

McCraw's PROPHET OF INNOVATION

SCHUMPETER'S BEST MOVE ☆

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A review essay of Thomas K. McCraw. *Prophet of Innovation: Joseph Schumpeter and Creative Destruction*. Cambridge, Mass.: Belknap Press, 2007. xii+719.

The Economist (2001) once suggested that only the exceptionally rare economist lived a life of sufficient interest to warrant a movie portrayal. The article suggested only two exceptions, John Maynard Keynes and Joseph Schumpeter. Warming to the idea, *The Economist* opined that Tom Cruise would be the right actor to play Schumpeter. The figure who emerges from Thomas McCraw's account does indeed share the energy, confidence, ambition, and adventure of the action hero of some of Cruise's early movies. But in many ways, the figure who emerges is different than the typical Cruise character – in intelligence, seriousness, and perseverance in the face of

*A few sentences in this chapter first appeared in entries on my blog (<http://artdiamondblog.com>). Thomas McCraw graciously read the final draft of the review and alerted me to four errors that would otherwise have appeared in print. (As per usual, any remaining errors are totally my fault.) McCraw was generally sympathetic to much of my discussion, while remaining unconvinced on some issues, such as my negative evaluation of FDR's New Deal.

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disappointments. Near the end of his comprehensive, substantial, and very useful new biography of Schumpeter, McCraw tells us that Schumpeter's story is "... one of restless adventure, almost unbelievably hard work, and ultimate triumph in the face of persistently bad luck" (p. 493).

The story told by McCraw has a different leitmotif from that told by the young Paul Samuelson who, in his earlier career, would sometimes gently ridicule his professor Schumpeter, making fun of his long wave theories and the quaint periodicity of his lecture attire. From the longer perspective of his own old age, however, Samuelson sees Schumpeter in a way that is more complementary to McCraw's story. Near the end of his banquet lecture at the 2002 meetings of the International Schumpeter Society, Samuelson (2003, p. 467) said, "In chess you are only as good as your worst move. In creative science you are as good as your best moves."

And though he did not precisely say so, in his closing sentences, Samuelson implied that Joseph Schumpeter's best moves were very good moves indeed!

Thomas McCraw's new, long-awaited biography of Schumpeter is primarily about Schumpeter's best move. For McCraw, Schumpeter's best move is what he had to say about innovation and creative destruction. I agree with McCraw on this, and the agreement makes me a highly sympathetic reviewer of McCraw's book.

In addition to the movie industry, many different audiences will find value in McCraw's book. The historian of economic thought, the economic methodologist, the student of entrepreneurship, and the seeker of sound economic policy will all find much to interest them.

COMPARING McCRAW WITH PREVIOUS BIOGRAPHERS

The previous major biographies of Schumpeter are found in the works by Allen (1991), März (1991), Stolper (1994), and Swedberg (1991). März's biography is a collection of independently written essays, some mainly biographical, and some mainly commenting on aspects of Schumpeter's economic thought. Stolper's signal contribution is to present evidence that explains and defends Schumpeter's activities in government and banking in Austria. Allen focuses extensively on the details of Schumpeter's personal life (see Moss, 1993), while Swedberg focuses more on the events and ideas of Schumpeter's academic life. McCraw also puts primary emphasis

on Schumpeter's academic life, although he includes more information about Schumpeter's personal life than did März, Stolper, and Swedberg (often citing Allen's research as his source).

Other differences between the biographies may be worth noting. Allen, März, and Stolper each had varying degrees of personal contact with Schumpeter, while Swedberg and McCraw did not. Allen conducted many interviews with those who knew Schumpeter, while März, Stolper and Swedberg relied much less on interviews. The nominal academic disciplines of the authors also differ: Allen, März, and Stolper were economists; Swedberg is a sociologist; and McCraw is a business historian.

McCraw's (2007) biography lays claim to being the most comprehensive of the group; not only most thoroughly covering all aspects and time periods of Schumpeter's life, but also most thoroughly mining the most sources of evidence. McCraw's biography is also a credible candidate for being the best written and most insightful of the group, at least for readers interested in innovation, the history of economic thought, and economic methodology.

