

SCHUMPETER'S ENTREPRENEUR AND THE GERMAN HISTORICAL SCHOOL. A CRITICAL ANALYSIS

MARIUS KLEINHEYER*

Resumen: Este artículo critica de forma fundamental el concepto de función empresarial de Schumpeter e identifica que el origen conceptual de su teoría sobre el empresario se encuentra en la Escuela Histórica Alemana.

Palabras clave: Escuela Histórica Alemana - Schumpeter - función empresarial.

Clasificación JEL: A12, A14, B15, B25, B31, B53.

Abstract: This paper provides a fundamental critic of the Schumpeterian concept of entrepreneurship. Being one of the most influential economist of the 20th century, Schumpeter inspired many different lines of economic thought. The nexus of his theory, the concept of entrepreneurship, can be seen as his most important contribution to economic theory. A deeper understanding of the complex work of Schumpeter requires to identify the intellectual roots and the core of his thinking. This paper claims that the core in his thinking can be found in the conceptual basis of the German Historical School. It is reasoned that the Schumpeterian entrepreneur is understandable and inherently consistent, if he is interpreted as a representative of the thought system of German historicism.

Key words: German Historical School - Schumpeter - Entrepreneurship.

JEL Classification: A12, A14, B15, B25, B31, B53.

* Master in Economics of the Austrian School, PhD Student, King Juan Carlos University.

I INTRODUCTION

This paper provides a fundamental critic of the Schumpeterian concept of entrepreneurship. The essence of a critical analysis consists in putting to the foreground what is underlying in the back. The critical analysis inquires the preconditions of observations. The aim is to arrive at a better understanding of the visible phenomenon.

In the case of Schumpeter this is particularly challenging. Being one of the most influential economists of the 20th century, Schumpeter inspired many different lines of economic thought. The nexus of his theory, the concept of entrepreneurship can be seen as his most important contribution to economic theory. A number of important approaches that all view Schumpeter's entrepreneur as their patron have emerged, including foundational work on evolutionary economics, the emerging theory of economic sociology as well as numerous frameworks and theories emerging in the study of strategic management, business organizations and marketing, to mention a few.¹ Baumol even goes as far as calling Schumpeter the proper originator of the entrepreneurial concept in economics in general.²

In fact, Schumpeter handed down a unique system of thought, which he elaborated and expressed in his comprehensive work. His writings include many classics in the field of theory and history in which he developed his views on methodology, business cycles and economic development. He himself joined an economic education in the heydays of the university of Vienna and was intellectually influenced by a vast array of as different as important thinkers, including Eugen von Böhm-Bawerk, Friedrich von Wieser, Léon Walras and Karl Marx. Schumpeter took a lot of inspiration from the work of these persons and transformed it into his original interpretation, rather than just following in the footsteps of one of them. Readers, grappling with his texts, can

¹ Becker/Knudsen (2003) p. 200.

² See Baumol (1968) p. 64 Obviously there is a long history of the term in economic theory before Schumpeter. For a brief historical overview of the development of the term see Hébert/Link (2006) *Historical Perspective on the Entrepreneur*. Insofar, Baumol's claim is interpreted as the underlining of the significance of Schumpeter's entrepreneur.

sometimes be left behind with the impression of a fascinating, and inspiring but at the same time confusing and inconsistent author. His notion of entrepreneurship has often been interpreted as contradictory and inconsistent in his transformation from the heroic leader of a new firm to the functional routine of mere employees in the hierarchies of large bureaucratic corporations. This is so far the visible phenomenon Joseph Schumpeter.

A deeper understanding of the complex work of Schumpeter requires to identify the intellectual roots and the core of his thinking. This paper claims that the core in his thinking can be found in the conceptual basis of the German Historical School. It is reasoned that the Schumpeterian entrepreneur is understandable and inherently consistent, if he is interpreted as a representative of the thought system of German historicism.

Since Schumpeter was eager not to be seen as a member of a special kind of academic school, the paper is not claiming a somewhat official membership in the circles of the German Historical School but an intellectual alliance, which is characterizing the core of Schumpeter's work. To make this point clear, the critical analysis is necessary.

The paper is divided in two major parts. In the first part, the research program of the German Historical School is presented and compared with the opposing approach of the Austrian School of Economics. This part concludes with an evaluation of Schumpeter's position towards these dualistic concepts. The second part shows that the crucial aspect of Schumpeter's theory of economic development is the historicity of entrepreneurship, based on the conceptual approach of the German Historical School.

II THE RESEARCH PROGRAM OF THE GERMAN HISTORICAL SCHOOL

Historicism in economics emerged in Germany in the second half of the 19th century. According to Schumpeter's own classification, there were three generations which can be identified as the core of the academic movement. The Older Historical School is represented

by Wilhelm Roscher, Karl Knies and Bruno Hildebrandt. The Younger Historical School consists for example of Gustav von Schmoller, Lujio Brentano and Adolph Wagner. The Youngest Historical School is represented by Arthur Spiethoff, Werner Sombart and Max Weber.³

The German Historical School can be described as a criticism of British classical economics. In opposition to the universally valid economic theory, it asserted that economic principles should be inductively derived through the study of historical facts of different countries. The root of the Historical School can be found in romanticist, idealist, and nationalistic ideology that was a reaction to rationalism and enlightenment, of which classical economics was one of the products.

Of particular philosophical interest were the philosophies of Hegel and later the positivists and empiricist which became famous in the Vienna Circle. In the following a short overview of the main positions is provided.

