

## Chapter 1

# Who Is Joseph Schumpeter?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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2. Noted in McCraw (2009): 249.

