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Working Paper

## Schumpeter and Mises as 'Austrian economists'

Freiburger Diskussionspapiere zur Ordnungsökonomik, No. 08/2

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Suggested citation: Vanberg, Viktor J. (2008) : Schumpeter and Mises as 'Austrian economists', Freiburger Diskussionspapiere zur Ordnungsökonomik, No. 08/2, <http://hdl.handle.net/10419/36462>

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ISSN 1437-1510

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# **Schumpeter and Mises as ‘Austrian Economists’**

by

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Whether and, if so, in what sense Joseph A. Schumpeter (1883-1950) and Ludwig von Mises (1881-1973) may both be classified as ‘Austrian economists’ is a controversial issue. In terms of their biographical background they were, of course, Austrian nationals, and as students of Böhm-Bawerk and von Wieser both qualify in a formal sense as third-generation members of the Austrian School. Yet, whether they so qualify in a substantive sense as well is much more questionable. Apparent differences between their views on a number of issues have often been cited as evidence for a paradigmatic divide between, on the one side, Mises as the true messenger of the Mengerian heritage and the principal inspirer for the modern revival of Austrian economics and, on the other side, Schumpeter as a renegade who departed from constitutive tenets of the Austrian paradigm. While this view has long been dominant among historians of economic thought, Mises’ student Israel Kirzner and others have more recently called for a re-evaluation of Schumpeter’s place in the tradition of Austrian economics. The purpose of the present paper is to take a closer look at the mixture of commonalities and disagreements in the writings of Schumpeter and Mises that have given rise to the ambivalent evaluations of their ‘Austrian’ credentials. Section 1 offers a few comments on their common Viennese background and their different personalities, section 2 looks at Mises’ and Schumpeter’s respective methodological views, section 3 contrasts their arguments on the socialist calculation issue, section 4 compares their outlooks at entrepreneurship, and section 5 draws some conclusions.

## 1. Austrian roots and divergent views

It has often been observed that, while Schumpeter may be classified as “a third-generation member of the Austrian school who shared an ‘Austrian’ background and training with Mises” (Keizer 1997: 78) there are doubts about his “Austrian-ness” (ibid.), and various authors have commented on Schumpeter’s ambivalent relation to his Austrian roots (e.g. Böhm 1990: 202; Hébert 1990: 190, 199; Salerno 1999: 40ff.; Festré 2002: 439). F.A. Hayek (1992: 160) expresses a widely held view when he notes that “though he had been trained at the University of Vienna and had been a leading member of the famous Seminar of Eugen von Böhm-Bawerk” in the course of time Schumpeter “moved further away from the

characteristic tenets of the Austrian school so that it became increasingly doubtful later whether he could still be counted as a member of that group.”

The ‘famous seminar’ Hayek refers to took place in 1905 and 1906 and it had as its topic the work of Karl Marx. As Schumpeter biographer R.L. Allen (1991: 39) notes, it “was a remarkable seminar not only because Böhm-Bawerk was at the height of his powers, but also because of the quality of the students.” Along with Mises and Schumpeter the small group included the “brilliant Marxist” (ibid.) Otto Bauer, who in defending the Marxian position acted as the principal adversary to Böhm-Bawerk (Hayek 1992: 138f.).<sup>1</sup>

In this seminar the contrasting stands of Mises and Schumpeter surfaced, a contrast that had its apparent roots in their different personalities no less than in their substantive disagreements on methodological and theoretical issues. As Allen (1991: 39) observes: “Schumpeter’s behavior in the Böhm-Bawerk seminar characterized his later attitude in class and on the lecture platform. He emerges as the man of paradox. One could never be sure where he stood. What did he really believe? ... He developed his style of toying with ideas, now arguing their merits and then attacking them viciously.”<sup>2</sup> By contrast, as Hayek (1992: 156f.) puts it, Mises “completely lacked the adaptability of his brilliant seminar fellow Joseph Schumpeter, who always quickly accommodated current intellectual fashions, as well as Schumpeter’s joy in *épater le bourgeois*.” One can assume that in Böhm-Bawerk’s seminar Mises took the firm and unambiguous stand that was to become his trademark. His reading of Menger’s *Principles of Economics* one year earlier (Mises 1978a: 33) had prepared the ground for his ‘Austrian’ and classical liberal outlook at theoretical and political issues that he would be staunchly promoting for the rest of his life. And it was in Böhm-Bawerk’s seminar that, so Hayek (1992: 139) supposes, “the foundations of (his) characteristic ideas on socialism were laid.”

Their participation in Böhm-Bawerk’s seminar may well have been the closest interaction the two economists were ever to have with each other. Even during the time they spent together in Vienna – Mises stayed in Vienna until he moved to Geneva in 1934, Schumpeter, after completing his doctorate in 1906, lived only for periods in Vienna before he joined the economics department at Harvard University in 1932 – they do not seem to have been in closer contact. Their professional paths crossed only once, and only indirectly, when

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<sup>1</sup> Mises (1978a: 39f.) reports on the seminar that “the discussion between Bauer and Böhm-Bawerk filled the whole winter semester. Bauer’s brilliant intellect was very impressive; he was a worthy opponent of the great master.”

