (Schmoller 1911, 467–68). Since abstraction meant to him a deviation from reality, it was natural that he could not give a realist status to concepts. From this position it was only a step to instrumentalism. But he was so much absorbed in the classification of particulars into universal categories that he emphasized only in the negative vein that concepts cannot describe real individuality and therefore fundamental truth. As a result, he was only concerned with broad data collection so as to load concepts with rich content. His conception of a developed, ideal science seems to have been such that concepts and definitions already contained enough truth to deduce more important results. He could not proceed to the instrumentalist methodology from the nominalist notion of concepts and allow an instrumentalist role of assumptions and hypotheses as deliberate mental constructs, because in spite of his nominalist position his ultimate goal was scientific realism.

III. Ethics and Economy

The second leading idea in Schmoller's economics is ethics. The place of ethical value judgment was definitely denied by Weber's thesis of value freedom. But the thesis that science should not deal with any ethical judgment does not deny Schmoller's ethical approach. Indeed, Schmoller was motivated by the social problems of Germany and concerned with the planning of social reform, but his social and political ideals can be separated from the formal structure of his approach. His treatment of ethical factors in economics was sufficiently careful to support the total structure of his thought, and I am concerned here with the formal structure of his ethical approach. It is a mistake to reject Schmoller's approach by the stereotyped notion of a value-free science.

Schmoller's view of economic institutions or organizations was that they are not only natural and technical but also spiritual and ethical. Insofar as economic phenomena such as price formation and income distribution are concerned, as is the case for British classical economists, it is not necessary to deal with the social framework in which the economic phenomena take place. In contrast, Schmoller believed that the historical evolution of institutions should be the theme of economics and focused on customs, laws, and morals as the social determinants of institutions. He described the intention of his *Grundriss der allgemeinen Volkswirtschaftslehre* as follows: "Economic behavior and economic institutions should not be derived only from value phenomena or something like instinct but, following the unity of today's human sciences, from psychological power in general, from sentiment and

instinct, from ethical ideas, and economic behavior should be grasped in the framework of morals, custom, and law" (Schmoller 1911, 448). As noted above, ethics gave meaning and direction to historical research in Schmoller's economics. According to him, in order to discuss economic institutions in a historical perspective, one must focus on the morals, customs, and laws that are embodied as facts in institutions. Three features are most significant with regard to Schmoller's ethical approach.

First, by morals Schmoller did not mean his own subjective moral judgments but objective moral judgments in the sense of historical facts. It is true that ethical and political ideals simply derived from metaphysical and nonempirical ground cannot be supported scientifically. In contrast, for Schmoller, ethical values were empirical materials in the historical research of institutional change. His ethical approach, it should be stressed, was not an attempt to mix values with facts, as he was accused, but that of dealing with factual values. He argued: "As ethics becomes more and more empirical so that it describes ethical duty, virtue, and good in the form of historical development rather than teaches norms, the elements of beliefs and their function in ethics naturally decline. Thus ethics gets near to social science or state science or what one calls today sociology" (Schmoller 1911, 438).

Second, in dealing with factual value judgments, Schmoller was opposed to the partial values advocated by political parties and social classes; he wanted to discuss universally valid values that were concerned with the total interests of society and shared by all of its members. He believed in the trend toward the empirical unification of ethical systems: "One might dispute many individual points, the derivation of ethical truth, and the scientific construction of ethical system, but on the most important practical value judgments, good and cultivated people of the same nation in the same cultural age reach agreement more and more" (Schmoller 1911, 494–95).

Third, Schmoller asserted that the ethical approach not only aims at the recognition of moral facts but also is formulated in a teleological form. Teleology is contrasted with causality. In the explanation of a phenomenon teleology focuses on the relationship between an end and means, not between a cause and effects. Teleology appeals to aims in the explanation of human actions and social systems. If a society, a group of individuals, can be regarded as a unified entity with its own aims—in other words, if holism can be assumed—teleological inquiry is possible. Since moral values are to govern a society as a whole, teleology is effective in the study of institutional organization embodying ethics. For Schmoller, the major content of teleology was a principle of justice. He argued: "The economic organization of a nation is not a natural product as was thought for a long time, but mainly a product of current ethical views about what is right and just in relation to different social classes. All progress in economic organization has been so far a triumph of ethical ideas and will continue to be so in the future" (Schmoller [1874] 1890, 55–56).

That ethics plays a system-constructing role in Schmoller's research program can be best understood in terms of the methodological importance of teleology in his thought. He regarded teleology as a heuristic device that supplements an empirical science when empirical knowledge is not sufficient; it assumes that individuals behave as if they would purposefully serve the ends of the whole. According to him: "Teleological investigation is the most important method because it grasps the total of phenomena, whose inner causal relations are not yet known, as a whole. It is similar to a systematic investigation insofar as the latter systematizes and grasps the total of phenomena or truth consistently" (Schmoller 1911, 437). This clearly indicates the methodological aim of Schmoller's teleology, which has nothing to do with the justification of a specific ideology. The aim is to provide a preliminary vision or *Weltanschauung* for the purpose of drawing a systematic picture of the world. Schmoller's teleology is a case of methodological holism. When one deals with the outcomes of individual behavior within a given social framework, as is the case with neoclassical economics, it is appropriate to assume methodological individualism. But there is much room for the use of methodological holism if one is to explain individual behavior and its consequences within a variable institutional framework.

Schmoller's teleology, thus interpreted, would be exempted from the charge that it confuses facts with values or runs the risk of optimistic historical determinism, an idea of the continuous progress of man and society. German historicism culminated in the neo-Kantian dichotomy between idiographic cultural science and nomological natural science, and behind the dichotomy there was the claim of the historical sciences to the teleological understanding about the human world in contradistinction to the natural sciences based on causal explanations.

An important methodological problem then arises: how can a teleological supposition be consistent with empirical research? Schmoller's empiricist conception of ethics is extremely important in this regard; it has two aspects. On the one hand, it is an undeniable fact that values determine human recognition, valuation, and action. One selects certain things as objects of recognition because they deserve special attention from the viewpoint of values. Whenever one values something as very important or desirable, he ranks the object according to a specific value system. Whenever one takes an action, he is motivated and directed by values as the motive and goal. The role of values in recognition, valuation, and action are undoubtedly empirical facts and are subject to empirical research; there is nothing unscientific in treating values as facts. Schmoller contended that these values are embedded in customs, laws, and morals of a society in the form of social and economic institutions. These institutions in turn regulate the economic behavior of individuals in a society. Thus values are imposed upon individuals by society.

On the other hand, there is another facet of the empirical conception of ethics, namely teleology as an organizing principle of social investigation. The mere record of existing morals cannot lead to teleology but only moral anthropology, although such a procedure certainly entails empirical knowl-

edge. Although it is necessary to observe reality and collect materials in the discussion of morality, it is required at the same time to formulate a normative principle and organize the moral reality. For this purpose, deductive construction of theory starting from appropriate assumptions is needed. Like his historical research, Schmoller's ethical approach lacks explicit theoretical formulation. Teleology as methodological holism does not prevent us from understanding moral values in terms of agreement based on the rationality of individuals, as is seen in the tradition of the social contract theory. The relationship between methodological individualism and holism can be explained in terms of two aspects of individual behavior with regard to social norms, i.e., agreement and conformity.

I would like to suggest a way in that one could interpret and reconstruct Schmoller's ethical approach in terms of two major concepts: reflective equilibrium and evolutionary science. First, as Schmoller correctly emphasized, a moral conception such as a principle of justice is worked out for specific social and economic institutions. It is not intended as the application of a general moral conception to the institutions of society, but rather draws upon basic ideas and convictions that are embedded in them. The moral conception is supported by what John Rawls calls an "overlapping consensus" in a society, i.e., a consensus on a political conception that, despite a diversity of religious, philosophical, and moral doctrines, could be attained by a process of convergence or intersection (Rawls 1987). The justification of morality on the basis of self- or group interests cannot be stable. Rawls tried to find a shared basis of agreement underlying specified political, social, and economic institutions. Schmoller's conception of objectively and universally valid values can be seen as parallel to Rawls's conception of an overlapping consensus.

At first sight, a deep disagreement exists on the way basic institutions should be arranged. But at the same time there is an implicitly recognized basis of agreement in our convictions, beliefs, and judgments. According to Rawls, we collect such convictions and try to organize the basic ideas implicit in these convictions into a coherent principle of justice on the basis of value premises, which is also consistent with the shared convictions. Rawls's method of constructing ethical theory is that of "reflective equilibrium," which justifies a moral principle by establishing a coherence between basic value premises, the moral principle, and shared convictions. Therefore, it is the task of ethical theory to articulate intuitive ideas and beliefs so that they can be recognized as coherent with a proposed moral principle and its basic premises.

Second, although Rawls's method of reflective equilibrium is valuable as a framework for theory construction in ethics and should be used to clarify one aspect of Schmoller's ethical approach, it is confined to the establishment of a static state with fixed social, economic, and political institutions. The strength of Schmoller's ethical approach lies in a historical perspective. In contrast to Rawlsian moral equilibrium, Schmoller explicitly considered an evolutionary process based on the interactions between morals and institutions. His teleology provides a basis of evolutionary theory. In a teleological view, the telos of systems and institutions is generally considered to be self-survival and

accounts for the mechanism of their establishment and transformation in terms of the goal-directed behavior of the systems. The teleological explanation of evolutionary process is based on a future goal as an always desired but as yet unattained objective; it cannot predict a future course; teleology only understands a process as we run after it.

If end-means rationality means the conformity of means to goal achievement, evolutionism maintains end-means rationality without end (Spaeman and Löwe 1981). In evolutionism there is no end-means relationship prior to the process of selection; what is useless to survival is removed spontaneously, and as a result of this process end-means rationality will be realized.

It is quite natural that the revolution of an economic system cannot be dealt with in terms of economic theory, separated from history, culture, morality, social structure, and so on. A dynamic economic theory incorporating capital accumulation and technical change is not enough to understand evolving economic institutions. According to Schmoller, institutions consist of two elements, both of which are left out of economic theory: technology and ethics. It is Schumpeter's contribution that technological innovation is regarded as a focal point of evolutionary economics. Yet ethical factors such as customs, laws, and morals were still excluded from economics mainly owing to the narrow conception of value-freedom. But they must be considered as another essential component of evolutionary economics.

The basic scheme of Schmoller's evolutionary economics can be expressed in a simple form. Schmoller distinguished three types of social organizations in a national economy: the family, the local community (city, village, state), and the firms (Schmoller 1900, vol. 1, 53–57). Each type is based on a different organizational principle. In the case of the family, it is sympathy, kinship, and love; in the case of the local community, it is neighborhood, nationalism, law, and coercion; and in the case of a profit-making firm, it is a contract based on private law. What Schmoller meant by the ethical and social determinants of economic institutions actually relates to these principles. According to Schmoller, it is wrong to argue that economic life is always an individual process because it is a technical process of satisfying individual wants. In contrast with the firm, family and community are not established primarily for economic activity. From autarchic family economy or tribal economy developed two types of organizations. On the one hand, organizations of the local community such as village economy, city economy, territorial economy, and national economy were formed for the purpose of controlling economic life and serving the public interest at different levels of the regional economy. On the other hand, firms were developed as an organization to pursue private profits and entailed various institutional arrangements such as the division of labor, markets, social classes, property ownership, and so on.

Schmoller's scheme of development in stages from village economy to city economy to territorial economy to national economy was designed in terms of the regional community as the carrier of social policy in a wide sense that worked to control the free play of firms in markets. The stage scheme was

concerned with the evolution of institutions brought about by the interactions between ethics and economy, between spiritual-social and natural-technical factors. Specifically, the control by guild in city economy, the rule by lord in territorial economy, and the social policy by government in national economy were attempts at the moral binding of an economy. Schmoller's stage scheme basically differs from the schemes of the old German Historical School in his treatment of the ethical aspect of economy in addition to its technical aspects, with which the old Historical School was exclusively concerned. Evolutionary stage theory is located at the intersection of the theory-history axis and the ethics-economy axis in the diagram suggested in the above (section I).

IV. Conclusion

I have been concerned with Schmoller's method, approach, and research program rather than his substantive economics in *Grundriss*. Now I want to say a few words about *Grundriss*. The book constitutes a coherent system: it begins with an analysis of the ethical foundation of economy, then discusses two branches of economics, i.e., the "anatomy" of the institutional framework that embodies ethics, on the one hand, and the "physiology" of economic circulation in terms of price and income, on the other, and finally investigates the development of society as a whole. But the lengthy description in *Grundriss* of economic conditions in different times and places is extremely boring and likely to put the basic scheme out of the reader's mind. If the fat were removed from the book so that a skeleton could be brought out in full relief, it could stimulate a theoretical mind to formulate the skeleton relations. Even in light of his research program, which consists of (i) the collection of data, (ii) definition and classification, and (iii) the causal explanation, *Grundriss* has hardly reached the third step. *Grundriss* is not a finished work of the new type of economics proposed by the German Historical School, but rather an accumulation of raw materials in a roughly classified form, on the one hand, and a presentation of the vague but stoutly built scheme of stage theory, on the other. There is a great gap between the enormous bulk of materials and the simple scheme; the former is not fused together to fit the latter mainly because the texture of supplementary functional relations is lacking on the theoretical side. Schmoller did not develop an effective tool to dispose of these materials in order to realize his basic vision concerning morals and institutions.

It is said that Schmoller hindered the development of theory in the sense of neoclassical economics for fifty years in the German-speaking world, but the potentiality of his vision to encourage evolutionary or institutional economics centering on the relationship between morals and institutions has proved to be quite high. I mention a potentiality, because, although contemporary economists have posed an increasing challenge to evolutionary or institutional economics, they know little about the German Historical School as their forerunner. The present criticism of the new institutional economics was already strongly advocated by Schmoller as the critique of classical and

neoclassical economics. The agenda of his historical-ethical approach is worthy of revaluation. From this point of view, I suggest, the best part of *Grundriss* is found not in the description of historical and statistical facts but in the summary and speculative interpretation of relevant phenomena. The following sections in *Grundriss* might constitute a better version of Schmoller's attempt to develop evolutionary economics: Introduction (Items 1–33), Book Two (Items 87, 93, 101, 112–13, 122–23, 131–33, 137–38, 147), Book Three (Items 148–49, 152, 158–59, 169–71, 173, 182–83, 185, 188, 202–3, 205, 213, 219, 229, 236), Book Four (Items 237, 245, 251–53, 272–76).

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Notes

- 1 The influence of Schmoller in German academics was manifested in the Festschrift for the seventieth and centenary anniversaries of his birth. See Geibel *et al* (1908) and Spiethoff (1938). The positive appraisal of Schmoller on a large-scale ended with the latter Festschrift in 1938. There followed a fifty-year period of complete neglect. However, since the 150th anniversary of his birth in 1988, there has been a growing revival of studies on Schmoller. See, for example, Richter (1988), O'Brien (1989), Balabkins (1989), Schiera and Tenbruck (1989), Bock, Homann, and Schiera (1989), and Backhaus (1993).

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3. Getting Back Max Weber from Sociology to Economics

I. In Pursuit of Weber's Legacy in Economics

This article is an attempt to examine Max Weber's sociology in order to suggest the ways in which economics may recover the various aspects of society that were expelled from the purview of mainstream economics. Needless to say, economics cannot properly deal with those problems that are more appropriately handled by the other social sciences, nor is there any reason why economics should meddle in these problems. There must be a kind of demand and supply relationship between economics and other disciplines to support an interdisciplinary effort. I find in Weber such a possibility.¹

Max Weber was one of those rare scholars who worked in a wide range of the social sciences. Social science, once integrated as moral science in the early modern period, had been split into independent disciplines: economics, law, political science, history, religion, ethics, and so on. Weber did not specialize in any of these disciplines but aimed at a unique interdisciplinary scholarship. He is known today as one of the founders of modern sociology. What distinguishes his sociology are the method and structure of his interdisciplinary approach. These elements were considerably influenced by the specific intellectual fields of the social sciences that Weber encountered at the turn of the century. His sociological approach was produced as an escape from a conflict between the dominant paradigms of economics at that time.

Two paradigms were in conflict: the intellectual field of the social sciences in late nineteenth-century Germany was characterized by the *Methodenstreit* between Carl Menger and Gustav von Schholler, or between theoretical and historical approaches in economics. Weber earned a doctorate in law at the University of Berlin and taught commercial law as a lecturer there, but he soon shifted his interest to economics and was named professor of economics at the University of Freiburg. Generally speaking, economics was taught in the department of law at that time, and the economics Weber learned was that of the German Historical School. He was inevitably involved in the *Methodenstreit*, and his methodological studies in the early period were addressed to solving that dispute. Throughout his academic life, Weber's sociological work can be interpreted as the practice of his methodological view.

The relationship between theory and history is a perennial question in economics. When a system of economics is established as a paradigm and its scope and method are defined, the conception of economy as the object of study is fixed in a certain way. The establishment of a scientific system is usually followed by development and elaboration within the system or paradigm, on the one hand, and by criticism and controversy from outside, on

the other. After English classical economics was established, neoclassical economics and Marxian economics became examples of the internal development and elaboration of classical economics. Although these three systems look quite different from each other, they belong to the same grand paradigm of economics in that theoretical abstraction of the economic world is accepted as a useful device for deriving economic laws.

The German Historical School, in contrast, challenged the theoretical approach of classical economics and put forward the historical approach, which had never played a paradigmatic role in economics. According to the Historical School, the individuality of a national economy is properly conceptualized by detailed historical inquiries. Its views of economics were influenced by German historicism concerning the concept of the state and the philosophy of ethical values.

Today, theoretical economics undoubtedly has gained a strong footing as a discipline, but there is a constant claim among economists that theory is too narrow to grasp economic phenomena embedded in a social context. After the age of the German Historical School, “economic sociology” or “institutional economics,” inheriting more or less the ideas of the Historical School, became an important field of economics and attracted those who were not satisfied with mainstream economic theory.

Economics, however, has not consciously inherited important ideas from Weber’s sociological work. In order to demonstrate his legacy to economics, this article clarifies, first, that Weber’s sociology is methodologically based on the same ground as neoclassical economic theory, although his methodology apparently uses conceptual jargons unfamiliar to economic theorists. I shed light on Weber from the standpoint of the philosophy of science and show an interpretation of Weber’s methodology as instrumentalism. Second, this article suggests that his sociology can provide useful notions to cope with the current stalemate in economic theory, although his sociology apparently concerns far wider issues of society than economic theory. In this respect, I show an exposition of Weber’s economic sociology as institutionalism. Speaking of a demand and supply relationship between economics and Weber, economics will provide an instrumentalist philosophy to sociology and demands his institutionalism from sociology.

In this discussion, reference will be made to Joseph Alois Schumpeter, who, nineteen years younger than Weber, contributed to the methodological solution of the *Methodenstreit* from a different standpoint and made an attempt to construct a kind of economic sociology. While Schumpeter started as an enthusiastic defender of neoclassical economics, his uniqueness, which was brought about by his sympathy with the German Historical School, lay in his work in economic sociology.

II. Restructuring the German Historical School

To start with, I refer to six basic viewpoints of the German Historical School summarized by Schumpeter: (1) a belief in the unity of social life and the inseparable relation among its component elements, (2) a concern for development, (3) an organic and holistic view of society, (4) a recognition of the plurality of human motives, (5) an interest in concrete, individual relations rather than the general nature of events, and (6) historical relativity (Schumpeter 1914).² I examine how Weber and Schumpeter responded to these features of the Historical School from the methodological perspective.

In view of the fact that the German Historical School was a branch of German historicism, a major intellectual stream in nineteenth-century Germany, we cannot neglect the strong influences of metaphysical and ethical ideas it had exerted on German historical economics. If we regard three sets of ideas—the concept of the state, the philosophy of value, and the theory of knowledge—as central to German historicism, the German Historical School was obviously imbued with these ideas (see Iggers 1983, 7–10). But Schumpeter was careful to isolate the first two and to concentrate on the third in discussing the scientific viewpoints of German historical economics.

In fact, the German Historical School emphasized the concepts of national and political rather than universal and cosmopolitan as the nature of economics, and this was the foundation of its criticism of English classical economics. The idealistic conception of the state was thus taken as an end in itself and led to the idea of policy-oriented economics, which, unlike English classical economics, was not interested in the formulation of universal laws. With regard to the philosophy of value, it was the recognition of historicism that whatever arose in history was in itself valuable and should be judged in terms of its own inherent values. Correspondingly, the German Historical School aimed at the historical and ethical perception of state and society, and this goal was most clearly seen in Schmoller (Shionoya 1989).

In discussing the characteristic viewpoints of the German Historical School, Schumpeter simply avoided the value-oriented outlook inherent in the school. In contrast, Weber took it seriously through his device of value-relevance (*Wertbeziehung*), which ingeniously prevented us from committing ourselves to value judgments but still made explicit the value premises of our scientific inquiry. He explicitly objected to the confusion between realism and metaphysics in the German Historical School.

Among the six elements that compose the theory of knowledge in the German Historical School, the recognition of the development and unity of social life, a combination of viewpoints (1) and (2) listed earlier, is the essence of the school as Schumpeter understood it. For Schumpeter, while an isolated inquiry of a specific area of social life is permissible only from the static or short-term perspective, in which we can plausibly assume that conditions in the other areas will remain constant, one should take into account the interrelated picture of all areas when he is concerned with the dynamic or long-term perspective.

Thus a broad perspective, beyond the individual disciplines of social science, is required for the observation of overall developments of social life. Historical studies will make this possible because they not only carry out detailed inquiries about specific ages and places but also, more importantly, throw light on how a society in its entirety changes in the long run. This is the task that the individual disciplines of social science are not able to accomplish by themselves. According to Schumpeter:

The historical report cannot be purely economic but must inevitably reflect also “institutional” facts that are not purely economic: therefore it affords the best method for understanding how economic and non-economic facts are related to one another and how the various social sciences should be related [to] one another (Schumpeter 1954, 13).

He showed a deep sympathy for Schmoller’s research program, among others, because it gave an “outlook for a universal social science” (*der Ausblick auf eine Universalsozialwissenschaft*) (Schumpeter 1926, 365), where the conventional lines of demarcation between separate disciplines should disappear. Both Schumpeter and Weber, on the basis of the recognition of viewpoints (1) and (2), sought for the possibility of this idea in economic sociology.

Against this background on the main features of the German Historical School, as Schumpeter summarized them, I will explain Weber’s contribution to the restructuring of historical economics. Weber had one foot in German historical economics and the other foot in neo-Kantian philosophy. Although the German Historical School emphasized the importance of historical research in economics, it lacked a methodological foundation that could explain the existence and validity of historical science. The task of methodological inquiry was left to the neo-Kantian philosophers in Germany at the turn of the century, such as Wilhelm Windelband, Heinrich Rickert, and Weber. They sought to establish an epistemological basis for the historical, cultural, and social sciences through criticism of Immanuel Kant, who had denied a scientific status to historical knowledge because it did not fulfill the criterion of general validity. The upshot of neo-Kantian philosophy was that the natural sciences were seen as nomothetic and the historical sciences as idiographic in accordance with the difference of cognitive interest in the generality versus the individuality of reality between the two sciences. Abstraction from reality in historical science, the neo-Kantians argued, must be carried out in such a way that the individuality and uniqueness of phenomena are not lost in the process of concept formation. The selection of phenomena for scientific investigation is based on the principle of value-relevance.

Weber’s own contribution was to develop two methodological devices to clarify the logical status of historical knowledge constructed by value-relevance: an “understanding” (*Verstehen*) and an “ideal type” (*Idealtypus*). I contend that these two devices are in fact a methodological reconstruction of

viewpoints (3), (4), (5), and (6) attributed by Schumpeter to the German Historical School.

In his first methodological essay, “Roscher und Knies und die logischen Probleme der historischen Nationalökonomie,” Weber criticized the curious combination between organicism and realism that was inherent in the thought of the German Historical School and rejected its emanational conception, which would explain, on the basis of biological analogy, historical and cultural phenomena in terms of their relationship to metaphysical factors such as *Volksgeist*. Emanationism regards a national economy as a coherent whole like an organism and mystifies the ideals and characters of a nation that are taken as the emanational ground of cultural phenomena. Historical economists, with the notable exception of Schmoller, who was a nominalist, held the position of scientific realism to the effect that a description of historical facts should represent a true copy of reality. In order to rescue the historical sciences from the encroachments of metaphysics, Weber fought on two fronts: he tried to replace organicism or holism with methodological individualism, on the one hand, and to replace scientific realism with instrumentalism, on the other.

The method of “understanding” (*Verstehen*) is to explain social action by reference to the motives, desires, and emotions of individuals, which are assumed to be the sources of values attached to meaningful phenomena. It is an attempt to methodologically reconstruct viewpoints (3) and (4), because it assumes methodological individualism without denying the possible influences of social institutions on individual behavior and allows for the plurality of human motives, not only rational but also irrational. Weber used the term *Verstehen* to indicate the scientific procedure in which an observer understands the actions of individuals by reference to their subjective meaning. The same procedure can be expressed by the term *subjectivism* when the reference to subjective motives, desires, and so forth of observed individuals is emphasized.

Weber’s other device, an “ideal type,” clarifies the logical status of historical concepts. It is a universal concept that, unlike a generic notion in the natural sciences, can emphasize the individuality of historical phenomena, viewpoint (5) of the Historical School. An ideal type does not describe the elements that the instances of a class of phenomena have in common in the empirical world, but rather the elements that they have in common in a theoretically constructed imaginary world. Thus it makes viewpoint (5) of the Historical School valid in an imaginary world without denying the logic of the natural sciences. Viewpoint (6), historical relativity, is also dealt with by the application of ideal types that are universal in logic yet are still based on the value of historical uniqueness.

III. An Interpretation of Weber’s Methodology

Schumpeter’s book *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908) was an important contribution to the methodology

of neoclassical economics, but it was almost neglected. Elsewhere I presented the interpretation that his methodological frame of reference was instrumentalism and was influenced by natural scientists such as Ernst Mach, Henri Poincaré, and Pierre Duhem (Shionoya 1990). Instrumentalism holds that theories are not descriptions but instruments for deriving useful results and are neither true nor false. As a corollary, it is asserted that it is not necessary to justify hypotheses as such in order to establish their truth; that the realism of assumptions does not matter. It is to be emphasized that Schumpeter's methodological work was developed to avoid useless controversies such as the *Methodenstreit* between theory and history. Because theoretical and historical methods, artificial creations of the human mind, are concerned with different research interests, different subject matters, and categorically different hypotheses, it is of no use to quarrel over the relative importance of the two methods.

By instrumentalism, I do not mean the currently accepted narrow view that scientific theories are instruments of prediction and to be evaluated in terms of successful prediction. The original version of instrumentalism, which was proposed around the turn of the century, did not restrict the roles of theories to prediction; it held that theories were instruments for clarifying, organizing, explaining, and predicting observable phenomena, although the current critics of instrumentalism tend to insist that theories that are not statements but instruments cannot lead to explanation. Schumpeter had such broad interpretation of instrumentalism. Therefore, his instrumentalism is also different from the methodological view of Milton Friedman, who has been called an instrumentalist.

I also examined Schumpeter's commentary on Weber's methodology and concluded that, in spite of Schumpeter's apparently harsh criticism perhaps due to the feeling of rivalry, the methodologies of the two are not different from each other in substance (Shionoya 1991).³ It is rather remarkable that at the time of the *Methodenstreit* Schumpeter and Weber worked out similar solutions independently, although they were influenced by different schools of methodology; Schumpeter by the early positivists and Weber by the neo-Kantians. By similar solutions I mean that they similarly developed instrumentalist methodology and similarly attempted to construct economic sociology.

Both *Verstehende* (interpretive) sociology and an ideal type concept are widely recognized as Weber's characteristic tools, and in the above discussion I have shown them to be a reconstruction of the methodological views of the German Historical School. My purpose here is to propose an interpretation of Weber's general methodological position as instrumentalism. *Verstehen* is simply a particular assumption of methodological individualism; it does not represent his general position.⁴ Similarly, ideal type is merely a kind of concept formation not representing his general methodological perspective. What has been lacking in the methodology literature on Weber is the effort to specify his general methodological position. My answer is that his position is instrumentalism.

To bear out Weber's instrumentalist methodology, I shall outline his structure by quoting some passages from his writings. First:

Only in this respect and for these reasons of methodological convenience is the method of sociology 'rationalistic.' It is naturally not legitimate to interpret this procedure as involving a rationalistic bias of sociology, but only as a *methodological device*. It certainly does not involve a belief in the actual predominance of rational elements in human life, for on the question of how far this predominance does or does not exist, nothing whatever has been said (*WuG*, 3; *E&S*, 6–7; italics added).

It is important to recognize that *Verstehen* is only a methodical (not methodological) or instrumental assumption, not a description of real fact, although Weber in this context is concerned with the hypotheses of an instrumental rationality (*zweckrational*) as an extreme case of methodical individualism. The instrumentalist view on the cognitive status of theories is that theories are neither true nor false because they are mere instruments.

Second, Weber conceived the nature of law as follows:

It is customary to designate various sociological generalizations, as for example "Gresham's Law," as "laws." These are in fact typical probabilities confirmed by *observation* to the effect that under certain given conditions an expected course of social action will occur, which is understandable in terms of the typical motives and typical subjective *meanings* of the actors. These generalizations are both understandable and definite in the highest degree insofar as the typically observed course of action can be understood in terms of the purely rational pursuit of an end, or where for reasons of methodological convenience such a theoretical type can be heuristically employed (*WuG*, 9; *E&S*, 18; italics added; translation modified).

Observation (*Beobachtung*) and meaning (*Sinn*) are the key words in this context. In order to understand what Weber actually meant here, it is useful to distinguish between three basic concepts: (1) "hypotheses," which may also be called axioms, postulates, or assumptions; (2) "theories," which are the conclusions derived by a certain scientific procedure from hypotheses and may be called laws, principles, or theorems; and (3) "facts," which are observations, data, or phenomena. To paraphrase Weber, "theories" in *verstehende* sociology must be based on "hypotheses" about the subjective meaning of individual action, on the one hand, and must be justified by objective "facts" of social phenomena, on the other.

Third, Weber added further explanations to emphasize the importance of the roles he attributes to "hypotheses" and "facts," or meaning and observation:

A correct causal interpretation of typical action means that the process which is claimed to be typical is shown to be both *meaningfully adequate* and at the same time the interpretation is to some degree *causally adequate* . . . Statistical uniformities constitute understandable types of action, and thus constitute sociological generalizations, only when they can be regarded as manifestations of the understandable subjective meaning of a course of action (*WuG*, 5–6; *E&S*, 12; italics added; translation modified).

Weber here presented two requirements for right theories in the sense of a right causal explanation of social phenomena: “meaningfully adequate” (*sinnadäquat*) and “causally adequate” (*kausaladäquat*). The former relates to the dependence of “theories” on subjectively meaningful “hypotheses,” and the latter to the correspondence of “theories” with empirically observed “facts.”

Fourth, what is the correspondence between “theories” and “facts”? It is not true that facts as such exist independently of theories and that observation gives support to theories even in a probabilistic form. In this regard, Weber denied the view of the German Historical School—Schmoller was a great exception—by saying that “whoever accepts the proposition that the knowledge of historical reality can or should be a ‘presupposition-less’ copy of ‘objective’ facts, will deny the value of the ideal-type” (*WL*, 192; *MSS*, 92). In order to answer this question, we have to examine Weber’s ideal type concept because for him theories were conceived as ideal types:

Substantively, this construct [abstract economic theory] in itself is like a *utopia* which has been arrived at by the analytical accentuation of certain elements of reality. Its relationship to the empirical data consists solely in the fact that where market-conditioned relationships of the type referred to by the abstract construct are discovered or suspected to exist in reality to some extent, we can make the *characteristic* features of this relationship pragmatically *clear* and *understandable* by reference to an *ideal-type*. This procedure can be indispensable for heuristic as well as expository purposes. The ideal typical concept will help to develop our skill in imputation in *research*: it is no “hypothesis” but it offers guidance to the construction of hypotheses. It is not a *description* of reality but it aims to give unambiguous means of expression to such a description (*WL*, 190; *MSS*, 90).

In instrumentalist methodology, the instrumental roles of a theory include organization, classification, reconstruction, and—through all these efforts—the understanding of facts, and they amount to what Weber called *heuristisch*.

Fifth, a well-known claim of instrumentalism is that the realism of assumptions does not matter. Although Weber was not a neoclassical economist, he did not deny the value of neoclassical economic theory. In his evaluation of neoclassical economics, his instrumentalist perspective is clearly revealed:

We have in abstract theory an illustration of those synthetic constructs which have been designated as “*ideas*” of historical phenomena. It offers us an ideal picture of events on the commodity-market under conditions of a society organized on the principles of an exchange economy, free competition and rigorously rational conduct. This conceptual pattern brings together certain relationships and events of historical life into a complex, which is conceived as an internally consistent system (WL, 190; MSS, 89–90).

The ideal types of social action which for instance are used in economic theory are thus unrealistic or abstract in that they always ask what course of action would take place if it were purely rational and oriented to economic ends alone... The more sharply and precisely the ideal type has been constructed, thus the more abstract and unrealistic in this sense it is, the better it is able to perform its functions in formulating terminology, classifications, and hypotheses (WuG, 10; E&S, 21).⁵

Sixth, and finally, how is the practical success of theories evaluated? Weber wrote:

Here, too, there is only one criterion, namely, that of success in revealing concrete cultural phenomena in their interdependence, their causal conditions and their *significance*. The construction of abstract ideal-types recommends itself not as an end but as a *means* (WL, 193; MSS, 92).

This is nothing but the criterion of theory acceptance advocated by the instrumentalist methodology.

Sociology, in Weber’s view, belongs to the category of theory in that it tries to formulate type concepts and provide uniform generalizations of social phenomena. Therefore it is subject to instrumentalist methodology; in fact, Weber explained the essence of instrumentalism using his own ideal type concept.

IV. The Framework of Weber’s Sociology

From the methodological features of Weber’s sociology, I now turn to its substantive aspects, focusing on economic sociology. Weber defined sociology as follows:

Sociology (in the sense in which this highly ambiguous word is used here) is a science concerning itself with the interpretive understanding of social action and thereby with a causal explanation of its course and consequences. We shall speak of “action” insofar as the acting individual attaches a subjective meaning to his behavior—be it overt or covert, omission or acquiescence. Action is “social” insofar as its subjective meaning takes account of the behavior of others and is thereby oriented in its course (WuG, 1; E&S, 4).

This definition does not contain a reference to specific areas of social life such as economy, politics, religion, and so on, but refers only to social actions or social relations that can be found universally in all areas of social life. For Weber, human action was social insofar as it took into account the behavior of others. When he spoke of society and economy, he meant by society (*Gesellschaft*) “the general structures of human groups” (*WuG*, 212; *E&S*, 356). If sociology is the science of society, it is not a specific discipline that is on an equal footing with economics, political science, and so on. Thus, for Weber, sociology is a universal theory or discipline that could be applied to all areas of social life, and the results of such application were specific types of sociology: economic sociology, religious sociology, legal sociology, and so on.

On the other hand, for Weber, sociology was contrasted with history. Both sociology and history were all-encompassing descriptions of society. As discussed above with reference to the viewpoints of the German Historical School, the historical development and interrelation of social areas are closely linked in the thought of the Historical School. A description of the historical process must involve interrelated changes in all areas of social life. But there is a difference. Whereas history is concerned with the causal explanation of individual actions, groups, and personalities, sociology tries to form type concepts and formulate generalized patterns of the historical process. With the help of ideal type concepts, sociology is distinguished from history with respect to the level of abstraction. Sociology is thus a universal as well as a general theory that explains social and historical phenomena. Universality is defined in terms of the scope of inquiry; generality is defined in terms of the abstract level of inquiry.⁶

Then, what is the conceptual framework of Weber’s sociology? I propose three kinds of category as the building blocks of his conceptual framework: (1) order, (2) type of organization (*Verband*), and (3) institutionalization. It is useful for us to have in mind the framework of economic theory for comparison.

The central notion of economics is equilibrium, which parallels the notion of order in Weber’s sociology. Insofar as economics and sociology, as well as any other science, are in a status of theory, they should be able to formulate an orderly state of affairs in the area with which they are concerned. Given the specifications of initial conditions, theoretical statements derived from various assumptions should indicate a unique state of affairs, whether in a deterministic or probabilistic way. Unless one can establish regularities of social phenomena, one is simply in chaos or in a status of historical inquiry.⁷

According to neoclassical economics, given the quantity of available resources and certain specifications of consumer tastes, techniques of production, and social structure, the assumed rational behavior of *homo oeconomicus* will uniquely bring about an equilibrium state of resource allocation—i.e., equilibrium prices and quantities of various goods and factors of production—through the play of individual self-interest and the working of a competitive market mechanism.

As mentioned above, Weber did not object to neoclassical economics. But, as far as the economic sphere was concerned, he engaged in the analysis of the sociological relationship in that sphere, namely economic sociology, not economic theory. Although in a few instances he used the word *Sozialökonomik*, which is different from economic theory and is a mixture of economic theory, economic sociology, and economic history, he did not develop its content and method clearly. What he actually presented in *Wirtschaft und Gesellschaft* as a major interpretation of economic sociology was an analysis of the institutional structures of economy by explaining their foundations in terms of individual orientation to an order and by setting up various axes of classification, i.e., household and firm, real economy and monetary economy, market economy and planned economy, *Gemeinschaft and Gesellschaft*, and so forth. He did not use the concept of equilibrium; instead, he depended on the concept of order as it applied to all areas of social life: economic order, legal order, and so forth.

Weber called regular social relationships an order—for example, customs, market order, convention, law, and morality. He attributed the regularity of actions to the sense of legitimate order held by individual actors. The actors ascribed legitimacy to a social order by virtue of tradition, emotional belief, value rationality, and instrumental rationality. These types were Weber's quadripartite classification of individual action. Thus, the legitimate order of society is reduced to the inner motives of individuals. We find here Weber's methodical individualism and subjectivism applied to the central notion of sociology, namely an order.

The legitimate order, however, is guaranteed not only internally but also externally; it is not only supported by actors but also imposed socially upon actors. Such external factors constituting the order are various types of organization, which have more or less an apparatus of enforcement for individuals. The concept of legitimate order in sociology has the role of coordinating individuals in a society and of adjusting the repercussions between individuals and organizations.

Social action is oriented to the behavior of others; more accurately, it is determined by expectations as to the behavior of others. But perfect knowledge about others is impossible. Social relations will be characterized by chaotic uncertainty unless there is some kind of order on which expectations can be based. Such an order warrants the objective chance concerning the results of behavior. In the article '*Ueber einige Kategorien der verstehenden Soziologie*' (1913, reprinted in WL), Weber wrote:

An important (though not indispensable) normal component of social action is its meaningful orientation to the *expectations* of certain behavior on the part of others and, in accordance with that, orientation to the (*subjectively*) assessed probabilities (*Chancen*) for the success of one's own action. A most understandable and important basis for the explanation of action therefore is the *objective* existence of these probabilities, i.e., a greater or lesser degree of probability as expressed in a "judgment of

objective possibility,” to the effect that these expectation are well-founded (WL, 417; SC, 159).

If expectations can take advantage of communication (*Verständigung*) and arrangement (*Vereinbarung*) with others and observance of rules by others, there is a great chance for the objective evaluation of possible expectations. Thus, social order can be conceived as a set of institutional attempts to cope with an uncertain social environment. At the same time, Weber recognized that the subjective orientation of actors to an order and the objective chance of expectation on the basis of an order are the cognitive ground of social relations. This recognition is the foundation of Weber’s institutionalism.

Roughly corresponding to Ferdinand Tönnies’s distinction between *Gemeinschaft* and *Gesellschaft*, Weber distinguished between *Vergemeinschaftung* and *Vergesellschaftung* as the tendency to form social relations and organizations respectively. *Vergemeinschaftung* is the formation of social relations on the basis of a subjective feeling of solidarity (emotional and traditional). *Vergesellschaftung* is the formation of social relations that are based on the adjustment of rationally motivated interests (instrumental rationality and value rationality) and are brought about by the cooperation of actors as the means to achieve their common ends. In a society there is what might be called a propensity to institutionalize an order.⁸ This propensity is reduced to a positive or negative propensity of individuals to take care of an order. By institutionalization, I mean the tendency or orientation toward organizations. Institutionalization based on the legitimate order is the fundamental idea of Weber’s sociological analysis and is applied to major areas of social life, i.e., politics, religion, and economy.

V. Weber’s Conception of Economy

In economic sociology where the idea of institutionalization is applied to economy, Weber described four typical measures of rational economic action, focusing on the criterion of the power of control and disposal over utilities (WuG, 35–36; E&S, 71–72): (1) the rational allocation of utilities between present and future (choice of consumption and saving), (2) the rational allocation of utilities to various commodities and services (choice of consumption pattern), (3) the rational production of utilities through the transformation of various means (choice of production pattern), and (4) the rational management for acquiring disposal power over utilities by means of *Vergesellschaftung* (choice of establishment of organization or exchange).

While measures (1)–(3) relate to the aspects of economic activity with which an ordinary economic theory is concerned, (4) indicates an important viewpoint that had not been known to economic theory until its discovery by R. H. Coase (1937). By the notion of transaction cost, Coase explained why there exists such an organization like a firm that performs a function of resource allocation besides markets. His contribution to the nature of a firm is

properly classified as an example of Weberian economic sociology, though in a limited sense.

Economic action includes types of social action other than instrumental rationality and is oriented toward various kinds of legitimate order.⁹ Weber's concepts of institutionalization and order are contrasted with the concepts of maximization and equilibrium in economic theory, where one assumes the existence of a market and ownership system without reference to any institutional factors and without an attempt to explain the emergence of institutions. From Weber's sociological point of view, the market represents the actions of *Vergesellschaftung* inasmuch as an exchange agreement is reached between actors within the framework of *Gemeinschaft*. On the other hand, the market is characterized by potential bargaining among potential actors, and to this extent, it is a process of *Vergemeinschaftung*. Weber contended:

From a sociological point of view, the market represents a coexistence and sequence of rational consociations (*Vergesellschaftung*). . . The completed barter constitutes a consociation only with the immediate partner. The preparatory dickering, however, is always a social action (*Gemeinschaftshandeln*) insofar as the potential partners are guided in their offers by the potential action of an interdeterminately large group of real or imaginary competitors rather than by their own actions alone. The more this is true, the more does the market constitute social action. Furthermore, any act of exchange involving the use of money (sale) is a social action simply because the money used derives its value from its relation to the potential action of others... Group formation (*Vergemeinschaftung*) through the use of money is the exact counterpart to any consociation (*Vergesellschaftung*) through rationally agreed or imposed norms (WuG, 382; E&S, 635–36).

When the market as a potential mass phenomenon does not have a law, actors in the market are consensually oriented to a certain order that is empirically valid. In this sense, the market is defined as a consensus community (*Einverständnissgemeinschaft*). Thus Weber summarized:

Moreover, a monetary private enterprise encompasses sheer associational, consensual, and social action (*Gesellschafts-, Einverständnis-, und Gemeinschaftshandeln*) (WL, 438; SC, 172).

These features of markets must be understood as the source of markets as a spontaneous order.

Ludwig Lachmann is correct in pointing out that in the Weberian theory of institution we can distinguish between the external institutions, which are designed by legislation and constitute the outer framework of society, and the internal institutions, which gradually evolve as an unplanned result of the market process and other forms of spontaneous individual action (Lachmann 1970, 81). Weber's economic sociology is to be examined in the context of the

school of thought that emphasizes the spontaneity of institutional evolution, including that of Carl Menger, Friedrich von Hayek, and other contemporary Austrians.

According to Weber, economic order is defined as follows:

Social economics (*Sozialökonomik*), on the other hand, considers actual human activities as they conditioned by the necessity to take into account the facts of economic life. We shall apply the term “*economic order*” to the distribution of the actual power of disposal over goods and services, that arises *consensually* in each case from the particular mode of balancing interests, and to the manner in which goods and services are used according to the intended meaning on the basis of the consensually approved actual power of disposal (*WuG*, 181; *E&S*, 311–12; translation modified).

In light of this conception of economic order, the establishment of market equilibrium by competitive forces exclusively based on the individual action of instrumental rationality would not be as important as the power configuration in the market. For example, in economic theory it is the consumer who determines the direction of production. But in fact, given the actual distribution of power in the market, the consumer’s wants are “awakened” and “directed” by entrepreneurs (*WuG*, 49; *E&S*, 92). This is what Schumpeter emphasized in his dynamic theory of innovation, which presented a picture of economy quite different from the static theory of competition.

The importance of power and domination is not understood if these phenomena are merely viewed as exogenous data of the economic system or noncompetitive conditions deviating from the normal economic situation. They are the real factors of institutionalization. Whereas the market depends on the autonomous adjustment mechanism through prices, various types of organizations use the coercive adjustment mechanism by power and order in the form of directives, customs, and conventions.

As is well known, Weber’s vision of the modern society involved the rationalization of various aspects of social life. Efficiency, the central notion of economic theory, is a limited part of rationality in Weber’s sense. In his view, although the ideal types in economic theory are unrealistic because they are concerned with what course of action would take place if it were purely rational and oriented to economic ends alone, nonetheless they are useful as heuristic instruments for analysis and as constructive instruments for the description of empirical complexities. Likewise, although Weber’s sociology is based on the use of ideal type concepts and abstracts from reality, its strength is that it takes into account heterogeneous motives and irrational phenomena in a wide range of social life and thus can deal with institutionalization as a dynamic factor in society. Weber stressed that sociology concerns historical phenomena that comprise all the branches of social life, whereas it is unrealistic in that it must depend on theoretical formulations:

In *all* cases, rational or irrational, sociological analysis both parts from reality and at the same time helps us to understand it, in that it shows with what degree of *approximation* a concrete historical phenomenon can be subsumed under one or more of these concepts (WuG, 10; E&S, 20; translation modified).

