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The Capitalist and the Entrepreneur in Joseph Schumpeter's Economic Theory

El capitalista y el emprendedor en la teoría económica de Joseph Schumpeter

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ABSTRACT

This paper aims to contribute to the understanding of the role of the innovative entrepreneur within Joseph Schumpeter's economic theory. Schumpeter's theoretical model highlights the importance of the entrepreneur and of innovations in his theory of economic evolution, based on a twofold and significant recovery of concepts: On the one hand, Schumpeter took the entrepreneur and their ability to innovate out of the twilight zone to which the classical and neoclassical theory had subjected them and, on the other hand, he helped free the innovative entrepreneur from their capitalist function, earmarking them to the speculative role of capital accumulation.

Keywords: Joseph Schumpeter; Economic theory; Entrepreneur; Capitalist; Innovations; Economic history.

JEL Codes: B10, N00

RESUMEN

Este trabajo pretende contribuir a la comprensión del papel del emprendedor innovador dentro de la teoría económica de Joseph Schumpeter. El modelo teórico de Schumpeter destaca la importancia del emprendedor y de las innovaciones en su teoría de la evolución económica, a partir de una recuperación de conceptos doble y significativa: por un lado, Schumpeter sacó al emprendedor y a su capacidad de innovar de la zona de penumbra a la que la teoría clásica y neoclásica los había sometido y, por otro lado, ayudó a liberar al empresario innovador de su función capitalista, destinándolo al rol especulativo de acumulación de capital.

Palabras clave: Joseph Schumpeter; Teoría económica; Emprendedor; Capitalista; Innovaciones; Historia económica.

Códigos JEL: B10, N00

Introduction

The central role played by entrepreneurs in contemporary societies, the sacralisation of markets and of the economic and social contributions of enterprises (Amaro, 2010) and the role played by innovations in the development and adaptability of capitalism aggravate the paradox of the neoclassical paradigm and the marginal-productivity theory which expelled the entrepreneurial function from the outset of their formal model of economic analysis (Valdaliso y López, 2011: 8). Such strange disappearance from the core of mainstream economic theory has to some extent contributed to a renewed acknowledgement of economists such as Joseph Schumpeter (1883-1950), who placed the role of the entrepreneur at the core of the economic analysis. According to Schumpeter, economic evolution was the result of a process that stemmed from within the very economic system (in a rapprochement to Karl Marx¹), in which innovations have a dynamic impact in the evolution of capitalism. As we will describe further ahead, this dynamic and the evolutionary concept of economy drifted apart from the stationary vision dominant in the neoclassical “circular flow” model, which defined capitalism as if it had neither movement nor change. In the Introduction to the re-edition of Schumpeter's *Capitalism, Socialism and Democracy*, Joseph Stiglitz (2018: 11-18), referred precisely to this new view of the evolution of capitalism, introduced by the Austrian economist, emphasising on his contribution to the awareness of innovation within the economic process, evidenced by the way the concepts of “innovation” and “creative destruction” were eventually embedded in explanations from various disciplines, making them popular even in common parlance. Schumpeter, as Stiglitz noted (2018:16), did, to his credit, argue against Léon Walras's (1834-1910) neoclassical model of competition, which excluded innovation and the entrepreneurial function from his analysis. However, he added that one of his greatest contributions was that he sparked “deeper thought about innovation systems”, so that today, the central question asked by Schumpeterian economists is “what is the best economic system to develop an innovation-friendly institutional environment?”. In fact, Blaug

¹ Joseph Schumpeter, in 1937, in the preface to the Japanese edition of his *Theory of Economic Development*, emphasised the influence of the work of Karl Marx in his economic analysis: “In fact, what distinguishes him from the economists of his own time and those who preceded him, was precisely a vision of economic evolution as a distinct process generated by the economic system itself.” (Schumpeter, 1996: 149).

