

SCHUMPETER AND MARSHALL

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In Japan, historians of economic thought have discussed the economics of J.A. Schumpeter in relation to that of Walras or Marx. This interpretation may not necessarily be false. However, it seems to me that they have overlooked another important aspect of the Schumpeterian economics, i. e., its criticism of the Marshallian economics. Therefore, this paper aims at clarifying Schumpeter's relations to Marshall.

1 Schumpeter as an admirer of Walras

It is well-known that Schumpeter was fascinated with the Walrasian economics in his youth. In 1906, he published a paper entitled "Über die mathematischen Methode der theoretischen Ökonomie", in which he expressed his high hopes for the mathematical method in economics as Walras did.¹⁾ And two years later, he presented his first work Das Wesen und der Haupt-

inhalt der theoretischen Nationalökonomie(1908) to Walras with the following compliments:

Je ne vous connais pas et pourtant c'est un livre d'un disciple.
Un nouvelle époque pour l'économie scientifique est marquée par vos beaux mémoires, qui, pour la première fois, ont traité la théorie économique dans une manière vraiment scientifique. Moi, je m'efforcerai toujours de travailler sur les bases indiquées par vous, de continuer votre œuvre. ²⁾

1 J. A. Schumpeter, Über die mathematischen Methode der theoretischen Ökonomie, in J. A. Schumpeter, Aufsätze zur Ökonomischen Theorie, 1952, S. 535.

2 William Jaffe, ed., Correspondence of Léon Walras and Related Papers, vol. 3, 1965, p. 378.

The central theme of his first work was a static equilibrium theory. A static theory was, in Schumpeter's words, 'simply a statement of the conditions of equilibrium and of the way in which equilibrium tends to re-establish itself after every small disturbance' ³⁾. In reality, he allotted a large part of his first work for the exposition of this static or Walrasian theory.

However, he was never satisfied with being a mere expositor of the Walrasian economics. He tried to get over the limitations of the static theory, for it could not explain the fundamental phenomenon of economic development.

When we think about the making of Schumpeter's ideas, we should have an eye to the process of his transferring from the static theory to the theory of economic development. And, it is my interpretation that he was most conscious of Marshall when he tried to build his own theory of economic development.

3 Essays of J. A. Schumpeter, edited by R. V. Clemence, 1951, p. 159.

Then, what was Marshall's view on economic development like? We will see it in the next section.

2 Beyond Marshall

Marshall's main work is, no doubt, Principles of Economics (1890). And it is a well-known fact that he adopted the word natura non facit saltum as the motto of that book because he held the view that economic development was a continuous and gradual process. His view was explained more fully in the preface to the eighth edition of his Principles:

Economic evolution is gradual. Its progress is sometimes arrested or reversed by political catastrophes:but its forward movements are never sudden;for even in the Western world and in Japan it is based on habit, partly conscious,partly unconscious. And though an inventor,or an organizer,or a financier of genius may seem to have modified the economic structure of a people almost at a stroke;yet that part of his influence, which has not been merely superficial and transitory, is found on inquiry to have done little more than bring to a head a broad constructive movement which had long been in preparation. Those manifestations of nature which occur most frequently, and are so orderly that they can be closely watched and narrowly studied, are the basis of economic as of most other scientific work;while those which are spasmodic, infrequent, and difficult of observation, are commonly reserved for special examination at a later stage:and the motto Natura non facit saltum is specially appropriate to a volume on Economic Foundations. ⁴⁾

4 Alfred Marshall, Principles of Economics, eighth edition, 1920, p. xiii.

However, Schumpeter made this motto his target in his works. For instance:

Natura non facit saltum—diesen Satz hat Marshall als Motto seinem Werke vorangestellt, und in der Tat drückt er treffend den Charakter desselben aus. Aber ich möchte ihm entgegenhalten, da die Entwicklung der menschlichen Kultur wenigstens, und namentlich die des Wissens, gerade sprungweise vor sich geht. Gewaltige Anläufe und Perioden der Stagnation, überschwangliche Hoffnungen und bittere Enttäuschungen wechseln sich ab und mag das Neue auf dem Alten fußen, so ist der Fortschritt doch kein stetiger. Unsere Wissenschaft weiß davon zu berichten.⁵⁾