This is the way in which Weber attempted to integrate theory and history. Thus we find that Weber's methodological conceptions about theory and history (*Verstehen* and ideal types) can be applied to his substantive sociological work in different fields of society (economic sociology, religious sociology, and legal sociology, in particular). It is illuminating to refer to Richard Swedberg's visual representation that Weber worked along the vertical axis of social economics ranging from economic theory to economic sociology to economic history, on the one hand, and along the horizontal axis of sociology ranging from the sociology of religion to economic sociology to the sociology of law, on the other. It can be seen that the vertical axis and the horizontal axis intersect at the field of economic sociology (Swedberg 1987, 29–30). We now turn to the horizontal axis, focusing on Weber's work on the Protestant ethic.

VI. The Place of 'Die protestantische Ethik' in Weber's Sociology

Based on the preceding discussion, Weber's work 'Die protestantische Ethik und der Geist des Kapitalismus' can be examined so as to shed light upon several basic questions with regard to the nature and structure of his sociological approach: (1) the relationship between economy and society at large, including religion as an element; (2) the relationship between theory and history in the context of religion; and (3) the interrelation between three major strands of Weber's sociology, i.e., economic sociology, religious sociology, and the sociology of dominance (or law). Since 'Die protestantische Ethik' was his earliest work in the field of religion, it is natural that his treatment of the relationship between economy and religion in that work was not necessarily based on any systematic view of the relationship between economic sociology and religious sociology. Nevertheless, one can present an interpretation of the place of 'Die protestantische Ethik' in the global configuration of Weber's sociology in order to suggest its relevance to economics.

First, for Weber, the relationship between economy and society depended on his value premise about the trend of rationalization that had proceeded in various branches of the Western society. Since the rationalization has taken place in a most definite way in the form of economic development, all inquiries into the unique features of rationalism in various spheres of life in the Western society should refer to its economic conditions. But Weber also emphasized the inverse relationship between economic and noneconomic spheres. Thus in the preface to his *Gesammelte Aufsätze zur Religionssoziologie*, he wrote:

Hence rationalizations of the most varied character have existed in various departments of life and in all areas of culture. To characterize their differences from the view-point of cultural history it is necessary to know what departments are rationalized, and in what direction. It is hence our first concern to work out and to explain genetically the special peculiarity of Occidental rationalism, and within this field that of the modern Occidental form. Every such attempt at explanation must, recognizing the fundamental importance of the economic factor, above all take account of the economic conditions. But at the same time the opposite correlation must not be left out of consideration. For though the development of economic rationalism is partly dependent on rational technique and law, it is at the same time determined by the ability and disposition of men to adopt certain types of practical rational conduct. When these types have been obstructed by spiritual obstacles, the development of rational economic conduct has also met serious inner resistance. The magical and religious forces, and the ethical ideas of duty based upon them, have in the past always been among the most important formative influences on conduct (*RS*, vol. 1,12; *PE*, 26–27).

Specifically, ‘Die protestantische Ethik’ was an attempt to explain the rise of the “economic mind” or “ethos” in modern capitalism through the rational ethic of ascetic Protestantism. In that preface, Weber admitted that this attempt was concerned with only one side of the causal relationship between economy and culture and that his several articles on ‘Die Wirtschaftsethik der Weltreligionen’ written in later years tried to deal with both sides of the relationship.

Second, in his discussion of the relationship between the economy and society, Weber attached importance to politics and religion as the specific cultural dimension to be distinguished from the economy. Thus, when he explained the conceptual framework of sociology in Chapter 1, Part I, of *Wirtschaft und Gesellschaft*, he concluded the chapter by defining political organization and hierocratic organization in addition to business organization as the basic concepts of the structural form in three major disciplines: economic sociology, the sociology of dominance, and the sociology of religion.

In his investigation of politics and religion as well as of the economy, Weber provided the *Verstehen* analysis of individual motives, on the one hand, and that of organizations, on the other, in order to elucidate the legitimate order inherent in each sphere of social life. The propensity toward institutionalization through *Vergemeinschaftung* and *Vergesellschaftung* linked two polar elements: individuals and organizations. Market in the economy, dominance in politics, and belief in religion constitute the order in society. In contrast with the economy, politics and religion are the home ground of charisma and are sometimes characterized by unordinariness. But Schumpeter’s conception of entrepreneurship in economic development was originally devised as a case of unordinariness in economic life that is distinguished from a static or stationary state. If so, one can speak of a homology in different areas of social

life, which is a useful viewpoint in sociological investigation. The purpose of religious acts is the provision of relief goods (*Heilsgüter*) that assure rebirth and salvation in psychological unordinariness. The components of relief goods specify religious systems. In the sociology of religion Weber contrasted prophet with priest as the carrier of these religious functions, church with sect as the religious organization. 'Die protestantische Ethik' provided the sociology of religion with historical materials for comparative studies. But it was Weber's claim that, even when one studies history, one must use the ideal type concepts by which history is constructed as a composition of genetic concepts. Although 'Die protestantische Ethik' does not include a detailed explanation of the ideal type methodology, 'Die Objektivität'—written in the same year—develops the methodology by referring explicitly to Christianity or other ideas. Thus Weber wrote:

Middle Ages, for example, which we may designate as the 'Christianity' of those individuals, would, if they could be completely portrayed, naturally constitute a chaos of infinitely differentiated and highly contradictory complexes of ideas and feelings... If we raise the question as to what in this chaos was the 'Christianity' of the Middle Ages (which we must nonetheless use as a stable concept) and wherein lay those 'Christian' elements which we find in the institutions of the Middle Ages, we see that here too in every individual case, we are applying a purely analytical construct created by ourselves. It is a combination of articles of faith, norms from church law and custom, maxims of conduct, and countless concrete interrelationships which we have fused into an 'ideas.' It is a synthesis which we could not succeed in attaining with consistency without the application of ideal-type concepts (WL, 197; MSS, 96).

The same applies to the spirit of capitalism, which is also a constructed historical individuality. Of course, there is a difference in the degree of abstraction of ideal type concepts between 'Die protestantische Ethik,' in which ideal types are constructed as genetic concepts for the recognition of historical individuality, on the one hand, and the sociology of religion in *Wirtschaft und Gesellschaft*, in which ideal types are forged as more abstract and purified concepts for the recognition of empirical regularity, on the other. But this is rather the strength of ideal types as instruments with which to approach historical reality according to different research interests.

Third, for Weber, economic sociology, the sociology of religion, and the sociology of dominance were not independent disciplines. Whereas the economy, religion, and politics are distinguished as different in cultural content, they are treated as interrelated by the method of sociology, which is a universal tool. Unlike the conception of economy in economic theory, Weber's conception of economy constructed on the basis of sociology is interrelated with religion and politics within an institutional framework of society that consists of various forms of organization with various kinds of order such as laws, conventions, and customs. As explained above, order, organization, and

institutionalization are the central concepts that are simultaneously applicable to various fields of social life. In contrast, the central concepts of economic theory are equilibrium and maximization; institutional factors such as organizations are just externally given.

Weber sought an inner source of economic motivation or a “practical motive to exchange” in the religious belief of Protestantism. His approach in ‘Die protestantische Ethik’ was to show how religious charisma gave rise to ethical prophecy, how the latter transformed the sense of legitimacy in the inner life of people and revolutionized economic ethics, and how the conditions of ordinary economic life in each social stratum affected the process of transformation and revolution in ideas. Social stratum includes status and classes, Weber’s key concepts in the sociology of dominance. He called the disparity in power that is determined by economic conditions ‘class structure,’ and he called the disparity in power that is determined by social esteem in terms of privileges ‘status situation.’

‘Die protestantische Ethik’ is primarily concerned with the affinity between certain forms of religious beliefs and economic ethos, but the relationship is analyzed in the social context of dominance and power. In this sense, ‘Die protestantische Ethik’ is a joint exercise of three major disciplines of sociology, namely economic sociology, religious sociology, and the sociology of dominance, although it was a seminal work before Weber’s idea of sociology was fully developed.

VII. Conclusion

Compared with sociological investigation, what economics is crucially lacking is an analysis of the institutional framework that regulates the economic behavior of individuals. If it is possible to characterize Weber’s sociological methods by its use of the concepts of order, institutionalization, and organization, the application of these concepts to different aspects of social life will enable us to integrate the economy with other areas, as we have seen in his study of the Protestant ethic. In particular, the propensity to institutionalize is of basic importance in providing sociological investigation with unity and integration.

The so-called new institutional economics, which tries to explain institutional structures by the economic logic of maximization, is a noteworthy development of neoclassical economics but needs reexamination in light of Weber’s sociology of institutions. There are similarities and dissimilarities. On the one hand, Weber’s *Verstehen* method and ideal type concept do not differ from the procedures in economics, namely methodical individualism, subjectivism, and instrumentalism. The fact that there is such a common ground between economics and sociology despite the absence of interchange between them seems to be remarkable and can be attributed to the efforts of Weber and Schumpeter, who both addressed methodologically the fissure between theory and history brought about by the *Methodenstreit*.

On the other hand, there are naturally several gaps between economics and sociology concerning practical conceptions: in terms of Weber's sociology, rational economic man versus man with four motives, equilibrium versus order, maximization versus institutionalization, economy versus society as a whole, and so forth. Nevertheless, insofar as the development of economics is expected to help overcome these gaps, and insofar as a methodological ground leveling for getting back Weber from sociology to economics is finished, it is now time for economists (especially new institutional economists) to take Weber seriously.

An earlier version of this article was read at the meeting of *Dogmenhistorischer Ausschuss, Verein für Socialpolitik*, at Weimar, April 1994. It is a revised version of my article 'Max Webers soziologische Sicht der Wirtschaft,' in K. H. Kaufhold, G. Roth, and Y. Shionoya, *Max Weber und seine "Protestantische Ethik,"* Düsseldorf: Verlag Wirtschaft und Finanzen, 1992.

Notes

- References to Weber's works are given by the following abbreviations:
WuG: Wirtschaft und Gesellschaft: Grundriss der verstehenden Soziologie, 5th revised ed., J. Winckelmann (ed.), Tübingen: J. C. B. Mohr, 1972.
E&S: Economy and Society: An Outline of Interpretive Sociology, ed. by G. Roth and C. Wittich, Berkeley: University of California Press, 1978.
WL: Gesammelte Aufsätze zur Wissenschaftslehre, Tübingen, J. C. B. Mohr, 1922.
SC: 'Some Categories of Interpretive Sociology,' trans. by Edith E. Graber, *Sociological Quarterly*, Spring 1981.
MSS: The Methodology of Social Sciences, trans. by A. Shils and H. A. Finch, Illinois: Free Press, 1949.
RS: Gesammelte Aufsätze zur Religionssoziologie, 3 vols, Tübingen, J. C. B. Mohr, 1920–21.
PE: The Protestant Ethic and the Spirit of Capitalism, trans. by Talcott Parsons, London: Harper Collins Academic, 1930.
- Schumpeter's work on the history of economics was published in a volume as Abteilung I (*Historische und theoretische Grundlagen*), Teil I (*Wirtschaft und Wirtschaftswissenschaft*) of the series *Grundriss der Sozialökonomik*, whose chief editor was Max Weber.
- Kurt Dopfer suggested in the discussion in the *Dogmenhistorischer Ausschuss* the need to work out the distinction between the versions of instrumentalism advocated by Schumpeter, Weber, and Friedman. For the distinction between Schumpeter and Weber, see Shionoya (1991); for the distinction between Schumpeter and Friedman, see Shionoya (1990).
- The term methodological individualism is a misnomer, although it is often used: what it intends to represent is not a methodological viewpoint but a procedural assumption. I would call it methodical or procedural individualism.
- Kurt Dopfer rightly mentioned that the unrealisticness of assumptions is neither a necessary nor a sufficient condition for a good heuristic construct. The unrealisticness is a resultant nature of the correspondence between theory and fact, the substantive criterion of success defined in the fourth point in the above.
- Referring to Windelband's famous distinction between nomothetic and ideographic, Kurt Dopfer suggested a *hisonomic* approach to the theoretical description of history (Dopfer 1986). In my view, Weber's solution to the integration of theory and history was the concept of ideal type that could include different degrees of

abstraction ranging from utility to Christianity. It must be admitted that Weber's integration of theory and history was addressed to the static construction of types rather than to the dynamic process of change.

- 7 Heinz Kurz in the discussion in the *Ausschuss* raised a question on the understanding of equilibrium and order. I interpret Weber's notion of order in sociology as a parallel to that of equilibrium in economics in the sense that in sociology as well as economics a unique state of affairs, under a certain specification of data and assumptions, must be ascertained if the discipline is to be autonomous. Weber did not inquire into the strict conditions of equilibrium and order in terms of their existence, uniqueness, and stability in the sociological context, but insofar as he was concerned with the regularity in social actions, the structure of sociological theory can be understood by elucidating what conditions will lead to such a state of affairs.
- 8 Dopfer pointed out his similar concept of propensity to associate.
- 9 Bertram Schefold in the discussion pointed out that mainstream economists could not understand the relevance of Weber because they believed in Mises's praxeological thesis that all human actions are rational by definition. Although one can form any assumption, all economic behaviors are reduced to tautology, insofar as economic regularities are explained by logical deduction from self-evident axioms. The hypothesis of *homo oeconomicus* is too narrow to discover meaningfully different patterns of behavior, and is based on the narrow model of "rational fools." See Sen (1977).

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4. Joseph Schumpeter and the German Historical School

I. Introduction

This paper discusses the relationship between Joseph Schumpeter and the German Historical School with regard to the theory and methodology of economics. Schumpeter was influenced by the approach of the German Historical School, especially that of the younger Historical School led by Gustav von Schmoller. The Historical School, however, was not the sole source of influence on Schumpeter's thought; Léon Walras and Karl Marx influenced him to a greater extent. Thus, the historical economics, neoclassical economics, and Marxian economics were the intellectual field to which Schumpeter was positively committed. From this heterogeneous complex he developed his own system of social science (Shionoya 1997b).

Schumpeter formulated the essence of historical economics into a workable form, introducing also the insight of neoclassical and Marxian economics. As he was working on it, he had to compete against John Maynard Keynes in explaining fluctuations and development of a capitalist economy, the urgent issue of the time. In fact, Schumpeter failed to immediately affect the course of events in theory and policy. The Keynesian Revolution and the subsequent Age of Keynes in the mid-twentieth century retarded the acceptance and spread of Schumpeter's thought that would convey the legacy of German economics.

After the 1980s, however, the growing interest among economists in the long-term development of capitalism has stimulated an attention to historicism, institutionalism, and evolutionism through a reappraisal of Schumpeter's work. His rich vision in the long-term and wide-ranging perspective has certainly given a stimulus to broadening the scope of economics.

In order to discuss the relationship between Schumpeter and the German Historical School, the present paper focuses on how Schumpeter reconstructed the research program of German historical economics from a methodological point of view, and how he developed his own system for a substantive analysis of the transformation of a capitalist economy. In my view, the Historical School tried to address the problems of the evolution of institutions through the historical and ethical methods. Their scope and methods of economics differed from those of classical and neoclassical economics, which were concerned with the problems of the determination of equilibrium prices and the abstract and value-free methods. Schumpeter was an important mediator who would bequeath the legacy of the Historical School to the future generations. The key words of this paper are institution, evolution, history, and ethics.

II. Overview on Schumpeter's Work

Before discussing Schumpeter's response to the Historical School, it is useful to give a bird's-eye view on his work. At the University of Vienna Schumpeter studied law, history and economics and made his debut as an *enfant terrible* in the field of abstract economic theory. Although his major teachers were Eugen von Böhm-Bawerk and the Friedrich von Wieser, major figures of the Austrian School, he was not accepted among Austrian School because he was critical of its essentialism and psychologism.

In 1908, he published *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*, which was the recapitulation of neoclassical economics on the lines of the general equilibrium theory of Léon Walras. The book was a methodological work that aimed to make a contribution to the solution of the *Methodenstreit* between Carl Menger and Gustav von Schmoller. Schumpeter ingeniously adapted the philosophy of science of Ernst Mach to economics and developed the economic methodology of instrumentalism, the view that theories are not descriptions but instruments for deriving useful results and are neither true nor false (Shionoya 1990a). According to this methodology, it is of no use to quarrel about the superiority of historical and theoretical methods because they are designed for different purposes. Schumpeter's methodological work can be compared to that of Max Weber, who was also devoted to the solution of the conflict between theory and history at the time (Shionoya 1991, 1996).

In 1912, Schumpeter published *Theorie der wirtschaftlichen Entwicklung*, which was a unique attempt to establish a dynamic economic theory on the basis of neoclassical static theory. Static theory had explored the logic of economic behavior that formulated the most pervasive adaptive forces of an economy in response to changes in exogenous factors, and had been applied to the circular flow and the steady process of economic growth. In contrast, Schumpeter's economic dynamics or theory of economic development was concerned with destruction of the circular flow by the introduction of innovation that includes new products, new techniques, new markets, new sources of supply, and new forms of organization. He defined economic development by reference to innovation (the cause of development), entrepreneurs (the carriers of development), and bank credit (the means of development). He emphasized the role of entrepreneurs because he sought an endogenous explanation of economic changes originating from an economic system itself rather than emerging from external disturbances.

When Schumpeter explained the nature of his theory of economic development, he referred to two great figures, Léon Walras and Karl Marx, to whom he had been indebted (Schumpeter [1937] 1951b). According to him, the former provided "a pure logic of the interdependence between economic quantities" and the latter "a vision of economic evolution as a distinct process generated by the economic system itself." Schumpeter's basic idea of evolutionary economic changes is that both a cause of changes in economic system and a response mechanism to changes are endogenous; thus he

regarded entrepreneurial innovation as the cause of economic development and formulated the phenomenon of business cycles as the process spreading and absorbing the impact of innovation through the response mechanism of an economy.

It is important to observe that Schumpeter's entrepreneur is a special kind of a leader in the economic domain. The leader as the carrier of innovations in a particular area of social life is in marked contrast to the majority of people who only take adaptive or routine actions. Schumpeter believed that such a contrast exists not only in economy but also in science, the arts, politics, and so on. He based the statics-dynamics dichotomy in various aspects of social life on the dichotomy of human types, i.e., the static and the dynamic man. In Chapter 7 of the first edition of *Theorie der wirtschaftlichen Entwicklung*, that was omitted from the subsequent editions, he gave a sketch of developments of a society as a whole in terms of the interrelations between the different areas of social life, that are characterized by different logic of statics and dynamics. This idea eventually led to his conception of universal social science (Shionoya 1990b).

He noted that the concepts of statics and dynamics were introduced into economics, not from mechanics but from zoology via Henri de Blainville, Auguste Comte and John Stuart Mill, and that the idea of evolution depended on a zoological analogy, for a mechanical analogy does not apply to the development of an economy and society from within (Schumpeter 1934, xi). He meant, for instance, that if a study of the organs of a dog were compared to statics, research on how dogs have come to exist at all in terms of concepts such as selection, mutation or evolution would be rooted in dynamics (Schumpeter 1939, vol. 1, 36–37).

After the publication of *Entwicklung*, Schumpeter soon shifted his interest to economic sociology and developed a theory of social classes that would serve as the link between the concept of leadership in various areas of social life, on the one hand, and the overall concept of civilization or the *Zeitgeist*, on the other (Schumpeter [1927] 1951a). In other words, social classes mediated the interrelationships between the economic and non-economic areas. This idea was a simplified and strategic version of the general interdependence between different areas of social life and shaped the skeleton of his economic sociology that was later developed in *Capitalism, Socialism and Democracy* ([1942] 1950a). In this book he presented his famous thesis on the demise of capitalism as the result of its success: according to him, the very success of capitalist economy will produce non-economic factors that are inconsistent with it; these factors will, in turn, worsen the economic performance of capitalism. This successful book was a synthesis of his work in economic sociology based on the research program of the German Historical School.

Before this book, Schumpeter published *Business Cycles* (1939), in two massive volumes, with the subtitle "A Theoretical, Historical and Statistical Analysis of the Capitalist Process." This book was intended as an expansion and elaboration of the theory of economic development in historical and

statistical context, and Schumpeter meant the book as a genuine product of historical economics. Thus he wrote:

Since what we are trying to understand is economic change in historic time, there is little exaggeration in saying that the ultimate goal is simply a reasoned (=conceptually clarified) history, not of crises only, nor of cycles or waves, but of the economic process in all its aspects and bearings to which theory merely supplies some tools and schemata, and statistics merely part of material. It is obvious that only detailed historic knowledge can definitively answer most of the questions of individual causation and mechanism and that without it the study of time series must remain inconclusive, and theoretical analysis empty (Schumpeter 1939, vol. 1, 220).

This remark manifests the essential spirit of the German Historical School. His comment concerning the goal of his research—"filling the bloodless theoretical schemata and statistical contour lines with live fact"—is also the aspiration of that school (Schumpeter 1939, vol. 1, 222).

These remarks can be compared to what Schmoller wrote for a summary of the bearings of the historical research in economics:

Historical research has created the conceptions of the historical development of nation, of man, and of economic institutions. It has properly brought economic research into contact with morals, law, the state, and the causes of cultural development in general. It has shown how to inquire into collective phenomena in addition to the conclusions starting from individuals and their self-interest. It has shown how to do a proper synthesis in addition to an analysis. It has given, for the first time, a proper complement to an isolating abstraction by showing how to regard the results of the abstraction as part of a coherent whole. Thus what used to be faded abstraction and dead schema has recovered blood and life (Schmoller 1911, 464–65).

Business Cycles was not a success because it did not appeal to economists who had been seriously infected with the Keynesian Revolution.

Schumpeter's another *tour de force* was *History of Economic Analysis* (1954), which demonstrated that he was perhaps the last of the great polymaths. This work was not a hobby of the social scientist; there was a deeper reason for his interest in the history of economics (Shionoya 1997a). For him, the development of an economy and society, on the one hand, and the development of science and thought, on the other, are two aspects of the same evolutionary process. Corresponding to three branches of social studies, economic statics, economic dynamics and economic sociology, he worked on the philosophy of science (the methodology for the rules of scientific procedure), the history of science (the development of scientific apparatus) and the sociology of science (the nature of scientific activity carried out in

social circumstance). These two sets of work and their relationships constitute Schumpeter's universal social science, which was a substitute for Marx's economic interpretation of history concerning the relationships between the substructure and the superstructure of a society. Schumpeter's two-structure approach to mind and society did not extend beyond comparing chronologically the long waves of economic activity with those of scientific economics.

III. Historical and Ethical Approach

Since, according to Schumpeter, the Historical School as a genuine school emerged at Schmoller, it is convenient for us to identify the Historical School with Schmoller insofar as we are concerned with the relationship between Schumpeter and the Historical School (Schumpeter 1954, 809). Indeed the Historical School before Schmoller generally emphasized the importance of historical research in reconstructing economics, but it was Schmoller who explicitly combined history and ethics. In fact, Schmoller called his school "historico-ethical" (Shionoya 1995).

The weight of the challenge of Schmoller's historical-ethical approach is illustrated by two controversies created by two aspects of that approach: the *Methodenstreit* between Schmoller and Menger and the *Werturteilstreit* between Schmoller and Weber. Although it is often asserted that Schmoller lost in both battlefields, the assertion is not necessarily fair in view of the simple fact that both theory and history are necessary and that values cannot be maintained by science. Schumpeter's famous 1926 essay on Schmoller examined the historical and ethical aspects of Schmoller's approach and suggested the possibility of a new, productive interpretation (Schumpeter 1926).

Schumpeter interpreted Schmoller's research program as the prototype of economic sociology and characterized its goal as a "unified sociology or social science as the mentally ('theoretically') worked out universal history" (Schumpeter 1926, 382). But he did not accept Schmoller's research program as it stood. He critically reconstructed it from the viewpoint of integrating history and theory. Let me examine Schumpeter's position on the two aspects of Schmoller's research program: historical and ethical.

Schumpeter accepted Schmoller's belief in the importance of the historical perspective, but he emphasized the need to construct a theory rather than to be content with the mere collection, classification, summarization, and ad hoc explanation of data. For Schumpeter, economic sociology was essentially characterized by the continual interaction between history and theory. He wanted to put a brake on what might have appeared to be an endless process of data collection in Schmoller's research program, a bottomless pit into which historical economists were liable to fall. To do so, he had to resort to a methodological perspective.

Schumpeter's methodology was instrumentalism, that had been developed in his first book *Das Wesen*. For him, economic sociology was part of theory in

that it is a sort of generalized economic history with a focus on institutions. This is what he often meant by "reasoned history." Therefore economic sociology is subject to instrumentalist methodology. This standpoint served as a basic test for Schmoller's research program.

In later years, in recalling the *Methodenstreit*, Schmoller seemed to have reached the same conclusion as Schumpeter:

Today this controversy [between history and theory] has retreated into the background, owing to the recognition that each researcher may naturally use either more induction or more deduction or both methods, depending on the personal quality and nature of the inquiry, problems and questions to be dealt with, a narrower or broader scope of study, and whether the project is a study of unsettled questions or a description of settled ones; and owing to the recognition that in general it is not possible to speak of the superiority of one method over another (Schmoller 1911, 479).

This is indeed a remarkable statement compared with his observations during the *Methodenstreit*, but there still remains an important difference between Schmoller and Schumpeter. For Schmoller, a theory is no more than a summary or generalization of empirical data, and deductive theorizing for complex social phenomena is possible only after a sufficient amount of inductive work has been accumulated.

Schumpeter's instrumentalism, in contrast, asserts that assumptions or hypotheses are arbitrary creations of human mind and need not be justified by facts. Theories deduced from assumptions are not descriptive statements but instruments for understanding and explaining facts. Instrumentalism facilitates deductive attempts even when empirical data are not sufficient according to the Schmollerian standard. A theory is useful not only as a device for collecting, classifying, and systematizing a given body of observable facts but also as a guide for exploring, predicting, and discovering facts undetected thus far. Therefore a theoretical formulation is rather essential for achieving Schmoller's historically oriented research program.

Then, the ethical aspect of Schmoller's program needs a more sophisticated analysis than a mere dichotomy between facts and values. It is a mistake to reject Schmoller's ethical approach by referring to the stereotyped notion of value-free science.

Although Schumpeter's essay on Schmoller has often been discussed in relation to Schumpeter's demand for the formulation of historical approach, little attention has been given to the ethical part of Schumpeter's essay, which seems to shed new light on his ideas on norms.

Schumpeter was right in viewing that Schmoller dealt with policy and institutions without advocating a particular partisan position, without defending the existing social order, and without indicating his own preference. Schumpeter was interested to see how it was possible to propose universally valid ethical values. He found the diminishing conflicts of interest in the context of the trend of rationalization in capitalism:

Rationalization, equalization, mechanization, and democratization, all of which constitute an aspect of the nature of capitalist civilization, facilitate the unity of aspirations all the more. In the rationalized world of capitalism, political parties lose their sacred banners (Schumpeter 1926, 350).

By the development of science and realistic policies, conflicts based on ideological illusion will be reduced. Just as rationalism expels ideology from science, it excludes ideology from society. "The time will come, when social preferences are unified so that in every given situation the choice of goals is made possible by means of science" (Schumpeter 1926, 351). I would call this the essential trend of history.

According to Schumpeter, Schmoller thought that, based on the essential trend of history, the unity of policy objectives will be realized so that certain ethical values be embodied in institutions. When Schumpeter discussed the transformation of a capitalist system, he utilized the notions of the *Zeitgeist*, ethical values, and the ways of thinking, embedded in the institutions of capitalism, as the crucial factors to be dealt with by the apparatus of his economic sociology.

The basic scheme of Schmoller's evolutionary economics was presented in the form of a stage theory of development. Developments in stages from village economy to city economy to territorial economy to national economy were designed in terms of the regional community as the carrier of social policy in a wide sense that worked to control the free play of firms in markets. The stage scheme was concerned with the evolution of institutions brought about by the interactions between ethics and economy, between spiritual-social and natural-technical factors. This is to be compared to Marx's schema of economic interpretation of history, consisting of the interactions between the superstructure and substructure of a society, and Schumpeter's schema of economic sociology, consisting of the interaction between the economic and non-economic areas.

IV. Apparatus of Economic Sociology

In *Capitalism, Socialism and Democracy*, Schumpeter presented his famous thesis on the demise of capitalism in consequence of its success. Although this book might appear to be a paradoxical and eccentric impromptu, it was a serious work of economic sociology and its scientific components were structured in many years of Schumpeter's academic life.

In fact, no book has been misinterpreted and misunderstood more than this. *Foreign Affairs* in the 75th Anniversary issue selects some sixty volumes as the "Significant Books of the Last 75 Years." Francis Fukuyama's comment on *Capitalism, Socialism and Democracy* is representative of the general misunderstanding: "Schumpeter's work stands as one of the most brilliantly wrong-headed books of the century in its central prediction that socialism

would ultimately replace capitalism because of the latter's insuperable cultural contradictions" (*Foreign Affairs*, September-October 1997, 214).

If Schumpeter had in fact predicted unconditionally the arrival of socialism, it would be natural to say that he was wrong, in view of the fact that present-day capitalism is far from dying and moving to socialism; on the contrary, socialism has collapsed and is moving to capitalism. But he did not make such a prediction. In order to remove such a misunderstanding, a few methodological notes should be presented.

First, by socialism Schumpeter did not mean the development-oriented system actually adopted by dictatorship in less developed countries. He believed that as capitalism grows and matures, it must change itself in the historical process. Socialism is, as it were, the highest stage of capitalism. The readers of Schumpeter should not confuse the two understandings of socialism. Moreover, as he consistently asserted that the premature socialization of countries would result in economic failure and political oppression, the breakdown of the socialist countries in the contemporary world rather demonstrates the truth of his thesis.

Second, Schumpeter did not contend that capitalism would automatically bring about a socialist system; rather, if the tendency inherent in capitalism should fully work itself out, socialism would be feasible. Even when it is feasible, it can be realized only by political choice, not spontaneously. If political choice in a large scale is directed to the resurgence of capitalism, the tendencies toward socialism can be reversed.

Schumpeter replied to the charge that his argument was defeatist:

The report that a given ship is sinking is not defeatist. Only the spirit in which this report is received can be defeatist: The crew can sit down and drink. But it can also rush to the pumps. If the men merely deny the report though it be carefully substantiated, then they are escapists (Schumpeter [1942] 1950a, xi).

The quest for a small government that started with the Thatcher-Reagan revolution in the 1980s has become quite common in most of the advanced capitalist countries today. The leading idea, attaching importance to the market principle, advocates the abolition of government regulations, the restructuring of the welfare state, and the improvement of efficiency in government administration.

Indeed, in the 1920s and 1930s, the capitalist countries suffered from two evils of capitalism, depressions and distributive inequality, and faced at the same time ideological challenge from communism. But they got rid of the crisis owing to the Keynesian full employment policy and the Beveridgian social security system. The continuous intervention of governments into markets before long had to affect the functions of a capitalist system adversely, because capitalism under social policy was more and more approaching socialism. Schumpeter continued to give warning against this situation, calling it "capitalism in the oxygen tent" or "capitalism in fetters."

The current attempts of reform in the advanced capitalist countries are nothing but what Schumpeter called the rush to the pumps to save a ship. The real process of institutional changes must be a zigzag around the essential trend of history, and Schumpeter said about this process: "a century is a 'short run'" (Schumpeter [1942] 1950a, 163).

Third, Schumpeter's argument does not depend on the value judgments that socialism is desirable. In terms of ideology he had a negative attitude toward socialism, but in terms of science he submitted a hypothesis on the trend of economic system toward socialism. After World War I, he joined the Socialization Commission of Germany and the cabinet of Austria, though he was not a socialist. Asked about the motive, he is remembered to have said: "If somebody wants to commit suicide, it is a good thing if a doctor is present."

So much for the methodological notes. Schumpeter summarized the lines of reasoning as follows: (1) as innovations are organized, automatized, and routinized, economic development becomes the task of experts in government bureaucracy, so that the function of entrepreneurs tends to become obsolete and their social status is lost; (2) owing to the development of rational habits of mind, the pre-capitalist elements that supported the working of capitalism with regard to moral, disciplinary, habitual, and institutional aspects are destroyed; (3) the development of capitalism has created a political system of democracy that is interventionist in the interest of workers and an intellectual class that is hostile to capitalism; and (4) the value scheme of capitalist society, with wealth as the standard of success, loses its hold, and there is an increased preference for equality, social security, government regulation, and leisure time (Schumpeter 1950b, 446–56).

Most readers of *Capitalism, Socialism and Democracy* are fascinated by his pens and liable to overlook the framework of economic sociology in that book. According to my reconstruction of the materials he left, the apparatus of Schumpeter's economic sociology consists of a set of submodels: (1) general theory of innovation, (2) theory of social classes, (3) theory of social values or social leadership, (4) theory of *Zeitgeist* or ideology, and (5) interactions between economic and non-economic areas.

Schumpeter maintained that there are a limited number of people in various areas of social life, who are able to destroy existing orders through the introduction of innovations and thereby succeed in creating the current of the time, in contrast to the majority of people who stick to adaptive and customary types of behavior. Those innovative people are called leaders or innovators. Entrepreneurs are innovators in the economic area. Based on the dichotomy of human types, Schumpeter distinguished between statics and dynamics in various areas of social life.

Such leaders in various areas, each in his own way, ascend the upper rank of society and form a set of social classes. Schumpeter's theory of social classes sums up the performance of various social areas and thus serves as a conceptual pivot for a universal social science. It was presented as a theoretical scaffold for his move from economics to sociology. His major points were as follows: Entrepreneurs can stand on the top of not only the

economic but also the social pyramid and exert influence on the spirit, culture, and politics of the time. However, there are leaders other than entrepreneurs; the social pyramid is not solely composed of economic material. The social pyramid is not single-peaked but consists of old and new strata involving a historical time lag.

Theory of social classes is closely related to two fundamental concepts: social values (or social leadership) and the *Zeitgeist*. Each social area has a social function (i.e., economic, ideological, military, and political) to undertake the specific tasks of a society imposed by the environment, and to contribute to the formation of social classes. Social functions attributed to individual social classes do not have equal rank. A hierarchy of classes, constituting the social order, is explained by the relative importance of social functions that determines social values or social leadership.

The superstructure is established as consciousness, culture, and institutional framework, which are peculiarly related to the class endowed with social leadership in view of its contribution to social values. Schumpeter's concept of the *Zeitgeist* or ideology can be used to symbolically denote the superstructure of a society. It is an analysis of the culture, ways of thinking, and value schemes of the time and corresponds to Schmoller's conception of ethics that was concerned with factual values rather than normative prescriptions.

Because in age of capitalism the economic area has the greatest social function and determines the principle ideas of the society, it is natural from the standpoint of scientific strategy that Schumpeter focused on economic sociology that is concerned with the interactions between the economy and surrounding institutions. In this picture of the society, the concept of social classes is pivotal, mediating the interactions between economic machinery endowed with social leadership, on the one hand, and the non-economic, institutional superstructure, on the other. This approach is compared to Marx's economic interpretation of history that is concerned with the relationship between the substructure and the superstructure of a society.

Based on the apparatus of economic sociology, Schumpeter's thesis of the demise of capitalism is derived as a result of historically specific interactions between economic machinery and the superstructure. The essence of the thesis lies, in my view, in the conflicting relationships between entrepreneurs and the bourgeois class, between anti-rationalistic entrepreneurship and rationalistic bourgeois mentality. The bourgeois class is the sum of the business class and the capitalist class. Entrepreneurs do not constitute a class, but successful entrepreneurs, irrespective of their origins, enter the bourgeois class together with their family. The ideology of the bourgeois class is rationalism, as is the civilization of capitalism. In contrast, Schumpeter persistently argued, the ideology of entrepreneurs is anti-rationalistic and anti-hedonistic. The rationalistic ideology emanating from the bourgeois class affects adversely the hotbed of entrepreneurship. In this manner, the economic world loses the only source of romance and heroism that survived in the form of entrepreneurship even in the unromantic and unheroic civilization of capitalism.

Thus, Schumpeter wrote:

The capitalist process rationalizes behavior and ideas and by so doing chases from our minds, along with metaphysical belief, mystic and romantic ideas of all sorts... Also, capitalist civilization is rationalistic 'and anti-heroic.' The two go together of course. Success in industry and commerce requires a lot of stamina, yet industrial and commercial activity is essentially unheroic in the knight's sense ... and the ideology that glorifies the idea of fighting for fighting's sake and of victory for victory's sake understandably withers in the office among all the columns of figures (Schumpeter [1942] 1950a, 127–28).

It is my interpretation that, in the general term, Schumpeter's thesis should be read with reference to the sociological framework of social leadership versus the *Zeitgeist*. In the ideological context, the thesis is interpreted as the antinomy between heroism and rationalism. It is interesting to see that, in the last analysis, Schumpeter's economic sociology is reduced to a sort of Hegelian idealism. This point might be illustrated by Samuelson's memoir of a Harvard seminar (Samuelson 1981, 8): Wassily Leontief dexterously summarized the discussions of Paul Sweezy and Schumpeter on the fate of capitalism to the effect that, according to Sweezy based on Marx, capitalism is dying of a malignant cancer, while, according to Schumpeter, it is dying of a psychosomatic ailment. The causal relationships between the superstructure and the substructure are just the opposite in the diagnosis of Marx and Schumpeter. Was Marx inverted who had inverted Hegel?

V. Conclusion

From the foregoing discussions we can summarize the relationship between Schumpeter and the Historical School in four major points.

(1) *Instrumentalism*. Schumpeter's contribution to the *Methodenstreit* was a formulation of instrumentalist methodology for economics. Although Max Weber's methodological work on the ideal type has exclusively been referred to as the solution to the debate, Schumpeter's work on instrumentalism is no less important. It is rather striking to see the similarity of their methodology. It is also illuminating to compare the two approaches with reference to their different origins, Neo-Kantian and Machian philosophy of science.

(2) *Historism*. Schumpeter accepted the idea of historism from the Historical School and interpreted it as the combined claim of development and the unity of social life as the subject matters of historical research. According to him, only from the viewpoint of development historical facts reveal the interdependence and unity of social life. He emphasized the need for the integration of theory and history. For Schumpeter, economic sociology rather than historiography was the discipline of historism. Reasoned history (i.e., theoretically worked out history) was his substitute for monographic history.

Schumpeter's case for economic sociology was supported methodologically by instrumentalism.

(3) *Evolutionism*. Schumpeter's evolutionary science in terms of the relationship between the economic and non-economic areas was animated by Schmoller's dichotomy between ethics and economy as well as Marx's dichotomy between the superstructure and the substructure. Schumpeter's theory of economic development was not fully evolutionary because it was confined to the economic area. Schumpeter's approach to economic sociology is to be compared to those of Schmoller, Marx, Comte, and Pareto, who had more or less broad views of society integrating economics and sociology.

(4) *Institutionalism*. Schumpeter defined economic sociology as the analysis of economic institutions and accepted Schmoller's research program with the evolution of institutions as the subject matters. Schmoller, as the defender of the "historico-ethical" approach, insisted that three kinds of norms (custom, law, and moral) are embedded in economic and social institutions and developed the stage theory of evolution in terms of the interactions between spiritual-ethical and physical-technical factors. Schumpeter's thesis on the fall of capitalism that was derived from the apparatus of economic sociology can be interpreted as a version of the Schmollerian analysis of the interaction between ethics and economy. Schumpeter's work on the spiritual-ethical aspect of institutions is compared to Weber's work on the protestant ethic and the spirit of capitalism.

Lastly, the character of *Capitalism, Socialism and Democracy*, the product from Schumpeter's apparatus of economic sociology, must be identified. The inclusion of ethics, spirits, and value schemes is crucial, but the treatment of these elements differs from an ordinary method of ethical and ideological prescription. They are embedded in institutions; thus they are the objects of science and analyzed as the factual values. To analyze the consistency or inconsistency between value schemes and economic machinery and to argue the evolution of institutions from this standpoint is the basic task of economic sociology. This is the prominent feature of discourses in the tradition of the German Historical School.

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5. Instrumentalism in Schumpeter's Economic Methodology

I. Introduction

Schumpeter's first book, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*, published in 1908 when he was twenty-five, was one of the earliest attempts to give a methodological foundation to neoclassical economics. His standpoint was influenced by the precursors of logical positivism, such as Mach, Poincaré, and Duhem.¹ Schumpeter's methodology in *Wesen* can best be interpreted as instrumentalism, i.e., the view that theories are not descriptions but instruments for deriving useful results and are neither true nor false.

Schumpeter's contribution to economic methodology has not received the attention it deserves.² There are several reasons for this. First, since Schumpeter remarked on the sterility of the *Methodenstreit* (the dispute over methods between Menger and Schmoller), of philosophical speculation, and of the conflicts between schools, economists have been readily misled to neglect the importance of his methodological work. In evaluating Schumpeter's early German works, Erich Schneider concluded: "His greatest loathing was reserved for methodological controversy, which he regarded not only as sterile, but as a direct obstacle to the progress of our discipline" (Schneider 1951, 108). This remark should not be interpreted as Schumpeter's actually claiming that methodology was sterile; the assertion concerns the sterility of disputes on methods. In fact Schumpeter advocated a methodology that would make any controversy on methods superfluous.

Second, because *Wesen* was not reprinted for a long time (until 1970) and has not yet been translated from German to English, it has not been widely read.³ There is little doubt, however, that it exerted a strong impact on part of the German academic world. As Morgenstern observed, "the work was read avidly in Vienna even long after the First World War, and its youthful freshness and vigor appealed to the young students. I myself remember what sort of revelation it was to me when I first laid hands on it and, like many others of my generation, I resolved to read everything Schumpeter had written and would ever write" (Morgenstern 1951, 198).

Third, because Schumpeter's primary contribution was to economic dynamics rather than economic statics, *Wesen*, which was exclusively concerned with static theory, has naturally attracted little attention, even among his adherents. As Samuelson correctly pointed out, however, "Schumpeter's most theoretical work was his first German book of 1908—*Das Wesen und [der] Hauptinhalt der theoretischen Nationalökonomie*"

(Samuelson 1982, 3). As I shall soon demonstrate, *Wesen* as a theoretical work was uniquely constructed also as a methodological work.

The literature on economic methodology has often discussed the nineteenth-century methodologists, such as N. Senior, J. S. Mill, J. E. Cairnes, and J. N. Keynes, as being directly followed by L. Robbins in the 1930s, and has made no reference to the early part of the twentieth century, when neoclassical economics was essentially established. Moreover, Robbins's methodology in *An Essay on the Nature and Significance of Economic Science* (1932), though representing only one among competing positions, has been treated as the primary authority and has won universal acceptance in modern economic theory. Quite recently this situation has changed: in accordance with an increasing plurality in the philosophy of science and a growing interest in the history of methodology as a result of the decline in the influence of logical positivism, different approaches to economic methodology, such as those by Robbins, Hutchison, Machlup, Friedman, and Samuelson, are now recognized.⁴ Schumpeter's methodology, however, is still overlooked in the current literature. By clarifying the origin and nature of Schumpeter's methodology in *Wesen*, this article helps fill a lacuna in the history of economic methodology. Moreover, although in the current literature on economic methodology Friedman's essay (1953) has been discussed as typical of the instrumentalist position, Schumpeter's instrumentalist methodology, published fully forty-five years before Friedman's, is noteworthy because it is explicitly and completely stated along methodological terms and has a clear source in nineteenth-century positivism.

II. Some Background Knowledge

Before making the case that Schumpeter's *Wesen* is a clear example of instrumentalist economic methodology, it will first be necessary to extend some background information. Here I explain Schumpeter's purposes in writing *Wesen* (section II.1), present his views on method and methodology, by which these purposes were to be realized (section II.2), and finally outline the currently accepted view of instrumentalism in order to compare it with Schumpeter's own version (section II.3).

1. Purposes

What were Schumpeter's intentions in *Wesen*, a huge book of more than six hundred pages? As is clear from the title, *The Nature and Substance of Theoretical Economics*,⁵ the author attempts a fundamental and systematic treatment of theoretical economics. Schumpeter understood theoretical (or pure) economics to be the exact theory of economics, or what is known today as neoclassical static theory. In his view, although dynamics belonged to economics, it did not yet constitute a part of theoretical economics because it

was far less developed. Schumpeter saw the task of *Wesen* as follows: "The following description ... tries to examine as correctly as possible the foundation, methods, and main results of pure economics with reference to its nature, its significance, and its development possibility" (20).⁶ He refers to the task of *Wesen* as the epistemology, or the methodology, of economics.

There were two reasons why Schumpeter wanted to write a book on methodology. First, he found deplorable confusion in economics around the turn of the century, as reflected in the conflicts between schools, disputes over methods, and futile controversies. He believed that this confusion was due to a lack of clear understanding regarding the foundation, nature, and significance of economics. The "marginal revolution" of Jevons, Menger, and Walras had already occurred, but British classical economics still dominated thinking in Britain and the United States. The German Historical School was steadily expanding, and the Marxists were gaining increasing strength. Wicksell in Sweden also deplored the state of economics at that time: "[in economics] no generally recognized result is to be found, as is also the case with theology, and for roughly the same reasons; there is no single doctrine taken to be a scientific truth without the diametrically opposed view being similarly upheld by authors of high repute" (Wicksell 1958, 51). In *Wesen* Schumpeter did not attempt a radical revision of economics but rather sought an appropriate interpretation and evaluation of procedures in economics from a methodological standpoint in order to rid the field of the confusion surrounding it. Economics as a self-contained or autonomous science was at the heart of his interpretation and evaluation. The idea is that it must not seek help from other disciplines.

