

## **Conflicting Views of the Entrepreneur in Turn-of-the-Century Vienna**

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**Abstract:** Joseph Schumpeter's theory of the entrepreneur is the most well-known approach to be developed in continental Europe at the turn of the century, and has exercised considerable influence on the literature. However, this paper shows that alternative theories of the entrepreneur were developed by scholars close in time and space to Schumpeter's *The Theory of Economic Development*. First, the contribution of Rudolf Hilferding is unknown in the literature on entrepreneurship and is important due to the absence of entrepreneurial theory in the Marxist literature upon which Hilferding built. Second, while the later contributions of Ludwig von Mises to entrepreneurial theory have been discussed, the early comments of his 1912 treatise are often passed over, and are a significant foil to Schumpeter's views. Discussing the early writing of Mises on entrepreneurship also helps show the ambitious scope of Mises's first book, and furthermore, allows us to properly position his writings in the history of economic thought.

### **1 Introduction**

At the turn of the twentieth century Vienna experienced a renaissance in the arts and sciences in which economics also experienced a revolutionary change (Janik and Toulmin 1973; Schulak and Unterköfler 2011). In economics one field in which there was significant progress was entrepreneurial theory. While Joseph Schumpeter's theory of the entrepreneur is perhaps the most important and certainly the best known developed in this period, this paper will show that other scholars in Vienna were simultaneously producing different theories of entrepreneurship which merit attention. In particular, our paper will be concerned with examining major contributions to entrepreneurship theory by Rudolf Hilferding, on the one hand, and Ludwig von Mises, on the other hand, and compare them to that of Schumpeter's theory.

The distinct aspects of the entrepreneurial function have sometimes become lost or blurred in the history of economic thought. Especially in the British classical tradition, entrepreneurial theory was largely neglected in favour of a narrower view of economic development which conflated any entrepreneurial function with that of the capitalist, to the neglect of the former (Hébert and Link 1988; Kirzner 1979). In the early twentieth century, however, Viennese economists, working in several different traditions in economic thought, considered entrepreneurship an important area of study. The founder of the Austrian School, Carl Menger, wrote only briefly on the subject (Gunning 1997; Martin 1979; Kirzner 1979: 53-75). Nevertheless, Menger's teaching inspired his students, particularly Victor Mataja, to continue work on entrepreneurship within the Austrian tradition (Schulak and Unterköfler 2011: 56-7). Eugen von Böhm-Bawerk also touched on the subject of entrepreneurship, although his theory remained largely nascent (McCaffrey and Salerno 2013). Thus, young scholars in Vienna intent on developing the theory of the entrepreneur had significant recent contributions upon which to draw, though to be drawn principally from a critical perspective. This intellectual setting in Vienna

led to a watershed in entrepreneurial theory with the publication of three treatises on money, banking and economic development: Rudolf Hilferding's *Finance Capital* (1981 [1910]), Joseph Schumpeter's *The Theory of Economic Development* (1911), and Ludwig von Mises's *The Theory of Money and Credit* (1912). Comparing and contrasting these three authors and their specific books together is not random; on the contrary, they form a natural triumvirate of economic writings from this period, as I show below.

This paper will therefore attempt to explicate the theories of Mises and Hilferding in their own right, as well as to provide some comparisons with Schumpeter's view, in order to show that at this early stage the field of entrepreneurial theory was a keenly contested one. Although it does provide some brief biographical context to tie the discussion together, this paper is not an historical account of Viennese economics in this period, but rather an exposition of two contributions to economic theory, and a short comparison on several points. The aim is not to show which theory succeeds most. Instead, my purpose is to provide hitherto-overlooked details of the disputed nature of entrepreneurial theory at this time and in this intellectual milieu, and thereby to contribute toward a sounder foundation for further study of the works of these economists.

This paper is structured as follows. Section 2 explains the importance of the work of Mises, Hilferding and Schumpeter and describes the relevance of these three economists both in relation to each other and for entrepreneurial theory more generally. It compares and contrasts some relevant themes from the books of Hilferding, Mises and Schumpeter, in order to highlight important underlying similarities and differences of each. In particular, ideas about the entrepreneur's ownership of capital, the role of uncertainty-bearing, sources of finance and equilibrating properties are shown to be sources of controversy. Section 3 then provides a deeper analysis by examining the entrepreneur in Hilferding's *Finance Capital*, explaining the nature of promoter's profit and how the entrepreneur fits in the development of the capitalist economy. Section 4 concerns Mises's comments on the entrepreneurial function, primarily the entrepreneur's role as the directing agent of production. A brief conclusion follows in section 5.

## **2 Influence and Disagreement between Hilferding, Mises and Schumpeter**

The rationale for grouping these three economists together is based on the fact that their early works emerged, first, in consecutive years, and, second, from the same intellectual milieu. All three authors were students in the seminar of Böhm-Bawerk at the University of Vienna, and although their views on economics differed widely, the seminar was a formative experience for all of them.<sup>1</sup> Starting from this common influence each developed an economic theory consistent with his interests at the time. Despite developing different traditions in economic thought and often pursuing dissimilar ideas in their respective books, common themes run throughout each of these early works, with the authors sometimes even specifically addressing the others' writings. To take one example, each book delved into the theories of money and banking, and helped continue debates begun decades earlier by the currency and banking schools in Britain (McCaffrey 2012). However, one area of contrast between their views which has not yet been considered is the theory of entrepreneurship.