WHAT WE CAN LEARN FROM McCRAW

McCraw's book has been widely and well reviewed, serving as a jumping off point for many kinds of observations – like Schumpeter's own corpus, McCraw's book may well prove fecund at leading to further research. Personally, I enjoyed reading the book and found it useful in various ways. For instance, in the course of the book, McCraw presents many pithy and sometimes amusing quotes by and about Schumpeter.¹ McCraw also brings to light significant episodes in Schumpeter's life that may have broader significance, for instance, in showing that the peer-review process was strongly against Schumpeter receiving the professorship at Graz (pp. 76–77). An individual or two intervened and perhaps made a major difference in the course of intellectual history. This episode could be relevant to improving institutions of higher education or to a discussion of path dependence or to a philosophical discussion of how the actions of individuals can matter.

In this review, I mainly will emphasize issues in McCraw's book that will be of interest to those studying the history of economic thought and economic methodology. But to a broader audience, the major contribution of McCraw's book is in illuminating Schumpeter's insights, evidence, and arguments on the role of innovation, entrepreneurship, and creative destruction as the essential facts about dynamic capitalism.

SOME BROAD RESERVATIONS

Some of what McCraw seems to be doing is the sort of biographical deterministic “explanation” that Stigler (1982) criticizes in his “Uses of Biography” paper. This method adduces events or circumstances from the subject’s life to “explain” what the person believed or did. But such a method produces mutually inconsistent theories that are illustrated with cherry-picked examples, but not systematically tested by a broader collection of data. For example, on the one hand, you can “explain” John Stuart Mill’s excelling in economics as due to his father’s having pushed him toward it. And, on the other hand, you can “explain” Alfred Marshall’s excelling in economics as due to his rebelling against his father’s having pushed him away from it (Coase, 1995). The problem is that we can always either embrace or reject the events and circumstances of our lives, and therefore, they can never fully explain what we say or do.²

McCraw “explains” (p. 92) Schumpeter’s limited success in the politics of Austria, by noting that Schumpeter’s experience with the “cloistered” politics of the academy was no preparation for the intrigue of real politics. Such a hypothesis has surface plausibility. But before much weight is put on it, we would want to also consider the lives of academics such as Woodrow Wilson and Paul Douglas, who are usually viewed as having made the transition from academics to politics with greater success.

In one example of the biographical deterministic mode of explanation, McCraw tries (pp. 465–466) to explain the different visions of Keynes and Schumpeter by their different lives – Keynes, a life of stability, and Schumpeter, a life of creative destruction. This view again has some surface plausibility, but can be doubted not only on the Stiglerian grounds just discussed but also on the basis of the soundness of the generalizations about Great Britain and Europe. The Great Britain of Keynes’ life was not always so stable, and the Europe of Schumpeter’s life was one of *destructive* destruction more often than it was one of *creative* destruction.

On the Great Britain of Keynes’ life, for example, a couple of recent books (Lukacs, 2008; Olson, 2007) have highlighted just how precarious Great Britain’s position was in World War 2. If we get beyond the certainty of hindsight, it is altogether conceivable that Great Britain might have lost the war to Hitler. And on the Europe of Schumpeter’s life, McCraw elsewhere suggests (pp. 83–103) that one of the dominant historical events was World War 1. But from the viewpoint of both McCraw and Schumpeter, World War 1 was an unnecessary, unmitigated disaster. Therefore, it is hard to find something creative in World War 1 – it was *destructive* destruction.

A second example of the biographical deterministic mode of explanation would be McCraw's account of Schumpeter's important presidential address before the American Economic Association in 1948 on ideology and vision. McCraw suggests that what Schumpeter had to say was controversial and that Schumpeter was taking a risk in expressing his views on the roles of vision and ideology in economics. McCraw goes on to suggest (p. 483) that with Schumpeter's health problems, "why not take the risk?" Apparently, McCraw's explanatory hypothesis is that we take more risks when our health is bad, and we are likely nearer death. But this is by no means clear. On the one hand, in theory, if one takes risks early in life, when health is better, one has more periods in which to enjoy the benefits of successful risk-taking and more periods in which to recover from failed risk-taking. And on the other hand, in practice, McCraw documents how Schumpeter in many ways also took substantial risks early in his life, when his health was much better.