<sup>2</sup> Swedberg (1991: 15) cites a participant in the seminar who speaks of “the playful manner” in which Schumpeter took part in the discussion. Allen (1991: 39) notes on Schumpeter’s role in the seminar: “The Marxists did not convert him, but neither did the spokesmen for capitalism convince him.”

Mises was considered as candidate for a chair in public finance at the University of Bonn to which, in the end, Schumpeter was appointed in 1925.<sup>3</sup> For the decade they both lived in the United States, between Mises' emigration in 1940 and Schumpeter's death in 1950, there are no reports of more than superficial encounters between them.

The often noted differences between their personalities,<sup>4</sup> between, on the one side, Schumpeter's "toying with ideas" as well as "his love for paradoxes and shocking others" (Keizer 1997: 79) and, on the other side, Mises' uncompromising pursuit of his theoretical and political convictions,<sup>5</sup> may not only explain the apparent distance the two Austrian economists kept from each other,<sup>6</sup> they must also be taken into account in interpreting the peculiar mixture of agreement and disagreement between their respective views that is the subject of the following sections.

## 2. Methodological Individualism versus Economic Mechanics

Chapter VI on "Methodological Individualism" is the only part of Schumpeter's first book (Schumpeter 1908) that has been translated into English. It was published as a monograph in 1980,<sup>7</sup> thirty years after his death. In his preface to the edition Hayek (1992: 160) describes the essay as "the still entirely Mengerian chapter" of Schumpeter's early book and as "the classic exposition of a view which he later abandoned."<sup>8</sup> As Hayek (ibid.: 161) speculates, Schumpeter's unwillingness to keep his first book in print,<sup>9</sup> much less having it translated,

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<sup>3</sup> As a reason for Mises' failure to gain the support of the Bonn faculty Swedberg (1991: 69) notes that he "was accused of being so caught up in his own ideas that he was unable to relate to other viewpoints in economics." – See also Allen (1991: 203f.).

<sup>4</sup> See Keizer (1997: 79, 89) for further references. Swedberg (1991: 11f.)

<sup>5</sup> Böhm (1990: 209) speaks of "Mises' lifelong crusade against everything that smacked of socialism" and "his uncompromising championship of libertarianism."

<sup>6</sup> To his above quoted view on the differences between Mises and Schumpeter, Hayek (1992: 157) adds the comment: "In fact, it appeared to me as if these two most important representatives of the third generation of leading Austrian economists (one can hardly consider Schumpeter a member of the Austrian school in the narrower sense), despite all mutual intellectual respect, both got on each other's nerves."

<sup>7</sup> The chapter was published by the Institutum Europaeum, Brussels, under the title "Methodological Individualism."

<sup>8</sup> Hayek (1992: 160): "Many of his students will be surprised to learn that the enthusiast for macroeconomics and co-founder of the econometrics movement had once given one of the most explicit expositions of the Austrian school's 'methodological individualism'."

<sup>9</sup> A reprint of the 1908 book by the original publisher, Duncker & Humblot, appeared in 1970 (Schumpeter 1970). – On recommendation by Wieser and Böhm-Bawerk the book had been accepted as Schumpeter's habilitation-thesis at the University of Vienna, even though both, Wieser and Böhm-Bawerk, had some misgivings about its contents (Perlman 2003: 167). – Indeed, as Salerno (1999: 41) reports, "Böhm-Bawerk did not have anything good to say about *Das Wesen*, because he correctly perceived how profoundly anti-Mengerian its theoretical method was." Of particular prominence is Böhm-Bawerk's later controversy with Schumpeter over the nature of interest (Swedberg 1991: 14; Salerno 1999: 41).

was “due to his understandable reluctance to see a work distributed which, in part, expounded views in which he no longer believed.”<sup>10</sup>

Even though he ended his 1908 book by “identifying himself with the Austrian theory position” (Perlman 2003: 167), the conception of ‘pure economics’ that Schumpeter advocated therein reflects much more the spirit of the Lausanne School than that of the Mengerian tradition. As he described the purpose of his efforts in the book’s concluding chapter, it is about “theoretical economics catching up with the technical sciences.”<sup>11</sup> In the words of R. Swedberg (1991: 24), it was Schumpeter’s ambition to “make economics into a real science with the help of mathematics,” into a science that can “take its place at the side of chemistry, physics and the other real sciences.” By contrast to the ‘Austrian’ conception of economics as a science of human action, and its characteristic junction of methodological individualism and subjectivism, Schumpeter’s ‘pure economics’ was to focus on relations between ‘economic quantities’ that, by contrast to the subjectivity of human volition, can be studied in an ‘objective’ manner, as if from a mechanical viewpoint.<sup>12</sup> It is the study of the functional relationships between these ‘economic quantities’ that for Schumpeter makes theoretical economics ‘scientific.’<sup>13</sup>

It has been pointed out that Schumpeter’s professed admiration for Walras<sup>14</sup> – he praised Walras’ “system of equations defining (static) equilibrium in a system of interdependent quantities” as the “Magna Charta of economic theory” (Schumpeter 1954: 242) – has its likely roots in his positivist conception of science and his belief in the “scientific rigor and power of mathematical economics” (Keizer 1997: 88).<sup>15</sup> It has also been pointed out that his admiration for the Walrasian system of equations and his fascination with

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<sup>10</sup> According to Perlman (2003: 176) Schumpeter later admitted that “the book caused him much embarrassment.” – See also Swedberg (1991: 31). – About Schumpeter’s 1914 book Perlman (2003: 174) notes that when it “was published, others in the Vienna economics community likely viewed it as Schumpeter’s breaking with the Menger tradition as it had become identified with Böhm-Bawerk.