This paper will therefore discuss the different theories of entrepreneurship developed by Hilferding, Mises and Schumpeter in these early works. In addition to

being a unique moment in the history of economic thought—when three economists from different economic traditions simultaneously examined the problem of entrepreneurship—the theories of Hilferding and Mises enjoy special justification for discussion.

At the centenary of his first book, Mises's *The Theory of Money and Credit* continues to influence scholars in monetary theory, but its scope is wider than that field alone (Hülsmann 2012). The book is in fact a blueprint for much of Mises's later writing on a variety of economic problems, writing which culminated in his treatise *Human Action*, first published in 1949. One of these relatively neglected early topics is the theory of entrepreneurship. Understanding Mises's first insight into this topic is important for three reasons. First, it shows the tremendous range and scope of the project of *The Theory of Money and Credit*, which is more than a treatise on money and banking. Second, the attention to entrepreneurs in the book shows that Mises's theory of the entrepreneurial function developed earlier than is commonly thought, and that his later work is in fact an extension of his earlier writings, a development which took shape systematically over nearly four decades from 1912 to 1949. Third, by dating the starting point of Mises's thinking on entrepreneurs to 1912 (as opposed to the 1920s or even later), it becomes possible to properly position Mises's work on entrepreneurship in the history of economic thought, and within the Austrian school, in particular. It is no surprise that Mises's writings falls within the tradition established by Menger, but exactly how they do is often misunderstood. Mises's fully-developed theory of the entrepreneur and its relationship to Schumpeter's view has been the subject of much discussion (Hébert and Link 1988; Kirzner 1973; Rothbard 1985), but his 1912 views remain neglected in the literature and merit attention.

Likewise, at the centenary of Hilferding's *Finance Capital*, King (2010) noted the unfortunate neglect the book has suffered, especially given its originality and the wide range of its subject matter. Paying special attention to the entrepreneurial aspect of *Finance Capital* can therefore be justified on similar grounds to those provided for Mises: Hilferding has not been discussed in entrepreneurship studies thus far, and merits a place in the history of entrepreneurial theory. Hilferding's entrepreneurial efforts are noteworthy, and their neglect unfortunate, given Marxism's lack of attention to entrepreneurship. For instance, Hollander (2008: 409-11) describes the conventional view that Marx, following the example of some of the British classical economists, conflated the entrepreneurial function with that of the capitalist, thus removing the possibility for a distinct entrepreneurial function. Samuel Hollander also argues, however, that Marx did in fact advance some ideas (particularly in his later writings) about the productive roles played by active industrial capitalists, roles that resemble entrepreneurial functions—even though these productive functions seem to conflict with other ideas in Marx's work, particularly the aforementioned conflation of entrepreneur and capitalist (Hollander 2008: 411-43).

Hilferding, Mises and Schumpeter each depend upon entrepreneurial activity to explain economic growth and development, and there are important comparisons to be made between their respective theories. Schumpeter's theory is well known, and requires little elaboration. Let us therefore consider first the case of Mises. Other authors have discussed the differences between Mises and Schumpeter on entrepreneurship (Hébert and Link 1988),<sup>2</sup> so this consideration is limited to points which are not typically raised in the literature. At least as late as 1931, Mises still considered *The Theory of Economic Development* to be one of the top four German-language contributions to economics, mostly due to its emphasis on the

entrepreneur as the driving force of the economy.<sup>3</sup> And Schumpeter in turn heralded the 'power and originality' of Mises's first book.<sup>4</sup> One great contrast between Mises and Schumpeter though is on the issue of credit as the prerequisite of entrepreneurship. Whereas for Mises ([1924] 1953: 339-66), credit created *ex nihilo* is deleterious, in fact disastrous, for the economy, for Schumpeter (1934: 57-94) such credit is absolutely necessary. Mises's approach relies on an entrepreneur-capitalist who draws on savings in order to expand future production, while Schumpeter's innovator-entrepreneur requires bank credit in order to introduce new combinations of the factors of production.

This conflicting view of Mises and Schumpeter on the role of money and credit to entrepreneurship led to differing views on the causes of the business cycle. In this regard, one fact which is often forgotten is that *The Theory of Economic Development* is a theory of entrepreneurship very much integrated into a theory of money and credit. In contrast, *The Theory of Money and Credit* is a treatise on monetary economics containing insights regarding how entrepreneurs arrange productive activities. Commentators often focus on Schumpeter's entrepreneur as a dynamic innovator and creator, while forgetting that he is also the key player in allocating new credit in the economy. In later expositions of entrepreneurship such as *Capitalism, Socialism, and Democracy*, Schumpeter largely avoided monetary matters, but it is clear that 'credit means of payment' were one of the most important problems in his early theoretical work. For Mises though, the emphasis is on providing a meaningful unit of accountancy to entrepreneurs, so they may properly appraise the prices of various goods. Although the connection is different, both authors found issues of money closely tied to the problems of entrepreneurship.

One of the reasons for this difference is that their theories have different purposes. Mises, even at this early date, was developing a theory of the market process wherein equilibrium states were a secondary concern compared to the actual conditions of the market. Entrepreneurs constantly rearrange the pattern of production according to their calculations of the future demands of consumers and the future prices of the factors of production. Mises's view of economic activity thus takes change as a given, and because change in the relevant human data is constant, disequilibrium always exists in the economy, and economic affairs never enter a general equilibrium state ('the final state of rest' as he would later call it), although there is a tendency toward such an equilibrium.

