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James Tobin

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PREFACE TO *SCHUMPETER* BY EDUARD MARZ,  
ENGLISH TRANSLATION, YALE UNIVERSITY PRESS, 1991

James Tobin

October 1991

Preface by James Tobin<sup>1</sup> to  
SCHUMPETER by Edward Marz, English Translation, Yale University Press, 1991

Like the author of this book, I had the good fortune to know Joseph Schumpeter at Harvard. I knew him when I was an advanced undergraduate 1937-39, a graduate student 1946-47, and a post-doctoral Junior Fellow 1947-48. I took all the courses he offered, and he was my dissertation adviser. Like most of my American contemporaries, I knew little of Schumpeter's pre-Harvard history in Austria and Germany beyond his alleged and admired youthful boast that he would be the "greatest horseman in Vienna, the greatest lover in Austria, and the greatest economist in the world."

Eduard Marz's book was first published in German in 1983. I have read only his English translation, which he had completed with preliminary revisions, though not alas with final polishing, before his death in 1987. The book illuminates for us who knew him in America the intellectual and personal background of this fascinating immigrant. And not just for us, of course. World events and intellectual developments over the past two decades have heightened interest in Schumpeter not only among economists, but also among other social scientists and political philosophers. Indeed many people of all ages and all walks of life have discovered Schumpeter and think that his ideas can help them understand the world they live in.

We Harvard students of the late 1930s told each other that the two greatest living economists in the world were Schumpeter and Keynes. The one was in our midst, awing us by his Austrian accent, his command of our native tongue, his amazing erudition, his mischievous wit, and his evident self-confidence. The other had just published a heretical book causing ferment and excitement throughout our profession. They were the same age. We imagined, rightly or wrongly, that Schumpeter too regarded Keynes as his main rival and resented the lift the General Theory gave him.

In the American economics profession, it has been Schumpeter's fate to

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<sup>1</sup> I am grateful to Professor Wolfgang F. Stolper of the University of Michigan for commenting on a draft of this preface and saving me from some errors of fact and of interpretation. Professor Stolper, like Schumpeter an immigrant from Austria, was a Harvard graduate student in the 1930s. He is a leading authority on Schumpeter. I alone am responsible for remaining errors.

have multitudes of admirers but few disciples. Schumpeter himself invited that outcome in several ways.

At Harvard, Schumpeter as teacher promoted neoclassical orthodoxy rather than his own heresies. He developed close personal ties with many of the top students and young faculty, especially those adept in formal theory and mathematical methods. I think of Paul Samuelson, Lloyd Metzler, and Richard Goodwin. I remember an advanced theory course of Schumpeter's in which these three, plus R.G.D. Allen visiting from England fresh from his work with J.R. Hicks in formal consumer theory, dominated the presentations. A boom in mathematical economics was beginning, and Schumpeter was anxious to be one of the boys. He and Professor W. L. Crum published a primer of mathematics for economists.

Yet Schumpeter as economic historian and social theorist regarded neoclassical theory as mostly irrelevant to the understanding of capitalism. For example, his famous "circular flow" can, I think, be regarded as a reductio ad absurdum of the logic of the neoclassical stationary state. Schumpeter's point was that no phenomena worth studying — not profits, not interest, not growth — can arise in that sterile, stagnant, and repetitive environment. How could anyone take seriously an economy with infinitely lived ageless consumers and with constant tastes and technologies? How could Bohm-Bawerk have thought he was refuting Schumpeter by citing, as in the passages Marz quotes, the many ways in which real world economic variables take on values other than those implied by the "circular flow"?

Schumpeter's young Harvard friends admired his theory of development as a tour de force of historical interpretation, but none of them were doing Schumpeterian economic research and writing. Most of them were Keynesians and neoclassicals at the same time. As my dissertation adviser, Schumpeter was friendly and helpful, although clearly my Keynesian subject, the consumption function, did not excite him. Some others, like Goodwin, Sidney Alexander, and Paul Sweezy, used Keynesian and neoclassical tools and were also Marxists. Sweezy's strong Marxist convictions and Marxist scholarship helped to make him and Schumpeter great friends, even though their public intellectual combat was a memorable event.