(1990: 219) also recognises that “his influence in the entrepreneurial function theory has been dominant and that authors who wrote about it thereafter have generally defined their ideas in contrast to those of Schumpeter”.

The timeliness and richness of Schumpeter's ideas are quite clear. In 1983, the year of Schumpeter's 100th anniversary, Herbert Giersch, German economist and avowed admirer of his work, stated that the next decades stood a fair chance of being the age of Schumpeter, just as the post-Second World War was the age of Keynes (Giersch, 1984: 103). The overstatement of the unconfirmed prognosis aside, the fact remains, however, that Schumpeter has been read and cited in recent decades as never before. Recent research (Diamond, 2007 and 2009) based, for example, on the number of books sold on Amazon and the number of citations on the *Web of Science*, shows not only a growing interest in his works (in particular *Capitalism, Socialism and Democracy*), but also an astonishing peak in the number of Schumpeter citations at the turn of the new millennium. Another more recent study based on the indicators (Dalton and Gaeto, 2018) confirms this trend in the rising interest in Schumpeter's works and concludes that the economist born in the former Austro-Hungarian Empire² outperformed his eternal rival John Maynard Keynes (1883-1946) over the last decade in terms of number of citations. Schumpeter has therefore been considered one of the top references in 20th century economic science. As Swedberg (1996) contends, many of the problems come from the fact that his research agenda remain central to the debate on different areas of knowledge: Entrepreneurial capacity, innovation systems, the instability of capitalism, the relationship between economics and other social sciences. Despite his paradoxical journey as a “scientist, academic, political, businessperson, and even as a human being”, one of his main biographers nevertheless states that his “string of failures was, paradoxically, a total success” (Allen, 1991: I, 4; cit. Louçã, 2018: II). Joseph Schumpeter was born in Triesch, a city that currently belongs to the Czech Republic, in 1883 – the same year of the death of Karl Marx and the birth of John Maynard Keynes –, studied in Vienna and lectured for the first time at Vienna University. He started being widely and internationally recognized in the USA from 1932 on, after he moved to Harvard University. His move to the US initiated the so-called American

² Joseph Schumpeter was born in 1883 in Triesch, now the Czech Republic, in the historical region of Moravia, at the time part of the Austrian Empire.

period (Frank, 1998). There he ended up contributing to some changes in the way he faced the role of the entrepreneur, not so romanticized and isolated, but above all where he changed his position on the advantages for the economic development of monopolistic companies.

In 1948 he was appointed President of the American Economic Association. In 1950, he was designated to be the first president of the International Economic Association. As a scholar, he wrote more than two hundred books, articles, and essays, from which *The Nature and Essence of Economic Theory* (1908), *The Theory of Economic Development* (1911), *History of Economics* (1914), *Business Cycles* (1939), *Capitalism, Socialism and Democracy* (1942), *Imperialism and Social Classes* (1951), and *History of Economic Analysis* (1954) stand out. His vast and fruitful work has contributed notably to the history of economic thought, economic growth, economic cycles, money and credit, economic sociology, economic history, and political science, *inter alia*. As Elizabeth Boody (Schumpeter's widow) notes in the foreword to *Ten Great Economists: From Marx to Keynes* (1951), it was a characteristic of Schumpeter that he "admired, and found useful, history and pure theory, econometrics and great compilations of factual material, sociology, and statistics" (Schumpeter, 1971: 11).