By contrast, Schumpeter's theory begins with an equilibrium construct, and along with it, a particular problem emerges. The question is: how can a static economy ever develop when all relevant data are given by the equilibrium conditions of the 'circular flow'? How does an economy, so to speak, 'break out of the Walrasian box' (Rothbard 1987)? Schumpeter's (1934: chap. II) dynamic theory of the entrepreneur is precisely an explanation of how change comes about from such a position of economic stagnation. In this situation all resources are used completely in every period, leaving no room for any resources which could be used to radically change production (Schumpeter 1934: 8-10). For Mises, economic analysis is the explanation of the market process, while for Schumpeter the problem is one of stationary equilibrium and explaining the process of economic change from an existing equilibrium to a new one brought about by entrepreneurial innovation. Because of this divergence in the objects of their respective theories, Mises and Schumpeter arrived at different conclusions regarding what sort of resources could be used to finance entrepreneurial behaviour.

Ultimately then, while there are certain broad themes in common between these theories, they are quite dissimilar. Despite some minor acknowledgements and a certain degree of mutual respect, there remains a fundamental difference between the methods of Mises and Schumpeter that, for the most part, prevented intellectual gains from trade. For example, Mises (1978: 36-7) criticised Schumpeter because 'In his first book he significantly related himself to Wieser and Walras, but not to Menger and Böhm-Bawerk. Economics, to him, is a theory of "economic quantities", and not of human action. Schumpeter's *Theory of Economic Development* is a typical product of the equilibrium theory'. As Hayek (1992: 157) describes the two economists, '[Mises] completely lacked the adaptability of his brilliant seminar fellow Joseph Schumpeter... In fact, it appeared to me as if these two most important representatives of the third generation of leading Austrian economists... both got on each other's nerves'.

Between Mises and Hilferding was even less of an intellectual affinity. As a dedicated Marxist, Hilferding's defence of the labour theory of value placed him even further apart from Mises than Schumpeter. Mises's intransigence on matters of economic theory, combined with a lack of intellectual common ground, meant that here too, Mises would have little effect on the views of his contemporary, and *vice versa*. In fact, Hilferding (1993 [1912]) negatively reviewed the first German edition of *The Theory of Money and Credit* for the socialist theoretical journal *Die Neue Zeit*, and barbs were occasionally exchanged by the two men for several years. In the field of money and banking the two economists were particularly opposed to each other (McCaffrey 2012). Suffice it to say that neither economist exercised an obvious positive influence on the thinking of the other.

The relationship between Hilferding and Schumpeter was far more congenial. Schumpeter first met Hilferding at the Theresianum gymnasium, an exclusive school for the Viennese aristocracy, and it appears they remained friends for some years (Haberler 1950). Hilferding, along with fellow University of Vienna student Emil Lederer, even invited Schumpeter to serve on the German Socialization Committee in 1919, and later helped Schumpeter obtain an appointment to the Austrian Finance Ministry (Allen 1991: I, 162, 165). In entrepreneurial theory there appears to be an influence running between Hilferding and Schumpeter.<sup>5</sup> Like Schumpeter, Hilferding advances a concept of the entrepreneur who neither owns property nor bears uncertainty in the market. Also, both entrepreneurs are innovators, although Hilferding's entrepreneur changes the firm from within, while Schumpeter's entrepreneur incites change from without the existing firm structure (Michaelides and Milios 2005). It is not unreasonable to suggest that Schumpeter may have been attracted to these portions of Hilferding's theory.<sup>6</sup>

Another source of influence is Friedrich von Wieser, who takes pains to establish the *character* of the entrepreneur and the leadership traits he possesses, an essentially sociological idea Schumpeter frequently mentions in his own works (see especially Schumpeter 1942). Wieser ([1914] 1927: 327) describes the entrepreneurs as 'Great personalities... bold technical innovators, organizers with a keen knowledge of human nature, far-sighted bankers, reckless speculators, the world-conquering directors of the trusts'. It is easy to see how this romantic notion of the entrepreneur influenced Schumpeter, who also regarded the entrepreneur as a man set apart from his fellows, guided by almost supernatural business instincts.<sup>7</sup>

Yet the influence of Hilferding on Schumpeter shines through also in the emphasis on the more technological aspects of the entrepreneurial function. It might almost be said that Schumpeter forms his own theory by taking

Hilferding's views and adding Wieser's 'romantic' notion of the entrepreneur—the grand industrial leader—and then grafting this hybrid theory onto his Walrasian circular flow model. The combination of these strange economic bedfellows—Hilferding, Walras and Wieser—generates the famous vision of the entrepreneur found in *The Theory of Economic Development*. This interpretation is consistent with Hébert and Link (1988), who mention the influence of Walras and Wieser, but not that of Hilferding, who is unappreciated in the entrepreneurial literature, as well as much of the English-speaking economic tradition.

Suffice it to say that there was much personal and intellectual interaction between these economists during these early years, and significant influence and controversy on problems pertaining to entrepreneurship. However, these personal and intellectual ties were broken over time. After the early days, especially with the emigration of many of the Austrian economists in the 1920s and 1930s, contact became more difficult, divisions between thinkers became more pronounced, and research interests often diverged. In his 1928 survey of literature on the entrepreneur, Schumpeter does not mention either Mises or Hilferding (Schumpeter [1928] 2003). By this point, Schumpeter had become regarded as an authority, and the contributions of his two early contemporaries largely forgotten.