Two important aspects in Hegel's philosophy should be pointed out. First, he elaborated the doctrine of the internal relations. According to this principle, everything that exists is bound together in a tight unity. This doctrine has drastic consequences for science. Since all things are connected, full knowledge of anything requires knowledge of everything. The view that the economy is tightly interlocked with other social institutions is an application of a category of Hegel's Logic: organic unity.⁴ Second, a central part of the philosophy of Hegel is his concept of the Weltgeist (spirit of the world). In this concept, the whole social unity is moving towards its determination on the line of its teleological rationality until a final stage is realized.⁵ The parallel here with the Historical School is apparent. Their members also attempted to elucidate the stages of historical development.⁶

The logical positivists or later so called Vienna circle met under the leadership of Moritz Schlick, a professor of philosophy at the

³ Schumpeter (1954) p. 807.

⁴ Harris (1965) pp. 279.

⁵ Prechtel (2005) p. 218.

⁶ Gordon (1996) p. 14.

University of Vienna. The essence of logical positivism can for our purposes be quite simply stated. All empirical statements, i.e., statements about the world, must be testable. If a statement cannot be tested, then it has no empirical meaning. By testable or verifiable the positivists meant capable of being perceived by the senses. This is the famous verifiable criterion of meaning, the Vienna Circle's most noted principle.⁷ The thoughts of the Vienna Circle can be traced back to Ernst Mach, empiricist of the 19th century. For him, scientifically valid is only the given, interpreted by senses. In conclusion, scientific knowledge is based on individual experiences. In consequence, the collection of empirical data is regarded as the only way to scientific knowledge.

The German Historical School was inspired by these movements and elaborated a rich body of literature, transforming the insights into the field of economics. For our purposes, the most important contributions of the Younger and the Youngest Historical School are presented, especially with regard to their most important representatives Gustav von Schmoller, Werner Sombart, Arthur Spiethoff and Max Weber.

1. The Younger Historical School

The historicist tradition of political economy, as developed by Roscher and Knies and then taken up by Schmoller, demands that economic phenomena need to be interpreted in their historical and cultural context. Historical formations have to be treated individually as coherent developing entities that consist of interdependent elements. Methodological holism therefore runs parallel with an organicist perspective that provides quite explicitly an array of evolutionary concepts.⁸ In retrospect, development is interpreted as a tightly connected social process, which only offers a perspective into the inner law of the movement through the careful analysis of the stages of development.

⁷ Ibid. p. 33.

⁸ Betz (1988) p. 429.

The Historical School regarded economics as a historical and practical discipline. They were not interested in the advancement of an economic theory but rather searched for useful insights into economics in order to strengthen the power of the state.⁹ The Historical School was politically oriented toward the industrialization of less-developed Germany and concerned with the building of an institutional framework on a national basis and thus could not accept British *laissez-faire* economics.¹⁰ The school stands in the tradition of German political economy born from the specific German brand of Mercantilism called *Cameralism*.¹¹ Its purpose was the transformation of economics as a science of household management to the science of the planning and control of state revenue and expenses. The uprising German nation was perceived as the moving social whole, which needed to be supported by the historical analysis of the developmental stages. Of course one aim was also the derivation of policy advice.

Schmoller's notion of economic development points at an unfolding pattern of development stages according to an evolutionary sequence of increasing complexity.¹² He postulated that the process of economic development is based on the development of the human being in general, especially development in the direction of increased economic capabilities and moral attitudes as well as on the formation of larger and more complicated, consistently better instituted societal economic organs and communities.¹³ This process drives the movement of the whole society. According to Schmoller, the process of an increasing complexity of economic interdependence in modern Europe ranges from the agrarian subsistence economy to the national economy which is integrated by international markets.¹⁴ Schmoller also adds a sociological component into his process. Increasingly complex and unstable modern societies are subject to internal class struggles as well

⁹ Gordon (1996) p. 8.

¹⁰ Shionoya (2005) p. 2.

¹¹ Campagnolo (2010) p. 99.

¹² Ebner (2003) p. 119.

¹³ Schmoller (1904) p. 748.

¹⁴ *Ibid.* p. 764.

as to external policy conflicts as a result of rivalry of nations involved in international trade.¹⁵ From this struggle arises cyclical rise and decline of nations and civilizations. More generally, the rise and decline of individuals, social groups and classes, as well as of peoples and nations, is perceived as a common development pattern, based on evolutionary competition.¹⁶

Within this framework, Schmoller insisted on the creative role of outstanding individuals as an internal factor of the development process. His definition of the entrepreneur was straightforward: «The one who takes the initiative, bearing risk under private law, is the entrepreneur; he is the center and the head of the enterprise.»¹⁷

Though this approach to economics is subjectivist, it does not refer to a principle subjectivism but opens the door to inductivism. Schmoller's position of methodological inductivism led him to believe that extensive historical and empirical research could uncover the fundamental laws of motion of societies, that is to say, the determinants of socio-cultural development.¹⁸ His methodology can be regarded as a prototype of economic sociology, the discipline for the development of institutions in terms of interactions among individuals.

Gustav von Schmoller describes economics as a basically historical science: «Historical research has created the conceptions of the historical development of nation, of man, and of economic institutions. It has properly brought economic research into contact with morals, law, the state, and the causes of cultural development in general. It has shown how to inquire into collective phenomena in addition to the conclusions starting from individuals and their self-interest. It has shown how to do a proper synthesis in addition to an analysis. It has given for the first time, a proper complement to an isolating abstraction by showing how to regard the results of the abstraction as part of a coherent whole. Thus what used to be faded abstraction and dead schema has recovered blood and life.»¹⁹

¹⁵ Ibid. p. 465.