But if McCraw is guilty of too-easy biographical generalizations, then so is Schumpeter himself. One of Schumpeter's own generalizations in the *History of Economic Analysis* (e.g., on p. 470) is that economists do their best work in the key third decade of their life. Schumpeter probably thought that his own life provided further evidence of the hypothesis. The primary work of his own third decade was the highly and rightly acclaimed *The Theory of Economic Development* (Schumpeter, 1961). In contrast, in his sixth and seventh decades, he labored mightily on the *Business Cycles* (Schumpeter, 1939), which was a critical failure; on *Capitalism, Socialism and Democracy* (Schumpeter, 1950), which he said was a mere "potboiler"³ (implying that it was not a serious work); and on the *History of Economic Analysis*, which he was not able to complete before his death. In the dark musings of his diary in his final decades, he was often very self-critical, sometimes even going so far as to consider himself a "failure" (p. 403).

McCraw presents evidence both against the claim that Schumpeter's third decade was his best and against the claim that overall Schumpeter was a failure. McCraw achieves the former, not by denigrating the third decade but by elevating the sixth and seventh. He notes that upon publication, scholars widely acknowledged the unparalleled value of the *History of Economic Analysis*. For *Capitalism, Socialism and Democracy*, the acknowledgment was not quite as quick, but in the fullness of time, it would be esteemed as one of the most important books of the twentieth century, a book that even today has growing influence in business, government, and the academy.⁴ And if we are to believe McCraw, when time is even fuller yet, we may also come to believe that the *Business Cycles* is a major, if flawed, achievement, both for its laying the foundation for *Capitalism, Socialism and Democracy* and for its

own contributions to our understanding of innovation and entrepreneurship. On the basis of these three books, and several important articles as well, it is credible to conclude that Schumpeter's best years were not those of his third decade, but those of his sixth and seventh.

On the claim of "failure," perhaps Schumpeter was a failure if the standard is that of leadership of his contemporary peers or if the standard is that of the development of a mathematical "exact economics" of the dynamics of capitalism. But McCraw argues that these are not the right standards. The right standard is to avoid the Ricardian Vice and present theories that are consistent with the actual history and current practice of capitalism.⁵ And by that standard, Schumpeter's success is secure.

CAN CAPITALISM SURVIVE?

One of the claims most associated with Schumpeter is his prediction that capitalism would not survive. The claim is made in *Capitalism, Socialism and Democracy*, and McCraw argues (p. 348) that *Capitalism, Socialism and Democracy* is a book replete with irony, rivaling the satire of Jonathan Swift. Most notably, he suggests that Schumpeter's claim in Part 3 of *Capitalism, Socialism and Democracy* that socialism can work is not to be taken at face value.

Along the same lines, we might guess that the prediction of the demise of capitalism is likewise ironic. But here, it turns out, Schumpeter was more straightforwardly serious. In the later chapters of the biography, McCraw documents Schumpeter's deep pessimism about the future of capitalism during the Great Depression, World War 2, and during the immediate post-war years preceding Schumpeter's death in 1950.

Schumpeter was very critical of the New Deal and feared that Franklin Roosevelt had ambitions to become a dictator (p. 201). In the post-war years, Schumpeter's pessimism moderated only slightly, as revealed in his speculations that a mixed economy might avoid spiraling toward socialism for a considerable time. The various "brilliant metaphors" (p. 441) he gave the mixed economy often hint at his disapproval: "amphibial state" (pp. 424-425, 433, 437, 441, and 471), "guided capitalism" (pp. 424 and 426), "state capitalism" (p. 424), "capitalism in the oxygen tent" (pp. 424-425, 437, and 471), "laborism" (pp. 434-435), "corporatism" (pp. 427-431), and "bureausadism" (p. 435). Schumpeter believed that the mixed economy would lack the "motive power" (p. 424) of Schumpeter's entrepreneurial capitalism, and its only saving grace would be its superiority to socialism (p. 430).