### 3 Rudolf Hilferding: The Entrepreneur as Promoter and Manager

Hilferding (1877-1941) is probably the least well known of these three economists, despite his considerable influence on the intellectual currents of Marxism in the first decades of the twentieth century. He was a member of a group of intellectuals who became known as 'Austro-Marxists'. The key figures in this school of thought were Max Adler, Otto Bauer, Karl Renner and Hilferding. The school is distinct among the many branches of Marxism in that it attempted to develop a scientific approach to Marx's economic and sociological theories, in addition to formulating a Marxist approach to epistemological questions that addressed and incorporated sources outside of Marxism's usual domain, such as Neo-Kantianism and early logical positivism (Bottomore and Goode 1978: esp. 15-18). The Austrian politician Otto Bauer describes the social and intellectual milieu of the Austro-Marxists:

Whereas Marx and Engels began from Hegel, and the later Marxists from materialism, the more recent 'Austro-Marxists' had as their point of departure [Immanuel] Kant and [Ernst] Mach. On the other side, in the universities these 'Austro-Marxists' had to come to terms with the so-called Austrian school of political economy, and this controversy too influenced the method and structure of their thought. Finally, living in the old Austria rent by national struggles, they all had to learn to apply the Marxist conception of history to very complicated phenomena which defied analysis by any superficial or schematic application of the Marxist method. (1978: 45-6)

Hilferding made his debut as an economist by writing a response to Böhm-Bawerk's critique of Marx, titled *Böhm-Bawerk's Marx-Kritik*. After this initial salvo, Hilferding set to work writing a comprehensive treatise describing the last stages of the evolution of capitalism. *Finance Capital* was published in 1910, and was Hilferding's major achievement in economic theory.<sup>8</sup> In this treatise Hilferding sought to explain the evolution of capitalism through a series of developmental phases that was not fully elucidated by Marx, as well as to describe in detail the

imperialistic tendencies of capitalism, and the causes of the capitalist business cycle. Although Marx had discussed the development of capitalism into socialism, he had left the economic aspects of his theory largely undefined at the time of his death, and Hilferding attempted to provide a theory to complete Marx's historical theory. To a great extent he was successful: *Finance Capital* elevated Hilferding to the status of one of the most important living socialist economists (Sweezy 1949: xvi).<sup>9</sup>

Hilferding's Marxist theory of the entrepreneur is an overlooked contribution to Marxism and, more generally, to the entrepreneurial literature. Although some research has noted his theory of promoter's profit, his theory is not well explicated, and is not discussed in relation to other theories (see Bottomore 1981: 5-6; Zoninsein 1990: 52-4). As mentioned above, Marx supplied some important hints about the entrepreneurial function, although the entrepreneur's role in his overall system is sketchy. Hilferding's economic system is atypical in that the entrepreneur plays a relatively large and explicit role. What is more, his entrepreneurial theory contributes to his larger vision of the last stages of capitalism. It does appear though that Hilferding took certain cues from Marx, especially building on Marx's ideas about joint stock corporations and the managerial role in the corporation. Despite Marx's somewhat ambiguous views on these subjects (Hollander 2008: 430-8), Hilferding takes a reasonably straightforward approach. Rather than explain all the complexities of Hilferding's theory of finance capital and its relation to Marx's work, we only elucidate his theory of entrepreneurial profit, and provide some explanation as to how it fits into his theory of capitalist development.

According to Hilferding, in the earliest phases of capitalism—before the emergence of the corporation as a major economic form—the functions of the capitalist and the entrepreneur were one and the same. This situation held so long as enterprises were individually owned. However, with the advent of the joint-stock company, the functions of the capitalist and entrepreneur become distinct. In fact Hilferding went so far as to claim that the transition from individually-owned business to joint-stock company is the defining characteristic of the latest stage of capitalism: 'Modern capitalist development... can only be comprehended in terms of the ascendancy of the corporation and its causes' (Hilferding [1910] 1981: 108). The structure of the firm (that is, its role as a joint stock company) thus provides the grounding for Hilferding's entrepreneurial theory, by making room for a special entrepreneurial role.

Hilferding begins his discussion of entrepreneurship with a distinction between 'money capitalists' and 'industrial capitalists'. This distinction and many of the subsequent definitions and discussions are borrowed from Marx, particularly in his discourse of profit and interest in Volume III of *Capital* (Marx 1909, Part V: esp. 397-488). A money capitalist is the financier of a corporation: 'His only function is to lend his capital and, after a period of time to get it back with interest... so also the shareholder functions simply as a money capitalist' ([1910] 1981: 107). These financiers invest wherever they see an opportunity to earn interest, and it is they who are the owners of any capital lent to firms in the economy. As the owners, they must also bear the uncertainty involved in investing.