5 J. A. Schumpeter, Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie, 1908, S. 8.

According to Schumpeter, we should focus on the creative response in the economic field, i. e., carrying out new combinations by the entrepreneur, when we treat the problem of economic development. However, Marshall was so fond of likening the growth of the economy to that of a tree in explaining his vision of continuous and gradual economic development that he could not pay due attention to the creative response. At any rate, it is to be noted here that Schumpeter, unlike Marshall, held the vision of discontinuous economic development:

Development in our sense is a distinct phenomenon, entirely foreign

to what may be observed in the circular flow or in the tendency towards equilibrium. It is spontaneous and discontinuous change in the channels of the flow, disturbance of equilibrium, which forever alters and displaces the equilibrium state previously existing. Our theory of development is nothing but a treatment of this phenomenon and the process incident to it.

6)

6 J. A. Schumpeter, The Theory of Economic Development, translated by R. Opie, 1961, p. 64.

In my view, Schumpeter's criticism of Marshall has been overlooked by historians of modern economics. That he criticized Marshall does not mean that he depreciated Marshall. On this point, Erich Schneider gave an interesting evidence:

Als ich Schumpeter zum ersten Male begegnete, fragte er mich, ob ich Französisch lese. Auf meine Frage, warum er das wissen wollte, sagte er: Sie müssen Walras im Original lesen. Das ist eine *conditio sine qua non* für jeden Ökonomen. Er fragte dann weiter, ob ich Englisch lese. Auf meine Frage, warum er das auch wissen wollte, gab er die Antwort: Marshalls Principles sind ein "must" für jeden Ökonomen. 7)

7 Erich Schneider, Joseph A. Schumpeter: Leben und Werk eines großen Sozialökonomen, 1970, S. 12, Note 9.

Schumpeter did appreciate the Marshallian economics which is full of suggestions for economic dynamics. However, he parted from Marshall in his method of economic dynamics. Schumpeter said:

His thought ran in terms of evolutionary change—in terms of an organic, irreversible process. And something of the flavour of it he imparted to his theorems and concepts and still more to the factual observations with which he presented them. I do not think that the theory of evolution at the back of them was satisfactory. No schema can be that does not go beyond an automatic expansion of markets—an expansion not otherwise motivated than by increase of population and by saving—which then induces internal and external economies that in turn are to account for further expansion.⁸⁾

8 J. A. Schumpeter, Ten Great Economists from Marx to Keynes, 1951, p. 101

Now, at last, the time for us to examine Schumpeter's theory of economic development has come.

3 Schumpeter's Theory of Economic Development

The starting point of Schumpeter's theory is a stationary economy. A stationary process is, in Schumpeter's words, 'a process which actually does not change of its own initiative, but merely reproduces constant rates of real income as it flows along in time'⁹). Here Schumpeter notes that a "stationary" theory does not mean a "static" theory, which is 'simply a statement of the conditions of equilibrium and of the way in which equilibrium tends to re-establish itself after every small disturbance'¹⁰).

9 Essays of J. A. Schumpeter, edited by R. V. Clemence, op. cit., 159.

10 Ibid.

In this stationary economy, economic subjects merely adapt passively to the given data such as resources, population, technology and social organization. And, there are no economic subjects other than workers and landlords, for entrepreneurs and capitalists do appear only in the dynamic economy in Schumpeter's theory. Since entrepreneurs and capitalists do not exist in the stationary economy, the whole value of the product must be divided between labor and land. Let us keep in mind that entrepreneurial profit and interest on capital do appear only in the dynamic economy.

However, this stationary state is to be destroyed by the carrying out

of new combinations by entrepreneurs, i. e., innovations. And, it is the credit creation by banks that provides the sums needed to purchase the means of production for innovations.

Why did Schumpeter attach importance to the role of bankers? The reason was, in my view, that he wanted to give an answer which is in marked contrast to the conventional or Marshallian answer that emphasized the role of savings. In his words:

But we may not even start from total "savings". For its magnitude is explicable only by the results of previous development. By far the greater part of it does not come from thrift in the strict sense, that is from abstaining from the consumption of part of one's regular income, but it consists of funds which are themselves the result of successful innovation and in which we shall later recognize entrepreneurial profit. In the circular flow there would be on the one hand no such rich source, out of which to save, and on the other hand essentially less incentive to save. The only big incomes known to it would be monopoly revenues and the rents of large landowners; while provision for misfortunes and old age, perhaps also irrational motives, would be the only incentives. The most important incentive, the chance of participating in the gains of development, would be absent. Hence, in such an economic system there could be no great reservoirs of free purchasing power, to which one who wished to form new combi-

nations could turn—and his own savings would only suffice in exceptional cases. All money would circulate, would be fixed in definite established channels. ¹¹⁾