<sup>11</sup> Schumpeter (1908: 607): “Sagen wir gleich, worum es sich handelt: Um den Anschluss der theoretischen Ökonomie an die technischen Wissenschaften im weitesten Sinne des Wortes.” – See also *ibid.*: 611ff..

<sup>12</sup> Hayek (1948: 90) notes about Schumpeter’s ‘positivistic’ outlook at economic phenomena: “To him these phenomena accordingly appear as objectively given quantities and commodities impinging directly upon each other, almost, it would seem, without any intervention of human minds.”

<sup>13</sup> As Kirzner (1976: 69) comments: “Whereas his immediate predecessors had been gradually advancing towards the conception of economics as precisely an aspect of human behavior, Schumpeter found it necessary to carefully exclude human activity from economic investigation. Schumpeter’s view of economics was a conscious effort to see economic affairs from the point of view of mechanics. ... In economics, Schumpeter explains, we have ‘economic quantities’ of goods undergoing mutually determined changes that admit of being expressed by means of mathematical functions. ... It is the existence of these functional relationships between all these quantities that makes economic science possible.”

<sup>14</sup> Swedberg (1991: 15): “In Schumpeter’s eyes, Walras was always ‘the greatest of all theorists’ and he considered Walras’ general equilibrium theorem to be one of the finest achievements ever made in economic theory.”

<sup>15</sup> Caldwell (1997: 4) notes that Schumpeter’s (1954: 827) praise of Walras as “the greatest of all economists” should be “sufficient in itself to remove him from the pantheon of Austrian School economists.”

general equilibrium theory are in apparent contrast not only to his own literary style of theorizing but also to his own emphasis on the limits of static analysis and his evolutionary approach to economic dynamics (ibid.: 75).<sup>16</sup> Whatever may be behind these “curious anomalies” (ibid.: 88), advocating, in his Viennese environment, an economics in the spirit of Walras and modeled after sciences like physics was surely an effective recipe for attracting attention, and Schumpeter’s well-documented “love for shocking others” may not be least among the reasons that can help to explain such apparent inconsistencies in his work.

It is significant that Mises chose ‘Human Action’ as title for the English edition of his opus magnum rather than ‘Economics’ which would have been the direct translation of the original German title ‘Nationalökonomie.’ By contrast to Schumpeter’s Walrasian inclinations Mises (1978a: 36) proclaimed: “What distinguishes the Austrian School and will lend it immortal fame is precisely the fact that it created a theory of economic action and not of economic equilibrium or non-action.” And he adds: “Because Austrian economics is a theory of human action, Schumpeter does not belong to the Austrian School. ... Economics, to him, is a theory of ‘economic quantities’, and not of human action” (ibid.). It is, in particular, the mechanical analogies of equilibrium theory that Mises rejects as incompatible with the Austrian emphasis on advantage-seeking and explorative human action as the incessant dynamic force that propels the continual process of economic change. As he puts it: “Because there are no constant relations in the field of human action, the equations of mathematical catallactics cannot be made to serve practical problems in the same way that the equations of mechanics solve practical problems through the use of data and constants that have been ascertained empirically” (ibid.: 58). For the same reason he rejects the belief that by processing statistical aggregates economics may prove its scientific status, a belief that surely motivated Schumpeter’s role in founding the econometrics society.

In light of the differences in their methodological views it may seem surprising that not only Schumpeter but Mises as well insisted on a strict separation of economic theory from psychology. To be sure, for Schumpeter to declare “the independence of theoretical economics from psychology” (Swedberg 1991: 27) is, as Kirzner (1976: 69) notes, consistent with his “stress on the impersonal changes in ‘quantities of goods’.”<sup>17</sup> By contrast, in the case of Mises one might expect his emphasis on economics as a science of human action to suggest

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<sup>16</sup> This is already a theme in Schumpeter’s first book (1908: 614ff.) where, on p. 621, he notes: “Economics as in fact it only exists today provides us with a *system*, like mechanics, but does not talk about *development*, like biology” (“die Ökonomik, die wir heute allein wirklich besitzen, gibt uns ein *System*, wie die Mechanik, erzählt aber nicht von *Entwicklung*, wie die Biologie”).