'Industrial capitalists,' on the other hand, are the entrepreneurs in Hilferding's system (although Hilferding uses the term, 'promoter' rather than 'entrepreneur').<sup>10</sup> Entrepreneurs are employed by specific enterprises over long periods of time. The entrepreneur manages resources *within* the firm, directing production and introducing innovations in order to increase the firm's profits. The entrepreneur is essentially the chief manager of the enterprise, owning no capital and bearing no

uncertainty. As managers, the entrepreneurs are the engineers of enterprise, operating according 'to the purely technical requirements of production' ([1910] 1981: 126). Because management consists of simply solving technological problems, the entrepreneurs alone are capable of focusing on the long-run problems of the firm. That is, because they are not concerned with generating short-term profits, it is possible for them to consider the long term more fully. These long-run interests must take precedence over 'the interest which owners have in obtaining the largest possible profit as quickly as possible, their lust for booty, which slumbers in every capitalist soul' ([1910] 1981: 126).<sup>11</sup>

Being a Marxist, Hilferding naturally believed that firms tended in the long run to earn the average rate of profit. But the emergence of the corporation as an economic form brings with it the possibility of selling shares at prices which exceed the prices of currently-invested capital, so long as the yield to capital is larger than the rate of interest on investments. When an individually-owned enterprise becomes a corporation and sells shares, it thereby sells claims on future production. These shares, however, are not tied to the prices of the industrial capital actually invested in the enterprise, but are what Hilferding describes as 'fictitious capital', that is, the price of a future revenue stream. This is not capital at all, according to Hilferding, but merely an accounting trick inherent in the corporate form. There is then no necessary relation between the yield of investment capital and share price ([1910] 1981: 111). Most importantly, a positive difference actually exists between the total share price and the actual yield of invested capital. Hilferding characterises this balance as entrepreneurial profit. Specifically, the entrepreneur earns 'The difference between capital which earns the average rate of profit and capital that earns the average rate of interest. This is the difference which appears as "promoter's profit", a source of gain which arises only from the conversion of profit-bearing into interest-bearing capital' ([1910] 1981: 112). The new profit derives from the ability to sell shares at prices which do not reflect the amount of capital actually invested in the firm, and this ability generates the income stream of the promoter-entrepreneur (Smaldone 1998: 43-4; Zoninsein 1990: 53-4). Specifically, the existence of a stock market makes possible competition for money capital between fixed-yield investments and shares. Competition between these opportunities bids down share prices until they equal the returns on fixed-yield investments. So long as share prices exceed fixed-yield returns there is a positive component of entrepreneurial profit in the share price ([1910] 1981: 109). Hilferding therefore considers entrepreneurial profit to be a category of income apart from either wages or interest: 'Promoter's profit is neither a swindle, nor some kind of indemnity or wage. Is it an economic category *sui generis*' ([1910] 1981: 112).

Alone among the Viennese economists, Hilferding is able to express the determinants of entrepreneurial profit in terms of a strict formula. According to Hilferding, 'capital is equal to one hundred times the interest, divided by the rate of interest' (1981 [1910]: 114). Therefore if we wish to estimate the difference between profit-earning and interest-bearing capital, we may use the following equation:

$$P = \frac{100Y}{d} - \frac{100Y}{p}$$

where  $P$  represents the promoter's profit,  $p$  is the average profit,  $d$  is the dividend on shares, and  $Y$  is the gross yield of the enterprise (1981 [1910]: 114).<sup>12</sup>



By innovating from within (rearranging resources and production techniques) the entrepreneurs manage capitalist enterprises as they pass through the final stages of capitalist development. At the core of *Finance Capital* is a discussion of the evolutionary nature of capitalism, and Hilferding argues that the 'latest phase' of capitalism—the main topic of his treatise—is the beginning of the end for capitalist society. As a part of their management activities, entrepreneurs assist in the transformation of individual enterprises into corporations. The gradual concentration of industry and its transformation into ever-larger economic entities with ever-increasing market power is a major theme of *Finance Capital*. It is through this transformation—along with the political transfer of power (for example, through electoral victory)—that capitalism can make the transition into socialism, by bureaucratising firms and centralising economic power. As mentioned above, the capitalists cannot advance any cause other than their own short-term interests without the entrepreneurs (who hold a long-run view), and the entrepreneurs are thus closely tied with the long-term growth prospects for capitalist enterprises. The possibility of earning entrepreneurial profits in addition to ordinary interest makes the corporate form desirable to capitalists, and this incentive creates a tendency within capitalism toward the formation of new corporations, and to enlarging and cartelising already-existing corporations. In particular, because banks are for Hilferding the primary source of business investment, they have a vested interest in overseeing these businesses and concentrating capital within them, and additional investment and share issue through banks produces additional profits (Hilferding 1981 [1910]: 116-21). This concentration, especially under the leadership of large banks, is one of the first steps in Hilferding's theory of the development of capitalism into socialism, the first phase of the last stages of capitalist economic evolution.

#### 4 Ludwig von Mises: The Entrepreneur as Owner and Director of Production

Ludwig von Mises (1881-1973) is the only one of these Austrian-born economists who can truly be said to belong to the 'Austrian' school of economic thought; the school founded by Carl Menger and developed in two major branches by Eugen von Böhm-Bawerk and Friedrich von Wieser. During his studies he attended the seminars of the great Viennese economists of his day: Eugen von Böhm-Bawerk, Carl Grünberg and Eugen von Philippovich, and was personally familiar with Carl Menger. It was Böhm-Bawerk's seminar, however, which played the most important role in the development of his economic thought. What distinguishes Mises from several of the most important students of the early 'Austrian' school is his intellectual devotion to Böhm-Bawerk and Menger, and the relatively small emphasis he places on the teaching of von Wieser, whereas the latter exercised a powerful influence on Schumpeter.