¹⁶ Schmoller (1901) p. 221.

¹⁷ Ibid. p. 413.

¹⁸ Ebner (2003) p. 122.

¹⁹ Schmoller (1911).

The formal aspect of the research program of Schmoller's economics consists of three steps:

1. The observation and description of economic phenomena according to time and space.
2. The definition and classification of the phenomena by a coordinated system, and the causal explanation of the phenomena by a coordinated system.
3. The causal explanation of the phenomena and recognition of their interrelations.²⁰

As already mentioned, this research program indicates an endless scenario of empirical research. The substantive aspect of the research program was summarized by Schumpeter into the following categories:

1. A belief in the unity of social life and the inseparable relationship among its component elements.
2. A concern for development.
3. An organic and holistic view of society.
4. A recognition of plurality of human motives.
5. An interest in concrete individual relationships rather than the general nature of events.
6. Historical relativity.

The Austrian School emerged as a fundamental attack against the approach of Schmoller and German historicism in general. It stood diametrically opposed to the German Historical School.²¹ What is today famously known as the *Methodenstreit* was not so much the question of how to deal with epistemological problems in economics in the most adequate way. The matter in dispute was essentially whether there could be such a thing as a science at all, other than history, dealing with aspects of human action.²²

²⁰ Schionoya (2005) p.18

²¹ Gordon (1996) p. 17.

²² Mises (1984) p. 12.

Carl Menger, by then the only representative of what was later called the Austrian school of economics, claimed the possibility of universal economic laws, which are always valid no matter in which country, nation or age. As Menger states: «The world of phenomena can be considered from two essentially different points of view. Either there are concrete phenomena in their position in space and time and in their concrete relationships to one another, or else there are the empirical forms recurring in the variation of these, the knowledge of which forms the object of our scientific interest. The one orientation of research is aimed at cognition of the concrete, or more correctly, of the individual aspect of phenomena, the other is aimed at cognition of their general aspect. Thus, corresponding to these two main orientations of the striving for cognition, two great classes of scientific knowledge confront us, the first of which we will in short call individual, the latter general.»²³ Menger insists that these two spheres of knowledge not only both exist, but also, that advances in one part cannot be reached with the utilization of the other. Historicism, denying the use of theoretical considerations, carry historical approaches into the field of economic theory.²⁴ This is not only not beneficial but has harmful consequences. While claiming for more statistics, history and the collection of material in general, Schmoller opened the door for positivism into economics which ultimately has to result in materialist determinism.²⁵ Thereby, Historicism proved to be inherent inconsistent. Though rejecting a-priori theory, it tried to distill laws of social development, a kind of «law of social physics»²⁶, out of history.

2. The Youngest Historical School

Among the generation of the Youngest Historical School, the most outstanding representatives are Werner Sombart, Arthur Spiethoff and Max Weber.

²³ Menger (1970) p. 35.

²⁴ Menger in his argumentation with Schmoller (1970).

²⁵ Mises (1984) p. 12.

²⁶ Ibid. p. 12.

In his theoretical refinement of Schmoller, Werner Sombart presented the notion of «economic system» as a conceptual framework, which grasps the essential institutional, organizational, and technological features of actually existing economic formation.²⁷ Later on he describes his thought more precise and states that «an economic system is a unitary mode of providing for material wants, animated by a definite spirit, regulated and organized according to a definite plan and applying a definite technical knowledge.»²⁸ For our purpose also very interesting is his perception of capitalism as an economic system, that had experienced an early phase of expansion, followed by a phase of dynamic high capitalism and then transformed into a phase of an increasingly bureaucratic late capitalism announcing the possible advent of a non-capitalist transformation. The economic spirit as the determining driving force of economic processes was understood as the reflection of the ideas of acquisition, competition and rationality which were identified as the major motives of economic agents in capitalist economies.²⁹ According to the phases, the ideas of how to proceed the economic progress changes. In this concept, Sombart introduces the entrepreneur as a stylized actor, based on certain characteristics. In the early times of capitalism the Sombartian entrepreneur is a heroic, adventurous business leader. With the decline of capitalism and the decomposition of the bourgeoisie as an intellectual and material force, entrepreneurship declines.³⁰ In Sombart's framework, the notion of one unified movement of society and the interrelation between its actors and drivers can be seen very clearly. Though Schumpeter criticized that Sombart failed to show a causal economic explanation for the decline of capitalism³¹ it is more than obvious, that the inspiration for his work on the economic process and its determination is rooted in the concept of Schmoller and Sombart.

²⁷ Sombart (1916) p. 14.

²⁸ Sombart (1930) p. 196.

²⁹ Ibid. p. 196.

³⁰ Sombart (1913) p. 60.

³¹ Schumpeter (1927) p. 211.

A third contribution to the thought of Schumpeter was the work of Max Weber, who also tried to establish an economic sociology. According to Weber, modern capitalism is identical with the striving for profit in continuous and rational capitalist operation, aiming for profitability.³² This view is combined with the perception of the entrepreneur as charismatic leadership for the introduction of something new, especially the establishment of organizations. He famously linked that insight with the ethic of Protestantism in order to explain the motivation behind ongoing rationalization in the process of the occidental type of modern capitalism.³³

Weber's sociology can be interpreted as the translation of the neoclassical notion of equilibrium into historicist terminology. According to neoclassical economics, given the quantity of available resources and certain specifications of consumer tastes, techniques of production, and social structure, the assumed rational behavior of *homo oeconomicus* will uniquely bring about an equilibrium state of resource allocation - i.e., equilibrium prices and quantities of various goods and factors of production - through the play of individual self-interest and the working of competitive market mechanism. Weber did not use the concept of equilibrium but instead used the term order to describe somewhat similar a given state of regular social relationships as the general structure of human groups.³⁴ The actors ascribe legitimacy to a social order by virtue of tradition, emotional belief, and rationality. Since society is therefore based on inner motives of individuals, his approach can be called subjective. Society as such is oriented to the behavior of others. Weber writes: «An important normal component of social action is its meaningful orientation to the expectations of certain behavior on the part of others and, in accordance with that, orientation to the assessed probabilities for the success of one's own action.»³⁵

Despite his notion of rationalization as a core characteristic for capitalistic economic processes, Weber is well known for

³² Weber (1920) p. 4.