Second, Schumpeter hoped to familiarize German economists with theoretical economics, especially Walrasian economics, because, in his view, theoretical development had not been satisfactorily pursued in Germany. For this reason he tried to acquaint them with economic theory through a methodological orientation rather than through its direct presentation in a mathematical form. This roundabout approach was perhaps thought to be more suitable for German economists, who were accustomed to philosophical and methodological speculation. Schumpeter frankly notes:

One of my purposes is to familiarize the German public with many things—concepts, propositions, and approaches—which have so far remained unknown to them because the development of theories was not adequately pursued. German economists have often very little idea of what "pure" theorists are really concerned with. Thus even if the knowledge of theories is taken for granted, still much can be done in order to bring the theories of foreign countries closer to the German discipline (xxi).

2. Method and methodology

Following Machlup (1978, 54–56), I understand methodology to be the study of reasons behind the rules or principles of scientific procedure (i.e., methods), on the basis of which certain propositions in science are accepted or rejected. In this sense methodology is a branch of philosophy or logic. Methods or techniques in any field of science relate to the prescribed rules or principles of scientific procedure, including the construction of concepts, making assumptions, building models, formulating hypotheses, observing facts, and testing theories.

There is no doubt that Schumpeter in *Wesen* correctly distinguished between method and methodology. In his academic life he occasionally discussed the significance of various methods of research in economics, i.e., theoretical and historical, static and dynamic, mathematical and statistical, micro and macro, and economic and socioeconomic. Although he briefly touched on the subject of methodology again in the introduction to his posthumous book *History of Economic Analysis*, it was only once in *Wesen* that he intensively analyzed the methodology of economics. He refers to *Wesen* as a study of methodology or epistemology, but he does not give any specific definition of the two terms. As is often found in most authors of methodology, the distinction between methodology and epistemology is neither definite nor essential in Schumpeter's thought. Considering the thought of the time, however, it would be safe to assume that he regarded epistemology as inquiry into the nature and basis of knowledge.

The *Methodenstreit* was a conflict between the uses of historical and theoretical methods in economics and, as I noted above, served as a stimulus for Schumpeter to embark on a study of methodology. In *Wesen* he hoped to clarify the rules of procedure in neoclassical economics and to propose reasons justifying such rules. For this purpose he adopted a particular approach to methodology. I referred to *Wesen* as a fundamental and systematic treatment of theoretical economics, but the book is quite different from those usually entitled *Principles of Economics*; it is so concerned with methodology that beginners would be unable to learn economics from it. *Wesen* clearly presupposes that the reader has sufficient knowledge of economics. The book is also different from methodological works often entitled *Scope and Method of Economics*; it is so concerned with specific theoretical problems in economics that those who expect a philosophical analysis of general ideas will be puzzled. *Wesen* is quite unique: it is neither a mere presentation of theoretical "substance" or of the epistemological "nature" of economics, nor does it attempt to mix together the two distinct approaches taken by economic theory and economic methodology. A fundamental characteristic of *Wesen* is that it discusses both the "nature and substance" simultaneously. Schumpeter addresses methodological issues in the context of every detail of economic principles and hypotheses. The title, *Wesen und Hauptinhalt* (Nature and Substance), indicates, as it were, a synthesis of methodology and theory in economics.

Schumpeter expresses his basic approach to methodology as follows:

In *our* view, one should not construct a methodological viewpoint a priori but adopt what leads us farthest in each case without being affected by any preconception. In particular, one should not mark off a priori the field of economics. We should instead innocently approach the problems which interest us and try to elucidate them. The method found useful, however, need not be universal for that reason. ... One cannot separate the study of methods from the study of concrete problems. Only in relation to the latter has the former a meaning (xiii-xiv).

His claim concerning methodological tolerance follows from this recognition of the dependence of methods on problems. He believed in methodological tolerance for the following reason:

Like many specialists [of the natural sciences] in our time, I am convinced that the contentions of almost all "schools" and of all individual authors are *correct*; most contentions are *true in ways* for which they are meant and *for the purposes intended* (vi).

Each method has its concrete areas of application, and it is useless to struggle for its universal validity. We shall emphasize over and over again that a discussion of methods has meaning only in relation to practical scientific works (7).

While Schumpeter referred to his particular methodological position as simply being "pragmatic" (xvi), I propose that it is fundamentally "instrumentalist." Referring to the fact that Schumpeter did not take one side or the other in regard to the *Methodenstreit*, Samuelson observes that "his methodology took the eclectic road of good sense" and calls him an "eclectic methodologist" (Samuelson 1982, 4). Schumpeter's position, however, is actually more sophisticated than this. Before I proceed to an interpretation of his methodology, it will be necessary to comment on the current conceptions of instrumentalism.

3. The current view of instrumentalism

The currently accepted view of instrumentalism was articulated by K. Popper, one of its leading critics. Popper referred to physicists such as Mach, Kirchhoff, Hertz, Duhem, Poincaré, Bridgman, and Eddington as instrumentalists (Popper 1963, 99), whereas he also called Duhem and Poincaré conventionalists (Popper 1983, 112). Popper defines instrumentalism as follows:

By instrumentalism I mean the doctrine that a scientific theory ... should be interpreted as an instrument, and *nothing but an instrument*, for the

deduction of predictions of future events (especially measurements) and for other practical applications; and more specifically, that a scientific theory should not be interpreted as a genuine conjecture about the structure of the world, or as a genuine attempt to describe certain aspects of our world. The instrumentalist doctrine implies that scientific theories can be more or less useful, and more or less efficient; but it denies that they can, like descriptive statements, be true or false (Popper 1983, 111–12).

Feyerabend, also a critic of instrumentalism, succinctly defined it as “the view that scientific theories are instruments of prediction which do not possess any descriptive meaning” (Feyerabend 1981, 17). Boland, who interpreted Friedman’s 1953 essay as instrumentalist economic methodology, relied on a similar characterization of instrumentalism:

It [instrumentalism] says that theories are convenient and useful ways of (logically) generating what have turned out to be true (or successful) predictions or conclusions. ... Thus, theories do not have to be considered true statements about the nature of the world, but only convenient ways of systematically generating the already known “true” conclusions (Boland 1979, 508–9).

Two aspects of theories are specified in these three quotations: the role of theories (they are merely tools for generating prediction) and the cognitive status of theories (they are regarded as neither true nor false). The instrumentalist position is currently often defined along these terms. It is to be noted, however, that this formulation limits the role of theories to prediction; this has given rise to the criticism that instrumentalism does not admit explanation as a role of theories. Popper’s version of instrumentalism is an extreme one in which scientific theories are nothing but computational rules for prediction. But original instrumentalists did not understand the role of theories in such a narrow way. If there were any reason to deny “explanation” in the original instrumentalist view of the role of scientific theories, it would be found in the special sense of the term used by the positivist schools, including the instrumentalists themselves, namely “metaphysical explanation.” Thus when Duhem said that a physical theory is not an explanation, he meant by “explanation” a metaphysical or ultimate explanation which describes the realities behind the appearances.⁷

Among current philosophers of science E. Nagel gives a moderate definition regarding the role of theories in instrumentalism. He views instrumentalism in a much broader light, one which does not limit the role of theories to prediction alone:

[Instrumentalism] maintains that theories are primarily logical instruments for organizing our experience and for ordering experimental laws. Although some theories are more effective than others for attaining these ends, theories are not statements, and belong to a different category of

linguistic expressions than do statements. ... [T]hey cannot therefore be usefully characterized as either true or false (Nagel 1961, 118).⁸

Morgenbesser admits explanation and prediction as the role of theories in the instrumentalist view and calls this position weak noncognitivist instrumentalism, in contrast to strong noncognitivist instrumentalism, in which theories are construed as having predictive use only (Morgenbesser 1969, 202). Thus instrumentalists can hold the view that theories are rules or devices for classifying, organizing, explaining, and predicting observable phenomena and also for serving as guides for action, although the current critics of instrumentalism insist that theories which are not statements cannot lead to explanation.

Although, as will be shown below, a fundamental assertion of original instrumentalism has been that serious problems of truth value associated with the method of induction must be avoided, it need not be characterized, in the mind of original instrumentalists, by the view that theories are tools for prediction alone; What is essential is its claim concerning the instrumentality of theories for any purpose. By an examination of the original instrumentalist authors Giedymin demonstrated that they did not hold the same extreme views as interpreted by some philosophers, especially Popper, and instead proposed that these earlier writers held a more moderate interpretation of instrumentalism (Giedymin 1976). Instead of using the modern, narrow conception of instrumentalism as a procrustean bed to which Schumpeter's view must be adapted by force, it will be more appropriate to interpret Schumpeter's methodological view in light of the broad conception of instrumentalist philosophy which was held by his contemporaries and by which he was actually affected. Hence we should understand the *central* claims of instrumentalism broadly as the view that, first, with regard to the role of theories they are merely tools, and second, with regard to the cognitive status of theories they are regarded as neither true nor false.

In addition to these two central claims, instrumentalism often makes three important, closely related claims. A discussion of these claims is both necessary to clarify the epistemological implications and, more importantly, to give a broader perspective to the instrumentalist view. But since these claims are also made by noninstrumentalists, and furthermore since all instrumentalists do not necessarily hold all of these claims, one should carefully differentiate them from the central or distinguishing claims of instrumentalism. Let us refer to them as the *subsidiary* claims of instrumentalism.

The first subsidiary claim is that instrumentalism is a response to the "problem of induction." As is well known, whereas *inductivism* asserts that knowledge must be judged on the basis of observations (Boland 1982, 14), it is impossible to argue inductively from the truth of particulars to a general truth. Moreover, any given set of empirical phenomena can be explained by an infinite number of mutually incompatible hypotheses, so that it is impossible to find a true theory by observational methods. Instrumentalism dismisses the "problem of induction" by directing sole attention to the usefulness of

theories, not to their truth. Secondly, instrumentalism is opposed to *essentialism*, which holds that theories describe the essences of phenomena or the realities that lie behind observable phenomena (Popper 1963, 103–7). As I explained above in relation to the special usage of the term “explanation,” instrumentalism denies ultimate causes and ultimate explanations. The opposition to inductivism and essentialism is shared with realism, as is demonstrated by Popper (1963, 103–5). Thirdly, instrumentalism is generally taken to be opposed to *realism*. The central theses of realism may be articulated in the following manner: “theoretical statements, read literally, possess definitive truth values, and, if true, the objects they postulate are on a par ontologically with ordinary objects of perception” (Levin 1984, 124).⁹ Instrumentalism claims that the theoretical (nonobservational) terms of science are not really assertions about the world but nonreferring symbolic devices for permitting derivations of statements about observable phenomena. Thus it denies ontological status to theoretical entities and structures. But some instrumentalists, still holding the thesis that theories are neither true nor false, admit that some theoretical entities are real.¹⁰ This is the reason why the difference between instrumentalism and realism is sometimes viewed as blurred; moreover, this is the reason why we regard the response to realism as a *subsidiary* claim of instrumentalism.

Having provided this background we are now in a position to turn to the analysis of Schumpeter’s economic methodology: the origin of his ideas (Section III); the formulation and nature of the elements of his instrumentalism (section IV); and the significance of his instrumentalist methodology as a practical solution to difficult issues in economics (section V).

III. The Influence of Mach and Poincaré

In the preface to *Wesen* we find a passage that has received little attention but in fact indicates the source of Schumpeter’s methodological ideas:

This approach to our problems [the pragmatic approach of searching for usefulness rather than truthfulness of theories] might appear strange. But it coincides with the line of modern epistemology which has grown out of practical works in the exact natural sciences. We will not and cannot discuss this point here; rather we would like to be careful lest our arguments appear to depend on the acceptance of that line of thought. Our arguments should be understood straightforwardly and unbiasedly in the same way as they were written, without being biased by any superior principle. I would only like to mention that I am not alone in my epistemological view, so that many expressions and remarks in this regard would not strike one as strange (xvi).

This statement clearly shows that Schumpeter was familiar with the contemporary philosophy of the natural sciences. Although he agreed with

its views, he was rather reluctant to express his uncritical acceptance of them. In view of the antitheoretical atmosphere in German academism at the time, he was probably worried about being accused of imitating the natural sciences. Nevertheless, approaching the end of the book, Schumpeter dared to say that "pure economics would be a 'natural science' in terms of its methodological and epistemological nature" (536). Further discussion in this section will illuminate Schumpeter's indebtedness to the contemporary philosophy of the natural sciences.

1. Mach

Ernst Mach, an Austrian physicist, was a professor of philosophy at the University of Vienna from 1895 to 1901, after teaching at Graz and Prague. Along with Richard Avenarius he established what is known as empirio-criticism, a forerunner of logical positivism. His thought dominated much of the intellectual life of the Austro-German world at the turn of the century. Our contention is that young Schumpeter was greatly influenced by Mach and adapted Mach's methodological standpoint to economics. Mach's philosophy of science is usually characterized by (1) the view that the aim of science is economy of thought, (2) phenomenalist epistemology, (3) instrumentalist methodology, and (4) the biological theory of knowledge.¹¹

(1) Mach held that scientific theories are devices for effecting the economy of thought (Mach 1882, 1883). According to him, the aim of scientific theories is to describe the world as economically as possible; in other words, it is to eliminate the need to know mere individual facts, or to "save the phenomena." Mach himself noted that his view was similar to that of Kirchhoff, Clifford, and Avenarius (Mach [1883] 1960, 592). It suffices here to refer to Gustav Kirchhoff, a German physicist whose famous definition of mechanics had an important impact on the philosophy of science: "Mechanics is the science of motion; we designate as its task to describe in the most complete and simplest manner the motions that take place in nature" (Kirchhoff 1876, 1). Although no explicit reference is made in *Wesen* to Mach as the source of the principle of economy of thought,¹² Schumpeter does mention Kirchhoff's definition of mechanics as the clearest expression of the task of exact science (38), and writes: "*A theory constructs a scheme for facts; its aim is to give a brief representation to an immense amount of facts and to achieve as simply and as completely as possible what we call understanding*" (42).

(2) Not only did Schumpeter accept Mach's general view concerning the aim of scientific theories, but, more importantly, in the hope of eliminating metaphysical speculation from economics, he attempted to apply to economics Mach's specific epistemological approach to physics. Mach's approach, which he himself called "phenomenological physics," rejected the assumption of essence and causal relations behind phenomena and confined the task of physics to a concise description of functional relations between "elements" known to us only through sense experience. Mach's phenomenalism has also

been referred to as physicalism or sensationalism. Schumpeter explicitly writes:

I would like to mention that in exact reasoning we avoid the concepts of “cause” and “effect” whenever practicable and replace them by the more satisfactory concept of function (xvi).

I want to talk not about the “cause” of phenomena, but only about functional relations between them. This brings greater precision. The concept of function is carefully elaborated by mathematics and has clear, unquestionable contents, but that is not the case with the concept of cause (47).

Schumpeter found in Walras an ideal application of Mach’s phenomenalism to economics. He favored the Walrasian version of neoclassical economics—general equilibrium theory—because, on the basis of Mach’s view, he believed that economic science should be constructed on the conception of a general interdependence of such observable economic variables as prices and quantities of goods and factors of production. In *Wesen* we find the following remarkable account of phenomenalism applied to the foundation of economics:

In our view, the objects of our inquiry are *certain dependent relations or functional relations*. The fact that economic quantities stand in such interdependent relations warrants a separate treatment of them if they are uniquely determined. The unique determinateness of the system of quantities is a scientific fact of the greatest importance. It means that when certain data are given, we have all the necessary elements together to “understand” the magnitude and movement of these quantities. In that case a separate, independent science about such phenomena is possible, and this is what we must establish above all. Even if an equation system shows nothing else than a proof of uniquely determined interdependence, that is in itself a great deal: that is the foundation of scientific structure (33–34).

Walras and the Lausanne School had less interest in methodology than the Austrians. Schumpeter’s *Wesen* can be interpreted, in this context, as the first epistemological work which was devoted to a clarification of general equilibrium theory on the basis of Mach’s phenomenalist view of science.

Another statement of Schumpeter’s well summarizes Mach’s influence with regard to the two points we have discussed above, i.e., economy of thought and phenomenalism: “The explanation rendered by our theory is therefore a description of functional relations between elements of our system with the help of formulas which are as concise and generally valid as possible. These formulas we now call ‘laws’ ” (43).

(3) Moreover, we must note that Schumpeter’s most characteristic methodological position in *Wesen* is also pure Mach. Although Mach’s phenomenalist position was that scientific theories only make existential

claims about those entities which are observable, he did not argue against the use of theoretical, unobservable entities as useful fictions, provided that they lead to the discovery of new empirically testable relations between observables. This is an assertion of instrumentalist methodology and does not contradict the phenomenalist epistemology. In fact Mach's critique of atomic and molecular theories was based not on his phenomenism or sensationalism, but rather on his instrumentalism, i.e., on his view that they had long since outlived their heuristic usefulness (Laudan 1981, 202–25). Nothing shows more revealingly Mach's position on the relation between epistemology and methodology than the following passage: "it should be emphasized that a hypothesis can have great heuristic value as a working hypothesis, and at the same time be of very dubious epistemological value" (Mach 1896b, 430, quoted from Laudan 1981, 224). Because the primary aim of this paper is to demonstrate at length Schumpeter's instrumentalist methodology, I only mention here that his attitude towards psychologism (the use of psychological hypotheses in economics) is in line with Mach's attitude towards atomism.

(4) On the basis of the Darwinian theory of evolution by natural selection, Mach talked about a kind of biological adaptation of thoughts or scientific hypotheses to facts. The cognitive functions of the human mind, he believed, are subject to gradual growth, and when thoughts as creations of the human mind are well adapted to facts we have a successful theory. Hence theories evolve as a consequence of the biological survival of thoughts. Mach's biological epistemology can be seen as an account of the historical process of scientific activity, in which science, conceived in terms of phenomenism and instrumentalism, is really a result of natural selection or the adaptation to facts. Since Schumpeter in *Wesen* is not concerned with the history of economics, we find there little influence of Mach's biologism. But the history of economics was a major concern of Schumpeter's, and his subsequent works on the subject, I only suggest here, indicate the influence of Mach and, in particular, of Poincaré, another proponent of biologically oriented epistemology.

2. Poincaré

Closely related to instrumentalism is conventionalism, and Henri Poincaré is best known as a conventionalist (Giedymin 1982). Conventionalism is the view that hypotheses in science are conventions or definitions, which depend on free creations of the human mind and are not subject to empirical testing. They might be useful or not in understanding the real world, but in themselves they cannot be said to be true or false. While conventionalism stresses that theories are arbitrary products based on conventional criteria, the same view can be called instrumentalism when a focus is placed on the instrumentality of theories in attaining their purposes. In this sense conventionalism and instrumentalism are often viewed interchangeably. Both deny a truth status to

theories. An alternative to the two is pragmatism, which stresses practical success as a sufficient criterion of the truth of theories. Although pragmatism is similar to instrumentalism, which characteristically emphasizes the practical usefulness of theories for any prescribed purpose, instrumentalism, unlike pragmatism, does not claim that a useful theory is a true theory. Although pragmatism is also similar to conventionalism, which provides the conventional criteria of theory choice, conventionalism, unlike pragmatism, does not claim that they are the criteria of truth.¹³ But the three views are similar in that they are all antirealist, denying an ontological status to theoretical entities insofar as they are unobservable in principle.

In discussing the relation between theory choice and empirical evidence Schumpeter articulates an important conventionalist and antirealist view with an analogy:

Pure static economics is nothing but an abstract picture of certain economic facts, i.e., *a schema that should serve as a description about them*. It depends on certain assumptions, and *in this respect* it is a *creation of our arbitrariness*, just as every exact science is. If, therefore, a historian says that our theory is a product of our fancy, he is right in *a sense*. Indeed, in the phenomenal world neither our “assumptions” nor our “laws” as such exist. But from this follows no objection against them. For this does not prevent theories from *fitting* the facts. Where then does this come from? The reason is simply that we work arbitrarily but rationally in the construction of our schema and *design it in view of the facts*. To use the analogy of a deep thinker: when a tailor makes a jacket, it is a product of his arbitrariness in the sense that he could cut it out differently. Nevertheless we expect that a jacket will fit us, and we do not wonder at all when it does. This is because he makes it to order.... We do not always make research “to order,” but hope that our schema will also fit the facts which we have not observed. Like a tailor who keeps ready-made jackets in stock, we expect that our products will fit a sufficient number of customers (527–28).¹⁴

In his *History of Economic Analysis* Schumpeter again refers to this analogy of the tailor, but this time he explicitly states that its source was Poincaré. In Poincaré’s trilogy on the philosophy of science is found the following description: “This frame into which we wish to force everything is one of our own construction; but we have not made it at random. We have made it, so to speak, by measure and therefore we can make facts fit into it without changing what is essential in them” (Poincaré [1902], 5; 1913, 29).

Schumpeter’s connection with Poincaré is not confined to casual quotation of the above metaphor; they share common views on the philosophy of science, that is, conventionalism and biologism. However, since their biological epistemology mainly relates to the process of scientific progress, a subject outside of *Wesen*, I shall now move away from Poincaré and proceed directly to an explication of Schumpeter’s economic methodology.

IV. Elements of Schumpeter's Instrumentalism

1. Theory, hypothesis, and fact

Schumpeter's view of scientific theories is that they are to describe facts not individually but "schematically." What he calls a "schema," "scheme," "formula," or "law" is nothing but a "model" in our usage. By theoretical, pure, or exact economics Schumpeter in *Wesen* means specifically the system of general equilibrium analysis, which consists of static neoclassical economic theory. He maintains that economic theory in this sense should be independent of all metaphysical, psychological, political, social, and historical questions, which are either difficult to solve in the field of science or belong to other fields of knowledge. Furthermore, he contends that this independence will assure the "clarity and autonomy" (23) of economics. Thus at the beginning of *Wesen* he takes up a group of questions which he calls the "great problems of principle" (22): in particular the motives of human behavior, the motive power of social phenomena, and the purposes of economy. Although economists regarded it as incumbent to discuss these issues before they could approach the proper problems of economics, Schumpeter raised the question "*whether we should actually solve all these issues, whether all the rocks should actually be blown up, and whether it is not possible to ward them off*" (24). He proposed to avoid these grand issues, believing that genuinely valuable inquiry in economics should include no trace of them.

What, then, is required for pure economics to be an exact and autonomous science? Schumpeter defines the domain of pure economics in terms of exchange relations and calls it "catallactics" (theory of exchange) by referring to Richard Whately, a nineteenth-century archbishop of Dublin. Catallactics is much narrower and more specific than traditional political economy and the moral sciences, in which one often indulged in metaphysical speculation as well as political advocacy. Schumpeter's notion of exchange includes all economic behavior, including production as well as consumption.¹⁵ This, he believes, is a case of attempting to achieve what Mach would call economy of thought and allows the "unity and purity" (228) of economics.

Exchange relations presuppose a given amount of goods, including factors of production, owned by individuals. Equilibrium is defined as a situation in which there is no longer a further exchange of goods and services. On the basis of the notions of exchange, the holding of goods, and equilibrium Schumpeter arrives at his definition of pure economics:

Thus the definition of pure economics, which is the most exact in an epistemological sense, would be the following: it has to reduce the quantities of goods owned by individual economic agents at a certain point of time to those quantities owned by them a moment before, and yet by the shortest way with reference to formal assumptions (143).

He notes that such an intertemporal reduction of phenomena is a fundamental procedure of the natural sciences. This procedure, if applied to economics, makes it possible to determine autonomously (i.e., without the aid of other disciplines) a system of interdependent economic quantities at any point in time.

This definition of economic theory raises the question of what assumptions or hypotheses should serve as the foundation of catallactics. Schumpeter discloses three assumptions as the major postulates of neoclassical theory. First, in order to justify the procedure of economic theory that starts from goods owned by individuals, he assumes an atomistic view of society, rather than a holistic one. He was the first to use the term “methodological individualism,” as noted by Machlup (1951, 100). Methodological individualism is not a political, ethical, or factual statement. Second, in order to explain the exchange behavior of individuals, he postulates the maximization of want satisfaction by consumers. As explained above, equilibrium is an imaginary state where no exchange takes place; this is so because the satisfaction of want for each individual is maximized to the extent that there is no incentive to change the quantity of goods in the hands of individuals. In accordance with the generalized notion of exchange Schumpeter expanded the concept of utility function (or value function) to cover production process and supported this procedure by the Austrian theory of imputation, which derives demand for factors of production from demand for consumer goods. These first two assumptions are combined in the hypothesis of *homo oeconomicus*. This hypothesis is also not a factual statement. It does not assert that human nature and behavior are exhaustively explained by economic interests, nor does it contend that all economic behavior is explained solely by economic interests. Third, an important hypothesis is required to explain the process towards equilibrium, i.e., the assumption of perfect competition (which Schumpeter calls free competition). Again, this hypothesis is neither a normative assertion nor a factual statement. All three hypotheses are useful fictions for establishing the autonomous science of catallactics or, in other words, for deriving an equilibrium state of all goods owned by individuals.

It does not follow, however, that any hypothesis is acceptable insofar as it leads logically to a self-contained set of economic propositions. So long as economics is an empirical science, Schumpeter argues, we should take into account the extent to which a theory can explain and predict an occurrence of economic phenomena. If pure economics is a mere logical construct that has nothing to do with facts or is contradictory to them, even though it may be exact and autonomous, it has no value at all (529).

In this connection he asserts that static theory constructed on the hypotheses of *homo oeconomicus* and perfect competition has very wide applicability to facts, for two reasons. First, the state of affairs (i.e., a circular flow) described by static theory is ordinary in real life; economic development and change, however remarkable, are exceptional (568). Second, and more importantly, the equilibrating mechanism of an economy (i.e., the price mechanism) described by static theory actually works even with changes in

economic life and absorbs the effects of disturbances so as to adjust an economy to new circumstances (562).

2. Schumpeter's propositions of instrumentalism

The subsection above gives a skeleton summary of Schumpeter's discussion of the relations between theory, hypothesis, and fact in the context of neoclassical theory. Against the background of this discussion we may now reconstruct his economic methodology by specifying a set of key propositions that concern the conceptions of, and relations between, theory, hypothesis, and fact. By this it will be shown that his methodology is clearly instrumentalist.

The following two passages from *Wesen* give us an important clue to our task:

Hypotheses we make are in themselves artificial, just as definitions are. Indeed, we are induced by facts to make hypotheses, but in principle we create them on our own authority. Their apparent certainty is due only to this circumstance, again as is the case with definitions. However, we must *claim* in hypotheses *as little as possible*, and even this little is presented not in the least as a *cognition*, but is used merely as an auxiliary means for description (46).

Whatever sophistication we may use in order to make the hypotheses appear justified or to disguise their hypothetical character, all this is meaningless to pure economics; and all metaphysical arguments or whatever in favor of our hypotheses cannot be a help to them, if their application leads to results contradicting reality. It is the sole purpose of hypotheses to produce a schema fit for economic reality; the merit of hypotheses can only lie in this purpose; it is irrelevant to this purpose to discuss where hypotheses originate and how they are decorated (68).

In *Wesen* Schumpeter repeatedly emphasizes the importance of these two passages:

The crucial point, upon which all depends, lies in the distinction between two different aspects of the matter: on the one hand, we have the fundamental arbitrariness of theories, on which their system, rigor, and exactness are based; on the other hand, we have the conformity of theories to, and their dependence on, phenomena, and this alone gives content and significance to theories. If one distinguishes between these moments and places them in a proper relation with each other, a clear interpretation will arise and thus the difficulties and doubts which we come across in the usual discussions of these questions will be effectively overcome (533).

The first quotation is clearly concerned with the arbitrariness of theories, and reminiscent of the conventionalism of Poincaré and the fictionalism of H. Vaihinger. It can be broken down into four distinct propositions:

- S₁: Hypotheses, rather than being ontologically real, are artificial creations of the human mind.
- S₂: Theories are not descriptive statements of the real world, and therefore they cannot be judged for truth and falsity.
- S₃: Theories are merely instruments for the purpose of description.
- S₄: Theories are to describe facts as simply and as completely as possible.

Similarly, the second quotation, concerning the empirical relevance of theories, can be dissected into two distinct propositions:

- S₅: It is not necessary to seek to justify hypotheses as such in order to establish their truth.
- S₆: The purpose of hypotheses is to produce a theory fit for facts, and thus they are evaluated by their practical success.

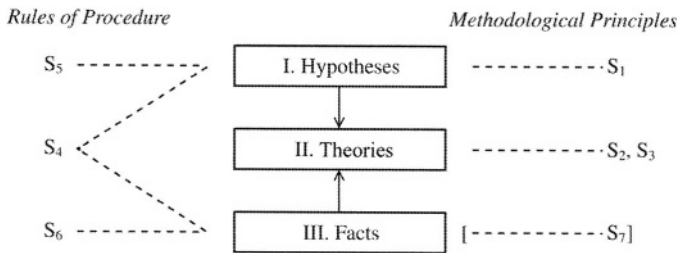


Figure 1.

In order to interpret Schumpeter's methodology and assess its implications it will be useful to construct a structure of thought by using propositions S₁-S₆ as building blocks. (We shall add S₇ later.) The kind of model of economic methodology that Schumpeter appears to have in mind can be represented as shown in Figure 1. "Hypotheses" in level I in this figure may also be called axioms, postulates, or assumptions. "Theories" in level II, i.e., the conclusions established by a certain procedure from "hypotheses," may be called laws, principles, or theorems. "Facts" in level III are observations, data, or phenomena.

S₁ expresses the conventionalist view regarding the nature of hypotheses and can be found on level I. S₂ specifies the cognitive status of theories and denies any truth status to them; S₃ specifies the instrumental role of theories for description. S₂ and S₃ are properly located at level II and have been previously identified as propositions concerning the central claims of instrumentalism. Description, conceived as the role of theories by Schumpeter in S₃, is articulated as follows:

We have identified as the task of our science *the description of interdependent relations of elements within our system for the purpose of successively reducing different situations to one another*. We have said that we understand just such description under *the concept of scientific explanation of phenomena* with which we are concerned. Accordingly, *the expressions "explanation" and "description" are generally synonymous for us, or in other words, we do not want and cannot contribute anything other than description to the explanation and understanding of economic facts* (37).

The instrumentality of theories for explanation, description, understanding, and the like is fundamentally important to Schumpeter. But he should not be understood as rejecting prediction as a role of theories.

As S_2 and S_3 form the core of instrumentalist methodology, it will be most legitimate to quote Schumpeter's own remarks to this effect:

The absolute truth of our hypotheses does not matter. Hypotheses do not belong to a part of results we have to defend, but are simply methodological auxiliary means whose value can only be judged from their fruitfulness. The role of hypotheses is merely *formal*; even if it were proved that they are in themselves true, nothing would be gained from it for our laws (64).

It is extremely important for a proper understanding of our theory and, eventually, every theory to be aware of this arbitrary character of a theory and not to seek in it an expression of some "absolute" truth. It is a method for description and nothing else; and as such it must be judged and organized for good or evil. ... *A theory consists only of a measure* which simplifies description and prevents it from becoming hopelessly complicated. ... If one realizes that only the goal justifies a theory, namely that only the result warrants it, then many objections and claims blocking our path will be removed (528–29).

Whereas S_1 – S_3 are methodological principles, S_4 – S_6 are concerned with the rules of procedure for the formulation and evaluation of hypotheses and theories. It will be logical to explain S_5 and S_6 before S_4 . S_5 simply denies a direct and independent justification of hypotheses at level I. S_6 prescribes that theories, as the conclusions from hypotheses, should fit observations at level III. In accordance with the methodological proposition concerning the role of theories (S_3), the fitness of theories to facts means that theories should describe the important aspects of facts. In *Wesen* Schumpeter does not discuss at length the problem of empirical fitting or testing. But it is clear that by fitness to facts he does not mean that a theory should make an unconditional forecast for an actual course of events. Although in *Wesen* he is concerned with static, abstract theory, which obviously cannot explain all economic phenomena, he still emphasizes that it can successfully fit important, basic, and universal aspects of an economy. Since in static theory all inessential factors that are unrelated to the formation of equilibrium in a market are grouped as exogenous data, a static explanation will be successful if the results of static

theory agree with those facts which are similarly elaborated in accordance with the abstraction on the theoretical side. This is not a problem of unconditional prediction.

S₄ is synonymous with Mach's principle of economy of thought and gives the criterion for the efficiency of hypotheses: deriving a theory that will subsume a large amount of observations by a small amount of simple hypotheses. It is thus concerned with the relation between level I and level III, and in fact integrates Schumpeter's two key passages quoted above. In other words, S₄ chooses among the theories that, starting from different arbitrary hypotheses, equally satisfy the requirement S₆. Schumpeter clearly states the relationship between the two requirements S₆ and S₄, namely, between fitness (ability of explanation or description) and usefulness (efficiency):

Let us remind ourselves what we mean by "explanation." It is nothing but a specification of the uniquely determined magnitude for the unknowns and of the laws of their motion. Every theoretical construction that achieves it is "right" for us, and one which achieves it most simply and best we call the "most useful" (340–41).

In regards to testing, it is interesting to notice in Figure 1 that Schumpeter does not remark on the epistemological nature of "facts," which could be placed at level III and named S₇. Do facts exist independently of theories? Or are they based on the acceptance of any theory? Schumpeter neither makes his attitude explicit about this question, nor does he seem to be aware of it at all. Yet it is clear that he does not assert in *Wesen* the so-called theory-ladenness thesis. This suggests that he was not an extreme conventionalist, one who argues that not only theories but also facts are conventions created by scientists. (It was on this point that Poincaré criticized E. LeRoy.) Schumpeter seems to have what would today be called a naïve positivist view that objective facts exist independently of theories. We can argue that he implicitly believed that there is a distinction between theory and observation. That is how he makes economics safe from the ravages of metaphysics. In fact, whether the observations are theory-dependent or not has little to do with the instrumentalist or realist standpoint (Giedymin 1976, 200). As will be suggested from his discussion of alternative theories of value, Schumpeter also held the view that conceptually different theories might be observationally equivalent. In that case it would be impossible to provide an inductive proof for a theory. This view was originally one of the basic sources of instrumentalism. We may, therefore, add the following to Schumpeter's set of propositions:

S₇: Observational facts exist independently of theories, but for any set of observed facts there might be several different theories.

In light of these general criteria, I hope to have shown that Schumpeter's methodological standpoint can best be construed as instrumentalist. One may

interpret his proposition S_1 as conventionalist, and S_3 and S_6 as pragmatist, but as a whole his system is being interpreted as instrumentalist because S_2 and S_3 point us clearly in that direction.¹⁶

I have discussed Schumpeter's instrumentalist position in terms of general propositions, but it was actually developed in the practical context of economic research. Thus it will do justice to his methodology to clarify his case for instrumentalism by examining the circumstances that led him to the instrumentalist view in the context of neoclassical theory. By doing so it will likewise be shown that Schumpeter's arguments also fulfill the subsidiary criteria for an instrumentalist approach, especially when contrasted with three views of knowledge discussed above: essentialism, realism, and inductivism.

V. The Significance of Schumpeter's Instrumentalism

What did Schumpeter intend when he adopted from the natural sciences the instrumentalist view—that theories are not descriptions but instruments without truth status—as formulated in S_2 and S_3 ? He resorted to this view in order to overcome the practical difficulties that surrounded the economics of the time. He believed that methodological clarification was required to elucidate what economists should not be concerned with and how economics should be constructed and appraised. Instrumentalism gave him an appropriate instrument for this task. For Schumpeter the difficulties were the result of at least three kinds of useless controversies in economics (apart from the intrusion of political beliefs into economic discussions): (1) the conflict between theoretical and historical methods (Menger versus Schmoller), (2) the controversy over value theory (classical versus neoclassical versus Marxian theories), and (3) the conflict between causal and functional approaches in neoclassical economics (Menger versus Walras). I shall try to demonstrate how Schumpeter relied on instrumentalism to cope with these issues. These issues were, he argued, not a challenge but an obstacle to the development of economics; it was necessary to devise methodological rules that would enable economists to dismiss them.

1. The separation of historicism

The first controversial issue that Schumpeter was confronted with was the *Methodenstreit* between theory and history. Although the doctrine of instrumentalism generally relates to the role and status of theoretical methods, not those of historical methods, Schumpeter's argument for instrumentalism was undoubtedly developed at least partly for the purpose of making a distinction and separation between theoretical and historical methods.

According to Schumpeter, description of facts includes two different approaches or methods: historical description and theoretical description. While the former only provides a catalogue of specific facts through selection

and classification, the latter gives a general “scheme” by way of the abstraction and transformation of individual facts. Here he deals with the most critical point in the *Methodenstreit* but denies that in principle any contradiction exists between theory and history. He explains the difference between theory and history in terms of the different concerns of theorists and historians with regard to what problems they are going to solve and how they are going to select facts. The amount of facts needed by observers simply varies with their purposes, and “there is the highest yield of knowledge for every purpose and for every observer under a given amount of phenomena, just as an appreciation of artistic objects requires the best distance from observers according to their purposes” (41).

Schumpeter next compares the theoretical method with the historical method:

While [historical] description does no more than make a catalogue of facts, a theory undertakes the transformation of facts, not for any far-reaching or mysterious purpose but only for a better summary of facts. A *theory constructs a scheme for facts; its aim is to give a brief representation to an immense amount of facts and to achieve as simply and as completely as possible what we call understanding* (42).

As shown above, this is how Schumpeter defines a theory with Mach’s thesis of economy of thought in mind. I emphasize that he discusses the thesis not only generally but also to propose a practical solution of the *Methodenstreit*, and that he generalizes the thesis so as to cover history as well as theory, so that economy of thought should be interpreted as a relative concept based on the purposes of inquiry. In his *History of Economic Analysis* Schumpeter, now explicitly referring to Mach’s principle of economy of thought, compares theories or general “simplifying schemata or models” with history or ad hoc “explanatory hypotheses” about facts (Schumpeter 1954b, 14–15).

Suppose, according to essentialism, that we can distinguish between three universes: essence, fact, and theory. Because, as we shall see below, Schumpeter denies the universe of essential reality (*essence*) by rejecting essentialism, there remain for him the universe of observable phenomena (*fact*) and that of descriptive language or symbolic representation (*theory*). Schumpeter accepts the instrumentalist position not only to deny the universe of essential reality, just as the instrumentalist natural scientists did, but also to specify the relation between the universe of observable phenomena and that of symbolic representation. Scientific hypotheses enable certain conceptual manipulations and calculations to take place within the universe of symbolic representation, but they do not have corresponding observable phenomena within their own universe: “In the universe of phenomena as such neither our ‘hypotheses’ nor our ‘laws’ exist by themselves” (527). The function of theoretical hypotheses is not to record events in the universe of observable phenomena, but rather to make it possible to infer from some symbols to other symbols in the universe of symbolic language. Schumpeter’s views on the

nature, status, and function of hypotheses with reference to the two different universes are best explained in terms of two methods: theoretical and historical methods in the social sciences.

Hypotheses in a broad sense comprise both theoretical and historical hypotheses. Economic theory depends on the use of theoretical hypotheses that are viewed as instruments and are to be distinguished in nature, status, and function from historical ones. Schumpeter distinguishes between these two types of hypotheses as follows (531–32).

(1) Historical hypotheses can describe phenomena in the universe of observables; theoretical hypotheses, on the other hand, are formal assumptions and need not have corresponding phenomena in that universe. (2) Historical hypotheses are attempts to reconstruct facts that are beyond observation and need verification by empirical test; theoretical hypotheses are artificial constructs and need not be true in themselves. (3) Historical hypotheses represent a cognition; theoretical hypotheses are mere methodological tools and do not mean anything real in themselves. (4) Historical hypotheses must be grounded on facts; theoretical hypotheses can be unrealistic. (5) Historical hypotheses can be matters on which opinions differ; for theoretical hypotheses realism does not matter, only expediency does.

In sum, Schumpeter's instrumentalism was applied to the differentiation between theoretical and historical hypotheses. If we follow the common practice in labeling as "historicism" an approach that emphasizes the historical method in economics,¹⁷ we can argue that his instrumentalism rejects historicism from static economics. Considering that the instrumentalist position was mainly taken by natural scientists, it is his unique adaptation that the social scientist Schumpeter, in introducing instrumentalism into economics, paid attention to differences between theoretical and historical hypotheses. To avoid misunderstanding, it should be noted that he never rejected historicism but only separated it from the domain of static economic theory. The separation of theory and history on the basis of instrumentalism was his own methodological solution to the *Methodenstreit*.

2. The choice of value theory

The second controversy in economics that I distinguished above concerned the general principle of economics. Schumpeter asks which principle is superior as a means of describing exchange relations, the main theme of static economics: the cost theory of value in the classical school, Marx's labor theory of value, or the subjective theory of value in the neoclassical school (119–31). Contrasting the truthfulness with the usefulness of theories as a criterion of theory choice, he adopts the last approach. He refuses to discuss a priori the truth and falsity of theories and is concerned with the competition of theories in producing "results." His conclusion is as follows:

We shall use the [subjective] value theory, not because we regard it as the only correct view, but because it is the most practical in obtaining our results and because we can go the farthest with it. But we shall not contend that all other views are “false” and cannot bring useful results, as is often said (57).

In *Wesen* Schumpeter repeatedly speaks of the “results” of hypotheses and theories; hypotheses and theories are to be assessed by their usefulness in producing “results.” What, then, are “results”? He asserts that fitness to reality is a necessary condition for a theory to be useful. The fitness of theories to reality refers to the ability of theories to describe, predict, and explain phenomena. In this regard, proposition S_6 gives a rule of procedure advocated by instrumentalist methodology. The condition that theories fit or be consistent with observable facts, however, cannot be the exclusive criterion for ascertaining the usefulness of theories; it is also important to see how consistent they are with facts, because, as proposition S_7 asserts, facts allow an infinite number of mutually incompatible theories. Other criteria must be invoked, therefore, to choose among theories which are all more or less consistent with facts. One may bring in ad hoc criteria such as simplicity, generality, and the like. But Schumpeter is consistent in defining the usefulness of hypotheses and theories by applying Mach’s principle of economy of thought to the appraisal of theories that are all equally regarded as fitting the facts.

From Mach’s thesis it follows quite naturally, for Schumpeter, that theories should be judged by their efficiency in attaining economy of thought. Efficiency is a relational concept between means and ends. Given the ends, it is more efficient for a theory to have simpler assumptions; given the means, it is more efficient for a theory to have more general or wider applicability. By applicability of theories Schumpeter means not only their fitness to a wide range of facts, but also the inclusiveness of a coherent theoretical system. For him the subjective theory of value explains a wider range of phenomena, including consumption, production, distribution, and money, with the minimum principle of utility. Thus the criterion of economy of thought can comprise a variety of attributes of hypotheses and theories.¹⁸ Schumpeter need not supplement the criterion of the predictive ability of theories with other ad hoc criteria (such as simplicity and fruitfulness); proposition S_4 is a single criterion for the choice among hypotheses and theories that are equally consistent with observable facts. It is also a case of economy of thought.

In relation to fitness to facts Schumpeter takes into account verification and falsification, which play crucial roles in determining the truth of theories in the doctrines of logical positivism and falsificationism. He does not believe, however, that truth or falsity can be settled in this way, and is more concerned with the expediency of theories. He gives an interesting discussion of verification and falsification in relation to the different theories of value indicated above (59–60). He argues that if one adopts the cost theory, the reproduction theory of wages (the doctrine that regards wages as the

reproduction cost of labor) would be derived as its necessary corollary; and that the cost theory as a hypothesis would only require that its derived theory of wages not be falsified by experience. On the other hand, if one adopts the subjective theory, one would not deduce the reproduction theory of wages from it. Thus in order to incorporate this kind of wage theory into the subjective theory of value, it should be recognized positively as an undeniable fact. In that case the reproduction theory of wages serves as an ad hoc hypothesis auxiliary to the subjective theory of value.

In this argument it is assumed that in both the cost theory and the subjective theory, the idea of reproduction wages is supported by, or at least not falsified by, facts. Two different theories are thus available to explain or predict the same facts about wages, so that it is not possible to give an inductive proof for any true theory. In order to avoid this difficulty, instrumentalism concerns only the usefulness of theories, without reference to truth or falsity. As a matter of fact, however, Schumpeter denies the idea of reproduction wages on the ground that it is not verified. And he regards labor force as exogenously given in the subjective theory of value, for it cannot explain the supply of labor.

If verification is actually not able to perform the justification of hypotheses, then even falsification would not necessarily proclaim the sudden death of hypotheses. Schumpeter argues that even if the consequences of a hypothesis are denied by experience, that would not compel us to discard the hypothesis completely: "In general we shall not abandon a system only because it fails in one point. ... If, for several reasons, we are induced to stay in the system in question, we do so with the aid of auxiliary hypotheses" (60). Whereas Popper asserts that a theory is simply discarded by an act of falsification, Lakatos indicates that by introducing the concept of a "protective belt" there exists the possibility that a theory can survive tenaciously even when it is falsified (Lakatos 1978, 48). What Schumpeter calls an auxiliary hypothesis belongs to Lakatos's "protective belt"; it is because of its fertility and usefulness in all other respects that a theory is supported and reinforced by this means.

3. The criticism of psychologism

Among the champions of the "marginal revolution" Menger was unique in maintaining that scientists should aim at the essence lying behind economic phenomena in order to "explain" them, and that theories are not creations of the human mind but descriptions of the eternal structures in the economic world. Kauder called this view philosophical realism (Kauder 1957, 414); Hutchison, following Popper, called it methodological essentialism (Hutchison 1981, 178). The dual characteristics of Menger's thought, realism and essentialism, essentially apply to psychologism of the Austrian School.

Austrian psychologism held that economics should be based on psychological facts as the ultimate explanatory basis. The Austrian School found the essence of economic behavior in the satisfaction of wants; the fundamental

principles in psychologism were the maximization principle and the law of diminishing marginal utility. Insofar as psychologism asserts an ultimate explanation of economic value based on the essences behind phenomena, i.e., on such psychological factors as need, want, satisfaction, and the like, its epistemological position is essentialism. At the same time, psychologism also claims that these theoretical entities, structures, and processes really do exist. In this respect it is identified with realism.