<sup>17</sup> Kirzner (1976: 70): “Schumpeter’s outlook is, of course, consistent with his wish to ignore human behavior as a factor in economics. Leaving human behavior to the psychologists, the economist is merely to examine the *results* of behavior in terms of related variations in the quantities of goods and prices.”



a closer relation to psychology as the discipline that studies human behavior. What leads Mises to draw a strict line between economics and psychology is his peculiar aprioristic methodology according to which economic theorizing proceeds not from empirical psychological conjectures about human behavior but from “the a priori category of action” (Mises 1978b: 41). Economic theory has its foundation in ‘praxeology’ or the ‘logic of choice’ and, so Mises insists, because of its “aprioristic reasoning” (Mises 1990: 29) praxeology is strictly separated from psychology: “Praxeology deals with choice and action and with their outcome. Psychology deals with the internal processes determining the various choices in their concreteness” (ibid.: 21).<sup>18</sup>

### 3. The Socialist Calculation Issue

What has become known as the ‘socialist calculation debate’ was set off by Ludwig von Mises’ 1920 article on “Economic Calculation in the Socialist Commonwealth,”<sup>19</sup> an article for which Mises claimed: “I have proven that economic calculation in a socialist society would be impossible” (Mises 2002: 351).<sup>20</sup> Mises’ principal argument was that by collectivizing ownership of productive resources socialism eliminates markets in which competition among potential users decides for which purposes these resources are employed. Without such competition in a system of free exchange, so Mises concludes, there is no way of knowing the *opportunity costs* of employing resources in particular uses, because opportunity costs, i.e. the benefits that could be had from the most productive alternative use, can only become visible where those who know better uses can outbid others for the right of resource-employment. As Mises (1935: 111) puts it: “Where there is no free market, there is no pricing mechanism; without a pricing mechanism, there is no economic calculation.” In other words, in the absence of a mechanism to reveal opportunity costs there is no way of

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<sup>18</sup> The following quotations from Mises’ *Human Action* (1949) characterize his view of economics as a praxeological science: “The starting point of all praxeological and economic reasoning is the category of human action” (ibid.: 67). “The scope of praxeology is the explication of the category of human action. All that is needed for the deduction of all praxeological theorems is knowledge of the essence of human action” (ibid.: 64). “Its statements ... are, like those of logic and mathematics, a priori.” – For a critical discussion of Mises’ arguments on the aprioristic status of ‘praxeology’ and his methodological views more generally see Vanberg (1975: 85ff.; 2004: 158ff.).

<sup>19</sup> The original German article appeared in *Archiv für Sozialwissenschaft und Sozialpolitik* (Mises 1920). The English translation appeared in F.A. Hayek (1935: 87-130).

<sup>20</sup> With this claim Mises begins a follow-up article “New Contributions to the Problem of Socialist Economic Calculation,” originally published in German in 1923. In an editorial footnote to the English version of this article, published in Mises (2002: 351ff.), R.M. Ebeling (ibid.: 351) notes: “In correspondence at the time when this article was in galleys, Mises accused Joseph A. Schumpeter, who was one of the editors of the *Archiv*, of attempting to change a part of the text without Mises’s permission.”

arriving at a 'rational' allocation of resources in the sense of putting them to their most productive uses. "There is only groping in the dark" (ibid.: 110).<sup>21</sup>

Even though Schumpeter was not directly involved in the 'socialist calculation debate' triggered by Mises' verdict, the view that he voiced on this issue in *Capitalism, Socialism and Democracy* came to play a significant role in the general perception of the outcome of that debate. Already in two earlier publications Schumpeter had addressed the issue of the workability of a socialist economy, first, in a paper on "Socialist Possibilities of Today" published in 1921 in the same journal in which Mises' articles on 'Socialist economic calculation' appeared and, second, in chapter IV, "Die Wirtschaftsrechnung im sozialistischen Gemeinwesen," of his book *Das Wesen des Geldes* (Schumpeter 1970: 88-107), a book that had been written during Schumpeter's time in Bonn between 1925 and 1932 but was first published only in 1970. In these contributions Schumpeter had argued, contra Mises, that a socialist economic system can function,<sup>22</sup> resting his argument in essence on the same kind of assumptions that were to play a central role in his later, more detailed exposition in *Capitalism, Socialism and Democracy*, namely the assumption that the central planning authority in a socialist system commands all the knowledge needed to direct resources into their most productive uses, the very knowledge of which Mises had argued that it cannot be had in the absence of markets for factors of production (Chaloupek 2003: 250).

In *Capitalism, Socialism and Democracy* chapters XV and XVI are devoted to the issue of the workability and the 'economic logic' of socialism. The very first sentences of chapter XV (Schumpeter 1950: 165) are: "Can socialism work? Of course it can." At the beginning of chapter XVI the question is asked "whether or not there is anything wrong with the pure logic of a socialist economy" (ibid.: 172), and the reader is told that, contrary to Ludwig von Mises' denial, "the answer is in the affirmative. There is nothing wrong with the pure logic of socialism" (ibid.). In support of this firm verdict Schumpeter asserts that in the kind of socialist system that he envisages "it is possible to derive, from its data and from the rules of rational behavior, uniquely determined decisions as to what and how to produce" (ibid.) because these data and rules "yield equations ... sufficient in number to determine uniquely the unknowns of the problem" (Schumpeter ibid.). The economist who, so

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<sup>21</sup> Mises (1935: 130) explicitly notes that his argument cannot decide the political question of whether or not socialism should be adopted, since it may be defended for other reasons, e.g on "ethical grounds." But, so Mises (ibid.) concludes his article, "he who expects a rational economic system from socialism will be forced to re-examine his views."

