



HISTORY OF ECONOMIC THOUGHT

Lecture Notes for Week 12

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Joseph Alois Schumpeter (1883 – 1950)

You can find many videos and texts on JAS on web. You ought to watch the video: [“The Man Who Discovered Capitalism”](#).

Why is JAS Important

JAS's importance stems primarily from explaining the dynamics of capitalism:

- JAS introduced the concept of "creative destruction," which describes how innovation leads to the demise of outdated industries and the rise of new ones. This process is fundamental to understanding how capitalist economies evolve and adapt over time,
- He highlighted the central role of entrepreneurs as agents of change in the economy. According to Schumpeter, entrepreneurs drive economic growth by introducing innovations and new business models, spurring economic change and development,
- He contributed to theories on business cycles, suggesting that innovation occurs in waves, leading to cycles of economic expansion and contraction. His perspective offered insights into patterns of economic growth and recession,
- His work laid the groundwork for modern theories of economic development, considering innovation and technological change as key drivers of long-term growth,
- His ideas have been highly influential in economics, business strategy, and policy-making. They remain relevant in analyzing how economies grow and how firms compete and innovate.

Life

- Born in Třešť (Triesch in German) in Moravia,
- First studies in the Theresianum in Vienna. It was the school for young aristocrats. He studied there especially humanities and languages: Latin, Greek, French,

English, and Italian,

- 1901 – 1906: He studied at the Faculty of Jurisprudence at Vienna University,
- After graduation, he visited England, where he met Marshall, Edgeworth and his 1st wife,
- 1907 – 1909: He worked as lawyer in Cairo; he managed the estate of an Egyptian princess,
- In 1908: He published *The Essence and the Principles of Theoretical Economy* (in German),
- 1909 – 1911: He had professorship at Czernowitz University (today on the Ukrainian territory),
- 1911 – 1921: He worked at Graz University (Austria),
- In 1912: He published the *Theory of Economic Development* (in German), with the explanation of creative destruction,
- In 1914: He published *Epochs in the Histories of Doctrines and Methods* (in German),
- 1913 – 1914: He had lectures at Columbia University in New York,
- After WW1, he was active in politics. A couple of months in 1919, he was minister of finance in a socialist government. He supported an extraordinary wealth tax, incentives to the influx of foreign capital, inflation aimed at reducing the real value of the public debt and he opposed the nationalization program of the government,
- 1921 – 1924: He was chairman of the private Biedermann Bank, that bankrupted under his leadership,
- 1925 – 1932: He worked at the University of Bonn, with some interruptions at Harvard and in Japan,
- In 1926: death of his 2nd wife and of his mother; his character becomes more pessimistic,
- In Bonn, he worked for 5 years on a treatise on money. It remained incomplete and was published in 1970,
- 1932 – 1950: He worked at Harvard University,
- 1937 – 1940: He was president of the Econometric Society,

- In 1939: He published *Business Cycles*,
- In 1942: He published *Capitalism, Socialism and Democracy*, in which he presents:
 - The opinion that the dematerialization of property leads to the desintegration and later to self-liquidation of capitalism,
 - The Market Theory of Democracy,
- In 1948: He became president of the American Economic Association,
- In 1950:
 - He was designated the 1st president of the International Economic Association,
 - He dies,
- In 1954: His *History of Economic Analysis* was published. It was edited by his 3rd wife, the economist Elisabeth Boody (who he married in 1937).

Method

He described his opinions on methodology in his *The Essence and the Principles of Economic Theory* (1908) as follows:

- Do not set methodological assumptions once and for all your purposes,
- Adapt methodological assumptions to each objective,
- Be as liberal in choosing methods as possible,
 - He criticized as sterile the famous struggle on method (“Methodenstreit”),
 - His opinion was that an extremely complex reality cannot be reduced exclusively to one methodology.

He opposed the belief that mathematical laws express the intrinsic essence of things and the theoretician’s task is just to uncover such laws. He believed that all sciences were just forms of representation of reality.

He had a cautious attitude towards methodological individualism. His opinion was that from theory in itself we can draw arguments neither in favour nor against political individualism. Theoretical propositions fall within the field of science and value judgments fall within the field of politics.

From Statics to Dynamics

- Schumpeter stressed the role of an entrepreneur as a creator of innovations. Innovations are inventions realized on market,
- In his opinion, development of market forms starts with a monopoly. Innovative activities of entrepreneurs destroy monopolies and lead to monopolistic competition,
- In his opinion, economic cycles are based on cycles of innovations. In his historical-statistical analysis, he tried to distinguish:
 - Kondratieff cycles, or K-waves: These are long-term economic cycles that span approximately 40 to 60 years. They were introduced by Russian economist Nikolai Kondratieff. These cycles are believed to reflect distinct phases of economic development driven by major technological innovations and major socio-economic transformations,
 - Juglar cycles: These are named after French economist Clément Juglar, and are medium-term economic cycles that last about 7 to 11 years. These cycles are associated with fluctuations in investment in fixed capital and reflect the natural rhythm of economic expansion and contraction within a market economy,
 - Kitchin cycles: These are named after British economist Joseph Kitchin, and are short-term economic cycles that last approximately 3 to 5 years. These cycles are primarily driven by inventory fluctuations within businesses and are an important part of understanding the ebbs and flows of economic activity over brief periods,
- JAS stressed the role of bankers for financing innovations. Banking system creates money for financing new innovations and the interest rate is basically derived from the expected profitability of new innovations.