Mises's early views on entrepreneurship require special explication. In his first studies Mises is concerned with the entrepreneurial function only tangentially, and his interest in entrepreneurs revolves mainly around their use of money to calculate and rationally allocate resources in society (Mises [1924] 1953: 48-9, 205, 223). While it is clear that the entrepreneur plays a most important role in Mises's later views of economic progress, in his first book his treatment of entrepreneurship is embedded in discussions of various monetary problems. However, in this tangential treatment there exist the seeds of a definite theory of entrepreneurship which Mises

was to develop in his magnum opus, *Human Action* (1949). As far as entrepreneurship is concerned though, his early writings are neglected in favour of his (far more complete) later work. The early formulation of his views on entrepreneurship is important for this paper inasmuch as it reveals a contemporary alternative to Schumpeter's thinking.

As with much of his economic theory, Mises borrows heavily from Böhm-Bawerk in his presentation of the entrepreneurial function.<sup>13</sup> Specifically, his notion of entrepreneurship ties the person of the entrepreneur almost inextricably to the capitalist. Despite this problem, it is important to note that although it may be difficult in practice to separate the *persons* of the capitalist and the entrepreneur, in Mises's theory the two are distinct *functions* which can be separated analytically. The two major characteristics of Mises's entrepreneur are, first, that he is an owner of resources, and, second, that he devotes these resources to time-consuming processes of production in an attempt to anticipate the future wants of consumers.<sup>14</sup> However, these two characteristics are often only implicit in Mises's discussions, and therefore we must take special care to bring them to light.

We begin with the idea of the owner-entrepreneur. Mises's entrepreneur demands capital for productive uses. It is important that Mises's entrepreneur is not simply a manager: as an owner, he exercises ultimate control over his resources. The demand for capital by entrepreneurs is the demand for *ownership* of capital. This becomes clear in a passage from *The Theory of Money and Credit*, addressing the entrepreneur's reaction to credit expansion:

An entrepreneur *who wishes to acquire command over capital goods and labour in order to begin a process of production* must first of all have money with which to purchase them. For a long time now it has not been usual to transfer capital goods by way of direct exchange. The capitalists advance money to the producers, who then use it for buying means of production and for paying wages. Those entrepreneurs who do not have enough of their own capital at their disposal do not demand production goods, but money. The demand for capital takes on the form of a demand for money. But this must not deceive us as to the nature of the phenomenon. What is usually called plentifulness of money and scarcity of money is really plentifulness of capital and scarcity of capital... The entrepreneur who would like to extend his business beyond the bounds set by the state of the market is prone to complain of the scarcity of money. ([1924] 1953: 340-1; emphasis added)<sup>15</sup>

Here is the theory in a nutshell. The preceding passage explicitly states that the entrepreneur is actively engaged in acquiring capital goods and devoting them to production. This indicates that in this early work Mises envisioned the entrepreneur as demanding money in order to purchase capital goods *which he then directs toward production*, or in other words, Mises is utilising a capital-owning conception of the entrepreneur. The entrepreneur is the fundamental bearer of economic growth, because it is the entrepreneur who guides the production process in the present in an attempt to increase consumer satisfaction in the future; it is the entrepreneur who directs production through time.<sup>16</sup>

There are other, more obscure references that convey the same general meaning as the above passage. For example, in a section from *The Theory of Money and Credit*, titled 'Economic Calculation and Accountancy', Mises discusses how capital consumption results from the depreciation of the monetary unit. In this context, Mises states that the entrepreneur consumes capital as a result of the

lowering of the value of money (Mises [1924] 1953: 205). In similar vein, Mises notes, 'The entrepreneur who is reckoning in terms of a currency with a stable value is unable to compete with the entrepreneur who is prepared to make a quasi-gift of part of his capital to his customers' (Mises [1924] 1953: 205). These observations can only be understood if the entrepreneur possesses some share of ownership in the stock of available capital, and if he exercises ultimate control over his resources. In addition, by arguing that it is the entrepreneur who consumes capital and makes 'quasi-gifts', Mises appears to suggest that it is the entrepreneur who bears the uncertainty of his own economic decisions (or at least the uncertainty present in the case of monetary depreciation). Bearing uncertainty necessarily implies ownership of resources which are at risk of capital depreciation in the marketplace; one cannot lose (or give) what one does not possess.

A question arises in regard to economic growth: where do the entrepreneurs obtain the resources they devote to the production process? For Mises, the answer rests with savings, as opposed to bank credit expansion ([1924] 1954: 221, 347, 361-2).<sup>17</sup> For sustainable economic growth to occur in Mises's system, individuals must adjust their consumption-saving preferences to allow for greater investment (that is, they must experience lower 'time-preference'). New investment enlarges the higher stages of production, expanding investment to include more 'roundabout' methods of production, guided by the decisions of entrepreneurs. The entrepreneur's profit is a return to successful anticipation of consumer wants through adjusting the structure of production. If instead the entrepreneur's judgements about the future prove incorrect, he incurs losses. Saving is the only way to align consumption-saving preferences with the supply of money, an alignment upon which economic stability depends. In this view, increases in the supply of money not corresponding to increases in the demand for money inevitably lead to economic crisis.