I did not personally find Schumpeter and Keynes seriously contradictory. Keynes stressed the essential unpredictability of business investment, and

Schumpeter gave important reasons why this should be so. While Schumpeter regarded bank credit and forced saving as the necessary sources of finance for investment booms, this was because he assumed his circular flow, with full employment, as the starting point. Once the process was under way, a Schumpeterian investment boom starting from conditions of unemployment and excess capacity could generate its own saving via Keynesian multiplier mechanisms. Both Schumpeter and Keynes expected nominal prices to move procyclically. The unconvincing part of Schumpeter's model, it seemed to me, was his assertion that production and consumption increased in recessions, which he described as inevitable adjustments and benignly therapeutic. Keynes's proposition that the downswings of business cycles were mostly deadweight loss made much more sense, especially in the 1930s. Perhaps the difference was one of degree, because Schumpeter did recognize extreme downswings, depressions and severe monetary deflations, as inessential and unconstructive.<sup>2</sup>

As Marz points out, Schumpeter himself almost never taught, discussed, or assigned his own substantive work. Most students read his writings, at least those available in English, but in my experience he did not gratify our hopes of hearing the master himself expound his ideas. He wrote Business Cycles pretty much on his own. He didn't recruit students to help him; he didn't suggest topics arising in his own research to students for papers or dissertations; he didn't try out the ideas or findings of his draft chapters in seminars. That so enormous an achievement was the product of lonely research tells what a great scholar Schumpeter was.<sup>3</sup>

Schumpeter did share with students his great work on the history of economic thought, posthumously published. His course rarely got much farther than Adam Smith, but as he reviewed Smith's many predecessors he was led to comment on the 19th and 20th century economists they anticipated. From those comments we could infer many of Schumpeter's views on the modern economists of interest to us, from Ricardo to Walras to Marshall to Keynes. But he gave us no hint where Joseph Schumpeter fitted in to the history.

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<sup>2</sup> I am indebted to Professor Stolper for pointing this out to me.

<sup>3</sup> Professor Stolper recalls one seminar Schumpeter gave on Business Cycles shortly after its publication, where young Harvard economists attacked him unmercifully, to his considerable annoyance.

Why did Schumpeter feel so much more comfortable teaching and discussing the ideas of other economists? It is hard to believe it was modesty, for we know from evidence in this book and elsewhere that Schumpeter was really quite egotistical. Was he afraid some of his ideas and empirical findings would be shot down by his bright young friends?

However, even if Schumpeter himself had made more effort to spread his word among students, his theories of development and business cycles were difficult to incorporate into the style and method that came to dominate economics, especially American economics, over the past fifty years. Formal model-building was quickly coming into vogue in the 1930s and 1940s. Schumpeterian theory does not lend itself easily to model building, either statics or dynamics. Both in theory and in application, economists have been looking for comparative static or comparative dynamic results. These are often conclusions about policy effects — what happens if governments increase income taxes or central banks buy bonds with money in the open markets.

One could believe Schumpeter's general proposition, that innovations are responsible both for capitalism's progress and for its instabilities, and one could learn from Schumpeterian versions of past history. But the innovations themselves seem unpredictable and uncontrollable. Schumpeter doesn't attempt to tell us how to speed them up or slow them down, or how to channel them into one direction or another. He does suggest some diffuse cultural and institutional conditions that are favorable to innovations, and others that are unfavorable. These suggestions might carry diffuse ideological morals of a conservative or "supply-side" cast, but they say little about how to prevent recessions and inflations or speed up the growth of productivity at particular times in particular countries.

In contrast, Keynesian economics was tailor-made for the analysis of policy effects. Keynes told us students in the 1930s what to do about the major problem that confronted us, the Great Depression. He gave us the fun of playing with a new set of analytical tools combined with the confidence that their application to practical policy could save the world. Schumpeter had written a surprisingly orthodox chapter in a 1934 Harvard book taking to task

the New Deal recovery program.<sup>4</sup> But in our years he participated very little in the exciting current debates about fiscal and monetary policy, except to sneer from the sidelines at the "future champions of bureaucratic self-interest," presumably the graduate students Professor Alvin Hansen, the leading American apostle of Keynesianism, was sending to Washington jobs.