In McCraw's account (p. 359), Schumpeter says that capitalism used to be safe in the United States because all the "brains" were drawn to business rather than to government. A corollary might be that the current fragility of capitalism is due to the "brains" being drawn into government because they have been taught that the government is where the bright, ambitious, and idealistic will have their talents put to the best use. If so, then there might be a scenario under which a robust Schumpeterian capitalism might revive and survive. That scenario would involve convincing the "brains" that their talents would be put to better use as entrepreneurs than as politicians.⁶

DEFENDING SCHUMPETER AGAINST UNJUSTIFIED CRITICISMS

Although McCraw acknowledges Schumpeter's imperfection, the book is primarily a defense of his main intellectual contributions and secondarily a defense of much of his character. Intellectually, McCraw's title "Prophet of Innovation" indicates his view of Schumpeter's primary intellectual contribution. The summary and elaboration of Schumpeter's contribution to our understanding of economic innovation is the recurring and dominant theme of the book.

In terms of character, McCraw can be seen thoroughly defending Schumpeter against various charges: that he failed as Finance Minister of Austria, that he failed as bank founder in Austria, that he displayed anti-semitism, that he supported the Axis Powers during World War 2, and that his strong advocacy for the use of historical evidence in economics was an aberration of old age. (In this section, I review McCraw's defense against each of these charges, except the last, which is reserved for the section on methodology.)

For about nine months in 1919, Schumpeter served as Finance Minister of Austria under a socialist government. The Austrian economy was in shambles after World War 1, and Schumpeter proposed a plan that McCraw paints as credible. Schumpeter's optimism that pro-capitalist policies could result in recovery was at odds with the pessimism of the rest of the government (p. 101). If Schumpeter failed during this episode, it was not a failure of his policies, but a failure of his political skills, and his judgment in joining a government with which he was so much at odds.

In 1920–1921, Austria's parliament awarded Schumpeter a license to operate a bank (p. 107). Schumpeter became the non-managing nominal

head of the Biederman Bank, which, before acquiring Schumpeter's license, had been a private bank. One of Schumpeter's primary benefits from his involvement with the bank was his line of credit that took the form of overdraft privileges. After the Vienna stock market lost three-fourths of its value in 1924, Schumpeter (and many others) was substantially in debt. As a result, Schumpeter was asked to resign from the bank, which he did. Although it took years, he eventually paid his debts.

Schumpeter did not foresee the 1924 Vienna stock market crash (just as Irving Fisher did not foresee the 1929 U.S. stock market crash). But though some might blame Schumpeter for lack of foresight, he deserves credit for working hard for years to pay off the debts he incurred as a result of the crash. Referring to this episode, a friend of Schumpeter wrote about Schumpeter's "almost feudal sense of honor" (p. 107). It took more than 10 years for Schumpeter to pay off his debt from guaranteeing the loans of a former classmate who failed in his efforts to finish a new glass factory during this period (McCraw, 2007, pp. 107–109).

McCraw (2007, p. 109) says "In the end, the experience of making and then losing a large sum of money taught him more than books ever could about issues vital to his research."⁷ It is perhaps interesting that both Schumpeter and Clayton Christensen (e.g., Christensen & Raynor, 2003), one of the most distinguished neo-Schumpeterian business analysts, have in common that their most important academic work was partly inspired by failed business experiences. Participation in the business world is not a *sine qua non* for doing relevant work, but it can be useful.⁸

McCraw gives (in the long footnote 12 on pp. 511–512) a detailed and plausible summary of the issues on whether Schumpeter was anti-Semitic. His basic argument is that, again and again, throughout Schumpeter's life, he personally assisted and supported Jews, often in very dire circumstances. One example is Schumpeter vehemently urging Harvard to hire Leontief (p. 202). Another, that I have seen evidence of in Harvard's Schumpeter archive, is Schumpeter's continued help for Paul Samuelson, both as a student and young scholar.