Discussing the monetary influence on the rate of interest leads Mises to comment further on the entrepreneurial role:

Now if the rate of interest on loans is artificially reduced below the natural rate as established by the free play of the forces operating in the market, then entrepreneurs are enabled and obliged to enter upon longer processes of production. It is true that longer roundabout processes of production may yield an *absolutely* greater return than shorter processes; but the return from them is *relatively* smaller, since although continual lengthening of the capitalistic process of production does lead to continually increasing returns, after a certain point is reached the increments themselves are of decreasing amount... Thus it is possible to enter upon a longer roundabout process of production only if this smaller additional productivity will still pay the entrepreneur. So long as the rate of interest on loans coincides with the natural rate, it will not pay him; to enter upon a longer period of production would involve a loss. (Mises 1954: 360-1; emphasis in original)<sup>18</sup>

The idea that entrepreneurs are 'enabled and obliged' to begin production refers to the opportunity and incentive for entrepreneurial behaviour. Divergences between the money and natural rates of interest provide possibilities for the expansion of production, possibilities which will be seized by entrepreneurs eager for profit. But in order to be successful, the return from the marginal productive increase must of course be greater than the entrepreneurs' outlay. The entrepreneur therefore adjusts his own behaviour to prevailing conditions, specifically the rate of interest, in order

to earn profit and avoid loss. In other words the entrepreneur exercises *judgement* in his use of the factors of production, which can ultimately be mistaken if the entrepreneur incorrectly anticipates the returns from production. In this specific case, the arrangement of the factors comes in the form of the lengthening or shortening of the structure of production. In addition to the profit incentive, Mises also mentions the disincentive of the prospect of loss. This once again implies that entrepreneurs are bearing the uncertainty of their own judgemental decision-making.

Although the above comments are not yet a complete theory of the entrepreneur, they reveal that even at this early point Mises was developing a systematic method of looking at economic development and the entrepreneurial function. What is more, these early thoughts place Mises within a tradition in entrepreneurial thinking which was germinating around the turn of the century. This emerging tradition begins with Menger, is visible in the works of Böhm-Bawerk, and is more fully developed in the writings of Frank Fetter (Martin 1979; McCaffrey and Salerno 2013; Salerno 2008). It is also closely tied to the idea of entrepreneurial judgement found in the work of Frank Knight, whose approach was quite similar to Böhm-Bawerk's (Foss and Klein 2012; Hébert and Link 1988: 69). Mises would later incorporate the ideas of Böhm-Bawerk, Fetter and Knight into his work much more fully, particularly in his complete exposition of economic theory, *Human Action* (Mises 1998; Salerno 2008). In these early days though, his attention was focused on the problems of money and banking. Nevertheless, *The Theory of Money and Credit* is an early foray into entrepreneurial theory, and one which is consistent with entrepreneurial thinking at the time, particularly with regard to Menger and the Austrian school (Martin 1979).

## 5 Conclusion

This paper has presented two theories of the entrepreneur, corresponding to two early contemporaries of Schumpeter: Rudolf Hilferding and Ludwig von Mises. Hilferding offers a Marxist alternative to the theory of entrepreneurship found in marginalist writings, and Mises provides some insights into the entrepreneur regarding the organisation of production, ideas that would bear fruit in his later works. Both of these contributions have been overlooked in surveys of entrepreneurial theory as well as in narrower studies of Hilferding and Mises. An examination of their ideas on this topic is therefore a worthy task for scholars interested in entrepreneurship, especially considering the increasing attention given to the theories of economists such as Mises and Schumpeter in entrepreneurial studies.

Although emerging in the same milieu, each of these authors forged his own theoretical path. Explaining the divergence between theorists is not difficult. Early on, each possessed a particular intellectual influence that shunted his respective views onto new lines, despite starting with a degree of common training and a desire to explain similar economic problems. In general, we might say that each takes away from entrepreneurial theory roughly what he brings to it to begin with. Schumpeter, strongly influenced by Walras, uses the entrepreneur as a tool to explain the escape from static equilibrium. Hilferding, following Marx, conceives of the entrepreneur as a fundamental explanation of resource allocation within the firm. And Mises, while in the process of integrating Böhm-Bawerk's capital theory into a theory of money, also contributed ideas about how capital is arranged (that is, how entrepreneurs alter the structure of production).

It is worth summarising at the close some of the major attributes of these three differently conceived entrepreneurs. First, neither Schumpeter's nor Hilferding's entrepreneur owns capital nor bears market uncertainty, whereas Mises's entrepreneur does both. Mises's entrepreneur may therefore earn losses instead of profits, a possibility ruled out for Schumpeter's entrepreneur and possibly Hilferding's as well. Second, while Schumpeter's entrepreneur innovates outside the boundaries of existing firms, Hilferding's innovates from within the firm. Mises's entrepreneur, on the other hand, is not bound to do either: arranging the structure of production may involve innovation (inside or outside the firm), but need not. Third, newly-created bank credit is a fundamental necessity for Schumpeter's entrepreneur. Banking activities also play a large role for Hilferding, especially through their role in expanding the supply of credit, thus helping to link and cartelise the industrial and financial forces in the economy. For Mises, on the other hand, bank credit is at the root of the business cycle, and entrepreneurial behaviour must be rooted in sound saving and investment decisions, lest unsustainable production occur.<sup>19</sup> Each of these three broad topics—capital and uncertainty, innovation and credit creation—possesses great relevance for the contemporary world economy, and is worthy of further exploration. In terms of both theoretical and historical analysis, future research will have much to say regarding the ideas of all three of these economists.

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## Notes

1 On Hilferding's life and work, see Wagner (1996) and Smaldone (1998). For Mises's account of Vienna and his early contact with Hilferding and Schumpeter, see his *Memoirs* and Hülsmann (2007). There are many biographies of Schumpeter, but the most important for this paper is Robert Loring Allen's *Opening Doors: The Life and Work of Joseph Schumpeter*. Biographical information is taken from these sources, except where cited. Some terminology is taken from Hébert and Link (1988).