<sup>22</sup> März (1983: 62) notes in reference to Schumpeter's 1921 article that at the time it must have come as a surprise to Otto Bauer to get support from somebody whom he used to count within the opposite camp. – In *Das Wesen des Geldes* Schumpeter (1970: 104) asserts that, "at least as a matter of logic," rational calculation in the socialist commonwealth is possible ("Wir sehen also, dass rationale Wirtschaftsrechnung ... auch im sozialistischen Gemeinwesen, zum mindesten logisch, durchaus möglich ist.").

Schumpeter reasons, had provided the proof for this assertion was Enrico Barone to whose arguments he refers readers “who want a rigorous demonstration” (ibid: 173).<sup>23</sup> Even though he acknowledges that his case for the rationality of socialist planning supposes “a stationary process of economic life in which everything is correctly foreseen and repeats itself and in which nothing happens to upset the plan” (ibid.: 178), he hastens to add that “no great difficulties arise if we go beyond the precincts of the theory of the stationary process and admit the phenomena incident to industrial change” (ibid.). Furthermore, having, as he claims, successfully cleared “the first hurdle – logical definiteness and consistency of socialist planning – “ (ibid.: 184f.) Schumpeter feels ready to “negotiate the next one” as well, namely the question of its “practical impossibility” on which, according to him, “it seems, most anti-socialist economists are at present inclined to retire after having accepted defeat on the purely logical issue” (ibid.: 185). As he asserts, his “solution to the theoretical problem” of socialist calculation “not only establishes a logical possibility but in doing so also shows the steps by which this possibility can be realized in practice” (ibid.).

As indicated before, even though Schumpeter was not directly involved in the socialist calculation debate as such, it was his authoritative verdict that “the anti-socialists,” by which he meant Mises and Hayek, had been defeated, that became very influential in solidifying the consensus on this matter that emerged in the economics profession (Keizer 1997: 77; Böhm 1990: 210; Lavoie 1985: 13).<sup>24</sup> Hayek (1948: 90) calls him “the original author of the myth that Pareto and Barone have ‘solved’ the problem of socialist calculation.” In his critical assessment of Schumpeter’s treatment of the issue Hayek (ibid.: 89ff.) accuses Schumpeter of having “fallen into a trap which the ambiguity of the term ‘datum’ sets to the unwary” (ibid.: 91), namely to presume that the information referred to as ‘data’ is simply ‘given’ to the socialist planning authority. Yet, so Hayek (ibid.) insists, to “assume all the knowledge to be given to a single mind in the same manner in which we assume it to be given to us as the explaining economists is to assume the problem away and to disregard everything that is important and significant in the real world.” The practical problem in the real world arises, in

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<sup>23</sup> Enrico Barone’s article “Il Ministro della produzione nello stato collettivista” appeared in 1908 in the *Giornale degli Economisti*. An English version, “The Ministry of Production in the Collectivist State,” has been published in F.A. Hayek (ed.) 1935. – In his *History of Economic Analysis* Schumpeter (1954: 987ff.) comments on Barone’s contribution: “Barone’s performance consists in a nutshell in this: after having presented on Walrasian lines the system of equations that describes economic equilibrium under conditions of pure competition in a private-property economy he wrote down the analogous system of equations for a socialist economy of a certain type. ... The essential result of Barone’s or any similar investigation is that there exists for any centrally controlled socialism a system of equations that possess a uniquely determined set of solutions, in the same sense and with the same qualifications as does perfectly competitive capitalism.”

<sup>24</sup> Swedberg (1991: 215) cites a letter to Gottfried Haberler in which Schumpeter notes: “I am not astonished that you begin to find fault with the Mises-Hayek theory. What I was astonished about is that you ever had a taste for it.”

Hayek's (ibid.: 90f.) words, precisely because the 'data' presumably 'given' to the planning authority "are never so given to a single mind, and because, in consequence, it is necessary that in the solution of the problem knowledge should be used that is dispersed among many people." It is, however, exactly this problem that, even if not as explicitly stated as in Hayek's later account, was at the heart of Mises' original argument that because of the absence of competitive markets for productive resources the socialist planners have no way of obtaining the knowledge of opportunity costs that only real market prices can provide.<sup>25</sup>

In his careful analysis and reassessment of the socialist calculation debate Don Lavoie (1985) has exposed the misinterpretations behind the myth that Hayek's later arguments on the 'knowledge problem' "were substantially different from Mises', constituting a retreat to the acceptance of the 'theoretical possibility' but a denial of the 'practicability' of socialism" (ibid.: 14).<sup>26</sup> As Lavoie argues, from the very beginning Mises "was definitely not making an equilibrium argument" (ibid.: 20) and was not taking issue with Barone's argument that, in terms of the solvability of the Walrasian system of equations, there is a "formal similarity between socialism and capitalism under static conditions" (ibid.: 21), but maintained, instead, "that such equations were inapplicable to the real world of continuous change" (ibid.). In this sense, so Lavoie concludes, "the central arguments advanced by Hayek ... did not constitute a retreat from Mises' position but rather a clarification" (ibid.).<sup>27</sup>

If not earlier on theoretical grounds it was, at the latest, because of the collapse of the socialist planning systems that the economics profession's outlook at the Mises-Hayek line of argument has, in the meantime, significantly changed, prompting S. Böhm (1990: 231) to the comment that "it is really scandalous how decades of ridicule poured upon Mises' 'impossibility thesis' suddenly give way to an appreciation of his views as if they had been part of conventional wisdom all along." It is now even explicitly recognized how paradoxical it was for Schumpeter to defend the socialist position against the Austrian critique in terms of static equilibrium arguments, given his own emphasis on the critical role of incessant

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<sup>25</sup> As Kirzner (1981: 54) notes, what Mises' critics "failed to recognize ... was that for Mises the results achieved through market prices are inseparable from the profit-motivated endeavors of competing entrepreneurs that drive the market."