Given the non-linear prolixity of Joseph Schumpeter's work, as well as the vast literature that has been developed on it, there seems to be little room left for new and comprehensive interpretations of his works and theories. Even so, it will be our purpose to contribute to a global understanding of the function of the (non-capitalist) entrepreneur in the context of his economic theory. In particular, we will seek to clarify that Schumpeter built his theory of economic development from a double rescue and that this can explain, to a large extent, its relevance and its inclusion, in recent decades, in heterodox (or non-dominant) currents of the economy: 1) On the one hand, Schumpeter placed the entrepreneur, companies and innovations at the centre of the explanation of the processes of growth and development of countries; 2) on the other, by making the theoretical distinction between the innovative entrepreneur and the accumulator capitalist, rescuing the entrepreneur from the parasitic role that classical (including Karl Marx) and neoclassical economics had theoretically reserved for him, he made the social function of the entrepreneur more sympathetic. It is our conviction that the above

has made all the difference in the reception and acceptance of Schumpeter's theories about entrepreneurship and innovation. In this regard, Galbraith (1987:153) observed that, unlike the capitalist, the Schumpeterian entrepreneur "does not carry any kind of Marxist guilt with him". The distinction between the role of the capitalist and the entrepreneur (in his opinion, remains cloudless) "is Schumpeter's greatest legacy" (Idem: 153). In fact, from Schumpeter's perspective, the entrepreneur and the company constitute the two main vectors of the innovation process and economic development. The Schumpeterian innovative entrepreneur, as opposed to the capitalist, has unique characteristics of creativity and leadership, is romantically compared to "knights in armour", and it is in companies where he makes his "new combinations" (Louçã, 2018: XIII-XIV). It is no coincidence, and we intend to leave it globally explained here, that it was this perspective of the non-capitalist entrepreneur of Schumpeter's theory that has found a better reception among institutionalist and neo-Schumpeterian economic currents (Hannusch and Pyka, 2007). It is from this perspective that companies, innovations and entrepreneurs are central to explaining the competitive reality of global capitalism. (Tolda, 2017).

Schumpeter's Economic Theory and the Function of the Innovative Entrepreneur

Some of the most prominent scholars of Schumpeter's work state that, if there ever was a clearer and more concise description of Schumpeter's driver of research, that had to be his 1937 preface to the Japanese edition of *Theory of Economic Development* (Swedberg, 1996). He explicitly addressed the Japanese readers to affirm that his entire theory of economic development was built by reference to the theories of two seminal economists: Léon Walras and Karl Marx. He owed his "concept of the economic system and a theoretical apparatus" to Léon Walras because he had found that the Walrasian concepts and techniques (he was careful to stress that it was him to whom he was most indebted) were linked to a paradigm of rigorously static characteristics that can only be usefully applied to stationary economic processes (Schumpeter, 1996: 148). As for Marx, Schumpeter refused any intention of "associating himself with such a great name" because the intention and results of his theory of economic development "are too different to give him the right to do so". He

acknowledged, however, their agreement on the fact that “economic evolution emerges as a distinct process that results from the economic system itself” (Idem: 149). Schumpeter, however, explained that his main aim was to “construct a theoretical model of the process of economic change in time”, in which “how the economic system ceaselessly generates the force that transforms it” would be clear³. That is why he concluded that the theory of a stationary economy was wrong, and avowed “a purely economic theory of change”, capable of “understanding the struggles and vicissitudes of the capitalist world” in a much more satisfying way “than the explanations provided by the theories of Walras or Marshall” (Idem: 149). What distanced him from Léon Walras, an economist he admired and whom he had credited with having been the first to construct the General Equilibrium model, was, above all, that in his theory, economic change was seen as exogenous to the economic process. And so, in Schumpeter’s own words, his life project as an economist was to construct a “purely economic theory of economic change which does not merely rely on external factors propelling the economic system from one equilibrium to another” (Idem: 149). Some years later, in the preface he wrote to the Spanish edition of the same book (1944)⁴, he confided that since the first edition in German (1911) he had sought to “develop and historically prove his ideas” and, in particular, to be able to argue that his “overall view of the economic process did not change” (Schumpeter, 1944: 9). In other words, having looked into all the factors and causes that led up to changes in the economic world, he had reached the conclusion that there was “a purely economic factor of major importance which he had named innovation” (Schumpeter, 1944: 11). He went on to add that innovations explained “the continuous economic revolutions, which are the main characteristic of economic history” (Idem: 11-12). In his view, the analytical tool of the economic theory of equilibrium or static economics not only failed to explain the “historical process of economic evolution, but also disregard the phenomena of evolution, ending up describing parts of the mechanism that remain more or less constant over time, but these parts of the mechanism are not useful to describe the relationships within an evolving reality” (Idem: 10). Hence, in reply to those who criticised his theory, Schumpeter explained: “My

³ In this specific case, Karl Marx’s influence is clear and was assumed by Schumpeter as being closer to the historical school and the Marxist analysis than to the neoclassical economists (Swedberg, 1996: XXI).