2 See also the work of Israel Kirzner, especially Kirzner (1973, 1979).

3 Ludwig von Mises, Letter to Miss Haider, dated July 3, 1931; quoted in Hülsmann (2007: 172).

4 Quoted in Hülsmann (2007: 208).

5 For discussions of Schumpeter's relationship with and intellectual debt to Hilferding, as well as to the broader Austro-Marxist tradition, see Bottomore and Goode (1978: 24-5, 35-6) and Michaelides and Milios (2005).

6 Michaelides and Milios (2005) document the influence of Hilferding on Schumpeter, although they emphasise the differences between the two on entrepreneurial theory.

7 In this sense Schumpeter's entrepreneur sounds almost Nietzschean. Some discussion of Schumpeter and Nietzsche is found in Reinert and Reinert (2006).

8 With the German subtitle *Das Finanzkapital. Eine Studie über die jüngste Entwicklung des Kapitalismus*, which is translated as 'A study of the latest phase of capitalist development'.

9 'Important' is perhaps more appropriate than, say, 'revered,' because although the work received much attention and praise, responses to Hilferding's work were mixed. Leon Trotsky, for example, considered Hilferding an 'armchair' Marxist and criticised him for lacking what he considered to be an appropriately revolutionary spirit (Trotsky

1970: 206-7, 213). *Finance Capital* did however command considerable authority in Marxist studies of imperialism and 'organized capitalism,' on which the book places considerable emphasis. Vladimir Lenin gave *Finance Capital* qualified endorsement in his own *Imperialism: the Highest Stage of Capitalism* (Lenin 1964: 195). Nikolai Bukharin was also heavily influenced by Hilferding (Cohen 1975: 19, 21, 25-6, 28). After the First World War, however, the influence of Hilferding and the Austro-Marxists on pure economic theory waned, largely due to conflicts among the different branches of Marxism.

10 Thus, as explained further below, Hilferding avoids the classical conflation of the entrepreneur and capitalist, at least *de facto*, if not *de jure*.

11 There are similarities between this exposition of the entrepreneurial function and the seminal discussion found in Coase's 'The Nature of the Firm' (1937). Hilferding in some sense anticipated Coase's theory of the entrepreneur as the manager of resources within the firm, although he did not anticipate Coase's transaction-cost analysis. Both theories focus on 'the *execution* of economic activity rather than its conception and planning' (Hébert and Link 1988; emphasis in original). Neither theory involves the ownership of resources, nor do they imply any problems of uncertainty. In this sense, both are somewhat mechanistic. It is also noteworthy how well Coase's theory dovetails with Hilferding's in the sense that both address the idea of socialism within the boundaries of the firm. To my knowledge, there is no evidence that Coase was familiar with Hilferding; nevertheless, it might be worthwhile for future research to fully compare the two.

12 Hilferding notes that if administration costs,  $e$ , play a role in reducing gross profits,  $Y-e$  may replace  $Y$  ([1910] 1981: 114).

13 Böhm-Bawerk did not develop an elaborate theory of the entrepreneur, although he was certainly familiar with many of the relevant problems and left the field largely open for exploration by his students (see Schumpeter 1954: 893). He did, however, make some important remarks about the subject (McCaffrey and Salerno 2013). His theory is therefore important as a foil, both for the work of Hilferding and Schumpeter on the one hand, and for economists closer to his theory on the other, particularly Mises and Frank Knight (Hébert and Link 1988: 69). And although Böhm-Bawerk was not of the same generation as Schumpeter, in some sense Böhm-Bawerk's theory, however undeveloped, may also be considered a contemporary alternative to Schumpeter's (Schumpeter 1954: 893).

14 Versions of this theory, emphasising ownership, uncertainty-bearing, and judgement, can be traced back as far as Richard Cantillon, an economist who in several respects anticipated the insights of the 'Austrian' school and of Mises in particular (Hébert 1985).

15 Mises's terminology is somewhat confusing, but he appears to intend 'producers' to be synonymous with 'entrepreneurs,' which clarifies the passage and points toward the above conclusions. This is also confirmed in Mises's later writing (Mises 1998: 254). For similar remarks, see Mises ([1924] 1953: 314-5).

16 A further clarification is necessary to distinguish between Mises's views on 'entrepreneurs' versus those on 'managers'. Entrepreneurs exercise *ultimate* decision-making authority, although managers may carry out all the practical business of the enterprise. Ownership of resources confers the privilege of decision-making, which in turn is capable of generating rent to the owner in the form of entrepreneurial profit. Managers, on the other hand, are merely wage-earners (Mises 1998: 301).

17 For Hilferding, however, saving decisions are irrelevant to the interest rate. In Hilferding's view, which is also similar to Keynes's, the problems of interest are restricted to the money market (King 2010). This adds a wrinkle to comparisons of Hilferding's views and those of the Austrians, which are sometimes thought to be

similar in regard to the business cycle (Rosner 1988). It should be noted that Hilferding draws heavily on Marx on the rate of interest; I am indebted to an anonymous referee for pointing this out to me.

18 It is important to note that in this passage Mises is discussing how entrepreneurs alter production in the face of distorting monetary policy. However, this does not affect the analysis of Mises's view of the entrepreneurial function, which remains the same even in the face of undesired economic outcomes. What is more, some of the problems suggested by Mises's cycle theory arise precisely *because* entrepreneurs behave in a certain way when monetary policy produces an artificial change in the money and natural rates of interest.

19 For a discussion of the monetary and banking aspects of these works, see McCaffrey (2012).

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