<sup>26</sup> März (1983: 61) repeats the myth when he comments on the Austrians' response to the Barone-line of argument: "Was nun folgte, waren Rückzugsgefechte, die allerdings nicht von Mises selbst, sondern hauptsächlich von seinem Jünger, Friedrich von Hayek, bestritten wurden. Die unmittelbare Reaktion Hayeks auf die schon von Barone herrührende Argumentationsführung war die, dass er einem sozialistischen Gemeinwesen wohl die theoretische, aber nicht die praktische Fähigkeit zusprach, seine Ressourcen optimal einzusetzen."

<sup>27</sup> Summarizing Mises' views Lavoie (1985: 24) notes: "The entrepreneurial market process ... generates the continuously changing structure of knowledge about the more efficient ways of combining factors of production. ... There is no way, Mises claimed, in which this knowledge can be generated without rivalry ... Market prices are seen as both the consequences of this entrepreneurial rivalry and as the guides ... for decisions that are made to achieve a more rational use of scarce resources."

economic change.<sup>28</sup> “Schumpeter’s final logic,” so P. Samuelson comments, “ought to have predisposed him to accord to Hayek the final victory ... in the debate over whether a socialist state could play the game of parametric pricing.”<sup>29</sup> And Keizer suspects that – besides his “ingrained desire to shock his Austrian colleagues” (Keizer 1997: 92) – it was Schumpeter’s “early belief in the power of mathematical economics and his espousal of the Walrasian GE model ... (that) explains the paradox of his use of the static Walrasian model to defend socialism against what was in essence a dynamic critique by the Austrians” (ibid.: 87f.).<sup>30</sup>

#### 4. Capitalism, Socialism and Entrepreneurship

As has been observed, there was, in fact, “some agreement between Mises and Schumpeter on a factual tendency towards socialism” (Chaloupek 2003: 250). Yet, their respective assessments of this tendency were markedly different. While Mises considered the socialist tendencies that he observed in his time as a fatal consequence of erroneous socio-economic conceptions and of misguided interventionist policies against which the intellectual forces of sound economic theory had to be mobilized, in Schumpeter’s view this tendency was a simple fact that economic science was not called upon to evaluate but to analyze in a detached and impartial manner. By contrast to Mises’ diagnosis, for Schumpeter this tendency was not a result of misguided policies but, instead, a systematic outcome of forces inherent in capitalist development itself. It is, in this regard, indicative when in a 1946 review Schumpeter comments on Hayek’s *Road to Serfdom*: “But the author deals with ideas and principles as if they floated in the air. If he had gone into the historical conditions, from which the ideas arose which he dislikes so much, he could not have helped discovering that they are the products of the social system which he does like.”<sup>31</sup>

According to Schumpeter it is the apparent trend towards concentration in industry and finance, the rise of big bureaucratic corporations, the separation of managerial control from ownership, the routinisation of innovation and technological change, and other developments

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<sup>28</sup> Even though in his *History of Economic Analysis* Schumpeter (1954: 987ff.) repeats his arguments why, in terms of Barone’s analysis, “so far as its pure logic is concerned the socialist plan makes sense” (ibid.: 989) he adds there on a more cautious note: “We must not forget that, just like the pure theory of the competitive economy, the pure theory of socialism moves on a very high level of abstraction and proves much less for the ‘workability’ of the system than laymen (and sometimes theorists also) think. ... For it is quite possible to accept it (the Barone result, V.V.) and yet to hold that the socialist plan, owing to the administrative difficulties involved or for any other of a long list of reasons, is ‘practically unworkable’” (ibid.).

<sup>29</sup> Quoted in Keizer (1997: 93). – Böhm (1990: 235) quotes Samuelson’s comment that “Schumpeter was uncharacteristically naïve in awarding Lange and Lerner victory over Ludwig von Mises on the issue of whether rational economic calculation would be possible under socialism.”

<sup>30</sup> Keizer (1997: 91): “Schumpeter’s greatest contribution to economics was his destruction of the static framework of neoclassical orthodoxy. ... His defense of socialist economics with the arguments of static neoclassical equilibrium theory is therefore paradoxical.”