⁴ In the introduction (prologue) to this first edition in Spanish, published by Fondo de Cultura Económica of Mexico and translated by J. Prados Arrarte in 1944, Joseph Schumpeter thanked the translator and the board of directors of the Fondo de Cultura Económica for the opportunity to present his fellows from Spanish-speaking countries this edition of his *Teoría del Desarrollo Económico* (Theory of Economic Development). However, Schumpeter signed the Prologue to that edition and dated it 12th April, 1941, Cambridge, Massachusetts, U.S.A.

theories may be wrong; my schema, surely, are no more than a few possibilities; but I am sure about two things: first, that one should treat capitalism as an evolutionary process and that all its fundamental problems are a result of this evolutionary process; second, that this evolution is not the result of external factors (including political factors) acting on the capitalist process, nor of the effects of a slow growth of capital, population, etc., rather of this kind of industrial mutation, if I may use that biological term, which I called innovation" (Idem: 14-15).

As Freeman and Louça pointed out (2004:75), Schumpeter was indeed ambitious: "He wanted nothing less than to formulate a sufficiently general theory that would encompass the determined nature of general equilibrium and the undetermined nature of general equilibrium". In other words, he sought to construct a "purely economic theory of change" in order to answer a crucial question for himself and for economic history: What drives constant mutation within the economic process? As we have explained above, innovation is, in Schumpeter's view, this engine of transformation, this "revolutionary force, the *alma mater* of capitalism" (Freeman e Louçã, 2004: 75). In the capitalist economy, innovations are, therefore, in Schumpeter's beautiful image, a "perennial gale of creative destruction" (Yueh, 2019: 171). Thus, any analysis of a static economy, in equilibrium, while ignoring the dynamics of its evolution "is a contradiction of the terms" (Schumpeter, 1939: 1033). The capitalist economy, he recalled, is an evolutionary process "long pointed out by Karl Marx", so he found it odd that some theories failed to see the obvious (Schumpeter, 2018: 121). Capitalism, he added, "is by nature a form or method of economic change and not only never is but never can be stationary" (Idem: 121). He completed his line of reasoning based on the economic reality by explaining: "The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates (...). This process of creative destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in" (Idem: 121-122).

We thus note that Schumpeter changed not only the theoretical focus of the neoclassicists from static to dynamic, but also put the perspective of analysis on the supply side. In other words, he shifted the