Examples are also given of Schumpeter aiding socialists. This is consistent with McCraw's comment that in Schumpeter's own research, he was "open-minded" (p. 217) and that "He is a zealot only in his opposition to zealotry" (p. 218). (Except that I wonder if Schumpeter might be considered to have rightly been a zealot in arguing for the importance of innovation?)

On the charge of support for the Axis Powers in World War 2, McCraw shows that in the years leading to World War 2, Schumpeter was more

concerned about the danger to Europe and democracy from Stalin than he was the danger from Hitler (pp. 313–314). But this was not an absurd view, based on the evidence at the time. And it was a view that many reasonable people shared.

Rumors of Schumpeter's sympathies, and the misinterpretation of Elizabeth Schumpeter's research on Japan, led in 1941 to a bizarre period in which Schumpeter and his wife were investigated by the Federal Bureau of Investigation (FBI). McCraw summarizes (pp. 337–343) the FBI file on Schumpeter and his wife. This small part of the book makes J. Edgar Hoover's FBI look like a stupidly and dangerously uncomical version of the Keystone Cops. Elizabeth Schumpeter had had a scholarly interest in Japan, and this was exaggerated into imagined support for Japan in the war. Schumpeter had originally viewed Hitler as a lesser evil than Stalin, which was exaggerated by the FBI into imagined support for Germany in the war. (The main investigation of Joseph Schumpeter seems to have ended in 1944, although there is an entry on him in the file as late as 1948, and the FBI again questioned Elizabeth Schumpeter in 1950 and 1951.)

Near the end of his account of this sorry episode, McCraw wryly notes "Nowhere in the thick FBI dossier is there any mention of Schumpeter's landmark book of 1942, *Capitalism, Socialism and Democracy*, which evidently escaped the bureau's attention" (p. 343).

SOME MINOR COMPLAINTS

In an ambitious book of over 700 pages, it is hard not to find some bones to pick, and I have found a few. Some of McCraw's minor claims can be reasonably disputed, such as the claims that Oprah Winfrey deserves a place on a short list of history's "great innovators" (p. 179), that Sputnik was a great achievement for the Soviet Union (p. 398), and that corporatism has "worked fairly well" in Germany and Japan (p. 429).

Several flawed passages arise from McCraw's uncritical acceptance of standard, but unsound beliefs about the Great Depression and its aftermath. For example, McCraw claims (p. 75) that there was a lack of "entrepreneurial energy" during the Great Depression. But as Amity Shlaes (2007) has shown in *The Forgotten Man*, it was not the lack of entrepreneurial energy that was the problem; it was confiscatory taxation policies and intrusive and random regulations. Again, McCraw claims (p. 275; see also pp. 317 and 369) that Keynes "was close enough to being

right” (p. 275) about how to end the Great Depression,⁹ while Schumpeter had nothing to say. But, again, as we learn from Amity Shlaes, if the importance of the entrepreneur had been understood, the Depression would have been shorter. (Keynes has little to say about the entrepreneurial function, but as McCraw himself points out, Schumpeter is “the world’s leading scholar of entrepreneurship” (p. 471).)

McCraw says (p. 389) of Galbraith’s Office of Price Administration (OPA) that “by all accounts the group did a superb job.” But the most recent account that he references is Bartel’s (1983) article – he provides no mention of Jacobs’ (1997) paper that offered a much less enthusiastic evaluation of the OPA. Given the sweep of McCraw’s study, he cannot have read everything relevant to every point he makes. But then he should be a tad more modest about what he claims is true “by all accounts” (underlining added).

McCraw (p. 355) seems to accept the common view that big business is essential, in Schumpeter’s opinion, to the success of capitalism. An alternative would be something closer to the account of Rosenberg and Birdzell (1986, p. 277), in which big business is important at some stages and in some circumstances, but what is key is the formation of new enterprises. McCraw also claims (p. 433) that “all other competent economists” believe that it is “obvious” that long-term economic growth requires “some degree of deferred gratification.” But again, Rosenberg and Birdzell (1986, p. 166) convincingly argue to the contrary.