While Schumpeter was writing Business Cycles, Ragnar Frisch, Jan Tinbergen, and others were trying to bring mathematical rigor to cycle theory. According to their new methodology, a theory that cycles are endemic to capitalist economies should display mathematically mechanisms that generate regularly repetitive cycles. Proper cycles were to be distinguished from fluctuations that simply mirror random exogenous shocks and could not be expected to be regular or periodic. At Harvard Samuelson, Metzler, and Goodwin were practicing the new methodology.

Schumpeter's theory, credible as it was as historical interpretation, is not cycle theory in Frisch's sense. At least Schumpeter's presentation of it is not such theory. Rather it is an account of fluctuations resulting from irregular exogenous shocks, Schumpeter's innovations. It is not clear what endogenous mechanism transforms those shocks into cyclical alternations of prosperity and recession, even less clear how the Schumpeterian process results in superimposed Kitchins, Juglars, and Kondratieffs.

Frisch himself suggested a mechanical analog of Schumpeter's theory; he

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<sup>4</sup> Douglass V. Brown and others, The Economics of the Recovery Program, New York: McGraw-Hill, 1934. Schumpeter explained that depressions have happened before, that they perform necessary economic functions, that they are structural not monetary, and that recoveries occur on their own and will probably do so again in the absence of unwise political interference. He did concede that the 1930s depression had been aggravated by non-economic forces, and he acknowledged the existence of "widespread suffering and needless waste" and saw some role for temporary "[public] expenditure to blot out the worst things without injury to the economic organism." Schumpeter was also a member of a Columbia University Commission which produced a Report, Economic Reconstruction, New York: Columbia University Press, 1934. In a personal addendum, Schumpeter foreshadowed some postwar Keynesians: "...[T]axation itself may be made a useful instrument of remedial policy if taxes which are in any way proportional to business success are systematically lowered in depression and increased in prosperity, in which case they would operate in a way similar to that of the variations of the rate of interest." The quotation occurs in Herbert Stein, The Fiscal Revolution in America, Chicago: University of Chicago Press, 1969, p. 88.

said it could be formulated mathematically, but he did not do so. The analog model assumes a fairly steady flow of water into a reservoir, meant to represent the stream of potential innovations. When the reservoir is high enough, water flows down a pendulum pipe. As the water escapes through a valve on one side of the pendulum, it makes the pendulum swing, but the opening of the valve is contrived to contract when it swings in the direction of the valve. When the valve contracts, the reservoir fills up again and is ready to flow down the pendulum once more when it swings back to its vertical position and the valve reopens. Although Frisch reports "long conversations and correspondence with Professor Schumpeter," it is not clear that Schumpeter found the model helpful. I doubt that he did. Presumably the swings of the pendulum represent business cycles, and the actions of the valve represent the receptivity of the economy to the innovations. The analogy is strained.<sup>5</sup>

What is beyond doubt is that Schumpeter had the highest opinions of all these pioneers and the highest hopes for their new methods. Schumpeter was an optimist about economics and observed with pride and admiration its professional and scientific advances. The last pages of History of Economic Analysis celebrates "macrodynamics," Schumpeter's term for formal business cycle modeling, as the wave of the future. His ultimate judgment of Keynes's analytical contribution is that Keynes, himself a static theorist, "unintentionally . . . gave a mighty impulse" to macrodynamics.<sup>6</sup>

The reader of Business Cycles finds its historical and empirical chapters wise and informative accounts. But he or she may wonder what, aside from the style and scope of the author, is distinctively Schumpeterian about them. They are only loosely related to his general thesis. Moreover, these empirical and statistical narratives eschewed econometric methods — another example of Schumpeter's deviation from methodologies that were starting to become orthodox in the 1930s and 1940s, beginning with Tinbergen's statistical

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<sup>5</sup> R. Frisch, "Propagation Problems and Impulse Problems in Dynamic Economics," in Economic Essays in Honour of Gustav Cassel, London: George Allen and Unwin, 1933, pp. 1-35. The Schumpeter model occurs at the end of this famous essay.