We have found that Schumpeter was opposed to any attempt to provide a justified basis for hypotheses on instrumentalist grounds. Specifically, he was against Austrian psychologism:

An attempt to ground [subjective] value hypotheses leads us to fields which are unrelated to us economists, namely psychology and physiology. [According to psychologism] one starts from wants and defines economic goods as objects in the outer world, which are in a causal connection with want satisfaction. From the relative intensity of the want impulse in economic agents making exchange, one derives exchange relations, and for this purpose the laws of valuation are established on the ground of psychological observations. One says, for example, that as saturation increases the demand for further food would decline and, as a result, a saturated individual is only willing to pay a decreasing price for every additional quantity. ... Why is such an explanation given? The fact we see is only that the individual offers a decreasing price. *Why* he does so is not interesting from the standpoint of economics. Moreover, we see only from the behavior of the individual that he is actually saturated (64).

It is clear that when Schumpeter said this he had Menger in mind.¹⁹ The main reason for his opposition to psychologism was twofold. He objected to (1) its causal approach and (2) its realist approach to value theory.

Within the framework of general equilibrium analysis it is meaningless to attempt a causal explanation of economic phenomena by psychological factors. Both the cost theory and the labor theory of value had cut off the chains of general economic interdependence at arbitrary points and tried to establish a causal explanation of value by a single factor, namely cost or labor. In the early stage of the "marginal revolution," marginal utility theorists, represented by Menger, had attempted a similar sort of causal explanation on the basis of their concept of marginal utility. Such an attempt, Schumpeter argues, should be replaced by general equilibrium theory, in which psychological factors are no longer the ultimate causes of value phenomena but are revealed as an interdependent solution as the economic system as a whole works itself out. Marginal utility, which is assumed as the function of quantity of goods in question, does not causally determine prices but is only related to prices in some specific way in an equilibrium.

Much of the difference between Menger and Walras, between the Austrian School and the Lausanne School, and between the causal approach and functional approach to the theory of value, is well known (Kauder 1965).

Although Schumpeter was in favor of the latter in this internal conflict within neoclassical economics, he did not simply take sides—that would not have contributed to a solution of the antithesis. First he contrasted Austrian essentialism and Lausanne phenomenism and then resorted to instrumentalism in order to provide a sort of compromise between them. If the instrumentality of theories and hypotheses is accepted, then a quarrel over the ontological nature of theoretical entities can be replaced by a rivalry over the practical success of theories.

Although Schumpeter accepted that psychological hypotheses concerning the utility function were central to the subjective theory of value, he maintained that economists should not adduce human psychology, desires, interests, and motives in order to justify psychological hypotheses. How is it possible, then, that economists refrain from justifying psychological hypotheses, whereas such hypotheses as diminishing marginal utility and the maximization of satisfaction still constitute the basis of economics?

If psychological hypotheses in economics are no more than instruments for practical purposes, Schumpeter asserted, then it is not necessary to ask psychologists to justify these hypotheses. The dependence of economics on psychology concerning the truth or falsity of hypotheses will deprive economics of scientific autonomy. Assumptions in economics can prove adequate only insofar as they are useful to given tasks, irrespective of whether they are true or not. The major consequence of psychological hypotheses in economics is that they make it possible to describe and understand an exchange equilibrium in a market in terms of the maximization of human satisfaction. Schumpeter's instrumentalist, nonrealist characterization of psychological hypotheses is most clearly pronounced in the following remark: "The economic facts, not the psychological facts, induce us to make those [psychological] assumptions" (542).

Schumpeter's criticism of psychologism was naturally unpopular among the Austrian theorists. In a long review article Friedrich von Wieser attacked *Wesen*, focusing on the role of psychologism (Wieser [1911] 1929). Wieser objected to Schumpeter's denial of the psychological approach on two grounds. First, whereas Schumpeter had imitated the methods of the natural sciences and confined himself to external observation, it is nevertheless possible to observe human beings from within and learn much more than from outside, because economics is concerned with conscious human beings. Therefore, Wieser asserted, there is no reason to abandon the psychological approach in economics. Second, whereas Schumpeter emphasized the arbitrariness of hypotheses, psychological or nonpsychological, Wieser contended that all hypotheses should be real and be based directly on empirical facts: the psychological method, placing emphasis on inner observation, can derive empirically confirmed psychological statements.

Wieser's first point does not constitute a basic point of dispute, because Schumpeter admits that one may start from any hypothesis. The second point represents a more substantive confrontation between their views. They were

divided on the cognitive status of psychological hypotheses. The following passage from Wieser indicates the difference between the two on this point:

In contrast to Schumpeter, the assumptions used by the psychological school are all empirical. No matter how many assumptions there may be, they must all be founded on facts. ... If theories are not to lose their empirical character, all assumptions must be taken from experience. Not only is nothing hypothetical to be allowed as assumptions, but also nothing arbitrary and formal. Their usefulness or expediency depends on their truth. ... The facts taken from experience are observed in isolation or transformed ideally as far as necessary; they provide the psychological method with the contents of its assumptions. The psychological method by steps builds up these assumptions so as to construct a system that is wide enough to absorb a great variety of common economic experience. It has been made clear, I believe, that Schumpeter erred when he tried to use hypotheses in our theory. Hypotheses are assumptions about unknowns; on the contrary, our idealizing assumptions are conscious transformations of knowns. Now with greater emphasis I can repeat the contention given above, that this whole system of assumptions must be based on facts and that in this system there is no room for hypotheses. The psychological method does not permit hypotheses (Wieser [1911] 1929, 406–9).

Schumpeter thought that the Austrians were mistaken in believing that their psychological hypotheses originated in empirical statements. We find his position best expressed in his ingenious remark that “the utility theory of value has much better claim to being called a logic than a psychology of values” (Schumpeter 1954b, 1058). This idea corresponds to what Schumpeter in *Wesen* had in mind when he called static theory a “logic of economic matters” (134). This means that neoclassical theory is a logical system deduced from arbitrary assumptions, while it can still hope to fit economic facts.

VI. Conclusion

In concluding our attempt to interpret Schumpeter’s methodology as instrumentalist, it will be incumbent on us to clear away possible, if any, doubts that he was not a methodological instrumentalist. Machlup’s essay on Schumpeter, one of the few works dealing with Schumpeter’s methodology, might suggest such a doubt (Machlup 1951). His treatment is not confined to *Wesen* alone, but here I shall only discuss his treatment of Schumpeter in relation to instrumentalism. Although Machlup does not use the term “instrumentalism,” he admits in a footnote that “it is noteworthy how closely these formulations—published in 1908—correspond to the most recent statements with respect to the methodology of physics (Machlup 1951, 98). Nevertheless a part of his argument in that essay might give readers the impression that Schumpeter was not an instrumentalist, because he argues that

Schumpeter would reject "the old dictum that correct prediction is the best or only test of whether a science has achieved its purposes" (Machlup 1951, 101). As is well known, Schumpeter was against the hasty application of economic theory to policies; this attitude was quite explicit in *Wesen*. Thus it is quite reasonable to expect that he would oppose economic forecasting in the real world as a test of economic theory. Machlup quotes from Schumpeter's *Business cycles* (1939): "It is as unreasonable to expect the economist to forecast correctly what will actually happen as it would be to expect a doctor to prognosticate when his patient will be the victim of a railroad accident and how this will affect his state of health" (Schumpeter 1939, vol. 1, 13, quoted from Machlup 1951, 101). Does this view contradict Schumpeter's instrumentalist position as I have described it? I believe it does not; it rather attests to Schumpeter's version of instrumentalism, which I have tried to differentiate from its modern, narrow version.

As I indicated above, despite his explicit statement on gaining fitness to facts as the purpose of hypotheses and theories, *Wesen* offers no thorough consideration of the relation between theory and fact and of the empirical testing of theory. When we leave *Wesen* and come to dynamic theory and the analysis of historical development in Schumpeter's subsequent works, we find him dealing with facts explicitly in terms of statistical and historical materials. It was not until this stage that he became strongly conscious of the problem of testing a theory. But this does not mean that he had to change his instrumentalist view. Instead he actually developed instrumentalist methodology during this stage of practical economic research. In 1935, when he was working on *Business Cycles*, he wrote on the meaning of verification in his preface to the fourth German edition of *The Theory of Economic Development* (1st ed. 1912). First of all, it is clear that he kept his basic position:

We must first agree on what we mean by "verification." Any situation that is not analyzed and *elaborated* cannot actually prove the truth or falsity of a theoretical statement. What is important to the practice of scientific work is not some "truth" but methods with which one can operate and—to put it simply—deal with data so that something might emerge corresponding to observed facts (Schumpeter 1935, xv).

Then he argued the practicable goal of testing a theory or ascertaining its fitness to reality:

It would not even be true that observations of *statistical or historical* facts could show us whether or not a specific theory is consistent with them. For a very real relation can be so much concealed by other factors that we see nothing about it *without an analysis digging deeply* into the situation itself. Therefore only a more modest goal can be attained—namely, to ascertain how the relations asserted by a theory are *perceptible*, or to put it differently, how big a contribution is made by a theory to the understanding of the situation (Schumpeter 1935, xiv).

Owing to the inevitable assumptions of *ceteris paribus* in the social sciences and to the disturbing factors included in the observation of social phenomena, a prediction or forecast that foretells an actual course of events is impossible. In the same place Schumpeter explicitly argues that the instrumentalist criterion of fitness to facts claims the following: (1) when a theory makes a description that permits quantitative expressions in principle, and when the data required for a test of that description are given, the theory should entail quantitative results that agree with the data; (2) when a theory makes a description which does not permit any quantitative expression in principle or by the availability of data, the theory should make us realize that the fact in question is something to be expected by and large on the basis of the theory; (3) when neither is the case, a theory should indicate the concrete circumstances as well as the direction and extent of disturbing factors, so that we could understand the situation by making appropriate modifications (Schumpeter 1935, xv).

What emerges from this is in fact a doctrine of moderate instrumentalism: the instrumental roles of a theory are not confined to prediction but include organization, classification, reconstruction, and—through all these efforts—understanding of facts. For Schumpeter the latter roles were much more important for a theory to deal with those facts which were not already embodied in existing theories. It was from this standpoint that Schumpeter must have opposed the mechanical notion of prediction—that a theory can derive results that are easily compared with facts—and the conception of prediction as the ultimate test of a theory. Although in empirical research he became aware of difficult problems concerning verification of a theory, he always understood the roles of a theory broadly, while holding the central claims of instrumentalism. His criticism of theories as predictive tools should be interpreted as a rejection of the narrow version of instrumentalism.

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Notes

- 1 In a historical survey of nineteenth-century positivism Oldroyd observes: “between them [logical positivists] and Comte we have a number of moderately distinct schools or ‘isms,’ such as pragmatism, conventionalism and instrumentalism, which may nonetheless be classified more or less satisfactorily as different manifestations of positivism” (Oldroyd 1986, 187). It was these “isms” that influenced Schumpeter’s economic methodology.
- 2 The exception was Machlup (1951).
- 3 The exceptions have been Japan and Italy: *Wesen* was translated into Japanese in 1936 and into Italian in 1982.
- 4 See Blaug (1980) and Caldwell (1982). Also see two anthologies: Caldwell (1984) and Hausman (1984).
- 5 The English title of *Wesen* is not uniquely fixed because the book has not been translated into English. The literal translation is *Essence and Main Contents of*

Theoretical Economics, but the metaphysical implication of "essence," I think, should be avoided in view of Schumpeter's position against metaphysics.

- 6 English translations of quotations from *Wesen* are my tentative ones. Numbers in parentheses at the end of quotations or explanations refer to pages of *Wesen*. Italics in quotations are all Schumpeter's original emphasis.
- 7 "A physical theory is an abstract system whose aim is to *summarize* and *classify logically* a group of experimental laws without claiming to explain these laws. ... To explain is to strip reality of the appearances covering it like a veil, in order to see the bare reality itself" (Duhem [1905] 1962, 7). "A physical theory is not an explanation. It is a system of mathematical propositions, deduced from a small number of principles, which aim to represent as simply, as completely, as exactly as possible a set of experimental laws" (Duhem, *ibid.*, 19).
- 8 Nagel's view of the role of theories corresponds to that of Duhem: "they serve only to give experimental laws a summary and classificatory representation" (Duhem [1905] 1962, 27).
- 9 Leplin's volume offers an overview on the current debate between realism and antirealism (Leplin 1984).
- 10 Nagel's definition of instrumentalism, quoted above, is followed by: "However, those who adopt this [instrumentalist] position do not always agree in their answers to the question whether physical reality is to be assigned to such theoretical entities as atoms" (Nagel 1961, 118).
- 11 For a summary of Mach's philosophy of science, see Oldroyd (1986, 176–82). For recent discussions of his works see "A symposium on Ernst Mach" in *Synthèse* (April 1968) and Cohen and Seeger (1970).
- 12 In his explanation of economic equilibrium in *Wesen* Schumpeter refers to Mach's equation representing the maximization problem (204).
- 13 For a recent discussion on the relations between instrumentalism, conventionalism, and pragmatism see Boland (1982, 141–52).
- 14 This can be compared with Mach's remark that "our concepts, it is true, are formed consciously and purposely by us, but they are nevertheless not formed altogether arbitrarily, but are the outcome of an endeavor on our part to adapt our ideas to our sensuous environment" ([1883] 1960, 318).
- 15 "We interpret all economic behavior as exchange and assume that even where no exchange exists, the economy runs as if such would exist. This is not so paradoxical as it appears. One should notice that all economic behavior is for us nothing but a change in economic quantity. Those who, for instance, exchange labor for bread change the quantity of both goods in their possession. The same is also performed by an isolated man who shoots game; he diminishes the stock of bullets or labor force and increases the foodstuffs" (50).
- 16 In light of our framework we can discuss Friedman's 1953 essay, the source of much stimulating current discussion in economic methodology. Surprisingly enough, there is no remark in Friedman's essay about the two *central* claims of instrumentalism. This is so because his paper lacks a philosophical analysis. Instead the following four points are clearly stated in his paper, and, barring the conjectures of interpreters, they are the building blocks of his system: (1) The realism of assumption does not matter; (2) the validity of theories is to be judged by their predictive ability; (3) observations cannot prove theories, only falsify them; and (4) the choice of theory depends on supplementary criteria such as the generality or fruitfulness of theories. We can say that (1) is synonymous with antirealism, (3) with anti-inductivism, and that both are responses to the subsidiary claims of instrumentalism. But (1) antirealism still allows different positions other than instrumentalism, and (3) is the falsification thesis of Popper, an anti-instrumentalist; (4) is not directly relevant to instrumentalism. Apparently only (2) is likely to be taken as the crucial element of instrumentalism, if one follows its current narrow version. But (2) does not necessarily mean that theories

are merely instruments. More importantly, Friedman does not say that theories are neither true nor false. When he says that "to be important, therefore, a hypothesis must be descriptively false in its assumptions" (1953, 14), he seems to admit that the assumptions of a theory are judged to be true or false. Friedman's essay thus does not include the necessary definitional elements of instrumentalism as formulated by its central claims.

The current interpretation of Friedman as an instrumentalist is based on a dubious inference from (1) and (2). The typical way of inference is this: "Friedman's most controversial statements, that the purpose of science is prediction and that the realism of assumptions does not matter, are instrumentalist" (Caldwell 1982, 178). Theses (1) and (2), which provide the basis of the current interpretation of Friedman as an instrumentalist, correspond to Schumpeter's theses S_5 and S_6 , respectively; they are not the same as S_2 and S_3 , respectively. If Friedman were an instrumentalist, he might hold views (1) and (2). But the converse does not hold. Friedman's (4), if elaborated upon and integrated in some way, will correspond to Schumpeter's efficiency criterion S_4 . In our framework (1), (2), and (4) or, alternatively, S_5 , S_6 , and S_4 are regarded as "rules of procedure," practical prescriptions in scientific activity. Friedman's element (3) accords with Schumpeter's S_7 and belongs to the category of "methodological principles." As regards S_1 , Friedman might be interpreted as implicitly holding such a conventionalist view, but this is not altogether certain. At any rate, because of the lack of the instrumentalist "methodological principles" S_2 and S_3 Friedman's essay is an insufficient basis on which to interpret him as an instrumentalist. As we have seen above, methodology is a philosophical study of the procedural rules in scientific activity; it argues the reasons or logic justifying such rules. Friedman's essay only provides the "procedural rules" in positive economics, not the instrumentalist "methodological principles."

- 17 Schumpeter, however, uses the term "historism" (1954b, 807–8).
- 18 In his early work on the history of economics Schumpeter gives a summary of the reasons why the subjective value theory should be accepted: "This shifting of emphasis on to the doctrine of 'subjective values' in economics produced four advantages. It is more correct. ... It is simpler. ... It is more general. ... Finally, the theory of marginal utility makes economic conclusions more relevant" ([1914] 1954a, 189–90).
- 19 Menger wrote in *Principles of Economics*: "the requirement for the acquisition of goods-character is the existence of some causal connection ... between things and the satisfaction of needs" ([1871] 1950, 57). Although he revised the expression "causal connection" to "teleological connection" in the second edition of *Principles* (1923, 23), it does not change the nature of his basic approach, because teleology is based on causality.

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6. Schumpeter on Schmoller and Weber: A Methodology of Economic Sociology

I. Introduction

It is well known that the theoretical economist Joseph Schumpeter, brought up in Austrian economics, disliked Menger's realism and essentialism and defected to Walras's general equilibrium theory. It is also known that when he discussed economic and social development, he took over the spirit of the German Historical School. He especially appraised the research program of Schmoller, the leader of the younger Historical School, as a prototype of "economic sociology," which he defined as "a sort of generalized or typified or stylized economic history" (1954a, 20). Specifically, economic sociology, as we shall see later, is the study of institutional factors which are treated as noneconomic givens in economic theory, and thus attempts to approach sociocultural development as a whole. Schumpeter's admiration for Walras and Marx is widely known, but he paid as much serious attention to Schmoller.

The 1880s were the period of the bitter *Methodenstreit* between Schmoller and Menger. Schumpeter's assessment of the *Methodenstreit* in his *History of Economic Analysis* seems to be broadly accepted as the standard view: "In spite of some contributions toward clarification of logical backgrounds, the history of this literature is substantially a history of wasted energies, which could have been put to better use" (1954a, 814). Schumpeter did not simply mean in hindsight that the *Methodenstreit* should have been dispensed with because it produced few substantive results. His standpoint was established by the methodological investigation in his first book, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908), which, as one of its purposes, purported to resolve the dispute and was an application of the instrumentalism developed by natural scientists such as Mach, Poincaré, and Duhem (see Shionoya 1990). In the face of a crisis in economics, Schumpeter gave a clear assessment of the controversy, although he did not join it:

With regard to their general argument, both sides [Schmoller and Menger] are mostly right. But one fails to appreciate the limits of the argument and overlooks that a party often thinks of problems different from those the other party does. Each method has its concrete areas of application, and it is useless to struggle for its universal validity. ... Our standpoint can be briefly characterized by the remark that historical and abstract methods are not inconsistent with each other, that the sole difference lies in their interests in different problems (1908, 6–7).

According to instrumentalist methodology, theory is an instrument for achieving useful aims, not a statement of the real world, and hence it is neither true nor false. Seen from this standpoint, the *Methodenstreit*, in which one group quarreled with another over the relative importance of historical and theoretical methods, is useless because theory and history are concerned with different research interests, different subject matters, and categorically different hypotheses. Thus a specific method can claim validity only for a specific problem. Schumpeter strongly advocated the separation of history and theory on the basis of instrumentalist methodology. Although in principle instrumentalism assures an *entente* between history and theory, Schumpeter in *Wesen* intended to clarify the methodological foundation of theoretical economics, defending theory against history at a time when the German Historical School suppressed theory and elevated history to a dominant position. He defined theoretical economics as a static theory of exchange, and those dynamic problems that were beyond its scope, such as technological innovation, capital formation, credit, profits, and crisis, together with all the problems of political, social, and cultural development, were relegated to descriptive historical research.

Later, when he himself launched into not only a study of economic development but also economic sociology, he advocated the cooperation of history and theory, instead of their separation, in order to deal with these dynamic problems. In his 1926 essay on Schmoller he attempted a methodological appraisal of Schmoller's historical and ethical economics and characterized his approach as an economic sociology in which history and theory could be integrated. In order to elaborate on my view of his methodological position, it is worthwhile to investigate what methodology Schumpeter had in mind for establishing historical knowledge, as opposed to purely theoretical knowledge.

The famous methodology of Max Weber was also an attempt to resolve the *Methodenstreit* and depended on the epistemology of neo-Kantianism, in particular that of Heinrich Rickert. Neo-Kantian philosophers, asserting the possibility of the cultural or historical sciences in contradistinction to the natural sciences, gave a philosophical and epistemological foundation to the approach of the German Historical School. What, then, is the relation between the methodology of Mach and Schumpeter, on the one hand, and that of Rickert and Weber, on the other, both of which were addressed to the resolution of the *Methodenstreit*? This question has not been discussed either by Schumpeterian or by Weberian commentators.¹ It seems appropriate to compare Schumpeter's methodological position with that of Weber in order to identify the distinctive features of the former.

My intention is to show that Schumpeter applied his instrumentalist methodology, as forged for static economic theory, *mutatis mutandis* to economic sociology. To sustain this argument I discuss how Schumpeter interpreted Schmoller's research program of historical economics, on the one hand, and how he evaluated Weber's methodology of historical science, on the other. This discussion compares Schumpeter's methodological approach with

Weber's, but it further suggests differences in the positivist and idealist schools of thought in the research of historical knowledge, which underlie the views of the two authors. Although Schumpeter strongly opposed Weber's methodology in a number of crucial areas, his methodology of economic sociology was very close to that of Weber despite their different origins. Through this approach I hope to uncover a hidden interrelationship among the grand ideas at the turn of the century in Germany, all of which aimed at not only providing an epistemological foundation to economics but also constructing a branch of economic sociology that went beyond economic theory.

I also hope to suggest the relevance of Schumpeter's methodology for economic sociology to the current debates over institutional economics. Schumpeter perceived economic sociology as a theoretical analysis of economic institutions and their changes in time, which had its origin in Germany. The current issues in institutional economics, including the methodological disparities between the old institutional economists (such as Veblen and Commons) and the new institutional economists (based on neoclassical economics), can be more effectively examined in light of the Schmoller-Schumpeter-Weber nexus. Since the conflict between the old and the new institutionalism can be seen, in a sense, as a reproduction of the dispute between Schmoller and Menger, Schumpeter's methodological standpoint directed toward the latter dispute can be applied to the former. My examination thus attempts to uncover a hidden chain linking the grand ideas in the field of institutional economics.

II. Economic Sociology and Institutions

Let us first consider the nature and function of economic sociology through an inventory of the toolboxes in economics. This is what Schumpeter did before embarking on the history of economics in *History of Economic Analysis*. In its introduction, entitled "Scope and Method," he enumerated four basic methods of economics: (1) history, (2) statistics, (3) theory, and (4) economic sociology (1954a, 2). Economic sociology, in contrast to the other three methods, goes beyond mere economic analysis in the sense that it explicitly deals with institutions that are exogenously given in economic analysis. *Capitalism, Socialism and Democracy* (1942), as well as three essays on the tax state, imperialism, and social classes (1918, 1919, 1927), are his works of economic sociology. It should not be overlooked that in his *History* he paid special attention to various past attempts at economic sociology, although the book has often been regarded as a description of the progress of our science toward a general equilibrium theory.

In discussing these four methods in economics, I propose to view the relationship between theory and history as the key factor fundamentally characterizing the paradigmatic nature of economics. I start with the dominant view on this relationship within current mainstream economics. For the sake of convenience I introduce mathematics as the fifth independent

method, which Schumpeter would have included in theory. In economics both mathematics and statistics are considered supplementary tools of theory and history, respectively, but they play a very important part in cooperation. In the sense that mathematics contributes to a logical construction of theory, just as statistics contributes to a quantitative construction of history, the position of mathematics in theory, I argue, parallels the position of statistics in history. Mathematical terms in a theoretical construct represent abstract and general magnitudes of economic variables, while statistical records represent their historical and specific magnitudes. Insofar as theory contains quantitative variables, it is therefore possible to bring theory into contact with history through the medium of mathematics and statistics. For example, when an economic theory deals with economic variables, such as prices, wages, profits, income, consumption, and investment, a theory can be given an empirical, historical expression if statistics are available for them. Theory and history overlap in the area of the statistical quantification of mathematical terms. This is the basis of econometrics or cliometrics. We may say that in the natural sciences theory is applied to experiment through the statistical quantification of mathematical terms. History in the social sciences is compared to, and also distinguished from, experiment in the natural sciences. It can be argued that history is a once-and-for-all experiment of the social sciences.

The contact between theory and history through the medium of mathematics and statistics involves an application of theoretical hypotheses to historical materials, on the one hand, and a theoretical formulation of historical materials, on the other. In other words, it involves a feedback process of testing an existing theory in light of historical observation and of inventing a new theory in light of fact-findings. In reality, however, works in econometrics and cliometrics have tended to be one directional, moving from theory to history with little or no feedback (see Meiners and Nardinelli 1986, 521). It could be asserted that in contemporary economics neoclassical theory leads historical inquiry and expels, as it were, the traditional interests and methods of history.

If, to the contrary, we lay a relative stress on history rather than theory, we can imagine a process in which fact-findings in history offer new materials for theoretical inquiry, even through the medium of mathematics and statistics. Moreover, we find that it is possible to interpret theory more loosely as historical hypotheses than neoclassical economics does and to utilize, for the construction of new theories, diverse historical materials even outside the scope of statistics. As will be indicated below, history-led theory is what the German Historical School actually proposed. We should recognize the limitation of the approach in terms of the mediation between theory and history through mathematics and statistics: the application of theory to history will yield no more than is expected by theory. Schumpeter's work is most illuminating in this respect.

In *Business Cycles* (1939), subtitled *A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*, Schumpeter based his research on the central contention that economic development figures in historical reality as

business cycles, and mainly dealt with a statistical time series of this phenomenon. The time series is evidently located in the overlapping area between theory and history. But Schumpeter's historical analysis is not limited to the scope of inquiry supported by statistics. In a section of *Business Cycles* entitled "The Fundamental Importance of the Historical Approach to the Problems of the Cyclical Process of Evolution," Schumpeter described the relationship between history, statistics, and theory as follows:

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

As we shall see, this remark clearly manifests the essential spirit of the German Historical School. His remark concerning the goal of his research—"filling the bloodless *theoretical* schemata and *statistical* contour lines with live *fact*" (1939, 222, emphasis mine)—is also an aspiration of that school. Summarizing the impact of historical research on economics, Schmoller, the leader of the younger Historical School had observed:

Historical research has created the conceptions of the historical development of nation, of man, and of economic institutions. It has brought economic research properly into contact with morals, law, the state, and the causes of cultural development in general. It has shown how to inquire into collective phenomena in addition to the conclusions starting from individuals and their self-interest. It has shown how to do a proper synthesis in addition to an analysis. It has given, for the first time, a proper complement to an isolating abstraction by showing how to regard the results of the abstraction as part of a coherent whole. Thus what used to be faded abstraction and dead schema recovered blood and life (1911, 464–65).

From these considerations it can be said that in his approach to capitalist development Schumpeter was dissatisfied not only with descriptive history but also with abstract theory and that he wanted to engage in a form of theoretical research whose framework was fully expanded by historical experience. Although Schumpeter's phrase "reasoned history" or "conceptually clarified history" is ambiguous in itself, it seems to demand a broader formulation of historical knowledge, rather than the mere integration of theory and history through the medium of mathematics and statistics. The method that is directed to meet this demand is economic sociology, the fourth method in

Schumpeter's toolbox of economics, and in his opinion it is borrowed from the German Historical School.

Economic theory regards an institutional framework of economic life as exogenously given. According to Schumpeter, however, institutions such as private property, free contract, and government regulation are dealt with not only by descriptive economic history but also by economic sociology. He explains the relationship between economic theory and economic sociology as follows:

To use a felicitous phrase: economic analysis deals with the questions how people behave at any time and what the economic effects are they produce by so behaving; economic sociology deals with the question how they came to behave as they do. If we define human behavior widely enough so that it includes not only actions and motives and propensities but also the social institutions that are relevant to economic behavior such as government, property inheritance, contract, and so on, that phrase really tells us all we need (1954a, 21).

Thus economic sociology is a theoretical analysis of the development of institutions abstracted from history. In terms of this definition of economic sociology we can interpret what is meant by a "reasoned (conceptually clarified) history." It means a generalization, typification, and stylization of history in terms of institutions. We can indicate some important methodological features of Schumpeterian economic sociology and the place of the concept of institutions in this discipline.

First, while Schumpeter clearly regards social institutions as the determinants of actions, motives, and dispositions of agents, he supposes at the same time that these institutions themselves, in turn, change as a result of interaction among agents in a historical process, as shown in the analysis of the evolution of the capitalist economic system in *Capitalism, Socialism and Democracy*. Thus economic sociology can be conceived as dealing with the complicated interaction of social and economic forces, which he calls "sociocultural development." These relations between the whole and its individual parts do not simply signify methodological holism, because the unintended results of individual actions as a whole contradict the holistic idea that the whole is more than the sum of its parts, that it has its own aims, interests, and motivations, and that it cannot be explained in terms of its parts. Nor are these relations exhaustively grasped on the basis of methodological individualism, which assumes the rationality of abstract individuals. The social institutions in which the individual agent finds himself constrain his behavior so that he might be seen as a product of culture and institution. Thus any reductionist approach emphasizing either the whole or individual parts must be inadequate for economic sociology.

Second, economic sociology does not incorporate all factors excluded from the scope of economic theory; it confines itself to an analysis of institutions. This strategy of economic sociology has an important bearing on theory. Since

institutions provide a set of rules in observance of which certain individual acts recur regularly, they have their own *modus operandi* and can be conceptualized in general terms. Herein lies one reason why a theoretical analysis of institutions abstracted from history is possible. Viewed in this way, institutions are social rules in a broad sense and include not only legal institutions but also social customs, morals, and values. (The essence of Schmoller's approach to economics was the recognition that institutions are not only physical and technical but also ethical and psychological, thus enabling the individual agent to behave on plural motivations.)

Third, the concept of institutions also has a significant implication for history. Since it resembles mathematical terms in the sense that institutions entail a group of acts conforming to rules, it is a means of generalizing historical events. But the concept of institutions is limited in generality, because it is only relative to a historically specific institution. Thus the concept of institutions can be conceived as a compromise between the generality meant by theory and the individuality meant by history. If all economic behavior is characterized by perfect uniformity, wherever it may occur, there is no use talking about institutions for which certain economic behavior is typified; only one meaningful institution would be in existence. On the other hand, if all economic behaviors are *sui generis*, one could not summarize them into any types or groups; there would be such an infinite variety of behavior patterns that it would be useless to speak of types. Economic sociology, with its focus on the concept of institutions, is based on a typology in historical research (see Gerschenkron 1968, 77–78) and thus allows the use of Weberian “ideal types” for the analysis of historical institutions.

Fourth, according to Schumpeter, economic sociology is one of the approaches to sociocultural development. In this broader perspective mathematics and statistics can no longer mediate between theory and history. Having examined the implications of the concept of institutions with regard to theory and history, we can assert that it is now an analysis of institutions that should mediate between theory and history. If such mediation were possible, economic theory could directly contact a broader perspective of history than in the case of mediation through mathematics and statistics.

What Schumpeter called “economic sociology” has been known as “institutional economics” in the United States. He included in economic sociology not only the works of Schmoller and the third generation of the German Historical School (Sombart, Weber, and Spiethoff) but also American institutional economics. The “new institutional economics” also aims at the integration of history and theory through an analysis of institutions, and its significance and limitations can be evaluated in light of the ideas of the German Historical School and their restructuring by Schumpeter.

III. Schmoller's Program and the German Historical School

In his 1926 essay on Schmoller, Schumpeter interpreted Schmoller's approach as economic sociology and critically reconstructed Schmoller's research program from the viewpoint of the relationship between history and theory. Schumpeter limited economic sociology to the study of social institutions that are relevant to economic behavior; this is the held on which Schmoller always put the greatest emphasis. But Schumpeter did not accept Schmoller's research program as it stood. Schumpeter's idea of economic sociology demanded a reconstruction of scope, method, and methodology in Schmoller's research program so as to develop its strengths and restrain its weaknesses; specifically, a radical change was required not so much in scope and method as in methodology.

1. The formal aspect of the program

Schumpeter describes the fundamental character of the German Historical School as follows: "the essence of the Historical School lies ... in the fact that it put historical and altogether descriptive work on details into the forefront as the most important, or at any rate as the primary task, of social science" ([1914] 1954b, 154). Admitting that the Historical School thus conceived was oriented differently from classical and neoclassical economic theory, Schumpeter called its tradition "economic sociology" and regarded Schmoller as its genuine leader. Schmoller's research program consisted of tripartite tasks: (1) the observation and description of facts, (2) the definition and systematization of facts, and (3) the causal explanation of facts and recognition of their interrelations (1911, 455). This was, in fact, a formal aspect of the program. Schmoller not only proposed this research program but himself carried out a tremendous number of specific historical studies and significantly influenced the contemporary pattern of historical research. The two volumes of his *Grundriss der allgemeinen Volkswirtschaftslehre* (1900–04) are a summary of the results of his program, covering the three kinds of research activity.²

There is a kind of academic folklore surrounding the German Historical School, such that some have claimed that it opposed theory on principle and proposed what might appear as a never-ending scenario of detailed historical studies. This is a misunderstanding. The Historical School only repudiated existing theory, and it did pursue historical theory or a theoretical formulation of history. As Schmoller's tripartite scheme indicates, research was not confined to the collection and description of historical data. The third task of his research program—causal explanation—was not based on any deductively derived theory; in other words, it was not an explanation based on the Hempel-Oppenheim covering-law model but one derived from ad hoc reasoning. According to Schmoller, economic theory should not be derived from a priori assumptions, it should rather be a generalization of facts

gathered from diverse historical processes—although he never excluded methods of the natural sciences, general concepts, laws, and the like. This attitude was based on his fundamental belief that because economics must deal with complicated and varying phenomena, it is not sufficiently advanced to apply the deductive-abstract method to these phenomena. It was also based on his scientific realism, which held that assumptions themselves should be realistic. Schmoller compared empiricism with rationalism, suggesting the comparison between history and theory (1888b, 147). He viewed the development of human recognition as the alternation of empirical and rational methods and insisted that instead of making rash generalizations on poor empirical bases, we should for the time being engage in empirical research before properly beginning theory construction.

Schumpeter showed a deep appreciation and sympathy for Schmoller in attaching importance to a historical perspective, but he emphasized the need to construct a theory rather than to be content with the mere collection, summarization, classification, and ad hoc explanation of data. For Schumpeter economic sociology was essentially characterized by continual interaction between history and theory. The task of economic sociology is not merely to apply existing theories to historical experience in order to explain fact; nor is it simply to make a summary of historical materials. In addition, theory must expand its scope in light of history: “Continuous interaction between the two [history and theory] belongs to, and constitutes, the essence of the matter. Schmoller’s program will produce a system of new theory in a more important sense than is implied by a mere supply of materials” (1926, 375).

Schumpeter wanted to put the brakes on what seemed an endless process of data collection, a bottomless pit into which historical economists were liable to fall. He also sought to stimulate theoretical work on history so as to achieve the goal of Schmoller’s program: a “unified sociology or social science as reasoned (theoretically worked out) universal history” (Schumpeter 1926, 382). He even defined economic sociology as “a specific discipline which, by the nature of its subject matter, is concerned with detailed historical research and the collection of materials, as well as theoretical inquiry” (1926, 369). It is interesting to note that as an agenda for economic sociology Schumpeter referred to business-cycle research and the theory of social classes, the subject matters in which he was later absorbed for many years. To get out of the blind alley in Schmoller’s research program, Schumpeter needed to resort to a methodological standpoint, as I contend later (see section 3.3).

2. The substantive aspect of the program

In his early work on the history of economic doctrines and methods Schumpeter summarized six basic viewpoints of the German Historical School, which were particularly pertinent to Schmoller: (1) a belief in the unity of social life and the inseparable relation among its component elements, (2) a concern for development, (3) an organic and holistic point of view, (4) a

recognition of the plurality of human motives, (5) an interest in concrete, individual relations rather than the general nature of events, and (6) historical relativity ([1914] 1954b, 175–80).

The most important significance of the historical method for Schumpeter was the recognition that historical materials reflect the development phenomenon and indicate the relationship between economic and non-economic facts, thus suggesting how the disciplines of the social sciences should interact. This recognition of development and the unity of social life, a combination of (1) and (2) above, is the essence of the Historical School as Schumpeter understood it. It is for this reason that he found in Schmoller's research program a "prospect of universal social science" (1926, 365) where the conventional lines of demarcation between separate disciplines should disappear in historical research.

Schumpeter recognized a purely scientific value in the claims of the Historical School concerning (3) and (4), because they are the proper claims of a sociological or institutional approach as distinct from the mainstream neoclassical economics, which is based on the assumptions of methodological individualism and utility-maximization.

He discerned that (5) and (6) are not fruitful issues; thus, as we shall see later, he was critical of neo-Kantian philosophy which went too far into them. According to Schumpeter, Schmoller was interested in history not for the sake of its individuality or relativity but simply because it was the source of knowledge. But in addition to this appreciation of Schmoller's potentiality for theory Schumpeter needed a refutation of Schmoller's methodological standpoint, because that methodology in fact precluded the latter from carrying out substantive theoretical work.

In light of the difference between the so-called old and new institutional economics Schumpeter's generous acceptance of the plurality of human motives is to be contrasted with assumptions of the rational maximizer in the new institutional economics. A crucial aspect of the new institutional economics is that it uses formal economic models and assumes the general validity of laws derived from the assumption of methodological individualism and a rational utility-maximizer in the explanation of institutions. But Schumpeter went far beyond the neoclassical approach, a basis of the new institutional economics: he was able to incorporate the holistic interpretation of a society by his use of the notion of social rules as the determinants of individual behavior, as well as his assumption concerning non-utility-maximizers such as the entrepreneur. Schumpeter's economic sociology is characterized by the interaction between social and economic forces, and thus by the alternation of the holistic and individualistic viewpoints and by the interaction between static and dynamic forces.

3. Methodology of economic sociology

Although Schmoller admits that in historical science there are universal phenomena to which the methods of the natural sciences, general concepts, and universal laws can be applied, he maintains that for complex social phenomena deductive theorizing is only possible after a sufficient amount of inductive work is accumulated. Thus he argues that if one confines the scope of economics to exchange and value as in neoclassical economics, a deduction from some simple psychological assumptions can legitimately explain the major phenomena, and that in a more complex field, only historical experience can make an advance possible. The question concerns more the methodology for economic sociology than that for economic theory in the narrow sense.

In reality, however, Schmoller's firm belief that the knowledge of economics was desperately defective hindered any attempt at deductive theorizing in economics: "We do not think that we must have laws at once at any price; we do not believe that we can pick them like blackberries, because we look first of all for true knowledge, i.e., necessarily and universally valid judgment. Where no law exists, we must be content with [1] the extensive observation of reality, [2] the classification of these materials, and [3] the inquiry of causes" ([1883] 1888b, 283–84; square brackets added). As we have seen, these three kinds of research activity actually constitute all of his program, and we must realize that his program excludes deduction from assumptions that cannot be judged as realistic.

Schumpeter's instrumentalism, in contrast, asserts that assumptions or hypotheses are arbitrary creations of the human mind and need not be justified by facts. Also, theories deduced from assumptions are not descriptive statements in themselves but instruments for understanding and explaining facts. Therefore a theory is neither true nor false; it proves useful if it can cover a large amount of facts. Instrumentalism facilitates deductive attempts even when empirical data are not sufficient by Schmollerian standards.

Although in principle Schmoller did not deny theory, he in fact remained a naive empiricist because he did not have a coherent methodological standpoint. When he considered the nature of concept formation, he advocated nominalism over realism and argued that concepts are auxiliary means to organize thought, not a perfect copy of reality (1911, 467–68). Since abstraction meant to him a deviation from reality, he could not naturally confer any real status to concepts. From this position it was only a step to instrumentalism. But he could not proceed to instrumentalist methodology from the nominalist conception of concepts and allow an instrumentalist role of assumptions and hypotheses as deliberate mental constructs, because in spite of his nominalist position his ultimate goal was still scientific realism. For Schmoller realism so overwhelmingly outweighed nominalism that the nominalist or instrumentalist role of theory could not be recognized. By interpreting Schumpeter's methodology of economic sociology as instrumentalist, we can understand how he could urge economists to engage in theory as opposed to the endless attachment to history, while nevertheless fully accepting the importance of historical research.

IV. Schumpeter's Criticism of Weber

At the turn of the century in Germany there were attempts by neo-Kantian philosophers, especially Windelband, Rickert, and Weber, to develop a theory of historical knowledge. They sought to establish an epistemological basis for the historical or cultural sciences through criticism of Kant, who had denied a scientific status to historical knowledge because it did not fulfill the criterion of general validity. They contrasted the historical sciences with the natural sciences and showed how knowledge of historical individuality is possible. The upshot of neo-Kantian philosophy was that the natural sciences were seen as nomothetic and the historical or cultural sciences as idiographic in accordance with the difference of cognitive interest in generality or individuality of reality between the two sciences. The basic issues in the *Methodenstreit* were given philosophical reflection by the neo-Kantian philosophers; especially, the standpoint of the German Historical School was philosophically evaluated on an equal footing with the natural sciences.

The starting point for Rickert and Weber was the recognition that in order to overcome an infinite multiplicity of concrete reality some principles of selection and abstraction are indispensable. They asserted that there are two such principles—generalization and individualization each corresponding to a different scientific interest. The principle of generalization requires the selection of those elements which are common to all concrete phenomena, and that of individualization prescribes the selection of those elements of individual phenomena that constitute their unique features. The former results in general concepts for the natural sciences, and the latter results in individual concepts for the historical, cultural, or social sciences. Abstraction from reality in historical science is done in such a way that the individuality and uniqueness of phenomena are not lost in the process of concept formation. To give scientific status to this procedure, Rickert related phenomena to generally valid cultural values. A phenomenon is selected because it embodies a particular value and is therefore significant. This is what is known as the principle of value relevance (*Wertbeziehung*).

As a student of the German Historical School, Weber criticized Roscher and Knies on the methodology concerning the relation between theory and history, on the one hand, and Schmoller on the methodology concerning the relation between theory and values, on the other. Here we are more concerned with the former methodology. In his long essay "Roscher and Knies" (1903–6) Weber took issue with the two concerning the logical problem of the relationship between concept and reality. Weber argued that the historical economists, concerned with the realistic description of history, were wrong in believing that history copied the total contents of reality. Instead they must depend on concepts in order to conceive certain aspects of reality. As we have seen, Schmoller was exempted from the charge of a confusion between concept and reality because his stance was based on nominalism. The historians were also liable to emphasize aggregate concepts, such as race or nation, as real entities and to adopt a holistic and organic approach to a society without

methodological consideration. Weber rightly claimed the artificiality or subjectivity of concept formation by referring to the principle of value relevance.

Weber's own contribution was to put forward two conceptual devices to clarify the logical status of historical knowledge constructed by value relevance. I contend that these two devices are in fact a methodological development of viewpoints (4) and (5)—recognition of the plurality of human motives and an interest in individuality—both attributed by Schumpeter to the German Historical School. One is an “understanding” (*Verstehen*) of human motives, desires, emotions, etc., which are the sources of cultural values attached to meaningful phenomena. The method of *Verstehen* is an attempt to reconstruct methodologically viewpoint (4) of the Historical School. The other is an “ideal type” (*Idealtypus*), which explains the logical status of historical concepts. It is a universal concept which, unlike a generic notion in the natural sciences, can emphasize the individuality of historical phenomena. An “ideal type” does not describe the elements which the instances of a class of phenomena have in common in the empirical world, but rather the elements which they have in common in an imaginary world. It makes the challenging viewpoint (5) of the Historical School valid in an imaginary world without denying the logic of the natural sciences.

Schumpeter, his junior by nineteen years, seemed to be not only impressed by Weber's energetic and variegated activities but spurred to rival him. In his obituary essay on Weber he describes the distinctive feature of Weber's methodological work and in doing so also reveals his own ideal:

They [Weber's works on methodology] were not speculative; they were developed in connection with concrete problems and were inseparably related to his great sociological works. They were valuable above all for conquering a stronghold of epistemological difficulty and for a scientific treatment of history.... With no other author do methodological work and productive research work flow together more closely than with him. In every specific work is reflected his total view on principle; in his every description of the view on principle is pulsating the life of his specific research; in every line of both works lies his whole personality (1920, 832–33).

Nevertheless, Schumpeter was critical of Weber's methodological views. Below I categorize the points of disagreement into four areas.

1. Natural science versus cultural science

Schumpeter is quite critical of the distinction, put forward by the neo-Kantian philosophers, between the concrete and the abstract, or between the individual and the general, which reflects, according to Rickert, a fundamental

distinction between the cognitive interests of historical research and theoretical research:

Generally, this sharp contrast between concrete and abstract in our sphere is only less infelicitous than the—certainly logically false—contrast between induction and deduction. If by “concrete” we understand “unanalyzed,” then there is nothing concrete either in historical description or in economics. If we make the contrast concrete-abstract coincide with the contrast individual-general, then the interest in the concretely significant and the interest in the generally true, or more correctly, in the universally applicable, can indeed be distinguished in conception, but in practical work they join together again at once (Schumpeter 1926, 362–63).

He argues that there is no fixed demarcation between the general aspects of phenomena and their individual aspects. The distinction is only relative and depends on the degree of abstraction from concrete reality, which in turn reflects the cognitive interest of research. There is neither a logical cleavage, he emphasizes, between the concrete and the abstract, or between the individual and the general, nor is there a logical jump in practical work in moving to different levels of abstraction.