I only noticed one minor internal inconsistency in McCraw’s book. He writes (p. 404) of Schumpeter characteristically letting “himself go” with “stream-of-consciousness monologues” during his course lectures. But earlier (p. 211), McCraw had written that Schumpeter “gave the impression of complete spontaneity, even though he prepared every class with meticulous care.”¹⁰

One flaw in the editing of the book is worth noting. McCraw includes nearly 200 pages of detailed, useful, and often insightful endnotes. But the accessibility of this material is extremely limited by the editors’ unexplained decision not to include any of the endnotes material in the index.

McCRAW ON SCHUMPETER ON THE HISTORY OF ECONOMIC THOUGHT

For the historian of economic thought, McCraw makes three sorts of contributions. The first is to help us understand more about Schumpeter’s

life. McCraw has mined earlier biographies, especially Allen's, which incorporated interviews with several of those, no longer living, who knew Schumpeter well. And in some cases, McCraw has uncovered, or made accessible, sources that were not earlier much exploited. One chapter, for instance, provides in print for the first time (pp. 285–300) many translated excerpts from letters to and from Mia Stöckel, a sometime German companion of Schumpeter's.

The second, even more useful, contribution is to summarize less accessible Schumpeter works. McCraw spends a chapter (pp. 251–278), for instance in a summary and partial rehabilitation of Schumpeter's massive *Business Cycles* book, arguing that there is much of value on entrepreneurship, creative destruction, and the history of capitalism, in this under-appreciated work. He also summarizes several other important works, placing their content in the context of the development of Schumpeter's thought. These include Schumpeter's untranslated dissertation attempting to reconcile the German Historical School with Austrian theorists (pp. 62–65), an early paper on tax policy (pp. 94–96), the well-received 1948 American Economic Association presidential address on economists' "visions" (pp. 476–483),¹¹ the comments on a plan for the historical study of entrepreneurship (pp. 471–475), and the notes for the Walgreen Lectures (pp. 475–476). (In addition, McCraw also includes useful chapters summarizing and giving context for the major accessible books: *The Theory of Economic Development* (pp. 67–83); *Capitalism, Socialism and Democracy* (pp. 347–374); and *History of Economic Analysis* (pp. 442–468).)

A third contribution is the discussion of the portions of Schumpeter's *History of Economic Analysis* that related to his concerns about capitalism and creative destruction. The most important theme of the discussion is Schumpeter's treatment of the Ricardian Vice, which will be discussed in the next section. But an additional thought-provoking suggestion of McCraw's (pp. 445–446) is that Schumpeter's *History* applied the idea of creative destruction to the evolution of economic ideas and theories.

MCCRAW ON SCHUMPETER ON THE METHOD OF ECONOMICS

On the method of economics, McCraw portrays Schumpeter as spending most of his career being of two minds. On the one hand, Schumpeter strove to produce a treatise that would be a major achievement in

“exact economics” to rival or surpass the mathematically precise models of Walras or Keynes. On the other hand, Schumpeter wanted to be true to the evolving historical detail of capitalism as it is actually experienced by entrepreneurs and policy analysts.

One form in which this conflict expressed itself was in Schumpeter’s inconsistency on the extent and manner in which economists should be involved in policy debates. At different points in the biography, McCraw presents quotations and actions of Schumpeter supporting both sides of the dilemma. On the one hand, the Schumpeter who aspired to “exact economics” sometimes seemed to believe that economists should stay away from policy out of a desire for scientific objectivity (pp. 169 and 447–450). (This would be the Schumpeter that McCraw describes as at times withdrawing into his studies as if they were a “psychic monastery” (p. 187).)

On the other hand, Schumpeter more often, and more intensely, wanted to make a difference in the world. McCraw admits

it is not difficult to identify a Schumpeterian program – at whatever level of analysis one chooses: the individual entrepreneur, the business firm, the industry, or even the country. At all levels, Schumpeter’s litmus test is whether the players are pursuing innovation and bringing about creative destruction. If they are, then the program is Schumpeterian. (p. 169)

Schumpeter describes “that most irritating of all situations” as being “to have to look on events without being able to help” (p. 344). This is hardly the attitude of one indifferent to policy.