<sup>31</sup> Quoted in Medearis (2001: 103).

within the capitalist system that prepare the ground for a transition to socialism, a transition that in the end, as he suggests, involves little more than a simple transformation of the industrial leadership from agents of private capital owners, who serve no longer a relevant function, into agents of the socialist commonwealth (Chaloupek 2003: 247; März 1983: 63). Schumpeter (1950: 186) even asserts that “the solution of the problems confronting the socialist management” is easier than “the practical solution of the problems confronting commercial managements” because the “uncertainties about the reaction of one’s actual and potential competitors” with which the latter have to deal vanishes in the socialist commonwealth where managements can get together “for concerted action.”<sup>32</sup>

It is instructive in this context to consider the contrast between, on the one side, Schumpeter’s view of the transferability of entrepreneurship from the capitalist into the socialist economy and, on the other side, Mises’ understanding of the entrepreneurial function in a market economy. As has been suspected by Kirzner, it may have been Schumpeter’s principal focus on the ‘disruptive’ or ‘disequilibrating’ aspect of entrepreneurial activity function<sup>33</sup> that led him to assign to entrepreneurship a limited and specialized role that can be carried over from a capitalist to a socialist economy. And others have argued that a shift in emphasis seems to have occurred over time in Schumpeter’s characterization of the nature and significance of entrepreneurial activity, from initially portraying it as the spontaneous dynamic force of a competitive economy to viewing it as a specialized function that, in mature capitalism, is methodically organized and bureaucratized in big corporations, a function that the employed ‘specialists for innovation’ can just as well carry on in socialist enterprises (Böhm 1990: 228).<sup>34</sup>

A prominent theme in Kirzner’s publications is the comparison between the Misesian and the Schumpeterian entrepreneur. By contrast to Schumpeter’s emphasis on the entrepreneur’s role in upsetting the routine-operation of the market process by major

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<sup>32</sup> In a footnote Schumpeter (1950: 186) comments on the role of ‘concerted action’: “So far as this is being done in capitalist economies, it is a most important step toward socialism. In fact, it progressively reduces the difficulties of transition and is in itself a symptom of the advent of the transitional stage. To fight this tendency unconditionally is tantamount to fighting socialism.”

<sup>33</sup> Kirzner (1981: 53): “For Schumpeter, in fact, the essence of entrepreneurship is that it consists in disrupting existing equilibrium states.”

<sup>34</sup> About the stage of capitalist development at which the transition to socialism may occur Schumpeter (1950: 178) notes that it is “important for the success of a socialist society that it should embark upon its career not only as richly endowed as possible by its capitalist predecessor – with experience and techniques as well as with resources – but also after the latter has sown its wild oats, done its work and is approaching a stationary state.” – As Swedberg (1991: 159) comments: “Schumpeter emphasized very strongly that socialism is possible only if the capitalist system has exhausted itself. ... The economy now consists of a small number of giant corporations, which run everything in a very efficient but mechanical manner. Entrepreneurs have become ordinary managers and innovations are mainly carried out within the giant corporations.”

innovations that initiate shifts of the economy to new equilibria,<sup>35</sup> Kirzner emphasizes that in Mises' and his own understanding entrepreneurship<sup>36</sup> is not only exhibited in the more spectacular acts of 'creative destruction' but constitutes the essence of the market process as such, in its ordinary function no less than in the more visible instances of major innovations.<sup>37</sup> The three essential aspects of the broader Misesian concept of entrepreneurship are, according to Kirzner (1981: 52), "(a) the recognition of the entrepreneurial element in each individual market participant; (b) the insight into entrepreneurship as the driving force behind the equilibrating tendencies within the price system; (c) appreciation for the entrepreneurial basis for the social efficiency achieved by the market economy."

Even if he occasionally may portray the differences between Schumpeter's disequilibrating entrepreneur and the Mises-Kirzner equilibrating counterpart as if they were mutually exclusive perspectives,<sup>38</sup> quite apparently Kirzner's intention is not to deny that the 'creative destruction' that Schumpeter emphasizes is an important aspect of entrepreneurial activity. He explicitly notes that "the innovative role assigned by Schumpeter to his entrepreneur finds its place naturally within the broader Misesian theory" (Kirzner 1981: 55).<sup>39</sup> What he wants to direct attention to is, instead, that to exclusively focus on the 'creative destruction' aspect means to ignore the indispensable role that entrepreneurship plays in the ordinary operation of market processes. By reducing its significance to heroic acts of innovation, this is Kirzner's (1973: 74f.) critique, Schumpeter "helps promote the quite erroneous belief that entrepreneurship is somehow unnecessary to understanding the way the market tends toward the equilibrium position." It tends to convey the message that in their ordinary operation markets function in a quasi-automatic manner, to the point of supposing that the function they perform can be carried on by socialist administrators and managers.

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<sup>35</sup> As Perlman (2003: 168) puts it, for Schumpeter the specific significance of the innovator-entrepreneur's role was his „coming forth with a product line that was so different as to create a permanent change in the market system, a change that erased the previous efforts at marketisation through equilibrium-focused price adjustments."

<sup>36</sup> Böhm (1990: 228) notes that Israel Kirzner's work "represents a consistent elaboration and extension of Mises' ideas" and that "most of the literature on Mises' theory of the entrepreneur is really a discussion of Kirzner's work."

<sup>37</sup> Kirzner (1979: 128): "For us entrepreneurship is manifested in short-run movements fully as much as in long-run developmental changes, and is exercised by the imitators (who move in to exploit the opportunities exposed by the activities of the innovators) fully as much as by the imitators themselves."