Elsewhere he says, referring to Windelband, Rickert, and Dilthey:

Their minds had been formed by the tasks and the training of the philosopher, historian, and philologist. So when they proceeded, with enviable confidence, to lay down the law for us, they drew an entirely unrealistic dividing line between the “laws of nature” and the “laws of cultural development” or the “formulation of laws” (nomothesis) and “historical description” (idiography), forgetting that great parts of the social sciences ride astride this dividing line, which fact seriously impairs its usefulness (though, for the truly philologico-historical disciplines it does retain validity). They were simply strangers to the problems and the epistemological nature of those parts of the social sciences, yet failed to add the proper qualifications to their arguments. That this was apt to mislead the many economists who listened to them—Max Weber, e.g., was strongly influenced by Rickert—was as inevitable as it was regrettable (1954a, 777).

His criticism is valid for Rickert and Windelband, but not for Weber. Weber was critical of the dichotomy between generality and individuality, between positivism and historicism, from his early stage of methodological inquiry, and his concepts of ideal type and cultural meanings were devices to overcome the difficulties surrounding the dichotomy and to lay the foundation of the cultural sciences.

2. Value relevance

At first sight Schumpeter seems to accept the principle of value relevance in his actual social-scientific work. In his 1926 essay he refers to “universal human interests” as an analytical lever for empirical research. The opening page of *Theory of Economic Development* also asserts the necessity of arbitrary abstraction in establishing objects of research: “The social process is really one indivisible whole. Out of its great stream the classifying hand of the investigator artificially extracts economic facts. The designation of a fact as economic already involves an abstraction, the first of the many forced upon us by the technical conditions of mentally copying reality” ([1912] 1934, 3). But Schumpeter does not go too far into the matter of value and interests, because from his standpoint of instrumentalist methodology the values and interests emphasized by Rickert and Weber, however useful they may be, are arbitrary hypotheses for theory construction. It follows that it is not necessary to justify hypotheses as such in order to establish their truth. Schumpeter would have definitely denied the justificatory function of the principle of value relevance. Here again, his criticism holds true for Rickert, but not for Weber. Whereas Rickert tried to find the validity of historical knowledge in universally valid cultural values, to which historical phenomena are related, Weber was committed to a pluralism of cultural values, as is well known by his discussion of the objectivity of the cultural sciences.

Indeed there remains a difference of appearance between the methodologies of Weber and Schumpeter, but this is not a crucial point. As an illustration, let us take up the views of Weber and Schumpeter on the foundations of marginal utility theory. In his article “Marginal Utility Theory and the Fundamental Law of Psychophysics” (1908) Weber criticizes the assertion of Lujo Brentano, a German historical economist, that marginal utility theory depends on the erroneous psychophysical law of E. H. Weber and G. T. Fechner. In marginal utility theory, according to Brentano, the valuation of economic agents, which produces external acts of exchange, is explained by a sensation caused by external impulse, i.e., the amount of goods, in accordance with a certain psychophysical law. In contrast, Max Weber argues that marginal utility theory represents an understanding of the meaning of human action in light of its specific cognitive objective. The cognitive objective in economic theory, according to Weber, is to clarify the significance of rationality embedded in the civilization of capitalism. Thus economic action is interpreted as based on a rational “calculation of merchants.” Specifically, economic agents are assumed to act rationally with regard to the end of want satisfaction, and this assumption has nothing to do with psychology.

Weber’s argument, which identifies rationality with “the mind of merchants” and finds the starting point of marginal utility theory in “the method of commercial bookkeeping,” clearly reflects his methodological principle of cultural value relevance. But this does not mean that the cultural meaning of rationality is objectively valid; on the contrary, Weber’s contention is that “the ‘objectivity’ of the social sciences depends rather on

the fact that the empirical data are always related to those evaluative ideas which alone make them worth knowing and the significance of the empirical data is derived from these evaluative ideas. But these data can never become the foundation for the empirically impossible proof of the validity of the evaluative ideas" ([1904] 1949, 111).

On the other hand, in *Wesen*, which appeared the same year as Weber's article on Brentano and the psychophysicists, Schumpeter too rejects the attempt to base marginal utility theory on psychology, but for a different reason (1908, 64–68, 542). In his view the assumption of utility function as such is quite subjective and arbitrary and needs no justification; it is nothing but an assumption for the explanation of an exchange equilibrium in the market. Assessment of an assumption rests on whether a theory deduced from it fits reality. While Weber embellishes the starting point of a theory with a meaning that is related to certain values, Schumpeter as an instrumentalist regards the results of a theory as the criterion of validity. As a proponent of an "ideal type" methodology, Weber explicitly agrees that theory is a heuristic device for the analysis, as well as a constructive device for the description, of empirical diversity. But as a successor to the neo-Kantian axiological theory of knowledge, he adheres to an analysis of the cultural significance of phenomena at the start of concept formation and emphasizes the incessant change in values.

3. Ideal type

But can we say that Schumpeter fully agrees with Weber's methodology of ideal type? The answer is no, as illustrated in the following remarks:

This method of (logically) Ideal Types has, of course, its uses, though it inevitably involves distortion of the facts. But if, forgetting the methodological nature of these constructions, we put the "ideal" Feudal Man face to face with the "ideal" Capitalist Man, transition from the one to the other will present a problem that has, however, no counterpart in the sphere of historical fact. Unfortunately, Max Weber lent the weight of his great authority to a way of thinking that has no other basis than a misuse of the method of Ideal Types.... The historical objections to this construction are too obvious to detain us. Much more important is it to see the fundamental methodological error involved (Schumpeter 1954a, 80–81).

The same purport is repeated elsewhere (Schumpeter 1939, 228; 1946, 186).

What exactly is "the fundamental methodological error"? And is this accusation of Weber justified? Weber's idea of the ideal type was essentially intended to propose a cooperation between theory and history, not to exaggerate the distinction or dichotomy between them. Specifically, it was a solution to the question of how historical concepts can be general and yet not lose their individuality. This question is exactly what Schumpeter encountered

with respect to the distinction between the general and the individual in the neo-Kantian theory of knowledge. In this regard, as indicated above, he had dismissed the importance of the distinction between the general and the individual because the one requires the other in a continual process of concept formation. In earlier methodological studies on Weber's ideal type it had been asserted that one should not put into one category diverse kinds of ideal type which vary in their levels of abstraction and thus include the concepts of abstract economic theory (such as utility, competition, and economic man) as well as those of historical individuals (such as early Christianity, the medieval city economy, and Protestant economic ethics). The most famous criticism to this effect is Schelting's (1922), but it was offered for the first time by Schmoller (1911, 468). For Schumpeter, however, the problem of diversity does not matter: since in his view there are various levels of the abstract and the concrete in historical concepts, it is natural that an ideal type includes concepts derived from different degrees of abstraction. The critics of diversity, such as Schmoller and Schelting, ignored Weber's intention of constructing historical individuality by universal concepts and adhered to Rickert's naïve dichotomy of nature and culture.

What Schumpeter means by "the fundamental methodological error" lies in his assertion that Weber misunderstood the ideal types as historical concepts and used them directly for historical description. Since in the conception of ideal types even specific historical concepts are granted a certain degree of generality as far as their typical elements are concerned, they are still thought-constructs or instruments. It should be recalled how Schumpeter in *Wesen* distinguished between historical description and theoretical description: while the former provides a catalogue of specific facts through selection and classification, the latter gives a general scheme by way of the abstraction and transformation of individual facts (1908, 42). In other words, Schumpeter distinguished between an ad hoc explanatory hypothesis about historical facts and an instrumental hypothesis or general simplifying scheme or model (1954a, 14–15). From this standpoint Weber could be accused of confusing theory and history, of using the ideal type as if they were historical explanatory hypotheses.

But Weber was careful enough to guard against misunderstanding in this regard, as the following remark indicates:

If one perceives the implications of the fundamental ideas of modern epistemology[,] which ultimately derives from Kant; namely, that concepts are primarily analytical instruments for the intellectual mastery of empirical data and can be only that, the fact that precise genetic concepts are necessarily ideal types will not cause him to desist from constructing them. The relationship between concept and historical research is reversed for those who appreciate this; the goal of the Historical School then appears as logically impossible, the concepts are not ends but are means to the end of understanding phenomena which are significant from concrete individual viewpoints. Indeed, it is just *because* the content of historical concepts is

necessarily subject to change that they must be formulated precisely and clearly on all occasions. In their application, their character as ideal analytical constructs should be carefully kept in mind, and the ideal-type and historical reality should not be confused with each other ([1904] 1949, 106–7).

Whether or not Weber was actually successful in capturing the relationship between Protestant ethic and capitalism without overloading abstract concepts with substantive historical contents, Schumpeter's critical view, although misplaced upon Weber, rather testifies their basic agreement on the instrumentality of the ideal type.

4. The understanding of meaning

Schumpeter was also critical of another of Weber's contributions, his thesis regarding the understanding of meaning. According to Weber, the subject matter of the cultural sciences is comprised of meaningful human actions. Knowledge of culture amounts to understanding human actors' motives, desires, intentions, etc., in contradistinction to knowledge of nature, which consists of meaningless facts—physical things and processes. Thus Weber distinguished between “understanding” (*Verstehen*), or knowledge of culture, and “grasping” (*Begreifen*), or knowledge of nature. He arrived at this thesis by developing Rickert's view that value relevance relates to values made by historical actors, not by historians. Those phenomena to which humans attach values become meaningful.

Schumpeter responded ironically to the distinction between understanding and grasping by observing that “it makes precious little difference to the practical work of a theorist whether Mr. Methodologist tells him that in investigating the conditions of a profit maximum he is investigating ‘meant meanings’ of an ‘ideal type’ or that he is hunting for ‘laws’ or ‘theorems’” (1954a, 819). In one of his posthumous essays, however (Schumpeter 1984), he did consider the problem of understanding in terms of the contrast between the values of an investigator and those of historical actors, specifically with regard to the concept of rationality, the major theme of Weber's economic sociology. Schumpeter distinguished between an observer's rationality (objective rationality) and rationality in the object (subjective rationality) and regarded the former as more important in the social sciences. This thesis seems to be opposed to Rickert and Weber's thesis of understanding. Whereas in Rickert and Weber the observer draws out the values from the objects of study, in Schumpeter the observer sets up his own values to observe the objects of study. This position is also a consequence of Schumpeter's instrumentalist methodology, which enables him to discuss phenomena without reference to prevailing cultural values.

On close examination, however, Schumpeter's criticism does not apply to Weber. It might be important to distinguish two different senses of meaning in

Weber (see Oakes 1988, 26–32). One is the subjective meaning that actors ascribe to their actions. The other is the cultural meaning that observers ascribe to a phenomenon. The value relevance in terms of which a phenomenon becomes the object of the cultural sciences and an ideal type is correspondingly constituted relates to the cultural meaning. The subjective meaning of actions is determined by the valuations of actors and gives a criterion of demarcation between natural phenomena as the domain of the meaningless and human actions as the domain of the meaningful. Therefore the subjective meaning of a phenomenon is a necessary condition for its cultural meaning, but the latter is not reduced to the former. Schumpeter's argument of objective rationality and subjective rationality is nothing but a specific version of Weber's cultural meaning and subjective meaning.

V. Conclusion

The German Historical School lacked a methodological foundation that could explain the relationship between history and theory in any consistent way. The task of methodological inquiry was left to the neo-Kantian philosophers. My contention here has been that Schumpeter also participated in this challenging work of the times, but from a different line of thought.

Adopting the concept of institutions from Schmoller, Schumpeter proposed a conceptual framework for theoretical research in the field of history, namely economic sociology. As I have argued, the concept of institutions makes it possible to apply generalizations to the objects of historical individuality. On this basis Schumpeter could use Mach's instrumentalist methodology in economic sociology. If Weber's concept of the ideal type is the methodological exploration of concept formation in economic sociology, Schumpeter's concept of institutions is a substantive specification of the ideal-type concept. The equivalence of the ideal-type concept and the institution concept is a result which we have reached through investigation of ways for cooperation between theory and history. In this sense the methodologies of Weber and Schumpeter are close parallels, except for the significant difference in their backgrounds and appearances—Rickert's idealism versus Mach's positivism. Schumpeter's methodological standpoint diverged from Weber's insofar as it eschewed idealistic elements. But his final word on Weber can be interpreted to imply that an analysis of institutions will contribute to the clarification of all the methodological issues concerning the relation between history and theory: “[Weber's] work and teaching had much to do with the emergence of Economic Sociology in the sense of an analysis of economic institutions, the recognition of which as a distinct field clarifies so many ‘methodological’ issues” (1954a, 819).

As this article is concerned with Schumpeter's methodology of economic sociology, I have not entered into a discussion of his substantive analysis in that field. But this methodological discussion may throw important light on the interpretation of his famous thesis on the decline of capitalism in

Capitalism, Socialism and Democracy (1942), his major work of economic sociology. His thesis that capitalism will decline because its economic success will prepare social circumstances unfavorable to it should not be interpreted as historical determinism. It has nothing to do with a historical hypothesis or prediction. It is a theoretical hypothesis derived from certain assumptions about the interaction between economic and social factors, and its validity rests on instrumentalist methodology. Schumpeter would certainly object to the interpretation of his thesis as a historical hypothesis, in the same way that he objected to Weber's use of ideal-type concepts in explaining the historical rise of capitalism via the Protestant ethic.

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Notes

- 1 For an exception see Osterhammel (1987). He regards both Schumpeter and Weber as nominalists and compares the former, who was influenced by Poincaré, with the latter, who was a neo-Kantian.
- 2 His major methodological writings are Schmoller (1883, 1897, 1900–1904 [Introduction], and 1911). For a critical evaluation of his methodology see Shionoya (1989).

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7. The Origin of the Schumpeterian Research Program: A Chapter Omitted from Schumpeter's *Theory of Economic Development*

I. Introduction

Schumpeter's first book, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908), was a recapitulation of neoclassical static theory from the methodological point of view. He next developed a skeleton of dynamic theory in *Theorie der wirtschaftlichen Entwicklung* (1912)¹ and after a long struggle worked out a theoretical, historical, and statistical analysis of capitalist economic development in *Business Cycles* (1939). Finally, in *Capitalism, Socialism and Democracy* (1942) he provided an account of the historical evolution of the capitalist system as a whole, and included not only economic but also political, social, and cultural factors. In Schumpeter's works, these three areas of research, i.e., economic statics, economic dynamics, and economic sociology, constituted the subjects of major concern to him.

What is the relationship between these three areas of research? On the basis of the received opinion that Schumpeter's distinct contribution was in the theory of economic development, it might be thought that the neoclassical static theory he discussed in *Wesen* was merely a body of thought to be superseded later by his dynamic theory and that *Capitalism, Socialism and Democracy* was a mere impromptu in sociology written in a popular style. But the contention of this article is that Schumpeter's statics, dynamics, and economic sociology should be interpreted in a systematic way as constituting a consistent whole (Shionoya 1986). This article argues that such an interpretation derives from Schumpeter's own research program, which was once expressed in the first German edition of *Theory of Economic Development* but has been completely forgotten.

It also argues that his program, which I shall call Schumpeter's research program for a "universal social science" (Schumpeter 1926, 365), actually presents ideas for a general theory of social order and social change. Incidentally, there has been an attempt to find Schumpeter's general theory of social order and social change in his analysis of social classes (see Dyer 1988). But this article shows that his theory of social classes is not such a general theory but its application.

II. A Fragment of the Sociology of Culture?

The final chapter (Chapter 7) of the first German edition of *Theory of Economic Development* is entitled “The Overall Configuration of an Economy” (Das Gesamtbild der Volkswirtschaft). Here Schumpeter first summarizes the economic discussions of the preceding chapters, then puts them into a wider context of social life and attempts to outline a comprehensive explanation of society as a whole. Areas such as the economy, politics, social relations, arts, sciences, and morals are considered. The chapter consists of 86 out of the 548 pages in the book.

Schumpeter’s approach to areas outside economics is clearly based on analogy, assuming comparisons or similarities between economic and non-economic areas. As we shall see, metaphors are used step by step to create similarities between the two. The most important subject of analogy is the dichotomy of statics and dynamics, which, as far as the social sciences are concerned, he believes has been satisfactorily established only in economics. But originally the dichotomy was introduced into economics in the nineteenth century from zoology and mechanics. He now conceives of the concept of the statics-dynamics dichotomy for an economy as a special case of the general hypothesis, with static and dynamic phenomena visibly distinguished in every sphere of social life.

Unfortunately, Schumpeter omitted the whole of this chapter from the second (1926) and subsequent German editions. The English translation (1934), which is based on the second German edition, does not contain this chapter.² In his preface to the second German edition Schumpeter explained the reason for the omission: he observed that it included “a fragment of the sociology of culture” (das Bruchstück von Kultursociologie) (2nd German ed., xi), and had unexpectedly attracted a great deal of attention, most of it adverse. He thus feared that readers’ attention would be diverted from his major contribution to economic theory. In that chapter Schumpeter went so far as to present a broad view of the development of society as a whole, including economic development as one element in that process. Because he believed that what was needed above all then was an “analysis of the *purely* economic features of capitalist society” (English ed., ix. *Italics added*) on the basis of the static economic theory, it was more important for him to receive recognition for his theory of economic development than for his broad vision of social development. He eliminated Chapter 7 not because he found it incorrect, but because as he noted, “a fragment of the sociology of culture” was preferred by readers to “the problems of dull economic theory” (2nd German ed., xi) and became an obstacle to a discussion of the latter problems.

The most direct evidence for Schumpeter’s continuing adherence to the views of Chapter 7 is his explicit declaration in his preface to the English edition (1934):

I keep to the distinction [between statics and dynamics], having repeatedly found it helpful in my current work. This has proved to be so even beyond

the boundaries of economics, in what may be called the theory of cultural evolution, which in important points presents striking analogies with the economic theory of this book (English ed., xi).

In fact, Chapter 7 is not “a fragment of the sociology of culture”; it is a research program for a universal social science, and for this reason it is most unfortunate that it has not become the object of scholarly investigation. If Schumpeter’s ideas in that chapter were widely known, his approach to a wider front of the social sciences would have received some systematic interpretation. My purpose here is to throw light on this omitted and forgotten chapter and to reconstruct his research program systematically in four stages:³ (1) how are the individual areas of the social sciences established? (2) what is the static phenomenon in each area? (3) what is the dynamic phenomenon in each area? and (4) what does the development of all social areas look like?

III. The Types of Man

When social scientists are confronted with social phenomena, which appear part of a chaotic yet indivisible whole, the first task is to identify and establish distinct research areas for separate disciplines. For example, how can the discipline of economics identify economic activity as the object of its inquiry? Schumpeter writes on the opening page of Chapter 1 of *Theory of Economic Development*:

The social process is really one indivisible whole. Out of its great stream the classifying hand of the investigator artificially extracts economic facts. The designation of a fact as economic already involves an abstraction, the first of the many forced upon us by the technical conditions of mentally copying reality. A fact is never exclusively or purely economic; other—and often more important—aspects always exist. Nevertheless, we speak of economic facts in science just as in ordinary life, and with the same right; with the same right, too, with which we may write a history of literature even though the literature of a people is inseparably connected with all the other elements of its existence (English ed., 3).

There is not by nature an independent economic area; it is artificially established by force of abstraction. In the passage above Schumpeter remarks that the manner in which an area is established for economics depends on “the classifying hand of the investigator” (*die ordnende Hand des Forschers*). The meaning of the German verb *ordnen* (put in order) should be emphasized here; the investigator extracts an area of economic facts so that it might itself exhibit an order. This is an important and fundamental idea, although it might seem commonplace. Thus, any research area should be identified so that it itself can exhibit an order; to put it differently, science should put the identified objects in order by means of the rules of scientific procedure. The contents of order

naturally vary according to individual sciences and even individual models in a science. In *Wesen* the object of economics thus becomes an exchange relation and through this an order is conferred upon the economy.

Let us examine concretely Schumpeter's approach to the identification of research areas. He asserts in Chapter 7 that different types of man should characterize different areas of social inquiry. Although he admits that man always has different motives, interests, and wants simultaneously, he justifies the isolation of human types on two grounds. First, in each area of social life, those characteristic people can be found whose main activities belong to that area. Thus in the economic area a distinctive type of man, called *homo oeconomicus* (i.e., economic man), is identified and his acts (i.e., maximizing behavior) specify and delimit the area of economic fact (i.e., exchange relations). The fact that such a type of man is not necessarily a product of one's imagination but is found in varying degrees in actual groups of people, such as workers, entrepreneurs, farmers, and merchants, provides the justification for delimiting the economic area. Similarly, the existence of distinctive groups of people, such as artists, politicians, and scientists, provides us with a *prima facie* reason for distinguishing separate areas of social inquiry. Second and more importantly, the behavior of a specified type of man is so different from that of other types that it has acquired a degree of independence and autonomy sufficient to enable a distinction to be drawn. "At all events it is clear that the act of a merchant in his office and the conduct of that merchant as a lover of art can be conceptually separated without difficulty" (1st German ed., 537).

In short, if an area of social activity is to be established as the object of a science, a type of man peculiar to that area should first be specified and then the state of affairs in that area be explained in terms of the behavior of the specified type of man. It is clear that this procedure involves the assumption of methodological individualism and that, although types of man are now split according to specialized social sciences, this delimitation of the social sciences follows the idea of the moral sciences established in the eighteenth century. Contrary to the physical sciences dealing with the laws of the material world, the moral sciences treated man as a being who feels, thinks, wills, and acts.

Schumpeter presents an analogy between the economic and non-economic areas of social activity. According to him, economics has been most successful in the definition of *homo oeconomicus* and in the formulation of his maximizing behavior; in other areas of the social sciences the specification of area, the definition of actor, and the formulation of behavior are still very much lacking. With respect to this problem, in *Capitalism, Socialism and Democracy*, Schumpeter later attacked the classical political theory of democracy. The classical theory regards democracy as an institutional arrangement for realizing the people's will to promote the common good. According to Schumpeter, on the contrary, that doctrine is merely a statement of normative judgment, not a description of the actual state of affairs in the political sphere under democracy. On the basis of an observation of human nature in politics, he views democracy as representing a competitive struggle of

politicians for political leadership. He identifies a type of man in politics and formulates his behavior apart from political philosophy. This is based on the analogy of a competitive struggle of economic agents for profits in a market.

IV. The Statics-Dynamics Dichotomy

The second stage of Schumpeter's program in the social sciences is characterized by an attempt to describe a state of affairs in a specified area as an orderly state. Schumpeter recognizes that the establishment of a unique state of affairs in an area of social life is brought about by a set of factors exogenously given to that area, on the one hand, and by human behavior endogenously governing that area, on the other.

It is well known that order in the static state of an economy is represented by the concept of equilibrium. According to static economic theory, given the quantity of available resources, consumer tastes, the techniques of production, and the social structure, the behavior of *homo oeconomicus* will uniquely bring about an equilibrium state of resource allocation—i.e., equilibrium prices and quantities of various goods and factors of production—through the play of individual self-interest and the workings of a competitive market mechanism. This is the essence of economic statics, and Schumpeter analogously applies the same procedure to other areas to explain the static states of social life in question.

Schumpeter observes that if in a certain area of social life a state of equilibrium can be uniquely determined corresponding to exogenous data, the area in question is logically so self-sufficient that an autonomous and independent science can legitimately be assumed for that area. If and only if a unique equilibrium can be proved for an area can the state of affairs in that area be taken to be a cosmos, not a chaos. Schumpeter remarks on the significance of the analogy:

The analogy we want to discuss is the following: every area of social life stands at any time under the determining influence of the given data, and these data are analogous to those data which determine an economy at any time according to the method of statics. This recognition signifies the dawn of the scientific understanding of human phenomenon. It has now become a common property—and a commonplace (1st German ed., 537–38).

To put it differently, the method of statics reduces unknown factors in a specific area to known factors outside the area. In the case of an economy, Schumpeter writes:

When we succeed in finding a definite causal relation between two phenomena, our problem is solved if the one which plays the "causal" role is non-economic. We have then accomplished what we, as economists, are capable of in the case in question, and we must give place to other

disciplines. If, on the other hand, the causal factor is itself economic in nature, we must continue our explanatory efforts until we ground upon a non-economic bottom (English ed., 4–5).

At first glance, the method of statics in the social sciences might appear to lack autonomy, because it explains the state of affairs in a specific area by making reference to the data given from outside. But this is not true. It is the crucial task of statics to explain what the endogenous variables in a specific area will be when the data are given; the autonomy of a science is found in the peculiarities of explanation in deriving a unique state of affairs from the given data. The substance of a static state varies according to the area in question. In the economic area, an individual household or firm is assumed to act in a determined manner (maximization) under the given data. “Every one will cling as tightly as possible to habitual economic methods and only submit to the pressure of circumstances as it becomes necessary” (English ed., 8–9). The static equilibrium in an economy is expressed as a “circular flow” if a time element is taken into account; the quantity and pattern of a national product remains constant as the process of production follows the same route year after year. Even if changes occur in the “circular flow” of an economy, they occur continuously and in small steps within a fixed framework. The thrust of Schumpeter’s approach to a universal social science in this stage is that the conception of static state as the routine activity within a fixed framework can be applied to non-economic areas as well.

The third stage is concerned with the identification of dynamic development as distinct from the static state. According to Schumpeter, in every branch of social activity, forces are working which will change the data from within the areas; they destroy the framework of those activities which are merely adaptive to the existing data. This is the phenomenon of dynamic development. In order that an area of social life may be established as the object of scientific inquiry, it is not enough that there should be a distinct type of man peculiar to the area and that an orderly equilibrium be reached in the area when the exogenous conditions are given. It is further necessary that the area should have its own mechanism of development that creates innovation from within itself and of itself destroys the existing order.

Schumpeter’s *Theory of Economic Development* describes the mechanism of economic development as the execution of innovation, which takes various forms, such as the introduction of new products, new methods of production, new markets, new sources of supply, and new forms of industrial organization. Its central concepts are the entrepreneur as the carrier of innovation and bank credit as the means of innovation. Thus Schumpeter’s development concept consists of three factors: innovation, its carrier (entrepreneur), and its means (credit). Again the analogy of development is applied to other areas. Indeed, each area of social life has its own mechanism, its own carrier, and its own means of innovation. But the essential feature is the same: the type of man defined as a “leader” destroys the existing order and creates a new direction. The entrepreneur is a special case of “leader” in the economic sphere. The

“leader” is in marked contrast to the majority which only takes adaptive and routine actions. Schumpeter’s idea is that such a contrast exists not only in the economic area but also in the areas of the arts, science, politics, and so on. He writes:

Groups in every area fall into two clearly discernible parts, just like economic men... In every area there are persons of a static disposition and leaders. The former are characterized by the fact that they essentially do what they have learnt, that they move within the traditional framework and their views, disposition, and behavior are determined by given data in their area. The latter are characterized by the fact that they see something new, that they alter the traditional framework of their activity and the given data of their area (1st German ed., 543).

It is interesting to note that Schumpeter regards scientific activity as a type of social activity, thus asserting that the same procedure of a universal social science could be applied to the area of scientific activity. An interpretation of Schumpeter’s approach to the history of economics from this point of view will produce illuminating results, although I cannot treat this topic here.

It is not surprising that Schumpeter should emphasize the human element in the dynamic phenomenon. As seen from the above, his discussion in all three stages of research program is consistent on this point: first, the identification of a research area requires a definition of a type of man peculiar to an area; second, the static theory for an area depends on the behavior, under the exogenous conditions, of the average man thus defined; and third, dynamic theory relates to the behavior of men of unusual ability who destroy the given conditions.

Schumpeter presents an important view on the relationship between statics and dynamics, found only in Chapter 7 of the first German edition, that whereas static phenomena have an equilibrium, dynamic ones do not. He writes:

It follows from our entire thought that *a dynamic equilibrium does not exist*. Development in its ultimate nature consists of the disturbances of an existing static equilibrium and does not have a tendency to return to a previous or any other equilibrium. Development alters the data of a static economy... Development and equilibrium are opposite phenomena excluding each other. Not that a static economy is characterized by a static equilibrium and a dynamic economy by a dynamic equilibrium; on the contrary, equilibrium exists only in a static economy. *Economic equilibrium is essentially a static equilibrium* (1st German ed., 489; italics added).

This remark concisely reflects Schumpeter’s epistemological view that, because a scientific explanation is incomplete without the reduction of phenomena to an equilibrium state, dynamic theory cannot stand alone without the support

of static theory. This problem may have something to do with the possibilities for mathematical formalization of dynamic phenomena. Indeed, Schumpeter worked hard to master mathematics and mechanics, but there are conflicting views about his intentions. Smithies, on the one hand, says:

Throughout his life Schumpeter gave an inordinate amount of his time to the study of mathematics and to the encouragement of its study by others... He always retained the forlorn hope that mathematics might produce the dynamic counterpart of the Walrasian system (Smithies 1951, 15).

Haberler [1951, 40–41], on the other hand, states:

He [Schumpeter] ... was willing to make limited use of them [mathematical models] for the explanation of minor oscillations around the great waves of economic development, but he felt that they are just as incapable of explaining the great economic rhythm as the ripples caused by high winds on the surface of the sea are incapable of influencing the great rhythm of the tide (Haberler 1951, 40–41).

Our last quotation above from Chapter 7 will suggest that his failure to formalize the process of economic development in terms of an equilibrium notion is at least not inconsistent with his conception of development. In his view, economic development is a deviation from static equilibrium, and a theory of economic development is justified only by recourse to a static theory dealing with the ultimate effects of innovation on the economy in terms of the equilibrating mechanism. His conception of economic development as a deviation from, or a disturbance of, a static equilibrium, as well as his presumption that economic development does not contain within itself equilibrating forces, defines the epistemological nature of the statics-dynamics dichotomy. In his view, static theory is immutable as the basis and complement of dynamic theory.

V. Socio-Cultural Development

As indicated above, Schumpeter applied a unified procedure of social inquiry to all areas of social life. Supposing that the procedure is successfully applied to these areas, then we are left with a set of separate social sciences. The fourth and last stage, the most ambitious one, in Schumpeter's research program, is to integrate all areas of social life. The question he raises at this stage is:

In spite of the relative independence of all areas, how is it taken as an important truth—indeed, the truth which we cannot so much prove exactly as perceive—that every element in every area at any time is connected with every element in every other area, that all situations of all areas determine

each other and depend on each other? If we call the aggregate of these areas the *social culture* of a nation and the totality of its development *socio-cultural development*, we can ask: how does our approach explain that the social culture of a nation at any time is in a unity and the socio-cultural development of a nation always has a unifying tendency? (1st German ed., 545–46).

Between the areas of social life there must be complicated interrelations whose analysis requires what might be called an interdisciplinary approach. The interrelations can be examined from either a static or dynamic viewpoint. On the one hand, if an area is looked at in isolation, static theory provides us with a causal explanation in the sense that the state of affairs in the area is explained by reference to the conditions given from other areas, and that the state of affairs in the former area, in turn, is seen as data conditioning other areas. But if all the areas of social life are looked at as a whole, the value of such a causal explanation would be reduced, because the walls separating the areas must now be removed and every factor in every area must be simultaneously regarded as endogenous. Thus Schumpeter proposes to substitute functional relations for causal relations:

In fact the next step of understanding is to substitute the moment of “general interdependence” for the “observation of causal relations.” For a theory of static facts this is a pure advantage and decisive progression. Instead of viewing every area as the result of other areas, there now emerges the conception of the total state of social life as a result of the total state in a preceding period. And this entails a widening of our theoretical horizon. But in this case, a theory of development loses its ground. For the transition from one state to another can take place only according to the static rule (1st German ed., 541).

We have here a situation which might be called general interdependence or general equilibrium on a large scale, where all the equilibrium states of all areas should be compatible with each other. Schumpeter calls this situation “the static unity of cultural level.” Insofar as we remain at a static viewpoint, even the enlargement of our perspective beyond a single area will not yield any worthwhile reward concerning the understanding of social evolution.

When the viewpoint of dynamics is adopted, on the other hand, the interrelations among areas involve reciprocal effects of innovation in one area on other areas: economic development influences the non-economic areas and brings about social change. Analogously, it is supposed that dynamic performance in one area more or less influences other areas. The interrelations among the areas in the dynamic process are different from the static interrelations. Schumpeter describes how such interrelations work: innovation in one area raises the social rank of successful leaders and influences social organizations; it affects the social values concerning what is important, valuable, and desirable; and it ultimately changes the presumptions and

conditions of human action in all areas. Whereas various developments in all areas of social life at first sight appear to be independent of each other because they are carried out by different leaders in different areas, it is Schumpeter's recognition of social classes that makes developments in all areas an interrelated unity. As we shall see below, Schumpeter's theory of social classes plays a pivotal role in integrating all social areas. If the integration could be adequately formulated, we would have a universal or all-encompassing social science addressed to socio-cultural development. Schumpeter concludes:

Thus, through the combination of relatively independent developments, what appears, if seen from enough distance, as unified cultural development comes into being. Thereby we release things from rigid causal chains and restore life to them. And in this overall view of cultural development the economy also has its specified place (1st German ed., 547).

I contend that Schumpeter's *Capitalism, Socialism and Democracy* was an attempt to carry out the program of a universal social science that he indicated thirty years before. Specifically, it deals with the interrelations between the economic and political systems, i.e., between capitalism and democracy. He concludes in that book that capitalism will collapse as a result of its economic success, because the successful economic development of capitalism would attenuate the innovating forces in the economy by creating political, social, and cultural environments which are hostile to capitalism. When the economic area is considered in isolation, the innovating forces which will change its given conditions appear to emerge from within the area; but when we take into account other areas as well, we find that the innovating forces will become stronger or weaker in response to the situations in the neighboring areas. This reasoning, central to *Capitalism, Socialism and Democracy*, depends on the concept of the reciprocal interactions of dynamic forms on a large scale, which is distinct from that of "static unity of cultural level" or static interdependence on a large scale. It was not in that book that he launched into this theme for the first time. The seminal idea of that book was clearly stated in his *Die Krise des Steuerstaates* (1918) and "Sozialistische Möglichkeiten von heute" (1920/21). *Capitalism, Socialism and Democracy* should not be taken as a product of casual effort, but as a work that was carefully formulated over a long period. It should not be judged by its success or failure in predicting the future of capitalism, but by its contribution to the understanding of social and economic process as a whole and to the practice of a universal social science. This assessment is based on Schumpeter's instrumentalist methodology, which I have discussed elsewhere (Shionoya 1990).

VI. Conclusion

In conclusion, I shall point out some crucial aspects of the program that he elaborated later. This examination will suggest that the idea in the omitted chapter from *Theory of Economic Development* was not a mere passing thought, but that he kept it as a framework to mold his subsequent works. Schumpeter did not fully develop a theory of socio-cultural development in that chapter. The argument there remained a vision, and he was still only twenty-nine years old at the time. In his later academic life, he attempted to give substance to the early vision of socio-cultural development and to cultivate the methods for his program of a universal social science.

Schumpeter admired those scholars who had a grand research program for the historical evolution of society. Needless to say, Marx was one of them; another was Gustav von Schmoller. Schumpeter offered the name a “unitary or universal social science” to their works. His views on the two scholars are referred to here only to illuminate the important aspects of his program, which is comparable with theirs with respect to scope and method.

Schumpeter denied Marx’s economic interpretation of history, although he highly praised its grand vision of social evolution and found in it a program for a “unitary social science” (Schumpeter 1954, 441). With regard to the relation between various areas of social life, Marx characteristically asserted a one-way relation from the area of production via the social structure to other areas, namely those in the superstructure of a society. Schumpeter’s criticism centers on this point; he instead stresses the functional or reciprocal relations between the areas. What I have called the reciprocal interactions of dynamic forces on a large scale is Schumpeter’s alternative to Marx’s economic interpretation of history.

According to Schumpeter, Marx’s theory of social classes was a substantive analytical tool to make an economic interpretation workable. Schumpeter developed his own theory of social classes in a long article entitled “Die sozialen Klassen im ethnisch homogenen Milieu” (1927). He claims that, unlike Marx’s contention, class structure is determined by diverse factors other than economic ones; he asserts that the contents of classes are changing like “a hotel or an omnibus, always full, but always of different people” (Schumpeter [1927] 1951, 165). Schumpeter’s theory of social classes does not link the superstructure with the substructure as in Marx’s theory. It represents, as it were, a final summary of investigations in all social areas. Although Schumpeter regards the class phenomenon as a special area of social life, men in the phenomenon of social classes, unlike specific types of man characterizing each area of social life, are mapped according to their social activity in various areas; they are like people from different local areas meeting together for a convention in a hotel or an omnibus.

The social function of class structure is “social leadership” in a general sense. The relation between the social rank of a class and its function consists of two factors. First, in each area of social life there is a distinct sort of leadership, i.e., the ability to carry out innovation. People are ranked

ultimately according to their different aptitudes with respect to leadership, and the vicissitudes of leadership connected with innovation in each area brings about changes in a member's position in social classes. Second, each social class is linked to a special socially necessary function, and the importance of the class function itself is ranked with reference to the social leadership that is created by the fulfillment of its function. The class phenomenon is an aggregate summary of individual performance in, and social importance of, various areas of social activity.

Schumpeter lumps together attempts at reducing the whole historical process to the action of one or two factors as a simple theory of historical evolution of the "Comte-Buckle-Marx kind" and contrasts them with Schmoller's pluralist historical approach, to which he is quite sympathetic (Schumpeter 1954, 811). In a long article entitled "Gustav v. Schmoller und die Probleme von heute" (1926), Schumpeter reconstructed Schmoller's procedure of research—what he termed "Schmoller's program"—as economic sociology and finds in it a "prospect of a universal social science."⁴

In *History of Economic Analysis*, Schumpeter advocates economic sociology as one of four basic methods of economic analysis in addition to history, statistics, and theory. Economic sociology, in his view, is concerned with the institutional framework which is fixed in economic theory, but it is different from economic history in that it treats institutions as "a sort of generalized or typified or stylized economic history" (Schumpeter 1954, 20).

In the 1926 essay on Schmoller, Schumpeter refers to business cycles as well as social classes as typical areas of research that need an application of Schmoller's program. Although his *Business Cycles* contains a large amount of historical facts, it does not constitute an attempt at economic sociology because its main body of analysis is confined to statistical time series in the economic area. *Capitalism, Socialism and Democracy*, on the other hand, is undoubtedly an attempt at economic sociology, an analysis of socio-cultural development.

If Schumpeter's major works are listed in order of publication, as done at the beginning of this article, the impression might be given that his interest shifted gradually from pure economic theory to empirical, sociological, and historical studies in an attempt to broaden his scientific horizon. It is said that one sometimes follows such a process as one's scholarship matures. But this was not the case with Schumpeter. At the beginning of his academic life he already entertained a research program with a broad perspective and thereafter continued to work within that vein.

An earlier version of this article was presented at the History of Economics Society meeting at Harvard University, June 1987. This article has benefited from the comments of Marguerite Mendell and other participants.

Notes

- 1 Hereafter the book will be referred to by its English title, but the editions are distinguished for page reference.
- 2 Nor does the English edition include Schumpeter's preface to the second German edition, but only his preface to the English edition, where he simply mentions the omission of Chapter 7 but does not explain the reason of the omission and the nature of the original Chapter 7.
- 3 It will be of interest to show the contents of Chapter 7. The chapter is divided into thirteen sections:
 1. Preliminary Remark
 2. Two Problems of Economic Theory
 3. Historical and Theoretical Problems of Development
 4. Discussion of the "Environment Theory" of Development
 5. Discussion of the "Growth theory" of Development
 6. Three General Propositions of Economic Development
 7. Influence of Development on Individual Economic Agents
 8. The Most Important Special Case
 9. A Model of Total Socio-Economic Process
 10. Overview of Our Analysis of Production Process and Some Applications
 11. On the Economic Structure of Society and the Problem of Social Class Structure
 12. The Social Atmosphere of Capitalist Economy
 13. Analogy of Economic Development in Other Areas of Social Life: Social Phenomenon.
- 4 For Schumpeter's appraisal of Schmoller's research program, see Shionoya (1989).

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8. The Science and Ideology of Schumpeter

I. Introduction

The program of research that Joseph Alois Schumpeter, as a social scientist, tried to carry out throughout his life was an elucidation of not only the economic development of capitalism, but also the *total* development of a capitalist society, which includes economic development as a part. Schumpeter once called the totality of a varied social life “social culture” (or *die soziale Kultur*) of a nation and the totality of the development of social life “socio-cultural development” (or *die soziale Kulturentwicklung*) (Schumpeter 1912, 545). How was his picture of the total or socio-cultural development of capitalism constructed methodologically and substantively?

The characteristic of Schumpeter’s works seems to lie not so much in his separate scientific treatment of the component parts of the total picture as in his comprehensive design, idea, or insight, which gives each component its proper place in the total picture. Schumpeter sought for the universal truth inherent in the process of capitalistic development: to use his favorite words, the “logic of things” (or *Logik der Dinge*) (Schumpeter 1915, 102). The presumption that such a logic should exist will demand the unity and consistency of ideas. One cannot adequately evaluate the significance of Schumpeter’s separate scientific achievements without an appreciation of his comprehensive ideas on the socio-cultural development of a capitalist society.

I would like to call for short Schumpeter’s design, idea, or insight his “vision.” He himself used this concept as an activity preceding scientific cognition. He paid attention to vision because the ideological element inescapably intervenes in the formation of vision, and attached a great importance to the intertwinement between science and ideology. In his personal inclination, Schumpeter showed repugnance against value judgments and policy discussions and preferred to talk about the progress of science as a purely analytical apparatus. Probably this attitude of Schumpeter has precluded one from noticing an ideological bias in his scientific works. It is crucial, however, for an understanding of Schumpeter to make clear the influences of ideology, which he stealthily brought in, on his construction of an analytical framework.

In this paper, we shall first make clear the concepts of science, vision, and ideology in the light of the contemporary philosophy of science, and then discuss and identify Schumpeter’s ideology that constitutes his basic insight sustaining his whole system of thought. At the same time, we shall examine what will remain as an apparatus of scientific analysis for the total

development of capitalism if ideological bias could be excluded from his system of thought.

II. Philosophy of Science and Sociology of Science

1. Science, vision, ideology, and value

Since the publication of his first book on economics, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908), Schumpeter always kept a deep interest in the methodology of economics, but his discussion of science and ideology was mainly developed late in his life.¹ Schumpeter observed that scientific inquiry in the broad sense consists of two stages: the formation of vision and the building of a scientific model. The first stage is to perceive as the object of an inquiry the set of related phenomena that we want to analyze. This requires a judgment of what is important from one's viewpoint in understanding natural or social phenomena. This prescientific perception is called vision. The second stage is to analyze the material conceived by the vision. The recognition and collection of facts leads to the building of concepts and an analytical apparatus, and vice versa. Through the feedback between factual and theoretical research scientific hypotheses or models are formulated.

These two stages, *vision* and *analysis*, are technically like a syllogism consisting of major premise, minor premise, and conclusion. In contrast, ideology indicates specific elements entering the stage of vision; it is a preconception existing in our mind about an object of inquiry. This preconception is no doubt influenced by previous and contemporary scientific views. Ideology in this sense is different from *value judgments* or political precepts for two reasons. First, though preanalytic, ideology includes a cognitive act and is a prerequisite for conceiving an object of research, while evaluative and prescriptive judgments are neither cognitive acts nor prerequisites of science. Second, in spite of the above, ideology is beyond our control and therefore dangerous to science, while value judgments are not so because they can be separated from science. Indeed ideology and value judgments are closely related to each other and usually regarded as synonymous, but ideology in Schumpeter's sense should be understood independently of value judgments.

Of these related concepts Schumpeter's major emphasis was on the relation between science and ideology; this is the subject matter of the sociology of science or knowledge, which treats science as a social phenomenon. Indeed, there are some points in his argument that might suggest Schumpeter's taking vision and ideology as interchangeable, but in his basic intention they are distinct. *Vision* is a preliminary image of problems and is to be formulated in the stage of *analysis* in accordance with rules of scientific procedure. The part of vision that is not amenable to scientific treatment is merely redundant to science and, so to speak, leftover material not processed. *Ideology* enters the

process of drawing the image of problems (vision) and is not the image of the problems themselves. In the stage of scientific model building ideological bias is excluded (hopefully) under the objective control of scientific procedure, whereas in the prescientific act of vision it is not so expected.

It is important to note that the part of vision that is not successfully formulated in the stage of model building has its own life and plays its own role. Such vision might sometimes disappear from science as a mere illusion, but sometimes becomes political value judgments or social beliefs and continues to exist in disguise in science as if it were science. In this case Schumpeter speaks of the victory of ideology over analysis.

Although in *History of Economic Analysis* (1954) Schumpeter alleged to write a history of economics as scientific analysis, not as political economy or economic thought, he was still interested in the relationship between science and ideology, i.e., the subject matter of the sociology of science. That Schumpeter paid special attention to the sociology of science in his discussion of the methodology as well as the history of economics is important for us in examining his view of science. He recognized that scientific cognition and value judgments are separable in principle but actually connected with each other because they are commonly produced from ideology and vision. Science, value, vision, and ideology are, so to speak, materials boiled and stirred up in the same pan; even a pure consideration of science would not allow us to neglect other materials—in particular, ideology.

2. Three major issues

So much for a set of concepts. Now, in order to illustrate Schumpeter's view on science and ideology, I will raise three issues, which he discussed in different contexts: relativism, economic development, and the filiation in the history of science.

First, in discussing the structure and procedure of science, the traditional philosophy of science usually assumed an ideal theory that is already completed. By contrast, Schumpeter bore in mind Marx's theory of ideology and Mannheim's sociology of knowledge, though critical of their treatment of ideology, and regarded the stage of vision formation explicitly as a part of scientific activity. This means bringing the sociology of science into the philosophy of science and stresses scientific relativism to the effect that any theory must be viewed in relation to a given social environment. Relativism itself is not new; the point here is what will be deduced from Schumpeter's version of relativism:

Roughly up to the middle of the nineteenth century the evolution of "science" had been looked upon as a purely intellectual process—as a sequence of explorations of the empirically given universe or, as we may also put it, as a process of filiation of discoveries or analytic ideas that went on, though no doubt influencing social history and being influenced by it in

many ways, according to a law of its own. Marx was the first to turn this relation of interdependence between “science” and other departments of social history into a relation of dependence of the former on the objective data of the social structure and in particular on the social location of scientific workers that determines their outlook upon reality and hence what they see of it and how they see it. This kind of relativism—which must of course not be confused with any other kind of relativism—if rigorously carried to its logical consequences spells a new philosophy of science and a new definition of scientific truth (Schumpeter 1949, 348).