attention to the capacity of enterprises and entrepreneurs to create needs, and not only to satisfy them. In this regard, Louçã (2018: XXXVIII) pointed out that “Schumpeter makes economic development depend on the entrepreneur’s ability to challenge the equilibrium, while, in contrast, economic agents without entrepreneurial spirit would only be ‘sad characters’”. We know, and Schumpeter did not ignore this, that the entire focus in neoclassical models is on how markets function. Profits, prices, and rates of return on labour and capital are variables that not only have nothing to do with enterprises and their entrepreneurs, but are, in essence, determined by the market. In the Walrasian model, needs are determined by the market, while for Schumpeter “real economic processes created new needs and lead to profounder transformations” (Idem: XXXVIII). Schumpeter refused, in theory and method, the stationary paradigm, admitting, however, the existence of a nexus between demand and supply, or even the needs of consumers as fundamental in the stationary circular flow theory, but added that we must take a different attitude “when we analyse *change, or what causes it*” (Schumpeter, 1944: 106-107). Schumpeter noted that it was the producer who as a rule “initiates economic change, and consumers are educated by him if necessary; they are, as it were, taught to want new things” (Idem: 107). Schumpeter added (Idem: 107-108) that economic development was defined precisely by the emergence of “new combinations” in the economic mechanism, which he defined as: 1) “*The introduction of a new good* (that is, one with which consumers are not yet familiar) or of a new quality of good; 2) *the introduction of a new method of production* (that is, one not yet tested by experience in the branch of manufacture concerned, which need by no means be founded upon a discovery scientifically new, and can also exist in a new way of handling a commodity); 3) *the opening of a new market* (a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before); 4) *the conquest of a new source of supply of raw materials or half-manufactured goods* (again irrespective of whether this source already exists or whether it has first to be created); 5) *the carrying out of the new organisation of any industry, like the creation of a monopoly position* (for example through trustification) or the breaking up of a monopoly position” (Schumpeter, 1944: 109-110)⁵.

⁵ As in previous cases, and henceforth, the responsibility for translation rests with us and, in this case, the italics are also ours.

As Schumpeter (1944: 105) pointed out, development thus “is a distinct phenomenon and entirely extraneous to what can be seen in the circular flow or in the tendency towards equilibrium”. It is a “spontaneous and discontinuous change in the channel of the circular flow, in the disturbance of equilibrium, which changes and shifts the previously existing state of equilibrium forever”⁶. As Blaug (1990: 218) noted, by distinguishing between “invention” and “innovation”, Schumpeter “outlined all the disruptive economic changes that led to innovation and identified the innovative as lying with the entrepreneur. This is the source of all dynamic change in an economy, and the capitalist system, for Schumpeter, could only be understood in the conditions that allowed the emergence of the entrepreneurial role”.

The Capitalist and the Entrepreneur in Schumpeter's Economic Theory

A core issue underlies the discussion – and continues to divide economists – on the function of the entrepreneur and/or the capitalist in the economy, from classical times to the present day: What is the origin of the profit of the entrepreneur and/or the capitalist? The answer to this crucial question presupposes the difficult understanding of the solution to two previous questions: It is the remuneration received by the entrepreneur the same as that received by the capitalist or, on the contrary, is their profit intrinsic to the entrepreneurial function? And, if so, which role economically justifies their remuneration? (Valdaliso and López, 2011: 3).

The way in which the various theoretical paradigms have sought to explain the origin of the entrepreneur's and/or capitalist's profit is key to distinguishing them, but also to define their role in the economy. Basically, we can say that three answers were given: 1) The origin of the entrepreneur's and/or capitalist's profit is the interest due on production factors (capital, land, labour), a perspective that led to the entrepreneur being viewed as the villain, given that the profit made is a result of speculation; 2) the classical and neoclassical schools of thought maintain that there is no pure economic profit for the entrepreneur, since their

⁶ Schumpeter tried to be even more explicit about what he defines as “transformations arising from within the system itself, causing disequilibrium that the new would never be achieved through the old as a result of infinitesimal changes”, offering the following concrete example: “Add as many mail coaches as you please, you will never get a railroad by so doing” (Schumpeter, 1944: 106).

remuneration results from their function as capitalist, owner of resources and workman, there being no place for a differentiating economic role as an entrepreneur (Valdaliso and Lopéz (2011: 4). Both perspectives share the same idea: no function distinguishes the capitalist from the entrepreneur, the latter not adding anything specific to the economy. In a perfectly competitive economy in long-term equilibrium, “profits will be entirely eroded by the factors according to their marginal productivity; profits will be eliminated and entrepreneurs make neither profit nor loss” (Blaug, 1990: 216). A third school of thought holds that the entrepreneur’s profit rewards his ability to anticipate the possibility of that profit. In this perspective, this ability is far from being available to all, thus contributing to the creation of additional wealth. Economists who, one way or another, tried to distinguish the function of the entrepreneur ended up continuing a trend that linked the etymology of the word entrepreneur (the one who deals with uncertainty, who takes risks⁷), or, in Schumpeter’s version, the innovative entrepreneur as the “protagonist of the change mechanism” (Schumpeter, 1944: 101).