<sup>38</sup> Such reading may be invited, for instance, when Kirzner (1981: 53) notes that Mises' and Schumpeter's positions need "to be sharply distinguished," when he emphasizes that in the Mises-Kirzner perspective "entrepreneurship is an equilibrating force in the economy, not the reverse" (Kirzner 1979: 115), or when he speaks of the contrast "between Schumpeter's vision of the entrepreneur as a spontaneous force pushing the economy *away* from equilibrium and (the Mises-Kirzner, V.V.) view of the entrepreneur as the prime agent in the process from disequilibrium *to* equilibrium" (ibid.: 112). – See also Kirzner (1973: 81).

<sup>39</sup> In the Misesian perspective, so Kirzner (1981: 54f.) argues, the market process is driven by "the profit-motivated endeavors of competing entrepreneurs ... who tend to notice where and how the resources can be reallocated to more socially valuable uses. ... It is in this way that the entrepreneurs, besides being responsible for the equilibrating forces in the market, are also the 'leaders on the way toward material progress'."

Based on such understanding of the ordinary market process Schumpeter's heroic innovator-entrepreneur can then be imagined to provide a socialist economy with the creative impulses that shift it to new equilibria, just as he serves the capitalist economy with his disruptive, disequilibrating genius. As Kirzner (1979: 119) puts it, "the entrepreneurship around which Schumpeter builds his system is in principle equally applicable to the centrally planned economy." What, according to Kirzner, is missing in Schumpeter's account is an appreciation of the fact that the ordinary everyday profit-seeking endeavors of market participants to discover and exploit opportunities for improvement provide the social mechanism that keeps the market process working,<sup>40</sup> a fact that Mises (1935: 120) stresses when he notes: "The entrepreneur's commercial attitude and activity arises from his position in the economic process and is lost with its disappearance."

## 5. Conclusion

Whether or not, and the extent to which, theoretical positions are perceived as similar or different obviously depends on the reference-standard against which they are compared. As important as the differences between Schumpeter's and Mises' views on the issues discussed in the preceding sections surely are, when contrasted to the mainstream neoclassical paradigm equally important commonalities between the respective views of the two 'Austrian' economists stand out, commonalities that have more recently attracted attention. As Keizer (1997: 78) has noted, while the "view of Schumpeter as a 'non-Austrian' was common in the first two decades after his death" the fact has gained increasing attention "that his great contributions to economics – such as the concepts of innovation, the entrepreneur and the dynamism of market capitalism – have a strong 'Austrian' flavor." The less weight one assigns to Schumpeter's paradoxical advocacy of the Walrasian general equilibrium approach the very foundation of which he undermined with his own evolutionary outlook,<sup>41</sup> and the

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<sup>40</sup> Kirzner (1979: 119): "What Schumpeter's picture of innovational development fails to explain is that the existence of a possibility is not enough, that a social mechanism is needed to ensure that possibilities are perceived and embraced. Schumpeter fails to show how the nonmarket economy can grapple with this central problem." - Pointing to the relevance of Mises' "view of the entrepreneurial market process" for his stance in the socialist calculation debate Böhm (1990: 229f.) notes: "The problem with market socialism, as Mises saw it, is that it does not provide a mechanism for the correction of maladjustments. ... Schumpeter turned a blind eye to the need for such a mechanism." – As Böhm (ibid.: 229) rightly points out, the essential point about the Mises-Kirzner theory of entrepreneurship "is that it aspires to be much more than another view of the role of the entrepreneur; it really is a theory about how a market economy is supposed to work."

<sup>41</sup> Keizer (1997: 92) points to the paradoxical fact that Schumpeter "spent his energy arguing the case for a static equilibrium theory that his own theories had already demolished." – In the same spirit Kirzner (1990: 247) comments: "Despite his own fascination with the Walrasian vision, Schumpeter continued to emphasize his appreciation for the dynamics of markets."



more one discounts his paradoxical stance on the socialist calculation issue, the more the similarities between the Schumpeterian and the Misesian market process theories stand out.<sup>42</sup>

It is in particular Israel Kirzner who has commented on the more recent shift of emphasis in the assessment of the commonalities and differences between Schumpeter's and Mises' theoretical outlooks. While according to the traditional view their contributions "were sufficiently divergent in spirit, purpose, and direction, to stamp them as being poles apart" (Kirzner 1990: 243), matters appear different, so Kirzner argues, when looked at from the perspective of theoretical developments in late twentieth century economics. The revival of the Austrian School and the resurgence of interest in Schumpeter's dynamic, evolutionary perspective have drawn increased attention to the fact that the "characteristic feature of the Austrian approach to economic theory," namely its "emphasis on the market as a process" and the dissatisfaction with "the orthodox emphasis on both equilibrium and perfect competition," is shared by 'Austrians' of such sharply differing persuasions as Mises and Schumpeter (Kirzner 1979: 3). From such late-century perspective Kirzner (1990: 244) feels justified to assert that "the writings of Schumpeter and Mises, divergent though these have certainly been, nonetheless jointly constituted vehicles through which key Austrian ideas were preserved and extended, during a period in the history of economics in which these ideas might otherwise have become completely lost."

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<sup>42</sup> In this sense Chaloupek (2003: 257) notes that the main contributions of Schumpeter and Mises "are not contradictory, but rather complementary." – See also Böhm (1990: 203).

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