Whereas in the natural sciences the influences of social context on theories do not extend beyond the choice of problems and approaches, relativism in the social sciences involves that a particular proposition might depend on beliefs and attitudes of observers and not always on universal experience that is invariant to the observers’ social location. For Schumpeter relativism meant not only that, compared with the natural sciences, the social sciences were immature, but also that they were by nature ideologically biased.

Unfortunately, Schumpeter did not explicitly explain “a new philosophy of science” and “a new definition of scientific truth” with reference to the social sciences. Although he had to admit relativism, he had recourse to the fact that many phenomena still looked alike to everyone, and that the methodological rules of procedure prevented ideology from intervening in the stage of model building. But he was not optimistic about the possibility of objective social science, so that he in fact pointed out that ideology was necessary but dangerous to science.

The significance of Schumpeter’s relativism, however, is not to be found in such pessimism or warning, but in the positive claim that science should be considered in a historical perspective, as I shall discuss in the following two issues.

Secondly, Schumpeter’s view that a vision plays a key role when it is concerned with the process of long-term economic changes is quite important, because he tackled this process throughout his life:

when we are concerned with nothing more ambitious than to formulate the way in which—on the plane of pure logic—economic quantities “hang together,” that is, when we are concerned with the logic of static equilibrium or even with the essential features of a stationary process, the role of vision is but a modest one—for we are really working up a few pretty obvious facts, perception of which comes easily to us. Things are very different when we turn to the task of analyzing economic life in its secular process of change. It is then much more difficult to visualize the really important factors and features of this process than it is to formulate their *modi operandi* once we have (or think we have) got hold of them. Vision (and all the errors that go with it) therefore plays a greater role in this type of venture than it does in the other (Schumpeter 1954c, 570).

As for the long-term economic process where a large number of factors are likely to change, there are many alternatives with regard to assuming a causal relationship and drawing a historical scenario. Moreover, a verification or falsification of a theory of economic development requires an accumulation of long-term experiences, without which any theory of the long-term process would not be more than a vision. Any effort to work out the total development of capitalist society is concerned with the long-term process, and Schumpeter admits that in this case vision and ideology might survive without a crucial check.

Thirdly, Schumpeter identified the source of ideology with the social circumstances of scientists. Scientists do not start from scratch; “we start from the work of our predecessors or contemporaries or else from the ideas that float around us in the public mind” (1949, 350). These things belong to the social circumstances given to scientists; in this sense, “the original vision *is* ideology by nature” (1949, 351; italics original). “Analytic work begins with material provided by our vision of things, and this is ideological almost by definition” (1954c, 42). The image of society (vision) starts from the preconceptions of scientists (ideology).

Through the retheorizing of ideas by successive generations, the historical inheritance of theory or “filiation of scientific ideas” (1954c, 6) constitutes a historical continuity in the history of science. If one takes superficially what Schumpeter said, his work in the history of economics appears to pursue only the internal development of analytic or scientific systems of thought. But paradoxically, in order to do that, he required a viewpoint of the sociology of science that was concerned with external moments of scientific activity. For Schumpeter, the association of the philosophy of science with the sociology of science was actually conceived and practiced in the context of the history of science.

The above three issues concerning science and ideology are closely related to each other. Our next task is to discuss the significance of Schumpeter’s position in the light of the recent development of the philosophy of science.

3. Context of discovery and justification

Logical positivists distinguish between the context of discovery and that of justification. These terms were introduced by Hans Reichenbach (1938) to mark the distinction between the way in which a scientific theory is discovered and the way in which it is formulated and justified. It can be argued that this distinction corresponds to Schumpeter’s distinction between vision and science.

According to the standard account, the contrast between discovery and justification is explained in the following way (Kordig 1978). Discovery concerns the origin and invention of scientific theories and hypotheses. Justification concerns their evaluation, test, and confirmation. Problems in the context of discovery are the concern of psychology, sociology and

history of science. The context of justification is the subject matter of the philosophy of science. Discovery is subjective, but it is only descriptive. Justification is objective, but it is normative because a theory must abide by its rule. Discovery deals with the initial selection of facts for study. Justification evaluates the process of the give and take between hypotheses and facts.

Logical positivists were interested only in the context of justification and neglected factors concerning the genesis of theories, because they believed that no logical method could be applied to the discovery of a theory and they only dealt with the static structure of a theory as the finished product. This point was made by the subsequent criticism against logical positivism. According to logical positivism a no nanalytic (factual) statement has meaningfulness or cognitive significance only if it is verifiable by observational evidence. But it is not possible to distinguish strictly between theory and observation because we can observe facts only on the assumption of a theoretical framework. Moreover, such a statement is not conclusively verifiable on account of the famous problem of induction, so that a theory is rather accepted in fact on various criteria, undergoes endless modification and proliferation, and continues to exist with tenacity even if it is falsified.

From the criticism against the positivistic philosophy of science, it has been established that the context of discovery dealing with origin, evolution, and acceptance or rejection of theories should be a legitimate and essential concern of the philosophy of science (Suppe, 1979, 125–26). The most important consequence of this change to the philosophy of science is serious attention given to the dynamics of scientific growth and persistence and thus to the history and the sociology of science. After logical positivism authors such as Popper, Kuhn, Lakatos, Feyerabend, Laudan and others contributed to this new stream.²

In the light of the above, it can be said that Schumpeter's discussion of science and ideology anticipated the subsequent development in the philosophy of science. He showed a deep interest in the history of economics and introduced the conceptual framework to deal with ideology that used to belong to the context of discovery, thus providing a basis for the analysis of the context of justification from the viewpoint of historical growth of theories. His position differed from the positivistic view that neglected the problems originating in the context of discovery, and also from the sociological view that dealt with those problems only as the concern of the sociology of science. It is not an incomprehensible inconsistency that while he always alleged to restrict himself to economics as an objective science, Schumpeter in fact paid considerable attention to the sociological factors that might affect the development of science. We shall take a step forward and suggest that his position is appropriately interpreted with reference to Lakatos's methodology of science.

4. A comparison with Lakatos

Lakatos's notion of "scientific research programme" is almost similar to Kuhn's "paradigm." A scientific research program consists of two kinds of methodological rules, namely, a negative heuristic (which tells us what research paths are to be avoided) and a positive heuristic (which tells us what research paths are to be pursued). At the same time, a research program is characterized by two components: a "hard core" (which consists of irrefutable general theoretical hypotheses) and a "protective belt" (which consists of refutable variants such as auxiliary and observational hypotheses, initial conditions, mathematical and experimental techniques, etc.) around a "hard core." While the negative heuristic forbids us to refute a "hard core," the positive heuristic allows us to change, invent, and develop a refutable "protective belt." It is the task of the positive heuristic to take charge of meeting criticisms and anomalies resulting from the gaps between theory and observation, and to extend the scope to which the theoretical hypotheses can be applied.

A scientific research program does not mean a single theory in isolation but a series of theories with common rules and values, and it allows cumulative expansion and modification within its system defined by a "hard core." In other words, the research program means a series of "protective belts" developed on the basis of a common "hard core." Lakatos defines a series of theories as progressive if it predicts some new, hitherto unexpected facts and if it leads to the actual discovery of some new facts. The progressiveness of a program is the criterion to determine the superiority of the program. But since a judgment of progressiveness takes a long time, Lakatos stresses the hindsight elements in appraisals of theories and regards the existence of competing research programs as a normal affair in science. This consideration leads him to stress the importance of "methodological tolerance."

Thus, Lakatos's position may be summarized as follows. On the one hand, Lakatos denies that science, as Popper presupposed, undergoes permanent revolution by ceaseless falsification of theories; instead, he states that a series of theories with a common "hard core" persists tenaciously in face of unfavorable empirical tests. On the other hand, Lakatos views the history of science, contrary to Kuhn, as a history of competing research programs rather than as a sequence of ruling paradigms. Of course, Lakatos keeps, by his criterion of progressiveness, elements of Popper's normative methodology of science, on the one hand, and adopts, by his concepts of "hard core" and "protective belt," elements of Kuhn's sociological principle of tenacity, on the other. Therefore, Lakatos's methodology is, in a sense, a compromise between Popper and Kuhn.

On the basis of a brief exposition of Lakatos's framework, we contend that his distinction between a "hard core" and a "protective belt" is similar to that of Schumpeter between ideology and science.³ Although Schumpeter brought ideology into the consideration of science, his intention was not to indulge in relativism of science but still to speak of scientific progress. Paradoxically

speaking, by explicitly introducing ideology into the realm of science, he could, though implicitly, speak of progress in the formulation of scientific models constructed on presupposed ideology.⁴ This is practiced in the context of the history of science. His key word in that context is the “filiation of scientific ideas,” and this could be compared to Lakatos’s conception of a series of theories developed around a “hard core.” Another key word in the methodology of economics put forward by Schumpeter in *Das Wesen und der Hauptinhalt* was “methodological tolerance,” which allows the coexistence of competing research programs, a concept similar to that of Lakatos.

If it is right to think in this way, ideology in Schumpeter is not an ad hoc factor that merely precedes a theoretical model and can be dispensed with once a model is formulated. Ideology stays as an irrefutable “hard core” at the center of a scientific research program and gathers several auxiliary hypotheses around itself, thus contributing to the structured system of science. We shall attempt to interpret Schumpeter’s structure of thought using Lakatos’s methodological concepts.

III. An Interpretation of Statics-Dynamics Dualism

1. Statics vs. dynamics

Schumpeter’s model of economic statics is a version of the neoclassical equilibrium theory. His static model basically relates to an economic equilibrium established under certain given conditions, but, if time is taken into account, it relates also to a stationary state or a circular flow that repeats itself year after year on the same scale and with the same pattern. His notion of economic statics includes not only the circular flow but also the growth process with steadily increasing population and capital. Under steady economic growth, changes are limited to the quantitative expansion of an existing economy and distinguished from doing something new and differently.

Thus Schumpeter selects only those essential factors that he insists characterize economic dynamics, and includes all the rest in the scope of economic statics. In this sense, his method is a purification of dynamic phenomena, which he calls “economic development.” His theory of economic development was given in *Theorie der wirtschaftlichen Entwicklung* (1912). Economic development is caused by “innovation,” broadly defined as the introduction of new products, new methods of production, new markets, new sources of supply, and new forms of industrial organizations. The significance of innovation is that it changes the data from within the economic system and shifts the system from an old to a new equilibrium.

Although Schumpeter sharply distinguishes economic development from the circular flow and the steady growth because economic development cannot be analyzed by the model of economic statics, he neither denies nor excludes the model of economic statics from his analysis of economic development. The

issue of statics versus dynamics in Schumpeter is not that the former should be replaced by the latter, but that both are required to describe the reality on account of a special connection between the methods and the objects of inquiry. Thus he writes:

one sees that dynamics should destroy and modify a lot of things. But these are only outworks and extensions, as it were. The core of the static theory should not be replaced by a conception that is dominated by development. Only for a total analysis of economic phenomena in general and for social philosophy statics is not applicable (Schumpeter 1912, 511).

Specifically, Schumpeter discussed four pairs as the interpretations of statics-dynamics dualism.⁵ First, two theoretical apparatuses: static theory and dynamic theory. Secondly, two real processes: circular flow and steady growth, the tendency toward equilibrium, and the adaptation to innovation, on the one hand, and a change in the circular flow and in the growth process, the deviation from equilibrium, and endogenous and discontinuous innovation, on the other. Thirdly, two periods in economic life: the depression period, when the liquidation and reorganization of an economic system takes place, and the boom period, when there is a deviation from an existing economic pattern. Fourthly, two types of individual: mere manager and entrepreneur, or more generally speaking, ordinary man and leader; to put it in terms of the motives of human conduct, the satisfaction of hedonistic wants and the pursuit of excellence, creation, and victory. Two different theoretical apparatuses are to explain three pairs of different facts.

Schumpeter's distinction between static circular flow (and steady growth) and dynamic economic development has incurred the criticism that his approach suffers from dualism or dichotomy.⁶ It is not necessarily open to criticism to say that different methods should be devoted to different problems. The point of the criticism would be that the relations between statics and dynamics are not sufficiently clarified in terms of problems and methods.

We claim that the theorizing of statics-dynamics relations would involve an important link between science and ideology in Schumpeter. Such double theorizing primarily determines the image of the objects to be grasped by science and then the structure of science. It is ideology in Schumpeter's sense that governs the process preceding a scientific analysis.

In the following we shall point out that the relation between statics and dynamics is not a simple dichotomy but a structure. The structure of statics-dynamics dualism will be examined in terms of three observations in the rest of this section.

2. Equilibrium theory as Magma Charta

First of all, it is noteworthy that Schumpeter states that the proof of equilibrium is the Magna Charta of economic theory as an autonomous

science (1939, vol. 1, 41). In neoclassical economic theory, given some exogenous data, the prices and quantities of various goods and factors of production—i.e., the pattern of resource allocation—are uniquely and interdependently determined. Schumpeter observed that if in a certain area of social life a state of equilibrium can be determined corresponding to exogenous data, the area in question is logically so self-sufficient that one can legitimately assume an autonomous and independent science for that area. The subject matter of an area can be taken to be a cosmos and not a chaos only if a unique equilibrium can be proved for a given situation. The subject matter of equilibrium economics is an orderly world in this sense.⁷

Then, Schumpeter's view that, although static phenomena have an equilibrium, dynamic ones have not, offers an important key to an understanding of statics-dynamics dualism. He wrote:

It follows from our entire thought that *a dynamic equilibrium does not exist*. Development in its ultimate nature disturbs an existing static equilibrium and does not have a tendency to return to a previous or any other equilibrium. Development alters the data of a static economy... Development and equilibrium are opposite phenomena excluding each other. Not that a static economy is characterized by a static equilibrium and a dynamic economy by a dynamic equilibrium; on the contrary, equilibrium exists only in a static economy. *Economic equilibrium is essentially a static equilibrium* (Schumpeter 1912, 489; italics added).

The notion of equilibrium growth or dynamic equilibrium, much discussed in the post-Keynesian growth theory, should belong to statics according to Schumpeter because an equilibrium growth is proved under some exogenously given conditions such as growth of labor, capital, and technical progress. Innovation, which is a disturbance of equilibrium by definition, is not amenable to equilibrium analysis. If there is no equilibrium in the sphere of innovation and economic development as such, it follows from Schumpeter's reasoning that economic development cannot be regarded as the object of science unless it is somehow linked with a mechanism of equilibrium and order. Indeed an investigation of economic development expands the scope of economics in comparison with static theory; the new sphere includes a basically different type of man (entrepreneur) and a new type of activity (innovation). This new sphere, however, cannot stand by itself; static theory is indispensable to theory of economic development.

Innovation means changes in the data, and statics can only deal with its effects on an economy in terms of the equilibrating mechanism, which will work so as to adapt the economy to innovation or to absorb innovation into the economy. As seen as the *objects* of inquiry, statics and dynamics are two separate phenomena, but as seen as the *method* of inquiry, they are not independent; it is statics that makes economics, including theory of economic development, possible as an autonomous science. Dynamics can add new propositions about economic development only with the aid of statics.

Schumpeter, therefore, does not have the dual methods of statics and dynamics; he has only the method of statics, i.e., equilibrium analysis, although he has the dual phenomena of static and dynamic economies.

It is Léon Walras who first established equilibrium analysis in economics. Schumpeter all along regarded Walras as the greatest theoretical economist. In the preface to the Japanese edition of *Entwicklung*, Schumpeter writes:

To Walras we owe a concept of the economic system and a theoretical apparatus which for the first time in the history of our science effectively embraced the pure logic of the interdependence between economic quantities (Schumpeter [1937] 1951c, 159).

Schumpeter discusses in greater detail the reasons why equilibrium analysis is essential to the understanding of an economy. His discussion is summarized in the following points (1939, vol. 1, 69–70). (1) However abstract the equilibrium theory may be, it gives “the bare bones of the economic logic.” (2) The equilibrium theory gives the description of a response apparatus of an economic system to changes in the data, whether exogenous or endogenous. (3) The concept of equilibrium is indispensable as the standard of reference, whether for an analytical or diagnostic purpose. (4) The most important relevance of the equilibrium concept depends on the possibility of a tendency toward equilibrium in the real world. While points (1)–(3) relate to the significance of the equilibrium theory as an analytical tool, point (4) is concerned with the equilibrating capacity of the real world and must be distinguished from (1)–(3).

3. Walras as ideology

Secondly, let me move to Schumpeter’s outlook on the real world. His view on the methods of analysis mentioned above is reflected in the view on the objects of analysis through point (4), i.e., the relevance of the equilibrium concept to the real world. In his masterpiece on statics *Das Wesen und der Hauptinhalt*, he described statics not as a discussion in a vacuum but as the statement of a universal existence. He wrote:

Our system [the static theory]... covers a great deal of facts and has closer relations with reality than an opponent of the theory seems to believe ... The opponent of the theory overlooks only too easily that the facts which conform to its scheme are quite extraordinary in number (Schumpeter 1908, 564).

In his empirical analysis of the business cycles, he stresses the fact that the capitalist economy, while embodying within itself factors of disturbance, is self-adjusting by the device of boom and depression:

What matters to us is precisely the presence or absence of an actual tendency in the system to move toward a state of equilibrium: if this concept is to be useful as a tool of business-cycle analysis, the economic system must strive to reestablish equilibrium whenever it has been disturbed or, ... it must tend to move, in reaction to every disturbance, *in such a way as to absorb the change* ... Common sense tells us that this mechanism for establishing or reestablishing equilibrium is not a *figment* devised as an exercise in the pure logic of economics but actually operative in the *reality* around us (1939, vol. 1, 47; first italics original, second and third italics added).

In contrast to speculating on the logic of static equilibrium analysis merely in the world of ideas, it is essentially ideology (in Schumpeter's sense) that will mold the image of reality and presume the existence of a tendency toward equilibrium. Schumpeter learnt this ideology from Walras; we call it Walras's ideology *W* in Schumpeter.

4. Theory of innovation as protective belt

Thirdly, having considered Schumpeter's emphasis on the static theory, we have to ask what the significance of his dynamic theory is. We raise an objection to the general understanding of Schumpeter that he simply rejected the traditional static theory and established a dynamic theory in order to explain dynamic phenomena, which are not covered by statics. Such an understanding might have been simply misled by his dramatic stress that capitalism is by its nature a process of constant change.

Moreover, it is most often asserted that Schumpeter introduced the process of circular flow into the theory of economic development only for the purpose of making the process of dynamic change conspicuous in contrast to stationary conditions, or for the purpose of making a useful mental experiment by asking what a capitalist economy would be like if the dynamic changes were absent.⁸ Samuelson in the same vein called the exposition of the circular flow in the first chapter of *Entwicklung* a "parable" (Samuelson 1943, 61). But such an appraisal, too, overlooks the methodological reason why dynamic theory requires the device of equilibrium theory.

Stolper's view varies from the ordinary ones: he is quite right in emphasizing that understanding the nature and role of equilibrium is as central a part of understanding Schumpeter's approach to economic development as is the nature and role of innovation; specifically he does justice to Schumpeter's view that the adaptive forces of an economy toward equilibrium are very strong (Stolper 1982, 30–33). But Stolper seems to go astray toward stressing the destructive power of innovation, which is required for the economy to get rid of an equilibrium.

For Schumpeter, both equilibrium and disequilibrium are important parts of reality and located in the business cycle. Paradoxically speaking, because

Schumpeter believed in the inherent stability and thus the order-conferring capacity of the capitalist economy, he could exaggerate the dynamic phenomenon, the destruction of the existing equilibrium, and the aberration from the existing order of the economy. Whatever destructive forces may emerge in the economy, the market can be relied on to adapt to them and absorb their effects to establish a new order. This is Schumpeter's notion of economic order, and economics as an autonomous science is guaranteed on this basis.

Let us summarize the relationship between statics and dynamics in Schumpeter from the methodological point of view. The Walrasian static theory gave Schumpeter the basic ideology *W* that takes reality as an orderly system. We can regard the static theory as a "hard core" in Lakatos's sense, which is maintained by those who, like Schumpeter, accept neoclassical economics as a grand "scientific research program." Schumpeter's theory of economic development can be interpreted as a "protective belt" around this core, because his dynamics is properly conceived as an auxiliary hypothesis added to the Walrasian statics. Far from denying the static theory, Schumpeter's theory of economic development, which we now call *W'*, stands on it and carries the function of forbidding criticism against it. Moreover, statics and dynamics should not be treated separately like two watertight compartments; they are complementary to each other as a "hard core" and a "protective belt" and have different functions, i.e., the negative heuristic and the positive heuristic. This is our interpretation of the statics-dynamics dualism.

5. Some drawbacks

Schumpeter's dynamics interpreted as the "protective belt" around the general hypothesis of statics is not free from drawbacks. In his view, innovation is historically individual and disorderly; economic development brought about by innovation is not an organic unity, so that the task of theorizing innovation and economic development is extremely difficult. Furthermore, the logic of economic analysis he was convinced of was the Walrasian general equilibrium theory. Under these restrictions, Schumpeter struggled hard to develop a theoretical apparatus of dynamics after he had grasped the crucial importance of innovation in economic development. His theorizing suffered from two drawbacks.

First, although Schumpeter paid special attention to innovation as the cause of economic development, it was the phenomena accompanying innovation that he actually engaged himself in theorizing; he failed to provide an analysis of the manner in which innovation takes place on the historical scene. His *Entwicklung* was criticized for neglecting all historical factors of change except entrepreneurial innovation in general. To this criticism he rightly replied:

My representation is not at all concerned with the *factors* of change, but with the methods by which these work, with the *mechanism* of change. Even the “entrepreneur” is here not a factor of change but merely the bearer of the mechanism of change (1926a, 93; italics original).⁹

He always emphasizes that innovation is an endogenous factor responsible for changes in the data. Actually, however, he does not analyze innovation in detail, but only describes various phenomena accompanying innovation, e.g., business cycle. Although one may say that innovation is endogenous in the sense that it is carried out by the entrepreneur, it is no less than an exogenous factor in the sense that it is an ultimate factor not susceptible to further analysis.

Secondly, another drawback is that Schumpeter failed to provide a manageable model of economic development. This is due to his belief that economic development is not an organic unity, and has also something to do with his hostility against Keynesian macroeconomic analysis. For he believed that innovation occurs in limited industrial sectors and thus economic development is in essence a microeconomic process:

Since this relation [between saving, investment, and the rate of interest] is the net result of the interaction of all the variables of the system, it can be expressed only in terms of the Walrasian apparatus. From the attempt to do so by means of two independent single-value functions of the rate of interest nothing but caricature can result (Schumpeter 1939, vol. 1, 78).

It is, therefore, misleading to reason on aggregative equilibrium as if it displayed the factors which initiate change and as if disturbance in the economic system as a whole could arise only from those aggregates. Such reasoning is at the bottom of much faulty analysis of business cycles. It keeps analysis on the surface of things and prevents it from penetrating into the industrial processes below, which are what really matters (1939, vol. 1, 43–44).

In order to develop fully his original vision of economic development his theory should have satisfied three requirements: first, it must be a monetary theory of production which takes into account the impact of bank credit on the structure of a real economy; secondly, it must have a framework of interindustry analysis which deals with the impulse of leading industries; and thirdly, it must explain the trend and cycles of economic activity simultaneously. The goal was too ambitious and he could not work out such a theoretical model.

What actually characterizes Schumpeter's development theory is rather a sociological description of the motive and type of an entrepreneur as the bearer of innovation, on the one hand, and an impressionistic description of the business cycles caused by innovation, on the other. Although the latter description in *Entwicklung* is usually taken as the presentation of a dynamic

process, the fact is that it does no more than indicate a series of causes and effects such as innovation, credit creation, forced saving, entrepreneurial profit, entry of competitors, overproduction, and depression.

Schumpeter's *Business Cycles* (1939), a theoretical, historical, and statistical analysis of the capitalist process, was not successful as Kuznets adequately evaluated (Kuznets 1940). While Schumpeter's primary concepts such as entrepreneur, innovation, and equilibrium were extended to explain in an impressionistic way the above-mentioned series of events, he failed to forge the necessary links between the primary factors and the statistical observations of business cycles. These links should have been given by a theoretical model that involves interindustry relations, monetary disturbances, and the three-cycle schema (the cycles of Kondratieff, Juglar, and Kitchin).

Schumpeter's observations of economic process, imperfect as they are in themselves, cover only a half of his perspective. Another half, a historical socio-cultural picture, consisting also of a "hard core" and a "protective belt," must be jointed to it. We now proceed to this.

IV. Economic Development and Socio-Cultural Development

1. Limits of *Theory of Economic Development*

Starting from *Das Wesen und der Hauptinhalt*, which is a recapitulation of economic statics, Schumpeter explored the area of economic dynamics in *Entwicklung* and *Business Cycles*. In view of his program of social scientific research, however, theory of economic development only marked a halfway position toward the goal. *Capitalism, Socialism and Democracy* (1942) established as the object of inquiry a wider area including politics, society, and culture as well as economy and discussed the historical evolution of the capitalist system in terms of the interrelations between economic and noneconomic areas. This wider perspective gave Schumpeter an opportunity for completing a more satisfactory theory of evolution. In this sense, the theory of economic development in *Entwicklung* and *Business Cycles* might be called a halfway house between *Das Wesen* and *Capitalism*.

In *Entwicklung* Schumpeter already realized that his approach was preliminary. The overall perspective of social life was fully described in the last chapter (Chapter 7) of the first edition of *Entwicklung*. This chapter entitled "The Overall Picture of the Economy" (*Das Gesamtbild der Volkswirtschaft*) consists of 86 pages and is extremely important in understanding Schumpeter's overall research program; unfortunately it was omitted in the later editions and the English translation for a reason which will be soon mentioned. This chapter should be regarded as a theoretical basis of *Capitalism* published 30 years later.

In that chapter he contrasted total or socio-cultural development with economic development. Usually in Germany at that time (under the influence of the Historical School) the overall historical process was equated to

economic development. On the contrary, Schumpeter in *Entwicklung* started from the abstract static theory as the “hard core” of economic theory and tried to construct a theory of economic development as its “protective belt.” His theoretical approach was at first not properly taken; instead people’s concern was mostly digressed to the description in Chapter 7, which he later called “a fragment of the sociology of culture” (1926a, xi). Schumpeter completely eliminated this interesting chapter from the second edition of *Entwicklung* in order to indicate the locus of his own emphasis in that book. Although he certainly hoped to approach the wider area in the future, he temporarily abstained from placing economic development in a wider perspective of socio-cultural development because he virtually intended, as the task of higher priority, to construct a theory of economic development on the basis of static theory.

On the other hand, he was also criticized for neglecting social and historical factors of change. In a passage quoted above, he stressed that in *Entwicklung* he was not concerned with factors of change, but with the mechanism of change; he really meant that in the discussion of development within the economic area innovation could be dealt with only as an ultimate factor of change, i.e., exogenously. Thus in *Entwicklung* he regarded the discussion of changing economic organization and practice as a separate problem, which should be treated appropriately in a wider perspective.

As seen from these evaluations, the theory of economic development in *Entwicklung* was considered as unsatisfactory. In fact Schumpeter’s mind was always ambivalent with regard to pure economic theory and socio-cultural history. Although in *Entwicklung* he called entrepreneurial innovation an endogenous factor that evokes changes in the data from within the economy, this is not exact. It is a limit of his theory of economic development that innovation is as a matter of fact exogenous to economic analysis.

Only in the overall perspective an endogenous explanation of economic development could be available. When Schumpeter limits himself to the economic area, he defines capitalism as a system of economic institutions, i.e., private ownership, motive for private profit, and bank credit. On the other hand, when he takes a broader view, capitalism is conceived as a civilization including also political institutions, the class structure, a way of thinking, value systems, science and art, styles of life, etc. It is presumed that among various areas of social life there are interrelations so as to form a grand general equilibrium. The theory of economic development conceived in the economic area is not sufficient to indicate the historical behavior of the capitalist society as a whole and is therefore no match for Marx’s analysis of capitalism.

An approach to the overall development of capitalism would require two things: first, to estimate the influences of economic development on noneconomic areas, and second, to estimate the reverse influences of noneconomic factors on the emergence of innovation. Schumpeter in *Entwicklung* found innovation as the cause of development in the economic area, but failed to explain what circumstances determine innovation; therefore, innovation remained an exogenous factor to an economic system in spite

of his contrary assertion. Explanation of innovation is made possible in a wider context comprising economic as well as noneconomic areas. A more or less comprehensive discussion of capitalism in such a context is finally provided in *Capitalism*.

2. Marx as ideology

When Schumpeter grappled with the process of change in the capitalist society as a whole with a perspective wider than the economic one, he learnt the ideology of endogenous evolution and self-destruction of capitalism from Marx. It is “a vision of economic evolution as a distinct process generated by the economic system itself” ([1937] 1951c, 160).

According to Marx’s materialistic or economic interpretation of history the forces of social evolution should be found in a conflict between forces and relations of production. Schumpeter appreciated this view as of “first rank importance” and put its essential points into the propositions (1954c, 439): (1) all the cultural manifestations of a society are ultimately functions of its class structure, (2) a society’s class structure is ultimately and chiefly governed by the structure of production, and (3) the social process of production displays an immanent evolution. Schumpeter formulated these propositions so that the Marxian color should be minimized.

Although Schumpeter repeatedly praised Marx’s analysis of social evolution and emphasized the similarity of his own view and purpose with Marx, he denied all the analytical apparatus and historical scenario of Marx. It was only an extremely general view of an immanent evolution and self-destruction of capitalism summed up in proposition (3) that Schumpeter virtually inherited from Marx. This I call Marx’s ideology *M* in Schumpeter. Schumpeter wrote on Marx’s vision:

the grand vision of an immanent evolution of the economic process—that, working *somehow* through accumulation, *somehow* destroys the economy as well as the society of competitive capitalism and *somehow* produces, an untenable social situation that will *somehow* give birth to another type of social organization—remains after the most vigorous criticism has done its worst. It is this fact, and this fact alone, that constitutes Marx’s claim to greatness as an economic analyst (Schumpeter 1954c, 441; italics added).

Schumpeter intended to describe the total process of capitalistic development by a different apparatus and a different scenario but still on the basis of Marx’s ideology. He regarded as non-Marxian all of the “somehow’s” italicized in the above quotation. We call Schumpeter’s theory of socio-cultural development *M'*, which should be consistent with Marx’s ideology *M*; here too, *M'* is to *M* what a “protective belt” is to a “hard core.” How does *M'* differ from the Marxian theory? It is convenient to use Schumpeter’s three propositions as a frame of comparison.

With regard to proposition (1), Schumpeter denied the Marxian causal relation that the superstructure is unilaterally determined by its economic foundation and class structure, and merely admitted the functional relation between them. Rather in his analysis of capitalist evolution, the reverse relation that the superstructure governs the economic process is crucial. Since Marx could discuss changes in the economic system within the orbit of the understructure, any analysis of the superstructure was merely a corollary of the main themes about the understructure. But Schumpeter tended to argue changes in the economic system in terms of the interrelations between the superstructure and the understructure. I would say that the notion of socio-cultural development based on the general interdependence of multifarious areas of social life is Schumpeter's substitute for the Marxian economic interpretation of history.

As for proposition (2), Schumpeter claimed that the class structure is also determined by diverse factors other than economic ones, and particularly paid attention to the dynamic phenomenon that the contents of classes are changing like "a hotel or an omnibus, always full, but always of different people" (1951a, 165). His theory of social classes does not occupy such a pivotal position linking the superstructure with the understructure as Marx's theory. Instead it represents a final summary of social investigation in terms of the general interdependence among different areas.

Let me start from the interesting fact that Schumpeter regards the class phenomenon as one of the areas of social life, described in Chapter 7 of the first edition of *Entwicklung*. In his view of the universal social science, any area of social life can establish itself as the object of an autonomous science by identifying three things: (1) a type of man that is specific to the area, (2) the specification of equilibrium under given data that exogenously define the area, and (3) the identification of the developmental activity that endogenously destroys the existing equilibrium. In the light of these criteria, the phenomenon of social classes indeed involves groups of men, but they are different from those specific types of persons that characterize each area of social life. Persons in the phenomenon of social classes are a total set of persons who work in various areas of activity; as it were, people from different local areas meet together in a hotel or an omnibus.

The social function of class structure is "social leadership" (Schumpeter 1951a, 210) in a general sense. In each area of social activity there is a distinct sort of leadership, i.e., the ability of carrying out innovation, and people are ranked ultimately according to their different aptitudes with respect to leadership. Social classes are the compound results of various kinds of leadership, and a play of leadership brings about changes in social classes.

If a compound of performance in various areas of social life is the class phenomenon, it would not be adequate to explain social classes by the functional categories peculiar to the economic area, particularly by the two categories of labor and capital as Marx did. For Marx the concept of social classes played a pivotal role because in his view social classes are determined

exclusively by the structure of production, and also because in his view the superstructure is a reflection of class structure. Since Schumpeter denies both views of Marx, his theory of social classes does not mediate between the superstructure and the understructure; the class phenomenon is rather an aggregate summary of performance in all areas of social life.

As for proposition (3), Schumpeter accepts only its general vision of the immanent social evolution. The Marxian substance of that proposition was jettisoned because propositions (1) and (2) were denied. Schumpeter carried out such an ingenious recast of Marx's economic interpretation of history by introducing Walras's ideology into a wider perspective of social life. We must now move to this problem.

3. Coordination of Walras and Marx

Schumpeter's *Capitalism* discussed the interrelations between the economic and noneconomic areas of the capitalist society from a long-term point of view and reached the conclusion that capitalism would collapse on account of its economic success. The way of his reasoning is that successful economic development has influences on the noneconomic areas, which produce in turn unfavorable effects on innovation in the economic area. Schumpeter's analysis of social evolution in this perspective is what we called M' . He raised the following factors as unfavorable reactions on the economic area: (1) the obsolescence of entrepreneurial function due to mechanization and routinization of innovation, (2) the disappearance of favorable factors due to the development of rationality, (3) the growth of a critical attitude among intellectuals against capitalism, (4) the decline of private vitality due to government intervention, and (5) the decay of the capitalistic moral values.

In appraising Schumpeter's argument we claim that the method of analysis which he put forward is much more valuable than the conclusion about the future of capitalism which he projected. His method is to inquire into the relationship, i.e., consistency or inconsistency, between the economic and the noneconomic spheres, between the economy and the civilization.

The vision which lies at the basis of this analysis is given partly by Walras's ideology that the capitalist market system is essentially stable, and partly by Marx's ideology that capitalism will break down by its immanent development. The apparent contradiction of these two ideologies is saved by the idea that the very success of the capitalist economy will produce the noneconomic factors that are inconsistent with it; and that these factors will then worsen the economic performance of capitalism. In short, although the economy can work successfully by itself, the impacts of external factors will ultimately spoil it; but taking account of the fact that the reactions of the noneconomic factors were the results of economic development, we can only assume a grand general equilibrium between the economic and the noneconomic spheres.

We have said above that Schumpeter's theory of economic development W' is structured as the "protective belt" to Walras's ideology W (i.e., the belief in

the inherent stability of capitalism), which gives the “hard core” to Schumpeter’s system. We now have Schumpeter’s analysis of historical development M' as another “protective belt” to Marx’s ideology M (i.e., the belief in the self-destruction of capitalism), which gives another “hard core.” How can we interpret the two sets of theories in Schumpeter? For the sake of convenience, let us represent innovation as I , the state of the economic area as E , and the state of the noneconomic area as N .

Therefore,

$$E = F(I)$$

stands for the total process described in *Entwicklung*: the economy will converge, by experiencing the business cycles, on a certain equilibrium state in response to innovation. Then,

$$I = G(N)$$

gives a specification of the effects which the noneconomic factors have on innovation. If innovation can be seen as an institutional factor determining the economic area, this equation properly belongs to economic sociology, where innovation as one of the determinants of economic changes is in turn explained endogenously in a wider context.¹⁰ Combining two functions, we can write

$$E = F[G(N)] = H(N).$$

In the economic area where the function G is unknown, innovation plays an important role as an exogenous factor, but in a wider perspective innovation is after all a factor that can be eliminated by substitution. As far as the economic area is concerned, only important is the mechanism of passive adaptation to the noneconomic factors, and this mechanism is indicated by the function H , the compound of F and G .

On the other hand, the consequences of economic development will affect the noneconomic area, which can be shown as

$$N = J(E).$$

In Marxian terms this function would indicate a theory of the superstructure.

The functions H and J with the variables E and N form a grand general equilibrium that covers the economic and noneconomic areas. Schumpeter did not analyze these functions in detail or comprehensively; the factors (1)–(5), which he mentioned in *Capitalism* and can be interpreted as an analysis of the functions H and J , are not necessarily inclusive. Rather it is important with

respect to his analysis that these functions are of a historical nature and do not have theoretical reversibility.

The essence of the historical scenario in Schumpeter's view on the future of capitalism is an approach to the "socio-cultural development" as a whole, i.e., what might be called the interdependent interpretation of history, which takes the place of the economic interpretation of history. The economic mechanism of capitalism is in itself a good-working machinery, but those who manipulate it are not abstract economic men but are placed in a political, social and cultural context. As long as men with such a style of life undergo a long-term transformation in the epoch of economic abundance, they will become unfit for handling the machinery of capitalism, and it is inevitable for the society to get rid of such an ill-fitting skin.

Methodologically speaking, the coordination between Schumpeter's theory of economic development, on the one hand, and his theory of socio-cultural development, on the other, can be attained by combining two hitherto independent auxiliary hypotheses W' and M' to produce the functions H and J , which specify the interrelations between the economic and noneconomic areas. Symbolically, the coordination can be represented in Figure 1.

Walras's ideology is indicated by the "hard core" W , which is surrounded by its "protective belt" W' , i.e., Schumpeter's theory of economic development. According to his program of social scientific research, this theory was not self-contained. Then, Marx's ideology is indicated by another "hard core" M , which is likewise surrounded by its "protective belt" M' , i.e., Schumpeter's theory of socio-cultural development. These two sets of theories are jointed to form a grand equilibrium system of social analysis. The joint system, we imagine, is constructed in such a way that the two "belts" are not separate but are extended bilaterally, as it were, as "conductive belts" into another system.

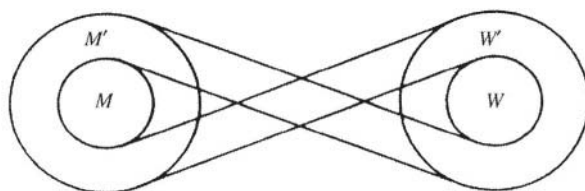


Figure 1. Walras and Marx in Schumpeter's system

V. Concluding Remarks

1. Innovation and ideologies

The concept of innovation plays such a conspicuous role in Schumpeter that the general understanding of his theory is centered on it. Indeed innovation is undoubtedly an obvious phenomenon characterizing the dynamism of capitalism. But attention to this fact does not in itself give any uniqueness to Schumpeter.¹¹ We shall see how the alleged importance of innovation in Schumpeter's scientific system recedes into the background in comparison with the functions of two ideologies *W* and *M*.

For all his apparent emphasis on innovation the framework of Schumpeter's system essentially consists of two general metaphysical propositions that would paradoxically reduce the substantive importance of innovation. The first proposition is that, in spite of the destroying and destabilizing effect of innovation, the capitalist system has a remarkable capacity of adaptation. The second proposition is that, in spite of growth performance of innovation, the capitalist system cannot survive infinitely. These two propositions are not basically different from what we have called Walras's and Marx's ideologies respectively, except that they now include the term innovation explicitly. In each of the two propositions it is claimed that, in spite of the effects of innovation, other forces represented by Walras's and Marx's ideologies will eventually govern the process because after all the auxiliary assumptions must be consistent with the basic ideologies. The elimination of the innovation variable *I* in the above equations seems to mean the same result.

The flamboyance of Schumpeter's emphasis on innovation is largely due to the sociological description of successful leadership; the economic description in his theory of economic development was no more than an explanation of phenomena concomitant with innovation by reference to the adaptive mechanism of the economy. To use a metaphor, Schumpeter acted like a magician performing a conjuring trick, who, in order to distract the attention of the audience from the trick, always attracts their attention deliberately to spectacular pops and gestures and thereby creates a false illusion about where the essential process is.

In the following we shall see two characteristic features of ideologies in Schumpeter: nonempirical and nonpolitical orientation. Both features are in striking contrast to the case of Keynes. We shall also make clear some specific consequences of ideologies on Schumpeter's framework of thought.

2. Nonempiricism

What Schumpeter depended on in drawing a vision of the capitalist economy as a prescientific act were the ideas of two predecessors, Walras and Marx. This is deeply connected with his view of science: he emphasized that the development of science creates, beyond ostensible discontinuity, a unified

picture through “an incessant struggle with creations of our own and our predecessors’ minds” (Schumpeter 1954, 4). Various scientific efforts are tried to search for some fundamental views, which would eventually be found and recur to scientific minds in the long run in the history of ideas. This is Schumpeter’s notion of the “filiation of scientific ideas.”

He regards as given data not only the object of science but also the tool of science, which, once established as an objective existence and thus as a part of social environments surrounding scientists, would not simply be neglected. With a belief in the continuity of great ideas Schumpeter himself showed an example of the inheritance of preconceptions or visions about the economic process from Walras and Marx.

This way of acquiring a preconception is different from the case of Keynes, who entertained a vision from observation of actual facts and broke away from the traditional view. That is to say, Keynes’s vision started from incompatibilities in the actual economy with the traditional view. He came to the perspective that capitalism, if left alone, could not escape from difficulties. As Schumpeter said, this vision of the inherent instability of capitalism was in common with Marx’s and different from Schumpeter’s in that the economic machinery of capitalism is diagnosed as suffering from inherent defects.

In general, the classical economists viewed reality with the preconception of the inherent stability of capitalism, as Schumpeter did with Walras’s ideology. In order to contend the self-destruction of capitalism consistently on the basis of a belief in its inherent stability, Schumpeter recast Marx’s theory, as we have seen, so that he could deduce the decline of capitalism through the unfavorable impacts of noneconomic factors, not through the malfunctions of the capitalistic economic machinery.

The idea of the self-destruction of capitalism in Schumpeter did not originate in the observation of empirical facts such as the Great Depression; it was inferred as a logical consequence of successful capitalistic development. The argument developed in *Capitalism* concerning the decay of capitalism and the march to socialism goes back to his earlier writings such as *Die Krise des Steuerstaates* (1918) and “Sozialistische Möglichkeiten von heute” (1920/21). The crisis of the tax state means a breakdown of a big government in the capitalist economic system. Schumpeter wrote about the future of the tax state, or of the mixed economy, to use the current usage:

If the will of the people demands higher and higher public expenditures, if more and more means are used for purposes for which private individuals have not produced them, if more and more power stands behind this will, and if finally all parts of the people are gripped by entirely new ideas about private property and the forms of life—then the tax state will have run its course and society will have to depend on other motive forces for its economy than self-interest. This limit, and with it the crisis which the tax state could not survive, can certainly be reached. Without doubt, the tax state can collapse ([1918] 1954b, 24).

Furthermore, the 1920/21 paper on socialism already dealt with most of the factors which are mentioned in *Capitalism* as leading to socialism.

His argument on the decay of capitalism is independent of an awareness of economic crisis or a political interest and belongs to the style of thought taken by the stage theory of development in the German Historical School, according to which the stage of socialism would be hypothesized as the successor of capitalism. His interpretation of the Historical School, especially of Gustav Schmoller provided a basic method for coordinating a theoretical model *W*' and a historical model *M*.¹²

3. Nonpolitical orientation

Exclusion of normative discussion constitutes Schumpeter's scientific work. We shall explore this characteristic with reference to his ideology. The important distinctions between Schumpeter and Keynes have also bearing on this respect. In the 1920s and the 1930s both were engaged in the studies of economic fluctuations but with different perspectives.

Schumpeter distinguished between economic theory as science and economic policy as practice and asserted: "no science thrives ... in the atmosphere of direct practical aim, and even practical results are but the by-products of disinterested work at the problem for the problem's sake" (Schumpeter [1933] 1951c, 101). Although economics was born out of discussions of practical issues, the progress of economics as science was made possible by an escape from politics and ethics. Schumpeter was convinced of such a view of science from his extensive studies in the history of economics.

When Keynes's *General Theory* was published, Schumpeter did not seem to understand correctly its theoretical points, but he had a keen nose for distinguishing a political orientation in Keynes' theory. In his review of the *General Theory*, Schumpeter regarded Keynes' attempt as offering, in the garb of general scientific truth, policy recommendations which carry meaning only with reference to the practical exigencies of the unique historical situation, and stated:

This sublimates practical issues into scientific ones, divides economists ... according to lines of political preference, produces popular successes at the moment, and reactions after—witness the fate of Ricardian economics—neither of which have anything to do with science (Schumpeter [1936] 1951c, 153–54).

This appraisal anticipated the immediate triumph of the Keynesian economics and the controversy between the Keynesians and the non-Keynesians in our time.