Classical economists (Adam Smith, David Ricardo, Stuart Mill), including Karl Marx⁸, did not ignore the function of entrepreneurs⁹. However, their economic theories made no distinction between entrepreneurial profit and return on capital. In Adam Smith’s work (1723-1790), the economic function of the entrepreneur, or rather, the capitalist, even though he plays an important function in his economic model (and also in his morale) is to accumulate capital and properly oversee the running of his business (Redondo, 1997: 32-40). In Smith, we do not see the entrepreneur having a distinct function: “There is the capitalist, and more precisely the accumulator of capital, and that is his essential role” (Idem: 32). Moreover, Schumpeter recognised in his article *Economic*

⁷ Schumpeter himself, in his article *Economic Theory and Entrepreneurial History*, collected in “Ensaio: Empresários, Inovação, Ciclos de Negócio e Evolução do Capitalismo” [Essays: Entrepreneurs, Innovation, Business Cycles, and the Evolution of Capitalism] (1996: 233-249), referred to Richard Cantillon (1860-1734), French-Irish economist, author of *Essai sur la Nature du Commerce en Général* (1755), as the first one to define the entrepreneur as the one with the function of procuring “production goods at certain prices and to combine them to obtain a product which he will sell at prices which are unknown at the time he commits to the costs” (Schumpeter, 1996: 234).

⁸ On David Ricardo and Karl Marx, Schumpeter (1996: 235) says: “With Ricardo and Marx, the process of production and trade is even more automatic. The functions of conception, management, leadership and coordination have practically no place in their analytical scheme”.

⁹ Adam Smith did not overlook the function of the entrepreneur. The concept of entrepreneur appears in his seminal work *The Wealth of Nations* in three forms: as an “Adventurer”, a concept that we can translate by associating “adventurer or speculator”; “entrepreneur/projector”, an ambiguous concept that can mean “one who makes machinations to cheat or steal”, or “one who makes plans or executes an honest invention”. In general, Smith is hostile to both the adventurer and the projector, condemning them for bankrupting the people who engage in their foolish projects. However, there is still a third form of entrepreneur, the undertaker, with whom Smith sympathises. The undertaker also undertakes projects, but unlike the projector, always acts with prudence and moderation” (Paula et al., 2004: 583).

Theory and Entrepreneurial History that, despite “the enormous influence of physiocratic economists and Richard Cantillon on Adam Smith”, what the entrepreneur does in his analytical system is “to provide capital and nothing more: the identification of the role of the capitalist and the entrepreneur is thus achieved” (Schumpeter, 1996: 234-235).

Adam Smith’s vision was eventually followed, as another variation, by the main classical economists, associating the figure of the entrepreneur with that of the capitalist, emphasising that entrepreneurial profits corresponded to the interest on invested capital” (Valdiso and Lopéz, 2011: 5; Redondo, 1997: 23). Several explanations have been given for this reluctance of classical (and neoclassical) economic thought to recognise the function of the entrepreneur. Everything suggests that the main cause lies in the very concept of economic development. Classical economists saw the production process as being automatic, valuing the overall process of capital accumulation and economically devaluing decision-making. In this model, the entrepreneurial function would hardly appear as a factor of production distinguished from capital.