³³ Ibid. p. 7.

³⁴ Shinoya (2005) p. 40.

³⁵ Weber (1922) p. 417.

introducing his instrumentalist methodology, which influenced not only Schumpeter but also the positivistic methodology of neoclassical economics up to Milton Friedman. Weber constructed an instrumentalist methodology in his attempt to explain economic sociology. The characteristic tools are interpretative sociology and the above mentioned ideal type concept. As Weber states: «Substantively, this construct (abstract economic theory) in itself is like a utopia which has been arrived at by the analytical accentuation of certain elements of reality. Its relationship to the empirical data consists solely in the fact, that where market-conditioned relationships of the type referred to by abstract construct are discovered or suspected to exist in reality to some extent, we can make the characteristic features of this relationship pragmatically clear and understandable by reference to an ideal type.»³⁶

Mises rejects Weber's methodology and its focus on ideal-type constructions very clearly and it is worth quoting him at length to illustrate the fundamental methodological differences between him and Weber: «The basis of Weber's misconception can be exposed only by consideration of the question whether the concepts of economic theory do in fact have the logical character of the "ideal type". This question is plainly to be answered in the negative. (Theoretical concepts) are not derived through one-sided intensifications of one or several aspects and through integration into an immanently consistent conceptual representation of a multiplicity of scattered and discrete individual phenomena, present here in great number, there in less, and occasionally not at all, which are in congruity with these one-sided intensified aspects. They are rather a generalization of the features to be found in the same way in every single instance to which they refer. The causal propositions of sociology are not expression of what happens as a rule, but by no means must always happen. They express that which necessarily must always happen as far as the conditions they assume are given.»³⁷

The construction of ideal types as so called one-sided intensification is very typical for the Historical School. Of course, this

³⁶ Ibid. p. 190.

³⁷ Mises (2002) pp. 84 and 98.

has nothing to do with the abstract *a-priori* reasoning which was presented by Mises.

The notion of a special economic style which affects the way of economic processes and therefore economic development was originated by Arthur Spiethoff. Based on empirical observance, a historical perspective of the dynamics of capitalism is delivered.³⁸ He states: «Most economic phenomena are time-conditioned and are rooted in specific geographical areas. They are subject to change over time and cannot be treated, therefore, with the help of concepts and theorems purporting to be of universal applicability. Economic theory can deal with those phenomena only by differentiating patterns of economic life, patterns which have come into being in the course of the historical process. As a matter of fact, as many patterns must be delimited as there are essential and typical differences in the basic economic institutions. Patterns of this kind are here called economic styles.»³⁹ At a different place, Spiethoff outlines the elements of his style:

1. Economic spirit, denoting attitudes and motives of economic action.
2. Natural and technological foundations, such as population dynamics, division of labor, technological regime.
3. Constitution of society, regarding social structure.
4. Economic constitution, concerning property rights as well as modes of production, distribution, and labor.
5. Economic dynamics.

This program reflects the range of the Youngest Historical School. The rationale behind the factor of economic spirit is derived from the assumption that capitalist economic attitudes tend to deconstruct non-capitalist motives.⁴⁰ It is worthwhile to note that within this framework an endogenous change of societal process is perfectly feasible. The interplay between the style elements could be able to explain a wide range of social dynamics.

³⁸ Ebner (2000) p. 362.

³⁹ Spiethoff (1952) p. 132.

⁴⁰ Ebner (2000) p. 363.

Business cycles can be interpreted as the result of fluctuations of a broad socio-cultural development.

3. Schumpeter's position

a) Biographical Background

So far, the critical analysis of Schumpeter's work explained the background of the thought related with German Historicism in the 19th and the beginning of the 20th century. Schumpeter's position towards the, at that time dominant, intellectual atmosphere of historicism can be illustrated with some biographical facts.

Two facts are regarded as relevant to his political and social thought. First, Joseph Schumpeter is an Austrian by birth, born 1883 in a village called Triesch in what was then a province of the Austro-Hungarian Empire: Moravia. His family lived there for generations and were well known in the region as cloth manufacturer. The Schumpeter family was a prominent and successful bourgeois family of the Catholic faith, which belonged to the German minority.⁴¹ Life changed for the family, as the father died by accident when Joseph Schumpeter was 5 years old. Schumpeter missed and idealized his father as a role model of a small business leader who takes also a prominent position in the social life of the family and the local community.