Market Theory of Democracy

JAS presents this theory in his book *Capitalism, Socialism, and Democracy* (1942). In this book, there are two relevant chapters on democracy: "The Classical Theory of Democracy" and "Another Theory of Democracy." According to Schumpeter, parties try to sell programs, voters are buyers, and competition influences the behavior of parties. This competition disciplines political elites and ultimately prevents them from exercising domination.

This theory is a minimal conception, but surely not a negligible conception of democracy. However, related problems have been studied, such as:

- Imperfect competition: just as firms can collude, political parties can collude as well,
- Competition is not over programs but over money, as politicians need funding for their campaigns,
- This approach to democracy devalues participation in elections. Can one consumer change the market? Can one vote change the outcome on the political market?

The History of Economic Analysis (1954)

This book is a comprehensive work that traces the evolution of economic thought from ancient times to the mid-20th century. Published posthumously in 1954, the book examines the development of economic theories, methodologies, and key contributors within the broader historical context. Schumpeter offers an extensive critique and analysis of various schools of economic thought, highlighting the interplay between economic ideas and societal changes. The work is renowned for its depth and scholarly rigor, providing valuable insights into how economic theories have shaped and been shaped by the times in

which they were developed.

JAS describes his two aims as:

- Illustration of the history followed by economic enquiries,
- Presentation of a theory of this history.

Some of his evaluations are anomalous. He shows great admiration for Aristotle and the Scholastics. He underestimates – in comparison with the general opinion – the Adam Smith's contribution. He gives positive appraisal of both Marx and Walras at the same time. In his opinion, for the understanding of Being, it is important to understand both Order (Walras) and Motion (Marx).

Miscellaneous

- Many great economists were his students, e.g. Leontief, Samuelson, Solow, Minsky, Sweezy...
 - Paul Sweezy (1910 – 2004) was an American economist and a prominent Marxist theorist, best known for his work on the dynamics of capitalist economies. He said: "JAS did not care what we thought as long as we did think",
- JAS's public image at the end of his life was negative. He was considered an ultra-conservative, who opposed to the Roosevelt's New Deal and who was too soft on Nazi Germany during the war years,
- In his youth, he wanted to become the richest banker in Austria, the best lover in Vienna and a world-class professor of economics. At the end of his life, he said he had succeeded in two thirds of those plans.

Closing the Course

What Have We Done?

There are three approaches for introducing the rich history of economic thought. The basic one gives chronologically the main theoretical developments. The second one describes the development of thought in some specific area of economics. And the third one illustrates the development on the lives and works of important economists. This course combines all three of them.

In the first ten lectures (and in the eighth and ninth seminars) we followed the first approach:

1. From Ancient Greece to the 16th Century,
2. From feudalism to capitalism, Pre-Classical Thought – Formative Period of Classical Political Economy: 16th – 18th century period,
Mercantilists. Sir William Petty. Bernard de Mandeville, Richard Cantillon, Physiocrats – Francois Quesnay, Anne Robert Jacques Turgot, David Hume,
3. Classical Thought: 1750 – 1850 period,
Adam Smith, Jeremy Bentham, Jean Baptist Say, David Ricardo, Thomas Robert Malthus. Classical Approach to Prices. Classical Approach to Recessions,
4. Modern Time – Basic Milestones: period since 1850,
John Stuart Mill. Marginalist Revolution – Background, William Stanley Jevons, Carl Menger, Léon Walras. Keynesian Revolution. Monetarist Counterrevolution,
5. Austrian School and its Neighbourhood: period since 1850,
Karl Menger, Ludwig von Wieser, Eugen von Boehm-Bawerk,

Ludwig von Mises, Friedrich von Hayek. Max Weber, Joseph Schumpeter. Neo Austrian School,

6. Neoclassical Thought in the Anglosaxonian World and its Neighbourhood before Keynes: 1870–1936 period,
7. Marxist Economic Thought and its Neighbourhood: period since 1850,
8. Keynes and Mainstream Macroeconomic Thought after Keynes: period since WWI,

Seminar:

- Piero Sraffa, Michal Kalecki and the Introduction to Post-Keynesian Economics: 20ies and 30ies of the 20th century,
9. Postkeynesian Economics and Its Neighbourhood: period Since WWII,

Seminar:

- Old and New Institutionalism: period since the end of the 19th century,
 - Ordoliberalism: period (Germany) after WW2,
10. General Economic Equilibrium Research Program. Welfare Economics, Freedom and Justice: period since the marginalist revolution.