11 Schumpeter, The Theory of Economic Development, op. cit., p. 72.

In short, it was Schumpeter's view that entrepreneurs did not have to own the funds needed to carry out new combinations, and that it was capitalists that provided the funds and beared the risk involved in the undertakings. This view was in contrast to Marshall's, for he did not make a clear distinction between entrepreneurs and capitalists. Let us read the following words by Marshall's:

They "adventure" or "undertake" its risks; they bring together the capital and the labour required for the work; they arrange or "engineer" its general plan, and superintend its minor details. Looking at business men from one point of view we may regard them as a highly skilled industrial grade, from another as middlemen intervening between the manual worker and the consumer. ¹²⁾

12 Marshall, Principles of Economics, op. cit., p. 293. To this definition of the entrepreneur Schumpeter expressed sharp criticism:

Hence the Marshallian definition of the entrepreneur, which simply treats the entrepreneurial function as "management" in the widest meaning, will naturally appeal to most of us. We do not accept it, simply because it does not bring out what we consider to be the salient point and the only one which specifically distinguishes entrepreneurial from other activities. (Schumpeter, *The Theory of Economic Development*, op. cit., p. 77)

Now, new combinations are usually carried out by transferring resources from the investment industries to the consumption industries. As we have seen, entrepreneurs who are granted credit have to outbid producers in the circular flow in the market for the required means of production. Relative prices are therefore shifted and absolute prices are temporarily increased.

According to Schumpeter, new combinations appear discontinuously in swarms, for the appearance of one or few outstanding entrepreneurs do facilitate others. In other words, success breeds imitation. Thus the appearance of new combinations in swarms will after a while bring goods produced by the new equipment into the market. As supplies of new goods increase, prices fall. In addition, since entrepreneurs begin to repay their debt to banks out of earned profits, it will prompt the fall of prices. In the meantime, the adaptation of the economic system to the newly created

state of affairs by new combinations is put in motion, and finally it will get back to the stationary state.

The above is Schumpeter's simplest model of economic development. We will not go into the problematic aspects of his model, but let us just take notice that Schumpeter believed that 'it contributes something to the understanding of the struggles and vicissitudes of the capitalist world and explains a number of phenomena, in particular the business cycle, more satisfactorily than it is possible to explain them by means of the Walrasian or the Marshallian apparatus'¹³⁾. In short, Schumpeter believed that he excelled Walras and Marshall.

13 Essays of J. A. Schumpeter, op. cit., p. 160.

However, this was not the end of the Schumpeterian economics, for he went on to present his unique theory of the decay of capitalism which was sociological and historical in character. And, he was conscious of Karl Marx when he tried to build that theory. Before going into his relations to Marx, however, we will contrast Schumpeter's entrepreneur with Marshall's.

4 What is an ideal entrepreneur?

Marshall thought that an ideal entrepreneur had to perform several distinct functions. He mentioned the faculties required in the entrepreneur in his Principles:

.....the manufacturer who makes goods not to meet special orders but for the general market, must, in his first role as merchant and organizer of production, have a thorough knowledge of things in his own trade. He must have the power of forecasting the broad movements of production and consumption, of seeing where there is an opportunity for supplying a new commodity that will meet a real want or improving the plan of producing an old commodity. He must be able to judge cautiously and undertake risks boldly; and he must of course understand the materials and machinery used in his trade.

But secondly in this role of employer he must be a natural leader of men. He must have a power of first choosing his assistants rightly and then trusting them fully; of interesting them in the business and of getting them to trust him, so as to bring out whatever enterprise and power of origination there is in them; while he himself exercises a general control over everything, and preserve order and unity in the main plan of the business. ¹⁴⁾

14 Marshall, Principles of Economics, op. cit., pp. 297-298.

In contrast to Marshall's entrepreneur, Schumpeter's must, in the first place, have "intuition"; secondly, he must need 'a new and another kind of effort of will'; and thirdly, he must overcome 'the reaction of the social environment against one who wishes to do something new' ¹⁵⁾.