Nevertheless, some classical economists stood out for being attuned to the role of the entrepreneur. The economist J. Stuart Mill (1806-1873), responsible for the dissemination of the French word “entrepreneur”¹⁰ in the English language (Valdiso and Lopéz, 2011: 6), even though he had followed the classical perspective on the profit of the entrepreneur as the interest on invested capital, extended this remuneration to the compensation of risk and for the work invested by the capitalist (Idem: 6). Schumpeter admired this nuance of the English economist, pointing out that he had been influenced by [Jean-Baptiste] Say to such an extent that he dropped David Ricardo’s theses by emphasising the function of the entrepreneur in the management of the productive process, for which “rare abilities” were required (Schumpeter, 1996: 235). In essence, however, Stuart Mill failed to break the hold of classical tradition, “according to which an entrepreneur was simply a multifaceted capitalist” (Blaug, 1990: 215).

¹⁰ Schumpeter (1996: 235) emphasises on the fact that J. Stuart Mill was disappointed that there was no adequate English correspondence for the French term “entrepreneur”, a position that demonstrates, in his view, his interest in entrepreneurial activity.

Other orthodox economists such as A. Marshall (1842-1924) and J. B. Clark (1847-1938), who “sought to include the entrepreneur in their economic growth models” (Idem: 6) also went further down this line. Marshall gave the organisation the status of fourth factor of production, distinguishing it by its capacity to organise business and, with it, the entrepreneur. From Marshall’s perspective, the entrepreneur accumulated the characteristics and rewards of both the capitalist and the skilled worker (manager), but did not delve into the aspect of risk, uncertainty, or innovation (Idem: 7). It fell to Clark to make room, within the neoclassical theory, for the separation of the functions of the entrepreneur and the capitalist, by distinguishing ordinary profits (managers’ wages), from extraordinary profits (dynamic gains) of entrepreneurs. According to Valdiso and Lopéz (2011: 7), the relationship that Clark’s theory established between the introduction of technological and organisational improvements and the entrepreneur’s profits implied, as Schumpeter also advocated, changing the stationary paradigm of economy for a dynamic analysis, and introducing the role of the entrepreneur in explaining the capitalist economy.

Despite these attempts to include the entrepreneur in the explanation of economic mechanisms, the neoclassical paradigm excluded entrepreneurs and enterprises from this economic analysis model. They have, in fact, gone much further in this respect than the classical economists. Somewhat paradoxically, given the central role that enterprises and entrepreneurs have always had in capitalist economies and societies, Léon Walras’s model remained unchanged in this respect and consistent with the principle that the capitalist and the entrepreneur have the same economic function. For Blaug (1986: 222-223), in the Walrasian economic model, each economic agent “is paid for its marginal productivity, and the value of the product is completely consumed in the payment of production factors. Therefore, there is no surplus to cover the payment of the entrepreneurial function”. According to this economic analysis paradigm, there is hardly any room for the development of a theory of the entrepreneurial function and even less for another concept on the origin of profit based on the residual income of entrepreneurs who take uncertainty-related risks. For Blaug (1990: 216), it is not surprising that economics textbooks are very “prolific in terms of consumer behaviour, profit-maximising decisions of enterprises (in short-term equilibrium), wage theory, interest rate theory, international trade theory, etc., but scant

when it comes to analysing technical progress, the growth of large enterprises, the causes of the wealth and poverty of nations – and the theory of the entrepreneurial function”.

Schumpeter made a totally different contribution to the entrepreneurial function in *Theory of Economic Development* (1911¹¹), precisely along the lines of the neoclassical stationary model¹². In this stage of equilibrium, devoid of technical progress, the economy would be based on a repetitive and routinary economic process, there would be no uncertainty, no profit, and even the interest rate would tend to be nil. This stationary perspective, however, fails to explain the dynamic side of economy, the economic change, and development itself. In explaining the disequilibrium Schumpeter came to terms with the entrepreneurial function in the figure of the entrepreneur-innovator as a disruptive force in the equilibrium of the economy. His entrepreneur-innovator theory and its connection with the “uncertainty arising from dynamic analysis is placed at the core of his economic research” (Blaug, 1990: 218). It is greatly to Schumpeter’s credit that he “proposed an epic and romantic theory” of the entrepreneur at a time (early 20th century) when the marginalist theoretical construct for analysing static equilibrium prevailed and seemed consolidated in economic science (Redondo, 1997, 97). He built on this to relate the entrepreneur’s activity with disequilibrium (development) of the economy¹³, but without totally breaking with one of the main neoclassical theorists (Walras) and his concept of equilibrium. Here lies what is considered Schumpeter’s most original contribution to economic theory: “The entrepreneur does not respond to disequilibrium, he creates it. And it is these disequilibria resulting from within the economic process that trigger economic development” (Redondo, 1997, 97).