Perhaps most tellingly, McCraw compares (p. 372) Schumpeter to the prophet Jeremiah, whose warnings went unheeded. Prophets passionately warn us of problems and call upon us to reform. And recall that the subtitle of McCraw’s book is “Prophet of Innovation.”

Although Schumpeter aspired to advance exact economics, McCraw sees even the early Schumpeter as appreciating the difficulty of fitting actual capitalism into an exact formal structure. McCraw quotes (p. 156) Schumpeter as saying that his “model” of entrepreneurship is “difficult to handle mathematically” and mentions (p. 163) a 1928 article where Schumpeter argues that innovation makes the idea of capitalist equilibrium misleading.

Later in his career, Schumpeter made many other observations that are equally inconsistent with the ideal of an exact economics. One of these would be Schumpeter’s view (p. 457) that the accuracy of an economic vision in an economist does not equal the analytic ability of an economist. A clear-cut

example would be Keynes (1936), whose analytical ability Schumpeter admired, even while rejecting his vision as “modern stagnationism” (p. 479).¹²

According to McCraw, in the last several years of Schumpeter's life, he increasingly came to terms with the impossibility of an exact economics. In a couple of papers, and in his National Bureau of Economic Research presentation, Schumpeter strongly argued for the importance for economists to study history. And conversely, in the posthumously published *History of Economic Analysis*, he criticized exact theoretical economists who ignored the history and current practices of capitalism, as producing work that misses the essential facts about capitalism by committing what he called “the Ricardian Vice.”

The original display of the Ricardian Vice occurred from 1817 to 1871, when the economics profession remained wedded to Ricardo's Corn Model, and its implication of steady-state stagnation, even as actual economic conditions were dynamically improving. Of the Corn Model, Schumpeter sarcastically wrote

It is an excellent theory that can never be refuted and lacks nothing save sense. The habit of applying results of this character to the solution of practical problems we shall call the Ricardian Vice. (Schumpeter, 1954, p. 473)

In his comments preceding this broad conclusion, Schumpeter pointed out that the Ricardian model makes several unrealistic simplifying assumptions and considers only a few aggregative variables. The conclusions follow logically from the assumptions, but because the assumptions are unrealistic, and because the model is too aggregated to represent the richness of the world, it is not a source of sound policy implications. Unfortunately, the model gets applied to policy anyway. In a footnote to the passage quoted above, Schumpeter points out that Lord Keynes counts as a “striking” practitioner of the Ricardian Vice (Schumpeter, 1954, p. 473; see also McCraw, 2007, p. 460).¹³

McCraw describes (p. 221) Schumpeter's original goal of working out an “exact economics” as “setting a real intellectual trap for himself.” One of the major, and possibly controversial, conclusions of the book is that Schumpeter's position on the nature of economics evolved over time, toward a more unambiguous appreciation of the role of history. McCraw says (p. 271) that in *Business Cycles*, Schumpeter tried, and failed, to fit the world into theories that would satisfy “exact economics.” In response to that failure, Schumpeter might have given up the world and stuck with “exact economics,” as many economists do when they practice the Ricardian Vice. Instead, he gave up exact economics and stuck with the world.

Just before Schumpeter died, in notes he prepared for the Walgreen Lectures he was to deliver the following week, he took the final step in the evolution of his views, by suggesting that there was a fundamental indeterminateness introduced into the economy by “random occurrences” and “exceptional individuals” (pp. 475–476). McCraw interprets this as an explicit acknowledgment that the goal of exact economics was a chimera (p. 476).

CONCLUDING COMMENTS

McCraw’s book has been widely reviewed and almost uniformly praised. This is partly due to the research effort that McCraw put into the book, as well as McCraw’s erudition, thoughtfulness, organization, and congenial writing style. But I suspect that it is also partly due to the book’s focus on Schumpeter, and especially on Schumpeter’s ideas on entrepreneurship, innovation, and the process of creative destruction. These are ideas that capture the imagination and resonate with applicability in the worlds of business and policy. That academic citations to Schumpeter’s work continue to grow (Diamond, 2009), nearly 60 years after his death, implies good news and bad news. The bad news is that so little has been done on innovation, that much of what Schumpeter had to say is still on the frontier of research. The good news is that the frontier is alive and growing.