Second, after the early death of his father, he moved to Vienna with his young mother and got the opportunity to go to school at the Theresianum, an elitist school of the Austrian empire. As the school tried to educate the future administration, the philosophy of the school was to teach how to stay neutral to special interests. A friend expressed the effect on Schumpeter this way: «Schumpeter never seemed to take anything in life seriously. He had been educated in the Theresianum, where the pupils were taught to stick to the issue and not let personal feelings interfere. One should know the rules of all parties and ideologies, but not belong to

⁴¹ Swedberg (1991) p. 7.

any party or believe in any one opinion. And Schumpeter knew how to play all political games superbly, from the extreme left to the extreme right.»⁴² A lack of commitment and seriousness was a constant criticism of his fellow men and was the source of many advantages and disadvantages.⁴³

Schumpeter grew up in Vienna at the end of the 19th century. It was at a time, when the industrialization started to transform the Habsburg Empire, where most people still lived in rural areas and worked for farms and small businesses. Between 1850 and 1900 the population of Vienna increased four-fold. The scale of business operations was becoming immense even within individual companies. Close to home, German companies such as Krupp and Thyssen in steel, Siemens in electrical equipment, and the chemical giants Bayer, Hoechst and BASF had become industrial powerhouses prospering also in the Habsburg area.⁴⁴

Tensions between Prussia and Austria were all around. Whereas Prussia was seen as the avantgarde of modernity, the Habsburg empire had the reputation of the romantic old-fashioned society.⁴⁵ Schumpeter himself used this sentiment, when he described the danger of Prussian control in Austria. «Just imagine what all of this means: a Prussian-Lutheran- Militaristic Middle Europe with an attitude towards the rest of the world like that of a beast of prey, baring its teeth. The Austria we know and love would cease to exist.»⁴⁶

Schumpeter lived already in his childhood through a similar transformation he later addressed to the capitalist process. He left his home, where his father, the prototype of an entrepreneur as we explain later, died and then moved to Vienna, where he was introduced to the aristocratic administration. He was impacted by an education which intended to prepare for leading administrative

⁴² Somary (1959) p. 170.

⁴³ E.g. Stolper (1994) pp. 13 Schumpeter was also infamous in that respect during his career as politician and banker in the time between the two world wars.

⁴⁴ McCraw (2007) p. 30.

⁴⁵ In fact the term «Austrian Economics» was chosen by representatives of the German Historical School located in Berlin to show their disrespect of the related academic work.

⁴⁶ Swedberg (1991) p. 50.

positions in the Austrian empire. He was grown up in the time of deep changes due to industrialization processes in Austrian and German society at the end of the 19th century.

b) The Academic Position

The German Historical School was the most powerful academic movement at the end of the 19th century. In order to advance an academic career in economics, there was a clear incentive for scholars to adopt historicism in their works. At least there was a requirement to deal with the methodological positions. In his first monographic work *Das Wesen und Hauptinhalt der theoretischen Nationalökonomie*, Schumpeter conceptualized his methodological approach. For him, historical theory consists of theory obtained from history. Schumpeter suggested that historical theories, as represented by Sombart's theory of modern capitalism, needed to be distinguished from economic history as well as from pure theory, for they were derived directly from the available historical material. Schumpeter explicitly states that in contrast with the so-called pure theory which represents the logic of deductive reasoning on economic universals it is the branch of historical theories that takes account of singular hypothesis concerning concrete questions on diverse and detailed historical facts.⁴⁷ For Schumpeter, from there follows that historical theory is dynamic. As he writes: «So they are nothing but static wherein lies a decisive difference with our essentially static theory. Perhaps the area of dynamics is all theirs.»⁴⁸ For Schumpeter, the research program of the German Historical School strives for grasping the essence of history itself, as it aimed for the integration of a general sociology with a universal history.⁴⁹

In consequence, the *Methodenstreit* was from Schumpeter's perspective a pure waste of time and energy. Both approaches have their useful contributions to make. He interpreted methodology

⁴⁷ Schumpeter (1908) p. 18.

⁴⁸ Ibid. p. 18.

⁴⁹ Schumpeter (1926) p. 46.

as an instrument for deriving results that are neither true nor false, only useful.⁵⁰ In fact, this position is not middle of the road between the two opposing sides but a clear advocacy for the relativist historicist conception. The consideration of formal-analytical as well as historical-institutional aspects represent an integrated conceptual vision. Therefore it is wrong to speak of a Schumpeter paradox.⁵¹ Schumpeter formulated a pluralist multi-tool research-agenda very much in accordance with the eclectic approach of German historicism. The following part explains the Schumpeterian entrepreneur and thereby illustrates the conceptual accordance with the German Historical School.

Very often, Schumpeter is attached to the founder of neo-classical economic theory, Léon Walras. Indeed, Schumpeter considered Walras to be the greatest theoretical economist, who came very close to the level of perfection like theoretical physics.⁵² In fact, the path breaking concept of Walrasian general equilibrium analysis determined economic research since the end of World War II and opened the broad entrance of mathematical instruments within social sciences.⁵³ Walras can be seen as the founding father of neo-classical economic theory. Rothbard suggests that Schumpeter was never able to emancipate himself from the Walrasian notion of general equilibrium.⁵⁴

In fact, the reason, why Schumpeter admired Walras is that he believed that the Walrasian framework gave the intuition of a unified account of the micro- and macro-functioning of an idealised market solution that simultaneously yielded the behaviour of very many individual markets tightly embedded in a single whole economy.⁵⁵ By translating the general equilibrium framework into his circular flow in the first chapter of his *Theory of Economic Development*, Schumpeter constructed his idealised type economy, in which routine was introduced as the factor of rationalisation

⁵⁰ Schinoya (2005) p. 52.

⁵¹ Ebner (2000) p. 356.

⁵² O'Donnell (1973) p. 199.

⁵³ Rothbard (1987) p. 97.

⁵⁴ Ibid.