<sup>6</sup> p. 1184.



model of the interwar U.S. economy.<sup>7</sup>

It is for these reasons that Schumpeter has been greatly admired but not imitated or elaborated by the mainline economics profession, especially in his adopted country. However, this situation may be changing. The stochastic models of fluctuations and growth currently engaging able theorists and econometricians look more compatible with Schumpeter's ideas than the models of the past. Perhaps his theory can now be rigorously mathematically formulated and tested, without sacrificing its distinctive content.

Economists may have neglected Schumpeter, but he successfully played to a larger audience, thanks largely to Capitalism, Socialism, and Democracy. He has made a bigger splash than Keynes or other mainstream economists with economic historians, general historians, political scientists, and political philosophers. In this respect he rivals Marx.

I have always thought that Schumpeter's ambition was to develop a theory of history of the same sweep and scope as Marx's, while at the same time turning Marxism upside down. I have inferred this from what Schumpeter did and wrote; I cannot know his subjective intentions and aspirations. Marx seems to confirm the hypothesis that Marx was both his idol and his target. Schumpeter's account of economic development follows, like Marx's, a dialectic. In Schumpeter, as in Marx, capitalism undermines itself and gives way to socialism. In Schumpeter, it is capitalism's economic success that does it in; in Marx it is capitalism's failure. Schumpeter provides theories of the state, of social classes, and of imperialism, all with explanations contrary to those of Marx. Like Marx, Schumpeter pretended to scientific objectivity, telling us history and the immutable future, not telling us his own hopes and preferences.

We students used to speculate about Schumpeter's politics. Much of his economic message seemed to be conservative — capitalism will do fine if left alone — but he also seemed to be put off by the culture of capitalism. Although he stressed "supply-side" incentives — he thought even estate taxes would discourage saving and enterprise — the crude anti-government laissez faire doctrines of Reaganomics would certainly have offended him. He assured

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<sup>7</sup> Jan Tinbergen, Business Cycles in the U.S., Geneva: League of Nations, 1932.

his readers that socialism will work and will even have certain virtues. He sounded resigned to the necessity of taking medicine he didn't like. Our favorite hypothesis was that he was nostalgic for feudalism, perhaps for the Austro-Hungarian monarchy, — not that he viewed restorations of such regimes as at all possible. That hypothesis gained some credence from his expressed admiration for the Japan he visited before the war. One of the few passionate opinions I ever heard Schumpeter express was his condemnation of the American bombing of Hiroshima.

Capitalism, Socialism, and Democracy in some ways looked better twenty years ago than it does now. His uniquely optimistic forecast of the growth of U.S. GNP to 1964, which had looked unrealistically rosy in 1940, had been over-fulfilled. And in 1970 his scenario for the death of capitalism did not look far-fetched. The children of the bourgeoisie were turning against the democratic-capitalist system that had given them the luxury of choice and the freedom to revolt, the system that had nourished the anti-capitalist intellectuals who taught them. I used to teach an undergraduate course on economic growth theory, which wound up with a lecture on Schumpeter in the spring. In both 1969 and 1970 I was in the midst of Schumpeter's reasons for the inevitable march into socialism when outside our classroom other Yale students were engaged upon a loud march into administrative office buildings. But today the defection of the bourgeois kids looks to have been only transient. Radical students of 1970 became yuppies of the 1980s.

More important, the dramatic collapses of communist governments and centrally planned economies in 1989 and 1990 suggest that Schumpeter over-estimated the viability of socialism and understated the survivability of capitalism — or more precisely, of the Western combinations of capitalism and social democracy of the past forty-five years. Of course, communism was not Schumpeter's idea of socialism, and despite recent conservative trends in capitalist democracies, it is possible that the march into a humane form of socialism will eventually be resumed.

Schumpeter would not be disappointed, or disheartened, by the evidence that capitalism may have at least one more Kondratieff upswing ahead of it.