It is a mistake, however, that Schumpeter was not interested in policy issues. He warned economists against indulging in hasty policy discussions without a

fundamental understanding of situations; he did not deny at all applying science to recommendations. He even said:

I am speaking of science which is technique that turns out the results which, together with value judgments or preferences, produce recommendations, either individual ones or systems of them. ([1949] 1951c, 271)

He thought that science, as can be seen in natural science, should be neutral technique that must be applied to whatever objective man may choose. But as we have argued, science is affected by ideology at the prescientific stage; ideology does not appear first at the stage of application of science, but exists already before scientific activity starts, and determines the direction and pattern of science. Keynes's case is a typical example that a policy orientation has essentially affected the ways of model-building. As Schumpeter himself expected, however, in the stage of scientific cognition ideology should be eliminated by the tests of factual observation and logical analysis, although this is an open question in the philosophy of science.

Schumpeter criticized Keynes on two major points. The first criticism is against Keynes's aggregate method. As we have seen, an economic system, according to Schumpeter's preconception, can only be analyzed in terms of general interdependence. From this point of view, Keynes's method is considered as picking up some variables that are directly relevant to practical problems and freezing all others for the sake of simplicity; thus it establishes simple macro relations among selected variables to get desired conclusions.¹³

In Schumpeter's interpretation Keynes's vision was that although investment opportunity declines, saving habits persist so that capitalism will fall into functional disorder. In order to develop this vision theoretically Keynes constructed a model by means of three schedules: the consumption function, the efficiency-of-capital function, and the liquidity-preference function. Schumpeter admired the skill of Keynes: "what a *cordon bleu* to make such a sauce out of such scanty material!" (Schumpeter [1946] 1951b, 281). But this was clearly a touch of irony. His skepticism of macroeconomic analysis was consistent, and he stated about the saving-investment relation that "the saving-investment mechanism, as such, does not produce anything that could qualify for the role of an explanation of crises or depressions" (Schumpeter 1939, vol. 1, 78).

His second criticism is concerned with Keynes's short-term analysis. While Keynes dealt with some aggregate variables, freezing all other factors, what was most intolerable to Schumpeter was Keynes's assumption that methods of production and the quantity and quality of capital equipment are not allowed to change. In Keynes's theory "*all the phenomena incident to the creation and change* in this [industrial] apparatus, that is to say, the phenomena that dominate the capitalist process, are thus excluded from consideration" (Schumpeter [1946] 1951b, 283; italics original).

For Schumpeter the waves of boom and depression are natural in the capitalist economy like the beats of the heart or the ebb and flow of the tide,

and it is silly to let oneself affected by temporary economic fluctuations without realizing the mechanism of capitalist development at work. Unemployment is essentially a temporary phenomenon that characterizes the period of adaptation subsequent to the prosperity phase. Whereas Keynes took this phenomenon seriously and made the vanishing of investment opportunity a vital point of his argument, his explanation of the investment process seemed to Schumpeter entirely unrealistic; Keynes's explanation that the lack of inducement to invest will produce unemployment had no greater practical importance to Schumpeter than a statement that "motor cars cannot run in absence of fuel" (Schumpeter [1936] 1951c, 156).

Schumpeter's criticism does not mean that aggregate and short-term analysis is in itself defective or meaningless. Schumpeter admits that, as far as Keynes's vision is given, his theory is ingeniously and adequately devised: "they [Keynes's conceptual arrangements] fit his purpose as a well-tailored coat fits the customer's body" (Schumpeter [1946] 1951b, 287). It is to this extent that Schumpeter praised Keynes as a brilliant economist.

It is thus clear that Schumpeter's objection to Keynes was based on his own ideology. But the fact that Keynes does not start from the Schumpeterian or Walrasian ideology cannot lead to the conclusion that Keynes's theory suffers from errors, in so far as it is constructed in accordance with scientific procedures. In opposition to Keynes's aggregate and short-term analysis, Schumpeter himself adopts a general equilibrium approach with a long-term perspective. Schumpeter's analysis of "social culture" as a whole is, as it were, an enlarged version of the general equilibrium analysis. The strength and weakness of Schumpeter lies in his view emphasizing the interdependence of all relevant factors. Walrasian general equilibrium of an economy and total socio-cultural development of a society are, for Schumpeter, equally the products of this view. His analysis of capitalism in the enlarged perspective is so extensive as to include policies and ideals as endogenous variables. In this framework, it is logically not possible to derive practical recommendations because all elements in it are endogenously determined. This is the logical reason why Schumpeter averted from policy recommendations. The aversion to policy orientation now stems not so much from his own inclination as from his model that works by itself independently of an initial ideology.

The usual procedure in a policy model is to select the policy or action variables as exogenous to the model in question: for example, Keynes's money supply and Marx's revolution are exogenous variables in this sense. In contrast, in Schumpeter's comprehensive model of socio-cultural development a society is conceived as moving by its own momentum. His model has provided a unique framework for finding the "logic of things" in the total or socio-cultural development of capitalism, i.e., a framework for analyzing the coordination between the economy and civilization (social system, style of life, system of values, etc.) of capitalism.

Beside its perspective of general interdependence, another feature of Schumpeter's model is its long-term perspective; this is also a corollary of his ideology that in the long run the capitalist economy is stable. However,

verification or falsification of a theory of socio-cultural development is not easy because under his long-term perspective “a century is a ‘short run’” (Schumpeter 1950, 163). Therefore, one cannot always expect that the underlying ideology will become extinct in the capacity of ideology as far as a long-term theory is concerned. It follows that when Schumpeter in the name of science criticized Keynes for his practical orientation and specifically for his aggregate and short-term analysis, he himself was not free from the ideological bias underlying his own general equilibrium approach with a long-term perspective. His criticism of Keynes cannot be understood apart from his ideology.

As to the scientific contribution of Schumpeter, his framework of analysis is more important than his conclusions reached with regard to the future of capitalism. Whether or not we agree with Schumpeter’s ideologies *W* and *M*, we can take seriously his analytical framework consisting of *W*’ and *M*’, because he has provided us with a framework of thought to cope with the grand problem of interaction between the economy and civilization. Schumpeter’s ideology must be appraised not in itself but as a prescientific act for producing such a framework.

This paper was dedicated to the memory of Professor Tullio Bagioti.

Notes

- 1 Schumpeter ([1946] 1951b, 268), ([1949] 1951c, 267–81), and (1954c, 41–47). Schumpeter’s early writings relating to the history and the methodology of economics do not literally discuss the relation between science and ideology, but reject rather strongly the ideological influences: see Schumpeter (1908, 1914). But as far as the issue of ideology is substantively a major subject matter of the sociology of science, it is already implied in his early discussion of the development of science, which evidently anticipates his later discussion of the filiation of scientific ideas: see Schumpeter (1915), which deals with the history of social science in a broad sense. Chapter 4 of this book is subtitled “Toward the Sociology of Science” (or *Zur Soziologie der Wissenschaft*).
- 2 As to the movements in the philosophy of science and their reflection in the methodology of economics, see Caldwell (1982). Caldwell discusses economists such as Robbins, Hutchison, Machlup, Friedman, and Samuelson as representing different methodological positions. But it is quite curious and unfair that he completely neglects Schumpeter. Schumpeter’s name appears neither in the index nor in the bibliography. This seems to have something to do with the fact that Schumpeter’s methodological inquiry *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* has not been translated into English.
- 3 As far as I know, Mark Blaug provides a similar contention. He cursorily writes: “Lakatos’s ‘hard core’ expresses an idea similar to that conveyed by Schumpeter’s notion of ‘vision’” (Blaug 1976, 157).
- 4 In the realm of analytic work, Schumpeter says, there is a widely accepted standard, so that one can speak of scientific progress between Mill and Samuelson in the same sense in which there has been technological progress in the extraction of teeth between the times of Mill and our own (Schumpeter 1954c, 39). Although Schumpeter does not explicitly define the standard of scientific progress, he seems

to have in mind a criterion concerning “analytic perfection” (*ibid*, 40) within a presupposed paradigm or research program.

- 5 Of these pairs, the second, third and fourth are mentioned in Schumpeter (1912, 512–13), and the first, second and third are in Schumpeter (1926a, 120–122; 1934, 82–83).
- 6 This sort of criticism was initiated by Beckerath (1929).
- 7 This important idea was expressed fully in Chapter 7 of the first edition of *Entwicklung* (1912), but this chapter was omitted in the later editions as well as in the English translation.
- 8 Among many arguments to this effect, the most recent one is made by Elliot (1983).
- 9 I slightly modified the English translation so as to be closer to the original German.
- 10 Schumpeter distinguishes four techniques of economic analysis: history, statistics, theory and economic sociology. While economic theory deals with the behavior of people and its effects, “economic sociology deals with the question how they [people] came to behave as they do” (Schumpeter 1954, 21). In other words, in economic theory actions, motives and properties are given under given social institutions; economic sociology is concerned with the institutional data of economic theory.
- 11 Thus Keynes unreservedly accepted Schumpeter’s explanation of economic fluctuations in terms of entrepreneurial innovation (Keynes [1930] 1971, vol. 2, 85–86). Keynes implied that such a fact is a matter of course; that it would be no creditable theory merely to attribute the dynamism of capitalism to the fluctuations in the marginal efficiency of capital, to use Keynes’s terminology in *General Theory*.
- 12 In this respect Schumpeter’s article on Schmoller (1926b) is important, but it is not possible to discuss it here.
- 13 Schumpeter called this method the “Ricardian Vice” and stressed the similarity between the aims and methods of Keynes and Ricardo (Schumpeter 1954c, 473).

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9. Schumpeter on the Relationship between Economics and Sociology from the Perspective of Doctrinal History

I. Integration of Theory and History: Reasoned History

The leitmotif throughout Schumpeter's academic life was, in his own words, the research program of a "comprehensive sociology."¹ In his early work on the history of thought he predicted the future direction of the social sciences to be their "*Soziologisierung*":

The substance of the new epoch is revealed by the tendency to understand as many things around us as possible—i.e., law, religion, morality, art, politics, economy, even logic and psychology—from sociology. The analysis of cultural phenomena is the lighthouse that the total fleet of different ships on different courses is headed for. And an epoch similar to the eighteenth century is approaching (Schumpeter 1915, 132–33).²

The eighteenth century was dominated by moral science or moral philosophy as the science of man. *Soziologisierung* for a reunification of the social sciences is the basic framework within which to understand Schumpeter's work. In fact, he did not develop a comprehensive sociology, but two sociologies—economic sociology and the sociology of science—that may be regarded as his strategic version of a comprehensive sociology. In this sense I have called the total body of Schumpeter's work a "two-structure approach to mind and society"³ after his discerning characterization of Giambattista Vico's work as "an evolutionary science of mind and society" (Schumpeter 1954b, 137).

In the *History of Economic Analysis* Schumpeter enumerated four basic methods of economics: theory, statistics, history, and economic sociology (1954b, 12). Economic sociology, in contrast to the other three methods, goes beyond mere economic theory in the sense that it deals with institutions that are exogenously given in economic theory. Institutions are dealt with not only by descriptive history but also by economic sociology; the latter is defined as "a sort of generalized or typified or stylized economic history" (*Ibid.*, 20). In other words, economic sociology is the generalization, typification, and stylization of economic history by means of institutional analysis. This is what he often meant by "reasoned history" (Schumpeter 1939, vol. 1, 220) or "*histoire raisonnée*" (Schumpeter 1950, 44; 1954b, 690, 818).

At the outset several points with regard to Schumpeter's background in economic sociology should be noted. First, in his studies on the history of economics Schumpeter considered not only the development of economic statics and dynamics but also that of economic sociology. The analytic elements he wanted to uncover in history were always those of economics and sociology. As the titles of his many articles show, he used both economics and sociology to analyze the overall nature of the problems in question.⁴ Second, Schumpeter's conception of economic sociology intended to integrate history and theory, the antitheses at the *Methodenstreit* between Gustav von Schmoller and Carl Menger. The method of integration was to construct "reasoned history" by means of the concept of institutions. Third, in Schumpeter's view, the source of economic sociology was the German Historical School. He appraised particularly the research program of Schmoller as a prototype of economic sociology and characterized its goal as "a unified sociology or social science as the mentally ('theoretically') worked out universal history" (Schumpeter 1926, 382). Schmoller's program of economic sociology, for Schumpeter, would eventually lead to a comprehensive or unified sociology. It follows that the key to understanding Schumpeter's basic view of *Soziologisierung* is found in Schmoller's research program.

Schumpeter, however, did not accept Schmoller's research program, both in its formal and substantive aspects, as it actually stood. In the formal aspect of the program Schumpeter characterized economic sociology as "a specific discipline that, owing to the nature of its subject matter, is not only a detailed and fact-finding discipline but also a theoretical inquiry" (*Ibid.*, 369–70). He emphasized the need to construct a theory rather than to be content with the mere collection, classification, summarization, and ad hoc explanation of historical data.

Schumpeter was also critical of the substantive aspect of the program. Among several distinct viewpoints of the German Historical School, Schumpeter took seriously two substantive elements: a belief in the unity of social life and a concern for development, a combination of which would explain the evolution of an economy involving interactions with noneconomic spheres.⁵ Instead, he rejected the School's claim that the relativity and individuality of historical experience would preclude general and universal theorizing of society. For him, the greatest significance of the method advocated by the German Historical School was the recognition that historical materials reflect the development phenomenon and indicate the relationship between economic and noneconomic areas, thus suggesting how the disciplines of the social sciences should interact in a historical context, with the economic area remaining the focus of investigation.

This recognition constituted his idea of economic sociology as well as a comprehensive sociology, because whereas economic sociology deals with the interaction between economic and noneconomic areas, a comprehensive sociology is supposed to be a synthesis of interactions between every single area and all others. Therefore, when Schumpeter examined the few existing

overarching systems of thought that had covered various aspects of society, he was interested in the relationship between economics and sociology within these systems.

Although Schumpeter did not explicitly develop a methodological inquiry into the relationship between economics and sociology, he did not hesitate to evaluate grand theories that involved economic sociology, unitary social science, universal social science, and the like, going beyond the boundary of economics. In what follows, I consider his writings on the grand theories in the history of thought in order to reconstruct his views on the method of an interdisciplinary social science. Because my analysis of Schmoller's research program as the prototype of Schumpeter's economic sociology is developed elsewhere (Shionoya 1997, 200–207), I deal here with Schumpeter's views on the work of four major sociologists—Auguste Comte, Karl Marx, Vilfredo Pareto, and Max Weber—with regard to their methodologies of the relationship between economics and sociology. Schumpeter discussed them not only in his 1914 and 1954 studies on the history of economics but also in separate articles on each of them (except Comte).

II. Schumpeter's Conception of Economic Sociology

In delineating Schumpeter's conception of economic sociology, we should examine more deeply the methodological significance of two elements he made much of among the viewpoints of the German Historical School. The perspective of the unity of social phenomena provides, as it were, a *horizontal* axis from which to observe a society that consists of various areas of social life. This perspective does not necessarily provide a dynamic view of society but a static view of interrelated social areas. To provide an accurate understanding of Schumpeter's conception of economic sociology, the horizontal axis must be combined with a *vertical* axis, which represents the viewpoint of the evolution of society. For Schumpeter, it is the observation of the historical process that integrates these two perspectives and makes economic sociology a genuinely evolutionary science. "Reasoned history" should formulate the mechanism for the evolution of society as a whole through the interactions between various areas of society. In this sense Schumpeter's evolutionism differs from the direction of current evolutionary economics, which concentrates on the economic area.

Indeed, Schumpeter's *Theory of Economic Development* provided an analysis of evolution based on entrepreneurial innovation, but it was limited to the economic area and did not address interactions with other aspects of society. As a next step of inquiry, Schumpeter argued in Chapter 7 of the first German edition of the book (although this chapter was omitted after the second edition) that his dynamic economics must be expanded to economic sociology as an evolutionary science by constructing a larger theoretical structure covering the noneconomic areas and by articulating a mechanism for interaction between the economic and noneconomic areas (Shionoya 1997, 32–

43). *Capitalism, Socialism and Democracy*, his most comprehensive work on economic sociology, synthesized his earlier research on social class, imperialism, and the tax state.

Schumpeter was interested in grand theories; among others, he felt an affinity with those of Gustav Schmoller and Karl Marx, although he did not abstain from criticizing them. He praised Marx for integrating history and theory along the line of the German Historical School: "He [Marx] was the first economist of top rank to see and to teach systematically how economic theory may be turned into historical analysis and how the historical narrative may be turned into *histoire raisonnée*" (Schumpeter 1950, 44). Schumpeter added an intriguing footnote to this sentence, arguing that it was not incorrect to say that Marx set the goals of the Historical School.

In terms of the integration of history and theory, Schumpeter metaphorically contrasted the "chemical" with the "mechanical" approach" (*Ibid*, 44). According to him, Marx mixed history with theory *chemically* in the sense that he introduced historical materials into the very argument that produces a theory, whereas most economists who deal with history use historical data *mechanically* to illustrate or verify a theory.

Schumpeter, however, was particularly critical of the "monolithic" view, which explained social phenomena by a single factor, if it was based, as it were, on the chemical combination of history and theory. Thus he rejected a "single hypothesis of the Comte-Buckle-Marx kind," which attempted to attribute the whole process of historical evolution to only one or two factors (Schumpeter 1954b, 811). As indicated below, this label is so broad that it includes both Hegelian intellectualist evolutionism and Marxian historical materialism. In contrast, Schumpeter was more receptive to Schmoller's "pluralistic" approach and labeled his *magnum opus*, *Grundriß der allgemeinen Volkswirtschaftslehre* a "comprehensive mosaic" (Schumpeter 1926, 354). Therefore, in terms of the integration or mixing of the various aspects of society, Schumpeter metaphorically contrasted the Marxian single huge block of stone with the Schmollerian mosaic pattern achieved by cementing together small pieces of stone, glass, etc., of various colors.

In sum, with regard to the attempts to integrate theory and history Schumpeter paid attention to the methodological aspects of economic sociology: horizontal versus vertical, mechanical versus chemical, monolithic versus pluralistic, and individualistic versus holistic. Identification of a grand theory in terms of these aspects will characterize the relationship between economics and sociology.

III. Between Positivism and Idealism

Before delving into the systems of the major sociologists, it is useful to take a look at Schumpeter's intuitive perspective on the German Historical School. In his early speculation of the history of social thought, Schumpeter made an interesting observation about the location of the German Historical School

(Schumpeter 1915, 70–81). Whereas in the seventeenth and eighteenth centuries the Enlightenment in Britain and France brought about the rise of social sciences based on rationalism, positivism, and universalism, historicism was formed in Germany under the influence of idealism as a critique of the Enlightenment. Schumpeter regarded Thomas Carlyle, Auguste Comte, and the German Historical School as a reaction to positivism and the Enlightenment in the social sciences that had occurred in the eighteenth century, and he located the Historical School at the midpoint between Carlyle and Comte. It is worthwhile to reflect on what this configuration means. Schumpeter wrote:

On the one hand, this school, like the Romanticists, reproached barrenness and banality of theoretical analysis, praised the national spirit and the unity of personality, and demanded the revival of philosophical observations. On the other hand, however, this school proclaimed “exact factual research” as its principle, as opposed to “nebulous speculation.” Both directions cannot coexist... Yet, when did a scientific program ever have logical unity? ... This school floated at the same time both in the stream of reaction of philosophical volition against analysis and in the stream of reaction of positivism against philosophy (Schumpeter 1915, 75–76).

Carlyle, who was influenced by German idealism and Romanticism, opposed the Enlightenment and utilitarianism. It may sound strange to regard Comte as a reactionary against positivism and the Enlightenment, because he was the originator of the words “positivism” and “sociology.” But he represented the current of social thought that pursued synthesis in opposition to analysis. In fact, his intellectual activity started with a farewell to the eighteenth century.

Locating the German Historical School between Carlyle and Comte illustrates its dualism. On the one hand, the Historical School, like the Romanticists, criticized the methods of isolation and abstraction in theoretical analysis as unrealistic and sterile. On the other hand, like positivists, it attacked the ambiguous and empty philosophical speculations of idealists. The Historical School could maintain this dualism because it was endowed with both the capability to grasp unified social phenomena and the inveterate propensity for empirical observation. Its historical approach had given the School this unique endowment.

These three perspectives equally regarded history as crucially important, but differences exist between them with regard to the formulation of history and characterize their distinctions. Hero worship of Carlyle constructed history as biographies of individuals. Schumpeter referred to the remark of his teacher, Friedrich von Wieser, that “sociology is history without names” (Schumpeter 1954b, 786). This is quite telling in polarizing Carlyle and Comte. Between them, historicism placed emphasis on collecting historical materials that would serve the source of inductive generalization. Thus we see here a spectrum with the degree of theoretical abstraction of history rising from Romanticism (Carlyle) to historicism (German Historical School) to sociology (Comte).

It is important to recognize that all three, in their own views, are located outside the boundary of natural scientific positivism, which believes in universal laws. When Schumpeter argued that the Schmoller school was not Comtist at all, he incidentally mentioned: "as regards the economists who faced each other in the Battle of Methods, Menger, the theorist, was much more Comtist than was Schmoller, the historian" (Schumpeter 1954b, 418). The Classical School of economics was an outgrowth of moral science to which Newtonian natural philosophy had been applied and had nothing to do with the Carlyle-German Historical School-Comte spectrum. As Schumpeter's attempt to cultivate useful contacts within the Historical School signified, as it were, a big leap from the positivist camp to the idealist one, he might be compared to Dr. Faust selling his soul to the devil in exchange for knowledge and power. The task of integrating theory and history implied the uneasy question of how to link the idealistic spectrum with the positivistic one. The strategy of linkage seemed to debunk Comte's pseudo-positivism which opposed the historical approach, to skip the position of Comte on the idealistic spectrum, and to devise a kind of historical approach that was compatible with the theoretical approach on the positivistic spectrum. Economic sociology was expected to meet the requirements Schumpeter imposed on the research program of the German Historical School. If Wieser called sociology "history without names," then Schumpeter called it "reasoned history." We begin our examination of Schumpeter's discourse on the relationship between economics and sociology with Comte, with whom sociology had started and who put more stumbling blocks in the way of theoretical development than the Historical School.

IV. Comte

Auguste Comte was an adventurer who launched into the organic unification of human knowledge in an era when the specialization of knowledge was inevitable. Schumpeter, who must have sympathized with such a project, treated him bitterly (Schumpeter 1915, 73–75; 1954b, 415–18).

Human societies, Comte argued, are fated to go through the theological, the metaphysical, and the positive stages of existence, and positive science develops in the order of complexity: mathematics, astronomy, physics, chemistry, biology, and, finally, sociology. Sociology, which would appear at the last stage of such evolution, was at first called social physics; it meant a science based on historical observation and was regarded as a universal human science at the positive stage. The hierarchy of science was based on the difficulty of observation, and the positive method had not yet been applied to complex social phenomena.

Then, what is the method of social physics? Comte thought that methods differ according to objects; that mathematics or a natural scientific method can be applied to the phenomena for which analytic isolation is possible; that since society is an organism that consists of interactions between parts, social

physics or sociology requires a historical method to grasp society as a whole. There is no independent place for economics in Comte's scientific system, because, he argued, economics depends on the isolation and abstraction of an economy from society as a whole and indulges in useless metaphysical speculation.

British economists at the time reacted strongly to Comte's view. Their criticisms are recorded in the methodological writings of John Stuart Mill (1865), John Cairnes (1873), Alfred Marshall (1885), and John Neville Keynes (1890). Schumpeter in a similar vein argued that Comte's hierarchy of science was nothing more than a metaphysical enterprise in the philosophy of history. Furthermore, he criticized Comte's conception of the positive method: although it started with the recognition of natural and exact science, it denied, as did the German Historical School, the method of abstraction and isolation for social phenomena, and it made generalizations from unanalyzed historical facts. Schumpeter disparaged Comte's methodology as a "comedy of errors" (Schumpeter 1954b, 418). In Comte's framework of science, natural scientific methods, starting with the tool of mathematics, are to be applied in sequence to different areas of research such as astronomy, physics, chemistry, biology, and sociology. Schumpeter wondered why this view of science could not be applied to the science of society, i.e., sociology. Schumpeter's criticism of Comte to this effect is consistent in his early and later writings.

There may have been a prejudice, like the hatred in kinship, in Schumpeter's critique of Comte. Unlike the British opponents of Comte, Schumpeter must have been distressed by a tension between the construction of an exact economic theory and the all-embracing grasp of society. He must have thought it inexcusable to deny the existence of theoretical economics by adopting a wrong method for the social sciences rather than develop an effective method of sociology. Anyway it is not possible for us to find a positive argument concerning the relationship between economics and sociology in Comte, who dissolved economics into sociology. In light of Schumpeter's rhetoric refuting Comte's sociology, his insistence on the autonomy of analytic economics is evident.

V. Marx

Part I of Schumpeter's *Capitalism, Socialism and Democracy* is devoted to an examination of the Marxian doctrine. It describes Karl Marx from four perspectives: as prophet, sociologist, economist, and teacher.

Schumpeter's discussion of "Marx the prophet" deals with the ideological aspect of Marx and reveals Marxism as a religion that presented the goals of life and a guide to them and promised a paradise on the earth. The religious quality of Marxism explained its success. Marxism not only advocated political slogans but also combined them with the positivistic and rationalistic mind. Furthermore, Marxism was an attempt at replacing feelings of the

masses with the alleged logic of social evolution. All in all, the success of Marxism was a combination of religionism, positivism, and historicism.

For just this reason, Marx's devotees found it outrageous to divide his work into pieces. Nevertheless, Schumpeter dared to separate it into "Marx the sociologist," "Marx the economist," and "Marx the teacher" in order to sort out the valuable from the valueless in Marx's entire body of work.

In his assessment of "Marx the sociologist," Schumpeter regarded Marx's sociological system as the historical interpretation of history or historical materialism and appraised it as one of the greatest achievements in sociology. He summarized it in the following moderate propositions: (1) all the cultural manifestations of a society are ultimately functions of its class structure, (2) a society's class structure is ultimately and chiefly governed by the structure of production, and (3) the social process of production displays an immanent evolution (Schumpeter 1954b, 439).

In Marx, the class structure of capital and labor is the axis of production relations; it governs the process of capital accumulation and exploitation of labor in relation to productive forces, on the one hand, and determines the superstructure including social, political, and cultural processes, on the other. In this sense, class structure is an important link between the superstructure and substructure of society, thus forming the monolithic system of economics and sociology in Marx.

Schumpeter criticized Marx's class theory for providing neither historical nor logical explanations because he believed in the success of innovation as the basis of social class formation. Schumpeter noted that arguing the ownership of the means of production as the determinant of social class is as reasonable as defining a soldier as a man who happens to have a gun (Schumpeter 1950, 18).

"Marx the economist" explains the mechanism of the substructure in a capitalist society, given the sociological concept of social class and the superstructure related to it. Schumpeter examined Marx's economic theories, including the labor theory of value, exploitation of labor, accumulation of capital, immiseration of labor, business cycles, etc., and concluded that all were defective in comparison with his own dynamic theory. Nevertheless, he admitted that Marx's economic theory was a truly great achievement:

The grand vision of an immanent evolution of the economic process—that, working somehow through accumulation, somehow destroys the economy as well as the society of competitive capitalism and somehow produces an untenable social situation that will somehow give birth to another type of social organization—remains after the most vigorous criticism has done its worst. It is this fact, and this fact alone, that constitutes Marx's claim to greatness as an economic analyst (Schumpeter 1954b, 441).

This remark indicates that Schumpeter did not accept any single economic theory of Marx but rather the total framework linking economics to sociology, although how to link them is the real problem.

By “Marx the teacher” Schumpeter meant Marx’s vision of structuring thought for an entire society. Its basic structure was the unity of economics and sociology in the sense that major concepts and propositions are both economic and sociological. Then it follows that:

The ghostly concepts of economic theory begin to breathe. The bloodless theorem descends into *agmen, pulverem et clamorem*; without losing its logical quality, it is no longer a mere proposition about the logical properties of a system of abstractions; it is the stroke of a brush that is painting the wild jumble of social life. Such analysis conveys not only richer meaning of what all economic analysis describes but it embraces a much broader field ... everything is covered by a single explanatory schema (Schumpeter 1950, 45–46).

In Marx’s synthesis every factor is placed on the same analytic plane, and history, institutions, and politics—which are all outside the economy—are treated not as givens but as variables. In other words, Schumpeter explains Marx’s vision of a universal social science as follows: “It is an essential feature of the Marxist system that it treats the social process as an (analytically) indivisible whole and uses only one conceptual schema in all its parts” (Schumpeter [1949] 1951b, 286). However, Schumpeter opposed Marx’s method of synthesis. Because in Marx’s system economics and sociology are one and are regulated by a single idea, there cannot be different *modi operandi* in economy and society or in the substructure and the superstructure, so that everything is reduced to the tedious theory of class conflict. “A valuable economic theorem may by its sociological metamorphosis pick up error instead of richer meaning and vice versa. Thus, synthesis in general and synthesis on Marxian line in particular might easily issue in both worse economics and worse sociology” (Schumpeter 1950, 46).

Schumpeter argued that cross-fertilization is likely to lead to cross-sterilization. With economics being self-limited, sociological aspects will rather stand out sharply in relief. In Marx’s monolithic system of thought, no matter how all-encompassing it may be, sociological aspects are passively determined by production relations and lose their causal importance and independent roles. Schumpeter, the horseman, used a unique analogy in criticizing Marx’s superstructure and substructure relationship: “all the rest of social life—the social, political, legal structure, all the beliefs, arts, habits, and schemes of values—is not less clearly conceived of as deriving from that one prime mover—it is but steam that rises from the galloping horse” (Schumpeter [1949] 1951b, 287). Steam disappears in the air and does not affect the horse at all. If so, economists need not study mere epiphenomena lacking any vestige of autonomy.

VI. Pareto

Vilfredo Pareto (1935) expanded the concept of general equilibrium in economics to that of “social equilibrium” in a broad sense. His sociology deals with the interdependence between various elements in society as a whole and includes economics as a kind of science of interest. Distinguishing between logical and non-logical human actions, Pareto identified instincts and emotions as the determinants of non-logical actions and called them “residues.” Residues are obtained through inductive research of reality. However, a justificatory inference to explain why non-logical actions take place is derived by logical and pseudo-logical deduction from a number of residues; Pareto called the result of this process “derivations” or ideology. Thus he characterized his method as logico-experimental.

On the other hand, Pareto defined logical action in terms of subjective and objective consistency between ends and means. In his view, interest as the central concept of economics is not limited to the economic area but typically governs logical actions in various social areas. But for Pareto, far more important types of actions in society are non-logical, although they are not illogical in the sense that they cannot be explained. The essence of Pareto’s sociology is the analysis of complex social relations consisting of non-logical actions in terms of “residues” and “derivations,” or the elements of sentiments and the logic and rhetoric of justification.

At the same time, Pareto developed a theory of social class focusing on the rise and fall of elite classes that stems from conflicting types of residues in society. From the perspective of a social class theory, the social equilibrium represents a morphological balance between different groups, and a change in the composition of social classes means a shift in the social equilibrium. Therefore, in his sociological investigations, the four major determinants of social equilibrium are residues, derivations, interests, and social classes.

How can the visions of Pareto and Schumpeter with regard to the construction of a universal social science be compared? Specifically, how can the relationships between economics and sociology propounded by the two authors be compared? Both have several points in common: a social equilibrium based on general interdependence, a distinction between logical and non-logical actions, a difference between the elite and the masses, and the circulation of the elite.

However, their methods of the construction of social science are different. First, in Pareto’s comprehensive sociology, economics or the science of logical action is a small subsystem to be embedded in the major framework of the analysis of non-logical action, because whereas economics only explains a theoretical equilibrium, sociology gives a concrete equilibrium of society. In other words, economics has developed an abstract theory not directly applicable to concrete social phenomena without synthesis with sociological elements. In contrast, the object of Schumpeter’s universal social science is divided into economic and noneconomic areas. These areas are not based on the logical-nonlogical distinction nor on the sub-super distinction; rather, each

area is characterized by the statics-dynamics distinction. Schumpeter treated the dynamic interactions of a social system not on Walrasian general social equilibrium but on the Marxian dichotomy between the superstructure and substructure of society.

Second, Pareto did not address theoretically as well as empirically the concrete relationship between the economic and noneconomic areas, nor did he clarify the place of social class theory within the framework of a comprehensive sociology. His theory of elite circulation remained an abstract idea based on the conflict between innovative and conservative residues. Schumpeter integrated the two areas on a sociological dimension, and his concept of social classes played the role of integrating various areas of social life. Because social classes in Schumpeter's theory had a historical dimension, he could write a scenario of the failing capitalist system on the basis of the ideological gap between entrepreneur and bourgeoisie. Pareto, in contrast, made a general study of human society, whose universal nature has been historically repeated.

In view of Schumpeter's "two-structure approach to mind and society," it is remarkable that Pareto's *Trattato di Sociologia generale* was actually called *The Mind and Society* in the English translation (Pareto 1935). In terms of the three corners of Pareto's famous triangle relating to residues (*A*), actions (*B*), and derivations (*C*), the relationship between *A* and *C* belongs to the world of the mind, whereas *B* considers the world of society. For Pareto, social equilibrium depended on the interaction between mind and society, which was addressed by a sociology of knowledge and a sociology of class circulation. It is in this sense that Schumpeter found two different analytic frames in Pareto's sociology: social psychology and social morphology (Schumpeter 1951a, 136–41). The frame of social psychology deals with the function and structure of "derivations" or ideology, whereas that of social morphology focuses on the dynamics of social classes. Pareto's two frames can be compared to Marx's superstructure and substructure of society. From this perspective Schumpeter observed that if Pareto had explained the derivation process in terms of class interests, and if he had defined class interests in terms of class status in the production system of society, then the theories of Pareto and Marx would have been similar.

In fact, however, Pareto interpreted the psychology of instincts and sentiments as abstract residues and was concerned only with the nature and function of theory or ideology derived from them. As a result, his analysis of the ideology of the elite was disconnected from social dynamics, which should have been developed within the morphological frame. In terms of Schumpeter's approach, his comment on Pareto means that there was no link between the morphological and psychological frames. It followed, according to Schumpeter's final remark, that Pareto's sociology was not of the first rank.

VII. Weber

As Weber's contributions to the methodology of science and the wide range of sociology are regarded as a partial solution to the problems raised in the *Methodenstreit*, it is illuminating to compare his work with Schumpeter's. Apropos of the methodology of science, Weber's "ideal type" is similar to Schumpeter's instrumentalism, although the philosophical sources of their thought—Weber's neo-Kantian origins versus Schumpeter's Machian origins—were different (Shionoya 1997, 207–22). With regard to their work in substantive fields, Weber's sociological approach is comparable to Schumpeter's economic sociology. Both are viewed as an attempt to integrate theory and history, based on their scientific methodologies, within the broader concept of *Sozialökonomik* consisting of theory, history, and economic sociology, although Weber's approach extended beyond the economy, to law, politics, religion, etc. As far as Weber's economic sociology is concerned, Schumpeter was right in identifying it with an analysis of economic institutions (Schumpeter 1954b, 819).

Our problem here is to determine Schumpeter's view of Weber concerning the relationship between economics and sociology. In an essay on his death, Schumpeter paid the highest tribute to Weber's work (Schumpeter 1920). But he consistently viewed Weber as a sociologist who was only indirectly and secondarily concerned with economic theory. In fact, according to Weber, the agenda of *Sozialökonomik* was to start with the general aspects of an economic phenomenon, then to go to the concrete historical facts, and finally to ascertain its cultural significance. The last stage of the agenda has much to do with the task of economic sociology. In Weber's economic sociology, economic activity is seen from a sociological perspective that focuses on the understanding of its meaning through application of the so-called interpretive sociology. This attempt produced a series of sociological categories that differed from economic ones. In this sense, Weber's economic sociology is not a monolithic construct of the "Comte-Buckle-Marx kind," which does not differentiate between economics and sociology.

For Weber, sociology was a universal theory or discipline that could be applied to all areas of social life, and the results of such applications were specific types of sociology: economic sociology, religious sociology, legal sociology, and so on. On the other hand, Weber contrasted sociology with history. According to him, although both sociology and history are all-encompassing descriptions of society, history is concerned with the causal explanation of individual actions, groups, and personalities, whereas sociology tries to formulate type concepts and generalized patterns of the historical process. Sociology is thus a universal as well as a general theory that explains social and historical phenomena.

Schumpeter's criticism of Weber is largely wide of the mark. Apart from his critique of the neo-Kantian flavor in Weber's methodological work, his analysis of Weber's economic sociology focuses on the alleged confusion between a theoretical hypothesis and an explanatory hypothesis in the use of

ideal types when he writes about Weber's "fundamental methodological error" in *The Protestant Ethic and the Spirit of Capitalism*:

This method of (logically) Ideal Types has, of course, its uses, though it inevitably involves distortion of the facts. But, if forgetting the methodological nature of these constructions, we put the "ideal" Feudal Man face to face with the "ideal" Capitalist Man, transition from the one to the other will present a problem that has, however, no counterpart in the sphere of historical fact. Unfortunately, Max Weber lent the weight of his great authority to a way of thinking that has no other basis than a misuse of the method of Ideal Types (Schumpeter 1954b, 80).

Schumpeter meant that Weber confused ideal types with historical concepts and used them directly for historical description. But it is fair to say that Weber was careful not to confuse ideal type with historical reality (Weber 1949, 106–7). This methodological discussion may throw light on the nature of Schumpeter's famous thesis on the decline of capitalism. For him, the thesis was not historical but a theoretical hypothesis in economic sociology.

Schumpeter did not examine the whole system of Weber's sociological work. Whereas the methodologies of Schumpeter and Weber reveal many similarities, there was a big difference in the substance of their economic sociologies. Weber's sociology was much more concerned with comparative static social systems than with the dynamic process of evolution, or, as it were, with a horizontal axis rather than a vertical axis of society. Weber's analysis of the relationship between economic and noneconomic areas remained static, as exemplified by the conformity between the Protestant ethic and capitalism. This may explain why Schumpeter felt more of an affinity to Marx and Schmoller than to Weber.

VIII. Conclusion

From these observations we can attempt to reconstruct Schumpeter's stance about the relationship between economics and sociology more clearly than from an examination of the little he wrote directly on this topic.

First, Schumpeter believed in the autonomy of economics and opposed the holistic and organic method of Comte, which diffused economics into sociology, the so-called queen of the social sciences. This criticism also applied to Marx, one of the proponents of the "single hypothesis of the Comte-Buckle-Marx kind." From this perspective we are left with what might be called a varying hypothesis of the Pareto-Weber-Schumpeter kind, which admits the coexistence of economics and sociology and allows plural courses of causation between various aspects of society.

Second, for Schumpeter, Marx's monolithic approach to economy and society was separable into economics and sociology by drawing a line between the substructure and superstructure of society, Marx's key concepts in his

economic interpretation of history. Given Marx's unilateral influence of the economic structure on the ideological superstructure, there is no need to inquire into the superstructure whose economic significance is nil. In contrast, Schumpeter transformed Marx's doctrine of historical materialism into economic sociology and focused on the bilateral relationship between economic and noneconomic areas, or between the economic mechanism and the *Zeitgeist*. In particular, the Pareto-Weber-Schumpeter model commonly advocated the influence of mind on society.

Third, both Pareto and Weber put forward a sociological theorizing that was distinct from, but did not replace, an economic theorizing based on the narrow sense of rationality. However, their sociological approaches that can be integrated with economic theory are very different. Pareto's sociology, the study of non-logical actions in terms of human instincts and sentiments, provided an analysis of a social system, to which economics gave an exposition of a subsystem. As seen below, according to Schumpeter the relationship between economics and sociology in Pareto was not so significant that Pareto's sociological system did not explain the evolution of society as a whole.

Weber's sociological method, which mainly addresses rational actions and is applied to all areas of society, consists of three basic concepts: order, organization, and institutionalization (Shionoya 1996, 56–59). Thus, for Weber, economic sociology was an analysis of the institutional structure of the economy that explained its foundations in terms of individual orientation to an order. This thought process can be seen as an extension of Pareto's view on residues to include their influences not only on human actions but also on social institutions. Weber's study of Protestant theology encompassed not merely religious sociology but also economic sociology in that it explained the motivational structure that predisposed individuals to an orientation to work and rational action.

For Schumpeter, the use of the *Zeitgeist* or social psychology to show the impact of institutions on the economy, as illustrated in his thesis of the fall of capitalism, corresponded to Weber's sociological apparatus explaining the rise of the economic ethos in modern capitalism through the rational ethics of ascetic Protestantism. Weber's sociology was a substitute for Marx's one-sided approach to the relationship between economy and society. But it was not so much concerned with social evolution as with comparative social systems, and Marx's apparatus was required for an evolutionary perspective.

From a comparative perspective in the history of thought, Schumpeter's idea of economic sociology emerged out of German historicism and gained a stimulus consciously or unconsciously from Marx and Weber. Schumpeter's analysis of the relationship between economic and noneconomic areas through the concept of social class was clearly an adaptation and a transformation of Marx's historical materialism. On the other hand, when Schumpeter tried to elucidate changes in institutional surroundings and their impact on economic activity, he attached importance to the rationality *Zeitgeist* in Weber's sociological work. In short, Schumpeter's economic sociology was an attempt

to flesh out the two dominant viewpoints of the German Historical School—social unity and development—with Marx’s analytic form and Weber’s analytic content.

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Notes

- 1 In a 1944 interview, Schumpeter called his long-standing research program a “comprehensive sociology” and noted: “All my failures are due to observance of this program and my success to neglect of it: concentration is necessary for success in any field.” *Harvard Crimson*, April 11, 1944.
- 2 This book is an expansion of his lecture on leaving the University of Czernowitz in 1911. It can be argued that Schumpeter’s early studies on economic thought consisted of *Epochen der Dogmen- und Methodengeschichte* ([1914] 1954a) and the 1915 book; the former dealt with economic theory and the latter with the social sciences, including sociology.
- 3 By a two-structure approach to mind and society I mean the three-storied structure of economic statics, economic dynamics, and economic sociology, on the one hand, and that of the philosophy of science, history of science, and sociology of science, on the other. See Shionoya (1997, 260–65).
- 4 E.g., ‘Economics and Sociology of Distribution’ a section title of Schumpeter (1916–17); ‘Economics and Sociology of the Income Tax’ (1929); ‘Economics and Sociology of Capitalism,’ a section title of Schumpeter (1946); and ‘The Communist Manifesto in Sociology and Economics’ (1949).
- 5 Schumpeter summarized six basic viewpoints of the German Historical School: (1) a belief in the unity of social life and the inseparable relationship among its components, (2) a concern for development, (3) an organic and holistic point of view, (4) a recognition of the plurality of human motives, (5) an interest in concrete, individual relationships rather than the general nature of events, and (6) historical relativity. See Schumpeter (1914, 110–13).

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10. Schumpeter's Preface to the Fourth German Edition of *The Theory of Economic Development*

I. Two Cultures?

Under global as well as multicultural conditions, it is one thing to admit that an international scientific community uses a common language such as English (mathematics being also a language) as a means of communication, but it is another to accept that a scientific community deals only with materials expressed by such a language. The former is conventionally desirable, while the latter is essentially undesirable. The gap between the two aspects is usually made up either by translating materials into a common language or by learning other languages relevant to materials. Joseph Alois Schumpeter is an interesting and unfortunate case. The Schumpeter studies are dominated by the use of English in communications as well as in materials. Since not all of his major German writings in the first half of his academic career have been translated into English, it is easy to suppose that there is a gap in a proper understanding of Schumpeter.

In the English-speaking world of economics, Schumpeter's classic work on economic development is taken as *The Theory of Economic Development* (1934), translated by Redvers Opie (*TED* hereafter). Although *TED* is considered as the translation of the second edition (1926) of *Theorie der wirtschaftlichen Entwicklung*, it is correct to call it an abridged translation of the original text. Simply in terms of the volume of text, 369 pages of *Entwicklung* were reduced to 255 pages of *TED*. It is probable that some of Schumpeter's stimulating rhetorical passages were lost in the English translation. Although the translating work was left to the young English man Opie, Schumpeter worked in collaboration with him at Bonn in 1931–32 and the manuscript was finished just before his move to the United States (Allen 1991, vol. 1, 277–78). If the translation was done under his supervision, he must have had the idea that verbal translation was unnecessary or even harmful for the English, particularly American readers. If so, what does it mean?

My inference is that his move to the United States was in a sense a watershed, separating his styles of research, and that this overlapped with the German-English divide. He had already completed his early trilogy, *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908), *Entwicklung* (1912), and *Epochen der Dogmen- und Methodengeschichte* (1914) in the “decade of sacred fertility.” He was also aware of the probability that “the essential elements and the basis of his life work were not

fundamentally changed since he had once developed them,” as he described his teacher Böhm-Bawerk (Schumpeter 1914a, 463). With hindsight, the second half of Schumpeter’s career can be seen as an effort to bring his work in the first half to fruition. The fields of his intellectual efforts were those of the trilogy (the methodology of science, economic dynamics, and the history of science) plus economic sociology. In fact, since he planned to develop each of the early works, he did not consent to the English translation of them at the mid-stage of his academic life. The sequel to *Entwicklung* was *Business Cycles* (1939), the first book of his later trilogy after the blank of 25 years,¹ and for him, *TED* must have been by that time a handy, introductory guidebook for his new project of business cycle analysis. Probably following Schumpeter’s idea, Opie mentioned the transformation of the text in his short Translator’s Note to *TED*: “the book is more than a translation” and aims “to convey the meaning as accurately as possible.”

The present essay addresses, from the two-cultures perspective, a small piece of his German writing published at the peak of his watershed and argues its significance in understanding the relationship between *Entwicklung* and *Business Cycles*. I imagine this is an aspect of Schumpeter in which my teacher Simon Kuznets and my friend Mark Perlman would both be interested.

II. Preface to *Entwicklung*, or prolegomenon to *Business Cycles*

There are several editions of *Entwicklung*, but after 1926, the text of the second edition has been reprinted without any change. Schumpeter wrote prefaces to the first, second, and fourth editions of the German text. The English version *TED* has a new preface by Schumpeter, but does not record any preface to the German editions. It is the preface to the fourth German edition (1935) that I am going to discuss here. This preface, amounting to nine pages (*Entwicklung*, 4th ed., pp. xiii–xxi), is the longest among the three and deserves our attention for several reasons.