⁵⁵ Goodwin (1990) p. 75.

and historic experience the source for analysing behavioural patterns. Additionally, it is nearby to conclude the affects of routine production processes on the shape of society and its class structures. The analytical framework of Walras gives Schumpeter the useful starting point for his ideal-type based rationalisation process in the context of the determination of whole society. «At every point in time the economy works with a stock of given experiences and is based on given data that are familiar by virtue of recurring routinely. Every economic period is similar to the previous one, as well in its basic outline as in the mass of details. [...] This is the case not only because the continuous circular flow of production and consumption times and creates the same objective situation [...]. It is also the case because the economic subject always approach them with essentially the same [...] slow-changing mentality the same knowledge and experience, the same openness of horizon, the same production methods, business habits, tastes, and the same relations to customers, suppliers, and competitors.»⁵⁶

The question Schumpeter is concerned with asks how changes from this routine take place and to what economic phenomena do they give rise.⁵⁷ Schumpeter wanted to build up on Walrasian work and by doing so tried to dynamize the conception of general equilibrium. He noted: «I felt very strongly that this [Walrasian economic theory] was wrong and that there was a source of energy within the economic system which would of itself disrupt any equilibrium that might be attained. If this is so, then there must be a purely economic theory of economic change which does not merely rely on external factors propelling the economic system from one equilibrium to another. It is such a theory that I have tried to build.»⁵⁸

Walras himself had a place for entrepreneurship within his theoretical setting, which is a mere auctioneer.⁵⁹ For him, the entrepreneur was the equilibrating force within a dynamic market process. Once general equilibrium is reached, there is no need for

⁵⁶ Ibid. p. 249.

⁵⁷ Schumpeter (1934) p. 60.

⁵⁸ Schumpeter (1937) 1989 p. 166.

⁵⁹ For a detailed interpretation see Walker, D.A. (1986).

entrepreneurial function. Walras provided a very narrow concept of the entrepreneurial function. In his view, the entrepreneur is the person who buys productive services on the market for services and sells products on the market for products, thus obtaining either a profit or a loss.⁶⁰ This function is distinct to owning a land or capital goods. If the entrepreneur takes part in the capacity of a director otherwise in the operation of the transformation of services into products, he is then by virtue of that activity in actuality a landowner, capitalist, or worker, and combines their distinct functions with his own.⁶¹ Walras was aware that this distinction is a theoretical one, but it allowed him to distinguish between capital interest and the profit of entrepreneurial activity. In general equilibrium, perfect market circumstances are obtained. This implies perfect knowledge of supply and demand and the equilibrium price equalling the cost of production.⁶² Profits and losses become zero in equilibrium due to perfect consumer sovereignty.

Schumpeter accepted the Walrasian approach as a correct theoretical description as far as theory can really explain economic processes. In order to give a useful explanation of real social processes, the in his view correct economic theory does not provide satisfying answers. In Schumpeter's perspective, dynamic explanation need to take into account the historicism of economic sociology. For his explanation of dynamic economic progress, Schumpeter elaborated on the Historical School. This will be demonstrated in the following part.

III THE SCHUMPETARIAN ENTREPRENEUR

Throughout his academic career, Schumpeter was interested in the specific role of the entrepreneur as the most important element for the dynamics of capitalism. Starting with his work *The Theory*

⁶⁰ Walker, D.A. (1986) p. 7.

⁶¹ Schumpeter (1928) p. 249.

⁶² Rothbard (1987) p. 97.

of *Economic Development* published in German in 1912 he tried to implement a «developmental method» to explain economic progress and make thereby an important theoretical contribution.⁶³ In 1926 Schumpeter wrote the essay «Unternehmer» (Entrepreneur) which was published in the «Handbuch für Statswissenschaften» (Handbook of State Sciences) which was an influential academic encyclopaedia for social sciences in this time. Today it provides an useful resource of Schumpeter's notion of the historicity of entrepreneurship. It implies his thoughts of the early work and already contains the elements on which he worked later. In this sense, the essay can be seen as the blueprint of his life's work.⁶⁴ In fact, it covers his view on entrepreneurship much more detailed than the famous second chapter of *The Theory of economic development*. Unfortunately it was translated only lately⁶⁵ into English and was therefore not part of a brought academic discussion in the last decades.

Schumpeter starts his analysis with the assumption of a general collective economic process which consists of interlocked elements. Human reality is characterized by the existence of a social whole moving in a broad line of development. Only in the socialist community it makes sense to speak of a conscious plan behind development in its purest sense. On the other side Schumpeter presents a social whole, in which responsibility is left to individual actors, such as individuals or firms. Although in that scenario there is no conscious plan it is still not feasible to speak of free decisions, since actions are highly dependent on other actions. The social whole is still manifest. Schumpeter writes: «However, even despite important differences compared to the deliberate economic plan of an exchange-less economy, the two forms of plan are indeed analogous with respect to their essential economic principles and results.»⁶⁶ This insight aggravates with the relativity, the social whole, be it the legislator of a nation that delegates responsibility to actors. Furthermore and most important, every period unfolds

⁶³ Witt (2003) p. 133.

⁶⁴ Young Back Choi (2003) p. 275.

⁶⁵ Becker, Knudson (2003).