It is to be noted that it was Schumpeter's view that the specific problem of leadership, i. e., entrepreneurship, appears only where new possibilities come out. And, Schumpeter emphasized that 'it is this "doing the things," without which possibilities are dead, of which the leader's function consists' ¹⁶⁾.

15 Schumpeter, The Theory of Economic Development, op. cit., pp. 84-87.

16 Ibid., p. 88.

By the way, as we have seen before, Marshall mentioned leadership in the organization as the second faculty required in the entrepreneur. This is characteristic of Marshall, for he mentioned organization as the agents of production along with land, labour and capital. As Masazumi Ikemoto pointed out, Marshall did not think that entrepreneurial profit could be explained fully by the individual entrepreneur's contribution. ¹⁷⁾ Instead he introduced the idea of a "composite quasi-rent":

The point of view of the employer however does not include the whole gains of the business: for there is another part which attaches to his employees. Indeed, in some cases and for some purposes, nearly the whole income of a business may be regarded as a quasi-rent, that is an income determined for the time by the state of the markets for its wares, with but little reference to the cost of preparing for their work the various things and persons engaged in it. In other words it is a composite quasi-rent divisible among the different persons in the business by bargaining, supplemented by custom and by notions of fairness.¹⁸⁾

17 Masazumi Ikemoto, What is the entrepreneur?, 1984, pp. 125-126 (in Japanese).

18 Marshall, Principles of Economics, op. cit., p. 626.

Now, the contrast between Marshall and Schumpeter is brought out. Our next problem is to go into Schumpeter's theory of the decay of capitalism, in which his relation to Marx has importance.

5 Schumpeter's Theory of the Decay of Capitalism

Schumpeter was, as we have seen before, an ardent admirer of Walras's general equilibrium; therefore he did not approve Marx's labor theory of

value. Nor did he accept the theory of absolute povertization. Nevertheless, he did appreciate Marx's magnificent vision of the capitalist economy. In particular, he and Marx were of the same opinion of the future prospects for capitalism:

However, even though Marx's facts and reasoning were still more at fault than they are, his result might nevertheless be true so far as it simply avers that capitalist evolution will destroy the foundations of capitalist society. I believe it is.¹⁹⁾

19 J. A. Schumpeter, Capitalism, Socialism and Democracy, third edition, 1950, p. 42.

However, Schumpeter did not think that capitalism would collapse because of its failure. Instead, he presented the idea that capitalism would collapse because of its success. Why? The reasons were summarized in his lecture entitled 'The March into Socialism':

First, the very success of the business class in developing the productive powers of this country and the very fact that this success has created a new standard of life for all classes has paradoxically undermined the social and political position of the same business class whose eco-

conomic function, though not obsolete, tends to become obsolescent and amenable to bureaucratization. Second, capitalist activity, being essentially "rational", tends to spread rational habits of mind and to destroy those loyalties and those habits of super- and subordination that are nevertheless essential for the efficient working of the institutionalized leadership of the producing plant. Third, the concentration of the business class on the tasks of the factory and the office was instrumental in creating a political system and an intellectual class, the structure and interests of which developed an attitude of independence from, and eventually of hostility to, the interests of large-scale business. Fourth, in consequence of all this, the scheme of values of capitalist society, though causally related to its economic success, is losing its hold not only upon the public mind but also upon the "capitalist" stratum itself.²⁰⁾

20 J. A. Schumpeter, *The March into Socialism* (1949), in Capitalism, Socialism and Democracy, op. cit., pp. 417-418.

We do not have space to explore this idea further; however, it is worthy of notice that he did learn a lot from Marx's vision and did avoid the difference between he and Marx in his theory of the decay of capitalism. He said:

But 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.²¹⁾

21 J. A. Schumpeter, History of Economic Analysis, 1954, p. 441.

Conclusion

Schumpeter was fascinated with Walras's theory of general equilibrium in his youth. However, he became dissatisfied with the statical character of the Walrasian economics, and began to build his own theory of economic development. It was Alfred Marshall that stand in his way there. And he tried to obtain originality by emphasizing the difference between he and Marshall. He believed that he excelled Walras and Marshall. Then, he set out to build the theory of the decay of capitalism, which was stimulated by Marx's grand vision of the capitalist economy. And, unlike his relation to Marshall, he did not underline the difference between he and

Marx.

The revolt against the orthodox theory has always been done by an acute criticism. Schumpeter made Alfred Marshall his target, and obtained originality by criticising his idea of economic dynamics.

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