Schumpeter left Germany for the United States in 1932. After the move, his work underwent not a little change. His main focus during the Bonn period (1925–32), after his return from politics and banking to academia, was to develop the ideas of *Entwicklung* both theoretically and empirically, and for this purpose he first thoroughly revised the book and published the second edition in 1926.² Then he had two tasks: first, to construct a theory of money to account for the monetary basis of innovation, and second, to analyze business cycles in the process of economic development. For the first task, he could not work out a satisfactory result and finally discarded the project by 1935. For the second, he launched in the summer of 1934 a huge project of empirical research on business cycles, which, after much effort, was to bear fruit in his *Business Cycles* (Allen 1991, vol. 2, 72).

After settling in the United States, he naturally stopped writing in German once for all and published only in English. An exception was his preface to the

fourth edition of *Entwicklung*, published in 1935. Why did he write a long essay in German as a preface to *Entwicklung* as late as in 1935 (exactly at the end of 1934)? The preface was written at the time he started the *Business Cycles* manuscript. The preface was entirely concerned with the new project of empirical business cycle analysis and its relation to his theory of economic development, and should have been regarded as a prolegomenon, heavier than a mere preface, to the forthcoming massive book. My query is whether the preface should have been better addressed to the readers of *TED* or *Business Cycles*. It seems to be a misplaced message from the new world to the old world. Serious readers and even reviewers of *Business Cycles* would not have seen it. Let us see what it is about.

III. Instrumentalism in the Empirical Perspective

Schumpeter's first book, *Wesen*, the book of economic methodology, introduced the idea of instrumentalism (as advanced by Ernst Mach) into economics (Shionoya 1997, Chapter 5).³ Instrumentalism is the view that theories are not descriptions but instruments for deriving useful results (the role of theories) and that they are neither true nor false (the cognitive status of theories). He asserted that fitness to reality is a necessary condition for a theory to be useful. Fitness of theories to reality refers to the ability of theories to describe, organize, and explain a body of phenomena, not the predictive value alone, unlike the contemporary narrow version of instrumentalism.

In *Wesen*, Schumpeter was confined to the abstract methodological argument in the context of static economic theory, but when he came to dynamic theory and the historical and statistical analysis of economic development, he was confronted with a new problem of verification. Schumpeter came up with the idea of writing methodology from the viewpoint of dynamic theory and revealed a plan to publish a book *Theoretischer Apparat der Ökonomie* (or *The Theoretical Apparatus of Economics*) as a sequel to *Wesen* (he did so in this preface). But the plan was never realized. The first part of his preface to the fourth German edition of *Entwicklung* was devoted to new thought on instrumentalism in an empirical perspective.

In launching empirical studies, Schumpeter starts with arguing afresh the standpoint of *Entwicklung* (the following translation is mine):

My theory intends to present a logically unified model of economic change in the present epoch, and insofar as it does, it gives at the same time necessarily an explanation of business cycles and a series of individual phenomena that accompany them. Therefore, an inquiry into the empirical materials of business cycles provides by itself all of what we need beyond the scope of equilibrium problems. And for this reason, these materials and the configurations they indicate are inexhaustible sources of theory. Theory can always draw from them new viewpoints, new problems, and new methods beyond such problems as to how business cycles are to be

explained or what is to be derived from a certain explanation of business cycles. Nevertheless, I might argue about the standpoint of this book as if the verification of existing theories were the goal of statistical and historical research—but I don't take this standpoint (*Entwicklung*, 4th ed., xii–xiv).

He declares that an empirical economic inquiry does not merely aim at verifiable knowledge advocated as meaningful by logical positivists, who maintain that a sentence or a theory is said to be cognitively meaningful if and only if it is in principle empirically verifiable or falsifiable.

Then Schumpeter discusses what is meant by verification from this standpoint:

We must first agree on what we mean by 'verification.' Any judgment of fact that is not analyzed and *elaborated* cannot actually prove the truth or falsity of a theoretical statement. It would not even be true to say that observations of *statistical or historical* facts could show us whether or not a specific theory is consistent with them. For a very real relationship may be so concealed by other factors that we can understand nothing about it *without an analysis that digs deeply* into the situation itself. Therefore only a more modest goal can be attained—namely, to ascertain how the relationships asserted by a theory are *perceptible*, or to put it differently, how much a theory contributes to an understanding of the situation (*op.cit.*, p. xiv).

This clearly indicates that empirical data that would test theory should be theory-laden in that they are constructed from crude facts by means of theory. If this is his view on the role of theory, then the status of theory should be questioned:

What is important to the practice of scientific work is not some sort of 'truth' but methods with which one can operate and—to put it simply—deal with data so that something may emerge corresponding to observed facts. From this viewpoint the words 'true' or 'false' might be used; and only if one is conscious of his commitment to pragmatism, which must naturally offend the philosophically minded, it does not matter (*op.cit.*, p. xv).

If we reflect on these two passages, it is clear that Schumpeter maintains here the basic tenets of instrumentalism. What he calls pragmatism is an American version of instrumentalism: he says here that the truth or falsity of a theory does not matter and that theory is an intellectual instrument for directing our activities when we are dealing with reality. For him, the "modest" goal of theory is an "understanding" of the situation, by which he means that one may use the terms truth or falsity only in the sense of instrumental usefulness as advocated in the pragmatism of William James and John Dewey.

Then, Schumpeter argues, plural criteria will be required on the relationship between theory and data, based on the recognition that available data are chaotic and unreliable due to the influence of contingent disturbing factors:

1. When our theory provides a description that allows quantitative expressions in principle, and when the data required for a test of that description are given, the theory should entail quantitative results that agree with the data.
2. When a theory merely gives a description that does not permit any quantitative expression in principle or because of the limited availability of data, the theory should make us realize that the fact in question is something to be expected by and large on the basis of the theory.
3. When neither is the case, a theory should indicate the concrete circumstances or concrete disturbing causes as well as the direction and exact or approximate extent of their influences, so that one can understand the situation by making appropriate modifications (*op.cit.*, p. xv).

In short, Schumpeter argues, the fitness of theories to facts does not mean an easy prediction in the sense that theories should derive deductively what is equivalent to systematized facts that exist independently, as in the instance in case 1 above. The instrumental roles of a theory are not confined to prediction in this sense but include organization, classification, reconstruction and—through all these efforts—the understanding of otherwise chaotic facts. Schumpeter covers cases 2 and 3, which are not conceived as verified knowledge by the rigid positivist standard but are rather to be promoted as guides and targets of active inquiry. Thus the meaning of verification differs according to the difficulties of organizing data.

After the remarks on the general standpoint and basic criteria on verification, Schumpeter expresses an optimistic view about his contribution in the forthcoming book, *Business Cycles*:

In a book published within a year, I hope I will demonstrate that the theory of this book fulfills all these requirements insofar as the test can be made at all. *Non liquet* arises only because of lack of or unreliability of materials. Where materials speak clearly, they agree with theoretical expectation except for occasional disturbances. In other words, those materials in the form of time series—such as price index and individual prices, quantity index and quantity of individual commodities, income, profits and wages in particular, rate of interest, unemployment, sale proceeds, checking account, insolvency, capital investment, etc.—behave in such a way as they must behave if the theory is correct. Of course, there is enough room for alternative ways of explanation, because time series show only the quantitative contours of a historical process, which can emerge in very different ways under the influences of very different events. If one believes one can manage with time series alone, he overvalues them very much. Rather a historical explanation of time series, i.e., an observation of what

actually happened in economic life year by year—possibly month by month—is necessary not only to see the ‘disturbances from outside’ but also to understand even the normal course and its mirror images in statistical figures. Only by this investigation is it proved that actually working factors are in fact those stated by the theory. In this regard, we have to enter into details, i.e., the course of individual combines, but this is far beyond my ability. But insofar as I could advance, only the confirmation of the theoretical model described by this book has arisen. Certainly this model had to be reconstructed and made more precise in detail; the task of constructing a bridge from the abstract propositions of the model to the complicated course of events has caused many new detailed problems. Particularly, the basic descriptive idea of the model in this book, according to which the first wave of capitalist development arises without disruption from a perfectly balanced equilibrium position and converges on a similar position, must have been transformed into the schema that can grasp the actual situation in which the influences of preceding development are always contained and there is nothing but chronic disequilibrium. Basically, however, all these are less important than I had anticipated. The nexus described in my theoretical model is so strong that it represents historically and statistically all of phenomena that constitute it practically (*op.cit.*, pp. xv–xvi).

Schumpeter’s main points are twofold. First, in the empirical analysis of economic process, theories are heuristic instruments for understanding reality in collaboration with data. Theories and data are not given independently of each other, but change through the interactions between them. Theories are informed with data; data are constructed by theories; and theories are supported by data. Although the relationship between theories and data is usually termed verification, I would prefer to use the term “coordination” if Schumpeter’s instrumentalist view is to be taken seriously. The coordination between theories and data, arrived at through the interaction between them, is not one-dimensional but multi-dimensional, at least three-dimensional, as is defined by his criteria above. Second, whatever the level of the “coordination” between theories and data may be, the theories-statistics relation must be led and supported by historical explanation. His use of historical description intends to go “toward filling the bloodless theoretical schemata and statistical contour lines with live fact and toward making our meaning clearer and more vivid” (Schumpeter 1939, vol. 1, 222). This was also an aspiration of the German Historical School. History and statistics are two different techniques of economic analysis, as Schumpeter later classified them (Schumpeter 1954, 12).

IV. Evaluation of the Coordination: Schumpeter versus Kuznets

In the latter half of the preface, Schumpeter presents his own evaluation of how his theories are “coordinated” with empirical data, referring to each chapter of *Entwicklung*. This suggests in what part of *Entwicklung* he anticipates that difficulties, if any, would lie in verifying the theory by empirical data. He discusses in the order of Chapter 5, 4, 3, 2, 6, and 1:

Chapter 5 (Interest on capital): Theory of interest in Chapter 5 belongs to ‘the most abstract’ part of this book. It attributes interest to the carrying out of new productive combinations, the success of which creates the fund of values; interest flows from it. Of course, this is concerned only with ‘productive interest,’ and again of course, this phenomenon, once it exists, spreads over the *whole* production and *all* economic activities so that we totally lose sight of the ultimate source, as the recent interest study indicates quite enough. Nevertheless, the interest rate moves in the course of business cycles basically as if it were only under the influence of the fundamental factor, i.e., entrepreneurial activity (*op.cit.*, p. xvii).

Chapter 4 (Entrepreneurial profit): Theory of entrepreneurial profit in Chapter 4 has not encountered fundamental objections from the beginning. But people might have expected that the total of profit from innovations of the economic process, described by the theory as the backbone of entrepreneurial income, would dissolve into a mixture of other elements and that this total amount would show movements independent of the pure entrepreneurial profit. Actually the ‘secondary’ profit of all kinds is usually much more important quantitatively. However, an important point, i.e., the context justifying the term ‘secondary’ appears unmistakably, and the historical figures of all production returns that are called entrepreneurial income in the widest sense cannot be different from those when they are only true entrepreneurial profit. Statistical extraction of this primary profit out of, for example, income tax statistics can be done only by the government office that could allocate hundreds of employees to this job, incidentally not a useless work. But, by an analysis of most prosperous particular industries and if possible, of many specific companies and the history of large property, at least much can be achieved (*op.cit.*, p. xvii).

Chapter 3 (Credit and capital): By contrast, because of the incompleteness of available materials it is very difficult to prove the relationship between productive innovation and capital investment, on the one hand, and between capital investment and credit creation, on the other. Similarly, since the statistics of capital formation suffers from all conceivable defects and since it is required to introduce the element of savings, that had been ruled out from the abstract outline, into the theoretical model before the model can fit the reality, only a belief in the correspondence of contours between theoretical expectation and the actual situation is important in the verification of theories of credit and capital in Chapter 3. Relationship between innovations, industrial bank issues, bank credit, checking account,

and what is misleadingly called the 'velocity of circulation of bank balance' is certainly clear in statistical figures and clarified further by an analysis of individual processes. This analysis can clarify especially the time discrepancy and make it at least partially less harmful. In the midst of temporarily unanswerable questions, we are encouraged by the fact that the deeper we penetrate, the better reality corresponds to the theoretical expectation (*op.cit.*, pp. xvii–xviii).

Chapter 2 (The fundamental phenomenon of economic development) and Chapter 6 (The Business cycle): In contrast, economic history of the past 150 years—and more—is the only arsenal of verificational evidence for the basic structure of Chapter 2, for the model of the ways and means in which the economic system changes, and for a piece of the sociology of leadership put into the service of economic analysis, and for the process from which the explanation of business cycles is derived in Chapter 6. To be exact, the waves of *historical* development streams find more and more satisfactory interpretation in the waves of the *theoretical* development model, the longer the waves are. Although it is not always easy to find the innovations that cause a wave lasting about forty months on average, the longest waves so far as we can grasp statistically—Spiethoff's 'cyclical periods' or Kondratieff's 'long waves'—correspond so well to the schema, that proof is almost unnecessary. The first wave is known by the name of 'industrial revolution'; the second, the wave of steam and steel, arose in the 1840s; and the third, the wave of electricity, chemicals, and automobile industries, began in the 1890s and is subsiding in our age—all three are not only clearly marked in our statistical series, but it is also quite clear that these phenomena have relationships with entrepreneurial activity, entrepreneurial profit, disturbance of equilibrium by easily identified new industries, and the downfall and reactionary process of the declining phase. The same applies to the middle wave, which I call Juglar cycle for the reason of scientific fairness. In all cases, as we have said, the explanation more than that of mere business cycles in this book is verified (*op.cit.*, pp. xviii–xix).

Chapter 1 (Circular flow): The model of a stationary economy described in Chapter 1 represents a pure intellectual construction and gives us a conceptually clear starting point, but it has something corresponding to itself in statistical and historical materials. What I mean by it is not self-evidence, that the theory of economic equilibrium, like all pure theories, merely makes the feature of reality logically more precise and that therefore its propositions of the relationship between elements of the system of economic magnitude must have always their 'realistic' complements in the tendencies observed in materials. Instead, I mean something much more direct: indeed we can counter the theoretical model of economic equilibrium with disequilibrium situations of all historical points, but this *actual disequilibrium* is closer to the theoretical equilibrium in a *certain historically ascertainable period or point of historical process* than other periods. To be precise, such a period or point of time does not appear by chance but subject to a law, though not with the same intervals. With a

strictly lawful, and also statistically ascertainable, change, the economic system departs from an equilibrium and returns to another equilibrium, and this is exactly what is demanded by the theory of the carrying out of new combinations (prosperity) and the adaptation of an economic system to changed situations (depression). Between these movements there are points—or perhaps a short period—which I call ‘points in the neighborhood of equilibrium’ in my workshop, and businessmen used to recognize as ‘relative normal.’ Thus actually an equilibrium that is not perfect but is approximately realized, precedes every prosperity, and this is exactly what emerges in the conceptual sharpness of theory and is claimed as facts as well in Chapter 6 (*op.cit.*, pp. xix–xx).

The above is Schumpeter's survey of the problems relating to the verification of *Entwicklung* by chapter. Finally, he concludes with a general remark full of confidence and optimism:

After the period of empirical studies, I can submit my model of economic development again with even greater confidence—i.e., with even greater confidence that the model is constructed correctly in respect to the essential points. Even the progress in theoretical and statistical technique, which has been brought about in the last ten years, does not change this (*op.cit.*, p. xx).

The above quotations represents almost 75 per cent (in translation) of the preface to the fourth German edition of *Entwicklung*. Of the book reviews dealing with the verification aspects of *Business Cycles*, that of Simon Kuznets (1940) is the most scrupulous. Kuznets, though confining himself to limited topics, wrote a destructive critique penetrating into the essence of *Business Cycles*. His evaluation stressed:

that the book does not present a fully articulated and tested business cycle theory; that it does not actually demonstrate the intimate connection between economic evolution and business cycles; that no proper link is established between the theoretical model and statistical procedure; that historical evidence is not used in a fashion that limits sufficiently the area of personal judgment; or that the validity of three types of cycles is not established (Kuznets 1940, 270).

Why is it that the evaluations of *Business Cycles* by Schumpeter and Kuznets are so different? It is not known how Schumpeter responded to Kuznets's critique. Two points are observed. On the one hand, in retrospect, it is fair to say that Kuznets was correct on all points of his criticism. Compared to overall indifference to the book in the whirlwind of the Keynesian Revolution at the time, Kuznets's critique, though destructive, was serious and constructive in indicating ways to improvement. On the other hand, Schumpeter's theoretical hypotheses on innovations and business cycles,

presented mostly in visionary prose, have had stimulating influences on subsequent economic research by Neo-Schumpeterians with a time lag of half a century. How can one make a compromise between the negative and positive evaluation of *Business Cycles*?

V. Concluding Observations

Mark Perlman compares the perception of economics of Schumpeter and Kuznets, ingeniously relying on Kuznets's two essays on Schumpeter: the 1940 review of *Business Cycles* and the 1924 manuscript for the MA thesis titled "Dr. Schumpeter's System Presented and Criticized" (Perlman 2001). Perlman discloses that Kuznets was consistently critical of Schumpeter's approach for more than twenty years, insisting on the importance of statistical observations to test hypotheses and despising theory without measurement, whereas Schumpeter favored the selective filiation and integration of fine ideas. I would like to develop Perlman's argument by submitting Schumpeter's preface in question as a cross-examination against Kuznets's prosecution.

Kuznets, a perfect inductionist, was engaged in statistical estimation and fact-finding all his life. He was never committed to model-building, whether deductive or inductive, but was content with finding and interpreting statistical patterns of reality. Although he believed in the value of theory, for him theory must be fully verified by observations in order for it to be said to explain facts. Since it was hard to find such a theory free from defects, he had to decline any theorizing in his own work as well as in his valuation of other economists' work. To use Schumpeter's criteria of verification, Kuznets's requirement of theory was strictly case 1, i.e., the correspondence of theory to statistical data. If the theory under examination fails to meet this verification test, it is labeled meaningless and is said to be neither true nor false. In contrast, Schumpeter admitted cases 2 and 3 still as legitimate cases of verification and maintained that the theory should cover efforts toward the "coordination" between theory and data, however incomplete it may be at a certain point in time by the logical-positivist standards, because he believed that a science consists in continuous conscious efforts at improving scientific knowledge.

Although sticking fast to the verification principle, Kuznets did not fail to recognize the significance of Schumpeter's insight into economic development and hoped that *Business Cycles* would stimulate further theoretical, historical, and statistical study of business cycles and economic development:

Whatever the shortcomings of the book as an exposition of a systematic and tested theory of business cycles, these shortcomings are relative to a lofty conception of the requirements such theory should meet It is my sincere hope that Professor Schumpeter's labor embodied in the treatise will be repaid by an extensive utilization of it by students in the field, aware though they may be of the tentative character of his conclusions and of the

personal element in some of his comments and evaluation (Kuznets 1940, 271).

"A lofty conception of the requirements" is nothing but the verification principle in the narrowest sense. Even if Kuznets's last passage expressing his "sincere hope" was not mere flattery, it is not consistent with his "lofty conception of the requirements" within the logic of methodological consideration. Kuznets's respect for Schumpeter's insight and vision is uttered outside the methodology. The separation of the methodology of science from the sociology and history of science typically featured the logical-positivist standpoint.

In my view, it is Schumpeter's instrumentalist methodology adapted to empirical research that supported his apparently inadequate use of statistical and historical data to support hypotheses and his apparently inadequate use of theoretical hypotheses to go beyond statistical and historical data. From the viewpoint of instrumentalism or pragmatism, the role of scientific theory is not confined to the static conception of verification on the assumption of available data, but includes creating effective stimuli for the exploration of data and the cultivation of theory. Nor is the role of data confined to the verification of existing theories, but includes providing inexhaustible sources of "new viewpoints, new problems, and new methods" (quoted above from Schumpeter). In view of the recent rise of Neo-Schumpeterian economics, Schumpeter's thought proves sufficiently successful in creating the "filiation of scientific ideas" over time, his key notion in the history of economics (Schumpeter 1954, 6).

As scientific acts consist of the formation of vision and its theoretical formulation, a revolution can take place on either side. The history of economics is partly a history of the attempts to formulate a vision by means of theoretical structures. The combination of vision and theory over time produces continuity in thought, and this is what Schumpeter called the "filiation of scientific ideas." While the "filiation of the scientific ideas" with a focus on the "vision-theory nexus" is one of Schumpeter's propositions in the history of science, the filiation view is supported by the instrumentalist philosophy of science with a focus on the "theory-data nexus." On the other hand, his flexible view on the "theory-data nexus," in turn, is informed by his teleological view of the "vision-theory nexus." Thus, Schumpeter's optimism in the self-evaluation of *Business Cycles* was based on his characteristic view of science consisting of a broad interpretation of both the "vision-theory nexus" and the "theory-data nexus." The cold reception of *Business Cycles* was due to the received methodological view that was so narrow on these two counts, apart from external circumstances that favored Keynes's responses to the most pressing political and economic problems of the time.

This article is written in honor of Professor Mark Perlman on the occasion of his 80th birthday.

Notes

- 1 Schumpeter's later trilogy is *Business Cycles* (1939), *Capitalism, Socialism and Democracy* (1942), and *History of Economic Analysis* (posthumously published in 1954).
- 2 The revision of *Entwicklung* in the second edition created another case of the German-English divide: 548 pages of the first edition were reduced to 369 pages and the seventh chapter of the first edition on the idea of a universal social science was lost. See Shionoya (1990). This gap was recently completely redressed by Ursula Backhaus (2003). See her English translation of the seventh chapter.
- 3 Again, because of the German-English divide, Schumpeter's instrumentalist economic methodology developed in *Wesen* is little known among economists. Instead, Milton Friedman's methodology has been interpreted as instrumentalism, although it is an imperfect system lacking a philosophical analysis. For a comparison between Schumpeter and Friedman, see Shionoya (1997, 108–10).

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11. The Schumpeter Family in Třešť

Schumpeter had a deep interest in biographical studies and wrote a series of such accounts on outstanding contemporary economists. Although in his description of man he excelled at grasping underlying characteristics in an abstract form, he also invariably paid attention to the external events of life distinct from intellectual achievements. In his essay on Keynes, he approvingly remarked that Keynes emphasized ancestral backgrounds in writing biographical sketches.¹ When Schumpeter could not include a biographical description along with the discussion of the work of a particular scholar, he always referred readers to obituaries and biographies of the person in question.

Although a serious biography of Joseph Alois Schumpeter has yet to be written, it is known that he was born at Triesch in Moravia on February 8, 1883, the son of a textile manufacturer. This is all he himself explained in his *Who's Who*, and he made no attempt to explore his family tree. The Schumpeter literature also has not discussed his birthplace and his family in more detail. The usual literature notes that his father died when he was four years old, his mother married a general in the Austro-Hungarian army, and he entered the Theresianum in Vienna, a school for the children of the elite. The latter undoubtedly played a decisive role in bringing him into contact with the elite of society and determining the direction of his thought and inclination, if not the content of his thought. If Schumpeter's mother had not remarried, his life could well have been buried in a nameless village in Moravia. One's family may imprint a stamp upon a person that is hardly erasable. The present essay seeks to add something new to the description of Schumpeter's birthplace and family tree, on the basis of a recent inquiry at Triesch.

I. Třešť

Triesch, the small town in Moravia where Schumpeter was born, belonged to the Austro-Hungarian Empire at the time of his birth. After the breakdown of the Empire at the end of World War I, Bohemia, Moravia and Slovakia formed the independent nation of Czechoslovakia. By superimposing a map of the nineteenth century on a present one, we find that Triesch is now Třešť (pronounced [ˈtrɔʒɛʃtə]) in the Czech Republic.

It is not true, as some claim, that the name Triesch was changed to Třešť with the establishment of Czechoslovakia. The first historical description of Třešť appeared in 1349 when a baron ruled the area. The town was then known as "Triesc." For this reason people in Třešť contend that their town has a history of six hundred years. For a long time the town was called "Triesch" in German and "Třešť" in Czechoslovak. The postmark on mail

from the town before World War I included both names, reflecting the racially complex nature of the Austro-Hungarian Empire. A nineteenth century map showing the name Triesch was a German invention. After Czechoslovakia became independent, the name disappeared.

Třešť, which lies at the basin of the Bohemian-Moravian Highlands, is located 120km southeast of Praha and halfway between Praha and Vienna. It became a town in 1901 and now has a population of 6,700. While it is now an industrial town with several factories, its castle and two churches retain the image of the earlier days.

II. Family

It is rather surprising to learn that the tree of the Schumpeter family has been already surveyed to a certain extent at Třešť. It was not undertaken with regard to our economist Schumpeter, but rather with the manufacturer Schumpeters, whose central role in the town's history could not be neglected.

The Schumpeter family was a rich and prestigious family in Třešť for many generations. The family register in Třešť can be traced back to Jan Šumpetr at the end of the sixteenth century. The family records for early periods are, of course, incomplete, but from that period onward we see the names, professions, and dates and places of birth and death for those who were in a direct line to our Schumpeter, as well as their brothers, sisters, and spouses. Moreover, it is known from documents in the Czech archives that the Schumpeter family first appeared in Třešť when Václav Šumpeter from Mildov and his wife Barbora from Hladov moved to the town in 1523.² Václav's profession is not known. But from the record that Barbora owed a lot of money to Václav and discharged her debt by her own patrimony in the region Piltenberk (or Pöltenberg) in Moravia, consisting of land, castles and other estates in many villages including Hladov, it can be argued that he was a merchant or moneylender. The place of Mildov is not known.

Since the middle of the seventeenth century, those who were in a direct line to our Schumpeter were born, on average, when their fathers were thirty-four years old. On the basis of that fact, we can extrapolate this generation span into the time preceding the middle of the seventeenth century. We thus infer that two generations whose names are unknown (Y and Z) would have existed between Václav Šumpeter and Jan Šumpetr and that Václav was born in 1478 and moved to Třešť at the age of forty-five. Although these dates are merely a conjecture, it is highly improbable that one or three, instead of two, generations existed in this interstice in the family register. We can conclude that thirteen generations existed at Třešť from Václav Šumpeter to our Schumpeter.

Table 1 summarizes the genealogy of the Schumpeters directly filiated to our Schumpeter. In the following we shall refer to them as Schumpeter I – Schumpeter XIII. The dates of birth with question marks for Schumpeter I – V in the table are estimates derived from the above extrapolation.

Table 1. THE GENEALOGY OF THE SCHUMPETER FAMILY

Name	Dates of birth & death	Profession	Date of marriage	Name of spouse	Spouse's birth place	Dates of birth & death	Number of children (Male)	(Female)
1. Václav Šumpeter	1478 ?-?	?	?	Barvora	Hladov	?	?	?
2. Y	1512 ?-?	?	?	?	?	?	?	?
3. Z	1546 ?-?	?	?	?	?	?	?	?
4. Jan Šumpetr	1580 ?-?	?	?	Kateřina	?	?	5	3
5. Nikodem Schumpeter (Ssumpetr or Ssumpeter)	1614 ?-1672	councilman	?	Estera	?	?	3	1
6. Jan Šumpetr (Ssumpetr, Schumpeter or Schumpetter)	1648-1704	mayor	1671 1679 1692 1704	Judita Kreuzberger Marie Pittauer Dorota Němc Marie Widerlechner	Třešt' Třešt' Třešt' Třešt'	?-1677 1663-1691 1671-1723 1682-1758	0 3(1*) 2(1*) 7(3*)	0 1 1(1*) 3
7. Jan Antonin Šumpetr	1680-1742	textile merchant	1736	Marie Alžběta Stromayer	Třešt'	1719-1737	0	1(1*)
8. Ludvík František Šumpetr (Schumpetter)	1704-1742	textile merchant	1737 1761	Františka Martigni Anna Marie Weissenbek	Třešt' Telč	1717-1742 1735-1815	2(1*) 6(3*)	1(1*) 4(1*)
9. František Xaver Šumpetr	1740-1814	textile merchant, mayor	180?	Veronika Hedbávná	Třebič	1782-1839	4(1*)	3(1*)
10. Josef Šumpeter (Schumpeter)	1777-1848	textile merchant, textile manufacturer	183?	Marie Wensel Zdiarsky	Třebič	1816-1864	4(2*)	7
11. Alois Jakub Šumpetr (Schumpetter)	1813-1898	textile manufacturer, mayor	1881	Jana Grüner	Jihlava	1861-1926	2(1*)	0
12. Josef Alois Karel Schumpeter	1855-1887	textile manufacturer	1907 1925 1937	Gladys Richarde Seaver Anna Josefinn Reisinger Elizabeth Boody Firuski	? Vienna Lawrence	1871-? 1903-1926 1898-1953	0 1(1*) 0	0 ? 0
13. Josef Alois Julius Schumpeter	1883-1950	economist						

* indicates the number of children who died in infancy.

There were diverse ways of spelling the family name, but “Šumpetr” (pronounced [ʃumpɛtər] in Czech and “Schumpetter” in German were the most frequently used. The current usage “Schumpeter” appeared by the seventeenth century.

The Schumpeter family lived continuously in Třešť from the beginning of the sixteenth century and their spouses were found first in Třešť, then in its vicinity. They were authentic Germans. We can conclude from the fact that the Schumpeter family never suffered religious persecution, that there was no Jewish element in the family. When Schumpeter in the United States campaigned for the support of Jewish economists in Germany in 1933, he stated that he was neither a Jew nor of Jewish descent. The religion of the Schumpeter family was Roman Catholic.

III. Business

The professions of the successive heads of the Schumpeter family were predominantly textile merchant or manufacturer, although a few outside of the direct line had other professions such as clergyman and soldier. There were no farmers or workers in the family. They accumulated capital first through trade, then moved to the woolen cloth industry. The raw materials for both endeavors perhaps came from sheep raised near by. It is also important to notice from Table 1 that the family sometimes produced mayors of Třešť, which means that they were not only economically wealthy, but also socially distinguished. Some members of the Schumpeter family not listed in Table 1 also became mayors, councilmen, and priests in the town. Based on the 600-year history of Třešť, we will now begin a description of the family's business activities from František Xaver Šumpetr (Schumpeter IX).³

The manufacturing industry emerged in Třešť in the nineteenth century, centering around clothing, wood, and matches. The Schumpeter family engaged mainly in the textile trade and manufacturing. Schumpeter IX was a wholesaler of textile goods and served some years as the mayor. One of his sons, Josef Šumpeter (Schumpeter X), also started wholesale businesses dealing in textiles, iron products, and salt. Later he began manufacturing textiles. In 1832–33 he constructed a factory at the back of his house, beyond the so-called Jewish street. This was the start of woolen cloth production in Třešť. He first used horsepower but later introduced steam engines for weaving and dyeing textiles. The factory was called “Josef Schumpeter & Son”, the latter referring to Josef's eldest son, Karel (1804–47).

After Schumpeter X's retirement and Karel's premature death, Karel's younger brother, Alois Jakub Šumpetr (Schumpeter XI), bought the factory from Karel's widow. Introducing new machines, he greatly improved and expanded the factory, which he called “Alois Schumpeter & Son”. The latter now referred to the eldest son, Karel František Dominik (1840–1906), who was the elder brother of our Schumpeter's father. In 1873 the Schumpeter factory had sixty mechanical looms and its own dyeworks, spinning-mills, and



Figure 1. Třešť', c. 1850.

fulling-mills, so that it was able to produce everything from raw wool to finished products without help from outside sources.

Schumpeter XI had many children, lived until the age of eighty-five, and was noted for his talent as a businessman. The historical survey of Třešť' states that his expansion of the factory marked the transformation from handicraft to textile manufacturing. In the town there remains a painting that gives a birds-eye view of Třešť' around 1850, in which we see a factory with a smokestack, a castle, and two churches (see Figure 1). The factory is believed to be the property of Schumpeter XI. He was the mayor of Třešť' for seven years and was given the title of honorary citizen. The record of Schumpeter XI's eleven children are summarized in Table 2. He had seven daughters and four sons, but two sons (the sixth and eighth children) died in infancy. Two surviving sons, Karel and Josef (Schumpeter XII), engaged in textile manufacture. As mentioned earlier, Karel became a co-manager of the factory with Schumpeter XI. It is not certain, however, whether Josef, younger than Karel by fifteen years, actually participated in the management of the same factory, because among these three Josef died first, at the age of

Table 2. CHILDREN OF SCHUMPETER XI

Name	Dates of birth & death	Name of spouse	Spouse's birth place	Dates of birth & death
1. Aloisie Mariana (F)	1837–?	Ferdinand Žižka	Bezděčín	?
2. Vilima Antonie (F)	1839–1919	Jan Ramach	Náměšť	1829–1914
3. Karel František Dominik (M)	1840–1906	Marie Zuka	Telč	1848–1930
4. Irma (F)	1842–1920	Adolf Korbel	Jaroslav	1831–1894
5. Veronika (F)	1844–?	František Budišovský	Třebíč	?
6. Ignác (M)	1846–1846	—	—	—
7. Františka (F)	1849–1937	František Killian	Jihlava	1837–1890
8. Josef Alois (M)	1851–1852	—	—	—
9. Kateřina Florentina (F)	1853–1916	Bedřich Schubert	Kojetín	?
10. Josef Alois Karel (XII) (M)	1855–1887	Jana Grüner	Jihlava	1861–1926
11. Johanka (F)	1858–?	Jan Schubert	?	?

(M): male

(F): female

thirty-two in 1887. Many generations of the Schumpeter family were strongly religious and often made donations for a religious purpose, as will be mentioned below. The Schumpeter factory was known as the Christian factory, in which work stopped every Friday at three o'clock to pray to God.

Schumpeter XI died in July 1898. In December of that year the factory burned down due to suspicious causes. The old site of the factory was sold in 1899 to a Jewish manufacturer from Hodice, Berthold Münch, thus ending the business history of the Schumpeter family in Třešť. Münch constructed a four-story modern factory producing textiles. It existed until 1931 and was an essential element in the landscape of Třešť, not to mention its economic base. There remain some photographs and paintings in which the old town of Třešť, consisting of a castle and two churches, is contrasted to the modern town factory building, with the so-called "New Pond" between them (see Figure 2). The factory was destroyed by a fire in 1931 and reconstructed into a three-story building. When the German persecution against Jews reached Třešť in 1938, Münch was captured and expelled. The factory building survived until 1965. A painting that includes a depiction of Münch's second factory now hangs on the wall of the mayor's office (the mayor was formally called the Chairman of the National Committee of Třešť under the communist regime), which was painted on the occasion of the 600th anniversary of the town. A Czech state furniture factory stands on that location today, and the pond beside the factory no longer exists; only a small river remains within a swamp at the back of the factory.



Figure 2. Třešť, c. 1910.

IV. Houses

From the registers that indicate house numbers for children's birth places and parents' place of death, we can ascertain where the Schumpeter family lived. These records extend back to Schumpeter IX. From the 1770s to 1810s, Schumpeter IX and X lived at Nos. 84, 93, 94, 95, and 96; after the 1820s, Schumpeter X and XI lived at Nos. 168 and 176. Since Karel, co-manager with Schumpeter XI, died at No. 168, we can assume that the house of the latter had been inherited by Karel. Schumpeter XII, the father of our Schumpeter, was born at No. 168 and died at No. 462. Our Schumpeter was born at No. 52; he had a brother, younger by a year, who was stillborn on April 10, 1884 at No. 468. Schumpeter XII was not the eldest son, so he established a branch family and lived apart from his father and grandfather.

It follows that our Schumpeter lived at least at houses Nos. 52 and 462 between 1883 and 1887, if the numbering system was consistent. At present each house in Třešť' has a house number and a street number, but the current house numbers are not only different from, but mixed with the old ones.

The appearance of the house numbers in the register record of Třešť' reflected the fact that the numbering of houses started in 1770. However, there were three sorts of numbering from the start. First, the houses on the road leading to Jihlava were numbered one by one from the Jihlava side, and the house numbers were followed by the letters "ND", meaning new houses (e.g., 13-ND). This numbering applied to the part of the town now called "Na domkách," or "Na kopci," Castle Street. Second, for "Little Town," separated by a bridge from the above area, a different numbering was used. In this case, no letter was added to the numbers (e.g., 13). A third numbering scheme was applied to the Jewish Ghetto, currently Lenina Street, where the house numbers were expressed by Roman numerals (e.g., XIII).

The Ghetto policy which was taken at Třešť' in 1686 to seclude Jews into a single street ceased to exist as late as the nineteenth century. Thus specification of the Ghetto houses by the Roman numerals lost meaning, and, in addition, a new uniform numbering was introduced, so that confusion between several numbering systems was brought about for a while.

According to the register record, as indicated above, Schumpeter XIII was born at No. 52 and his father Schumpeter XII died at No. 462. But several sources suggest that both numbers indicated the same house: No. 52 was an old Jewish number and No. 462 is a new number. The house of No. 462 is located in Rooseveltova Street, which is the southwestward extension of Lenina Street (see Figure 3). The younger brother (1816–1876) of Schumpeter XI, the mayor of Třešť' too, once lived in that house. It is now used as a grocery.

It is unlikely that after Schumpeter XII died in 1887, his wife, then twenty-six years old, remained at Třešť' much longer. She probably returned soon to her home in Jihlava with our Schumpeter, then four years old. In Třešť' the buildings of a German primary school and a Jewish primary school remain, but we cannot assume that our Schumpeter stayed there long enough to enter



Figure 3. The house where economist Schumpeter was born, No. LII or No. 462.

either school. The departure of mother and child from Třešt' ultimately opened the way to his move to Graz and Vienna.

Apart from the register of house numbers, there are three two-story buildings in which the Schumpeter family is said to have lived. One is on the site of the Schumpeter factory (street number Lenina 38; house number 388). The other two stand side-by-side on one side of the street (street numbers Lenina 39 and 41; house numbers 169 and 164). The buildings are shown in Figures 4 and 5.

Since the system of house numbers has changed, it is impossible at present to locate these buildings in terms of the old numbers. But since they stand at the end of the so-called Jewish street, and on the site of the Schumpeter factory and across the street, they can be regarded as the residence of the main family, i.e., Schumpeter X, XI, and Karel (the eldest son of XI). A 101-year-old woman living at Lenina 39 says that her family bought the house from the Schumpeters. These buildings are magnificent compared with the neighboring houses. One of them (Lenina 41) is now used as an office for a state factory of agricultural machinery. The factory was later added to the house (see Figure 6). The entrance of the house leads to a spiral staircase to the second floor, the walls of which are decorated by seven large paintings, all of which are 1×2.5 meters in size. Each contains a full-length portrait of a young woman (see Figure 7). One of them is said to be the wife of Schumpeter XI or Karel Schumpeter—, others his girl friends. It seems reasonable to assume, however,



Figure 4. The house of the Schumpeter family, Lenina 38.



Figure 5. The so-called Jewish street. Two buildings at the end of the left-hand side of the street were the houses of the Schumpeter family, Lenina 39 and 41.



Figure 6. The house of the Schumpeter family, Lenina 41.

that Schumpeter XI had his seven daughters painted. Except for the castle and churches, these paintings are the only artistic works remaining at Třešť’.

V. Monuments

The legacy of the Schumpeter family can also be found in some religious memorials remaining in the town. The altar of St. Catharine’s Church in Třešť’ was built by a donation from Schumpeter IX in 1771. The iron cross on a stone pedestal built outside of the church depended on the generosity of Schumpeter X in 1815. When the church was burnt down in 1824, the Schumpeter family assisted with its reconstruction. A gilt Holy Grail in another church, St. Martin’s, has the name “Brosche” on it. The time of donation is unknown. Karel, the elder brother of our Schumpeter’s father, had four sons, and one of them married a daughter of the Brosche family.

The names of the Schumpeter family remain on several memorial crosses along the roadsides in Třešť’, similar to those often seen in Austria and Bayern. The Station of the Cross on a slope on the southern outskirts of the town, though partly destroyed, was built in 1758 by Jiří Jan Šumpetr (1706–1777), a cloth-cutter. He was a son of Schumpeter VII and brother of Schumpeter VIII. He also built a Station of the Cross at a roadside on the eastern outskirts of the town, engraved with the year 1766 and the letters IGS (see Figure 8). In front of the Schumpeter factory a road currently called



Figure 7. The paintings in the house of the Schumpeter family, Lenina 41.



Figure 8. The Station of the Cross built by Jiří Jan Šumpetr 1766.

Lenina Street branches off, and at this fork Schumpeter X built in 1815 an iron cross on a stone pedestal, on the back of which his name is inscribed.

Many such objects were probably destroyed or forgotten over the course of time. From the above description, however, we can infer the social status and religious piety of the Schumpeters.

No other object reflects the prestige of the family more than the chapel in the cemetery of Třešt', erected on the highest spot on the grounds. This cemetery is located on a hill in the east side of the town, from which there is an overall view of Třešt'. The chapel, 3 x 3.5 meters in size, is white with Maria Theresian yellow, and on the front wall is marked "Familie Schumpeter-Killian" (see Figure 9).

Schumpeter XI, XII, and Karel (the elder brother of Schumpeter XII) are buried here (see Figure 10). The name of Killian is seen in Table 2. Anastazie Schumpeter (1845–1868) was a daughter of Josef Schumpeter (younger brother of Schumpeter XI), married to František Killian (1837–1890), the son of a Jihlava merchant who became mayor of Třešt'. Anastazie died three years after marriage. František then married her cousin, Františka Schumpeter (1849–1937), a daughter of Schumpeter XI. The first marriage produced Eugen Killian (1866–1902), and the second, Emil Killian (1870–1886) and Richard Killian (1875–1918). All these Killians are buried in the chapel.

We can assume that Schumpeter XI and the Killians, who were of similar socioeconomic status, agreed to build the family chapel following the deaths of Emil Killian in September, 1886, and Schumpeter XII in January, 1887.



Figure 9. The chapel of the Schumpeter-Killian families in the cemetery of Třešt'.



Figure 10. The names of the Schumpeters on the wall inside the chapel.

While these names are written on the inside wall of the chapel, the names of other members of both families, who died before the 1880s, are written on the front of the altar. The names include Schumpeter X, his wife, his two sons (except Schumpeter XI) and their wives, his two children who died in infancy, and the wife of Schumpeter XI. Their graves were probably relocated into the chapel after its construction.

It is more or less a custom in many areas of Europe that when no one has taken care of the grave, the cemetery cancels the previous contract and provides the lot to others. A family that acquires a new lot in a cemetery abandons previous gravestones and erects new ones, or deletes old names and inscribes new ones. This might be the reason why old gravestones are rare in cemeteries, except for those of famous persons. Although the Schumpeter family in Třešť' died out, their large chapel still remains because it is now used for funeral services for the general public.

Among the eleven children of Schumpeter XI, Karel and Josef (Schumpeter XII) kept the name of Schumpeter. While the line of our Schumpeter died out, Karel had four sons, who have so far left two further generations of descendants with the name of Schumpeter. All these families left Třešť'.

VI. The Grüners

After the death of her husband, the wife of Schumpeter XII, i.e., the mother of our Schumpeter, had to seek a new way of life. This had a decisive effect on his

later life. His mother, and later his second wife Anna, became his “guardian gods,” influencing his intellectual effort. This is a very interesting psychological phenomenon underlying his diaries for 1926–49, which are kept in the Harvard University Archives.

Here we shall only describe some findings about her background in relation to the Schumpeter family in Třešť. Jana (Johanně) Grüner (1861–1926) was a daughter of a surgeon in Jihlava, Julius Grüner (1827–1887).⁴ Jihlava (the German name was Iglau) is 10km north of Třešť and now has more than 50,000 inhabitants. As indicated in Table 2, the children of Schumpeter XI found their spouses in neighboring towns such as Jihlava, Třebíč, and Telč, not Třešť. All were much bigger than Třešť. It can be argued that the wealth and fame of the Schumpeter family made possible their marriage with the intellectual strata of more advanced neighboring towns.

The Grüners were known and respected as a family of doctors. Franz Julius Grüner (1797–1879) was the father of Julius Güner. He came to Jihlava when he was young and worked as a doctor for many years. In 1841–69 he was the head of the town hospital. He was a botanist, too, specializing in research on moss plants.

Johanně’s father was at first an army doctor and then took over his father’s position in the town hospital in 1869, where he worked until his death. Her mother (1835–1888), Julie Wydra was born in Podebrad. Johanně had a sister, Willhelmine (born in 1865), who took the name Klimesch after marriage, and a brother, Friedrich (born in 1869), who worked as a railway clerk in Vienna.

Although our Schumpeter’s father died before achieving importance in his profession, the Schumpeter family, at least since the early seventeenth century, engaged in business, industry and sometimes in local government. The Grüners were a prestigious family of doctors. These family characteristics were the initial endowment and background which our Schumpeter had been given when he left Třešť. What influence these two families exerted upon him is beyond proof or test. Although the external conditions into which he was born were considerably favorable by village standards, they were scarcely enough to ensure his future career. His breakthrough had to wait for later good fortune. The fact that past Schumpeters did not include men of glittering genius or celebrity would perhaps explain why he did not attempt to trace his family tree, which he may have been interested in otherwise.

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Notes

- 1 J.A. Schumpeter, *Ten Great Economists: From Marx to Keynes*, New York: Oxford University Press, p. 260.
- 2 Czech Archives, edited by Josef Kalousek, Prague, 1892, vol. XI, pp. 452–53.
- 3 *Třešť : Šest set let městečka pod Špičákem*, vydal městský národní výbor v Třešti, 1959. (*Třešť : 600 Years of the Town below the Špičák Hill*, published by the Town National Committee in Třešť.)

- 4 Both Smithies and Haberler describe Julius Grüner as a physician in Wiener-Neustadt, but this is not true. S. E. Harris (ed.), *Schumpeter: Social Scientist*, Harvard University Press, Cambridge, Mass., 1951, pp. 11 and 24.