⁶⁶ Schumpeter (1928) p. 236.

special institutional constraints to individual actors. Schumpeter enumerates surviving guild-like cooperations, agreements and cartels, the condition of the banking world and power-positions in the buyer- and supplier-relationship.⁶⁷ These constraints of individual actors are «in fact of such importance that, besides a narrow circle of questions belonging to theoretical economics, it is advisable at all times, even for liberal epochs, to interpret the action of the group as the primary and essential, and to understand the autonomy of the economic unit as a derivate that has to be explained in each particular instance.»⁶⁸

Schumpeter sets the framework which opens the door for economic sociology of the historical school. Already the assumption of the existence of a social whole, conceivable as a nation shows the fundamental influence of Gustav von Schmoller. Though, individual responsibility is identified as a driver of economic progress, it is only derived competence from the social whole. This interpretation of methodological individualism is directly opposed to the subjectivism introduced by the Austrian School, especially by Carl Menger and defended against Schmoller in the *Methodenstreit*. Schumpeter rejects economic theory as the proper tool to analyze economic processes but insists on the unity of events in the historical perspective. From that there follows directly the claim to collect enough data and material in order to derive at scientific knowledge, which is bound to the historical period and cannot claim universal validity.

In the next step, the capitalist enterprise is introduced as the typical form of individual actor within capitalist processes. Schumpeter explicitly links his understanding of the capitalist enterprise to the Weberian notion of a capital accounting and profit maximizing entity. According to Schumpeter, private enterprises correlate with the existence of a special mentality, «prone to economic activity» The enterprise is presented as the nexus of a capitalist culture, cause of some and requirement of other essential cultural characteristics.⁶⁹ To fully grasp the picture

⁶⁷ Ibid. p. 236.

⁶⁸ Ibid. p. 237.

⁶⁹ Ibid. p. 237.

of the enterprise, Schumpeter lists several elements, which are, according to him, outside capitalism and therefore extra-economic facts which shape the form of production and the organisational structure of the enterprise.⁷⁰ These elements include:

- Not purely economic: the formation and the struggle of the nation states and their colonial policy.
- Brought about by state intervention: the financial policy of the state, in particular the very different policies leading to power positions of financial groups on one hand and the state regulation of monetary and banking matters on the other.
- Due to individual influences: the personal, national and social quality of the people.
- Extra social: inventions, discoveries fortuity associated with the production of precious metals.

According to these elements, types and characteristics of enterprises change, while its economic purposes always are the same, the economic activity as such.

The periodization of the capitalist development is beginning with the capitalist prevalence in the middle of the eighteenth century, at least in England. Within the capitalistic epoch, Schumpeter detects a shift from the enterprise of the competitive economy to the enterprise of a trustified economy, i.e. neomercantilism.⁷¹ This shift is derived from the dominance of specific institutional patterns including entrepreneurial types. Trustification, the process that marked the emergence of a neo-mercantilist period of capitalism, would lead to the dominance of large corporations as an outcome of industrial concentration by organizational restructuring. This transformation goes along with three major shifts. First, the tendency for industrial concentration and the emergence of corporations and trusts, leading to the economic dominance of bureaucratic organizations. Second, the rationalization of economic life, as indicated by the systematization and automatization of technical progress, implying that the entrepreneurial function would become

⁷⁰ Ibid. p. 238.

⁷¹ Ibid. p. 241.

obsolete as bureaucratic administration replaced entrepreneurial leadership. Third, rationalization paralleled by a separation of the economic sphere from pre-capitalist and non-economic sentiments and bindings, as illustrated by the decreasing values as a motive for the private accumulation of wealth.⁷²

The change of the economic epochs implies a change in the socio-economic data giving the epochs their characteristic typification. The epoch of competitive capitalism was well represented by competing family enterprises. The motivation of the corresponding entrepreneurial type of the industrial bourgeois was accordingly characterized by a well established sense of duty as well as an unambiguous family-orientation.⁷³ The entrepreneurial type was additionally portrayed as a socially responsible businessman who cared for the enterprise in personal terms.⁷⁴

In contrast, the epoch of trustification would be represented by the entrepreneurial type of corporate captain of the industry with his specific professional habits and his official authorization by shareholders, acting as the unintentional pioneer of the planned economy during mercantilism.⁷⁵ Visionary intuition that characterized the commercialization of technical inventions in the competitive period was replaced by the professional calculation of engineers and statisticians, preparing the decisions for the captains of industry.

The characteristic type of entrepreneurship is both the product of and the cause for the change in the style of economic processes. Schumpeter links entrepreneurship to the individual capability of leadership. In all spheres of economic life we observe the distinction between leaders and those that are led, a distinction that in the end rests on differences in individual competencies. Of primary importance is the strength of will.⁷⁶

Thereby, leadership only has a function if something new has to be carried out, not something already established by experience

⁷² Schumpeter.

⁷³ Schumpeter (1929) p. 135.

⁷⁴ Schumpeter (1928) p. 247.

⁷⁵ *Ibid.* p. 253.

⁷⁶ *Ibid.* p. 247.

and routine.⁷⁷ New means the breaking out of the experienced circular flow of economic process. The entrepreneur is always the disequilibrating factor breaking out of an existing routine. According to Schumpeter, this move requires a much higher degree of rationalism, alertness and energy than the average person can draw on. With regard to the average psychological disposition of economic actors, the smooth and almost automatic course of the normal economic period can be explained. Every element of productive power follows in principle the same path year in, year out.⁷⁸

Schumpeter categorizes three types of interruptions of this equilibrium situation. First, there is a continuous growth mainly due to an increase in population. Second, extra-economic phenomena are conceivable to be responsible for change. Events of nature can be counted into this category. Third, and by far the most important category is the entrepreneur. In fact events of category one and two can also be interpreted as subgroups of the third. Schumpeter famously states that the essence of the entrepreneurial function lies in recognizing and carrying out new possibilities in the economic sphere. Economic leadership occupies itself with tasks that are summarized in the following types:⁷⁹

1. The production and carrying out of new products or new qualities of products.
2. The introduction of new production methods.
3. The creation of new forms of industrial organization (for instance trustification).
4. The opening up of new markets.
5. The opening up of new sources of supply.