In the first seven seminars we followed the second approach:

1. The Ethical Foundations of Economics,
2. Developments of Ideas on Property Rights,
3. Development of Ideas on Public Finance,
4. Economies as Systems,
5. Development of Ideas on International Trade,
6. Factors of Production and Economic Growth and Development in Historical Perspective,
7. The History of Monetary Economics.

At the end of the semester we followed the third approach:

1. Adam Smith,
2. Alfred Marshall,

3. John Maynard Keynes,
4. Joseph Alois Schumpeter.

Why Does Economic Thought Develop?

- It reacts to changes in political and social environment, e.g. Mercantilism developed with the birth of nation states and Marxism as reaction to the problems of poverty of the working class,
- It reacts to changes in economic environment, the latter caused e.g. by technological development, as during the industrial revolution in the 18th century or by the development of new types of firms, as during the boom of joint stock companies in the second half of the 19th century,
- It reacts to changes in the epistemological space (space of knowledge), e.g. the development of mathematics in the 20s century helped to the development of the general equilibrium theory,
- Economic thought develops also endogenously: internal discussions open new questions that call for theoretical reflexing.

What Character Has Our Knowledge of Economics?

- History of economic thought is a very broad topic. It is about the creation of both practical and theoretical knowledge. Both types of creation start with a vision. In the following stage, concepts are clarified and arranged into a system. Parallely, some concepts are analysed in more depth with the use of the methodology that is considered appropriate at the moment. There is a feedback from the analytical to the conceptual level,
- J. A. Schumpeter set himself the target to write the history of economic analysis. He tried to avoid writing about visions and concepts that had not been elaborated to the analytical level, that is into clear logical structures, nowadays it means into mathematical models. Even with this constraint, his *History of Economic Analysis*

has about 1200 pages and it must be said that he wrote about non-elaborated visions and concepts as well. In the history of economic thought, we can find a couple of theoretical systems – e.g. the classical system, the neoclassical system or the neo-classical synthesis. Each system has its main scope of investigation – e.g. the classical system the accumulation of capital, its structure of fundamental concepts – e.g. wage, rent, profit, surplus and others in the classical system and its methodological rules – e.g. marginal analysis in the neoclassical system. In each period, some „linguistic canons“ exist that delimit the discourse of the specialists in the system and among systems,

- Success of a theoretical system depends on its logical coherence, its ability to respond to a certain social need and on the success in the competition with other systems,
- The success in the competition depends on the same factors as success in other types of innovation; i.e. to be in the right time in a right place and to get a large „share in the knowledge market“ as fast as possible,
- Competing systems can coexist. The system of these systems is a complex system with many feedbacks. Its dynamics is complex, there are discontinuities in the development of knowledge and it is impossible to predict when such discontinuities occur.

For better understanding of the character and development of knowledge, we can add some insights from the philosophers of science:

- Thomas Kuhn developed the notion of scientific revolutions. Each scientific field develops around some basic idea, the so-called paradigm. From time to time we get a scientific revolution, in which the current paradigm is changed for a new one. In economics: e.g. the marginalist revolution, the Keynesian revolution and the monetarist counterrevolution. More paradigms can be developed simultaneously,
- Imre Lakatos developed the notion of research programs. In these research programs, a set of basic ideas is being developed and a research program is good if it gives enough space for the development of itself. In economics: e.g. the research program microeconomics, public economics, international economics...

- Charles Popper developed Falsificationism. All theories are just hypotheses that we use until they are falsified. One of basic tasks of scientists it to try to falsify the knowledge that we have,
- Paul Feyerabend was against the purity of methods used. Any method can be used if it helps to the solution of the problem. (JAS would agree with this opinion.)

Repetition of what Adam Smith believed:

- Creation of knowledge depends on three sentiments:
 - Wonder, excited by what is new and singular,
 - Surprise, excited by what is unexpected,
 - Admiration, excited by what is great or beautiful,
- Systems of knowledge are mere inventions of the imagination, to connect together the otherwise disjointed phenomena of nature. Philosophers create, rather than discover knowledge,
 - My commentary: If this is the case, then knowledge that we have is relativist and depends on the philosophers' background,
- Method of rhetoric is proposed as the way to select the propositions to be accepted and those to be rejected. An impartial spectator is assigned the role of the arbiter of what is true and false – provisionally, not absolutely,
 - My commentary:
 - I believe that there exists a structure intrinsic to reality. The role of „hard sciences“ is to discover this structure. Social sciences are reflexive in the sense that what they discover about their object can have an influence on the object, so they can “create“ reality,
 - Imagination can create systems of knowledge that do not have links with the structure intrinsic to reality. Maybe it has its sense, but I prefer systems linked with real structures,
 - John Stuart Mill in his *On Liberty* stressed the importance of free speech. Free speech in scientific discourses brings us closer to the truth.

Why Do We Study the History of Economic Thought?

- For understanding a system, one must understand both its state and its dynamics,
- Economics is a system of knowledge; one must understand both its state and its dynamics,
- We learn the current state of Economics in Microeconomics, Macroeconomics, International Economics, Development Economics and other courses,
- History of Economic Thought helps us in understanding the dynamics of Economics.