NOTES

1. For example, on higher education, Schumpeter is quoted as asking the rhetorical question (p. 453): “demand for teaching produces teaching and not necessarily scientific achievement?”

2. Perhaps a single biography of this sort is a fertile ground for suggesting hypotheses, but not by itself, for testing them. (But several biographies, examined together, might begin to become a database? Perhaps, as Stigler (1982, p. 92) once suggested, something like prosopography would be useful.)

3. See Allen (1991, vol. 2, p. 133). See also McCraw (2007, pp. 345–346; also see p. 399) who writes that Schumpeter seems to have little idea he was writing a classic. But I think a case can be made that Schumpeter had some idea he had written something important. I have photocopies of letters from the Harvard archives, in which Schumpeter urges the Harper and Brothers publishing house to do a better job of advertising the book. Also, in a letter dated October 12, 1942, Schumpeter

suggests that the book might be published in England as part of a series from the London School of Economics entitled "The Library of Economics." In the same letter, he suggests that review copies be sent to the *Economic Journal* and to *Economica*. In this letter and other letters to Harper, he gives names and addresses of distinguished economists to whom he requests that *Capitalism, Socialism and Democracy* be sent. These include Edward Chamberlin, Gottfried Haberler, Alvin Hanson, Roy Harrod, F.A. Hayek, Wassily Leontief, Edward S. Mason, and Paul Sweezy. I speculate that the "potboiler" comment is gracious false-modesty.

4. Refer Diamond (2007, 2009).

5. McCraw (2007, p. 160) summarizing Schumpeter's achievement: "He was not "revolutionizing" either economics or sociology. Instead, he was integrating the two disciplines into a fresh and invaluable social economics that elucidated the fundamental nature of capitalism."

6. The Acton Institute may be implementing this scenario when they portray the entrepreneur as pursuing a morally noble "calling."

7. McCraw (2007, p. 112) quotes from Schumpeter's diary: "Really, I don't quite regret any of my efforts and failures – every one of them taught me something about myself and life that uniform success would have hidden."

8. Zvi Griliches recommended (Krueger & Taylor, 2000, p. 186) another pathway by advocating that early in their careers, economists should spend a couple of years in policy making or policy analysis.

9. McCraw claims (p. 423) that per capita consumer spending in the United States actually increased by 22% during World War 2. But if consumer spending actually went up, at a time when so many resources were devoted to the war, what an indictment that is of the collapse of production during the Great Depression. And if production collapsed so far, for so long, in the Great Depression, then how can McCraw have anything positive to say about the economics of the New Deal?

10. Allen (1991, vol. 2, p. 40) describes Schumpeter's teaching as meticulous (perhaps too meticulous): "Never did he indicate that he had slaved over notes, preparing for that presentation, or that his comments distilled hours and hours of late-night reading and study. Although he never used notes in his class or for any of his other talks, he did prepare them. Nor did he ever use the same class notes twice. At the end of the term, all the notes for a course were bundled into a small package and laid away, never to be touched again. The next year, he might give the same course, but he made a new set of notes for a different lecture series, worked out laboriously before class, studied, and then laid aside." In footnote 10 on p. 48, Allen states that "several boxes" at the Harvard archives contain Schumpeter's course-related material, including lecture notes.

11. The published version of the address is reprinted in Schumpeter (1989).

12. Refer also McCraw's (2007, p. 459) summary of Schumpeter on Keynes' vision of England's aging capitalism.

13. Since Marx built his own views on Ricardo's analytical framework, it is not surprising that Schumpeter also considered Marx to be guilty of the Ricardian Vice. McCraw claims (p. 161) in particular that Schumpeter gives the Marxian view that the rich get richer, as another example of sticking with a theory in the face of opposing facts (what he elsewhere sometimes called the "Ricardian Vice").

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