In this regard, the essence of leadership is initiative in the sense of deciding what should take place, and carrying it out. Schumpeter states, that the nature of the achievement to be accomplished in this process is partly also characterised by the resistance of the social environment against doing so. In the yearly circular

⁷⁷ Ibid. p. 248.

⁷⁸ Ibid. p. 249.

⁷⁹ Ibid. p. 250.

flow of what is familiar people cooperate automatically. Workers, consumers, creditors, and public opinion need to be convinced to implement change and leave the familiar routine processes. Overcoming this difficulties requires characteristics that are only possessed by a small percentage of the population.⁸⁰

Leadership as such exists in every period and form of economic organisation. In that sense, entrepreneurship is a type of leadership which is special for the capitalist epoch. The dominant type of the competitive era is the factory owner and merchant. Very often, the entrepreneurial position is motivated by the establishment of a social position over generations. Schumpeter has very much in mind the small business owner as his role model. The entrepreneur is not only his own manager, he is furthermore his technician and commercial manager, sometimes even his lawyer.⁸¹ The entrepreneurial function as such is in reality combined with a lot of occupations and cannot be observed that easy in its purest form.

In contrast, the type of modern captain of the industry is described in terms of the lack of accessory functions. Business organisation is changing from the small owner focused company to the large shareholder driven conglomerate with many different subbranches.

This shift goes hand in hand with the transformation of the whole society. Scientific rationalisation is replacing traditional routine. Also the business process gets more and more rationalised. The coupling between science, technology, innovative investments and the market, once loose and subject to big time delays is now much more intimate and continuous. In later capitalism, the bounds of rationality are being broken. Conscious rationality is beginning to conquer not merely the entrenched conventions of the past but also the previously unknowable future. Improvements in computational and management technique will provide closer and closer approximations to true rationality and may even unbound rationality in some spheres.⁸² Schumpeter describes the consequence of this development:

⁸⁰ Ibid. p. 250.

⁸¹ Ibid. p. 252.

⁸² Langlois (2003) pp. 292-293.

This social function [entrepreneurial function] is already losing importance and is bound to lose it at an accelerating rate in the future even if the economic process itself of which entrepreneurship was the prime mover went on unabated. For, on the one hand it is much easier now than it has been in the past to do things that lie outside familiar routine – innovation itself is being reduced to routine. Technological progress is increasingly becoming the business of teams of trained specialists who turn out what is required and make it work in predictable ways. The romance of earlier commercial adventure is rapidly wearing away, because so many more things can be strictly calculated that had of old to be visualised by the flash of genius.⁸³

Schumpeter implements the Weberian notion of rationality and interprets economic progress as a truth revealing process which does not leave any space for genius or metaphysical beliefs. The importance of the entrepreneurial type must diminish, because the unknown becomes increasingly calculated rationally, the extra-logical function of the entrepreneur becomes increasingly unnecessary.⁸⁴ «The more accurately, however, we learn to know the natural and social world, the more perfect our control of facts becomes; and the greater the extent, with time and progressive rationalisation, within which things can be simply calculated [...] the more the significance of this [entrepreneurial] function decreases. Therefore the importance of the entrepreneurial type must diminish just as the importance of the military commander has already diminished.»⁸⁵

The key to the understanding of the Schumpeterian entrepreneur and its decline lies in his understanding of rationality. Early capitalism is in his view characterised as a stage of low knowledge and therefore low rationality and therefore low market perfection. In this setting, the need for strong characters and guidelines of leadership is very high. With the ongoing rationalisation of processes, there is no need for visionary actions.

⁸³ Schumpeter ([1943] 1992) p. 132.

⁸⁴ Langlois (2003) p. 292.

⁸⁵ Schumpeter (1934) p. 85.

In this sense reality and truth is finite and once discovered, there are only administrative tasks. With this change, there is also a change in the style of entrepreneurship. Both, the motivation for economic action and the style of daily business changed. The capitalist era is coming to an end, with the end of its typical style and level of rationality.

Schumpeter considers Socialism as a possible outcome of his historicist determinism. As the social whole is as such moving into the direction of its next stages, the internal forces only can push history to its next epoch; the better, the faster.

IV CONCLUSION

There is no contradiction between the entrepreneur of the competitive area and the entrepreneur of the neo-mercantilist era or a contradiction between Schumpeter's early thoughts on evolution and later thoughts on socialism. As he has shown with his historical development illustrated by typification the alleged contradiction is part of the general transformation of western civilization. In this concept, the intellectual legacy of the German Historical School is captured. Elements of Schmoller's notion of the movement of the social whole are as visible as the institutional interpretation of economic processes, inspired by Sombart. The perspective of economic styles can be linked back to Spiethoff and the use of types instead of theory in order to claim universality goes back to Weber. Both, the heroic leader of the small firm and the decoupled administrator of large-scale companies are expression of their historical time and as such only understandable through an historicist approach.

Schumpeter clearly belongs into the intellectual tradition of the German Historical School. A possible reason why this is not widely acknowledged could be seen in the misunderstanding that the German Historical School died out as a scientific movement. In fact, with the movement of many scholars from Germany especially to the United States in the first half of the 20th century, Schumpeter himself was one of them, many thoughts and principles were

adopted and transformed into the new ideas. It is worthwhile to further investigate in how far the principles of the German Historical School are still present today, under different names, for example in positivist, institutional or evolutionary economics. From the beginning on, the Austrian School of Economics was a critical opponent of that line of thought.

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