Given the central role of enterprises and entrepreneurs in his theory of economic development, Schumpeter aimed to be exhaustive in characterising them in several of his works. Due to the scope and ambiguity of some of the core concepts of his models some of his critics

¹¹First editions: In German, 1911; in English, 1934; in French, 1935; in Spanish, 1944.

¹²As Louçã notes (2018: II), Schumpeter was against the neoclassicists as described in the very definition of the research programme since his subject was institutional and technological change. However, one paradox remains to be explained: “why did he not explicitly reject the neoclassical paradigm”, and continued to defend “the theory and paradigm of equilibrium” throughout his lifetime?”

¹³According to (2018: XLII) “Schumpeter was not ready to break with the Walrasian half [stationary equilibrium] of his theory, more for philosophical than for theoretical economic reasons”.

regarded his theory as a way of justifying entrepreneur profit¹⁴. Schumpeter sought to make a very clear distinction between the entrepreneur and the capitalist, limiting the concept of entrepreneur to a privileged few. The Schumpeterian entrepreneur is not only distinguished from the capitalist, but performs an entrepreneurial function that is not always identified with one person or group of people. As Blaug (1990: 219) noted, “the same person can be an entrepreneur when they act as an innovative businessperson, losing this characteristic as soon as their activity is perfectly established”. For Schumpeter, the figure of the entrepreneur resulted from the very concept of enterprise: “The carrying out of new combinations we call enterprise, and the individuals whose function it is to carry them out we call entrepreneurs” (Schumpeter, 1944: 118). The entrepreneur therefore performs a special function that is not available to all: “It is a privilege of a certain type of men, far fewer in number than those who have the ‘objective’ possibility of doing so” (Idem: 127). In Schumpeter’s view, “everyone is an entrepreneur only when he actually carries out new combinations”, and loses that character as soon as he has built up his business, when innovations are generalised, which it is very rare for anyone always to remain an entrepreneur throughout their life¹⁵. Schumpeter clarifies that being an entrepreneur is neither a profession nor a lasting condition, “entrepreneurs do not form a social class in the technical sense, as, for example, landowners, capitalists or workmen” (Idem: 124). Schumpeter thus recognises that entrepreneurs are “a special kind” of people and one same person can be an entrepreneur when acting as an innovative and capitalist businessperson in running their business as merely routine work. As Blaug noted in this regard, “the population of entrepreneurs, at a given moment in a capitalist economy, is constantly changing because the function associated with entrepreneurial ability is typically associated with other types of activities”.

Aware of the influence that economic history has on theories, Schumpeter recognised that the distinction he made of the entrepreneur function and that of the capitalist was facilitated by the fact that he witnessed a change in the financing methods, in which capitalists were not

¹⁴ In the first English edition (1934) of *Theory of Economic Development*, Schumpeter answered his critics: “One of the most unpleasant misunderstandings I had when this first book was first edited (1911) was that this theory of development disdained all historical factors except one, which was the individuality of entrepreneurs. If my view were that which is pointed out by critics, it would undoubtedly be a foolish one. However, I am not concerned with concrete factors of change, rather the methods through which they act, that is, the mechanism of change. The ‘entrepreneur’ is simply the bearer of this mechanism” (Schumpeter, 1944: 101).

¹⁵ For Schumpeter (1944: 123), “this is naturally the rule, with the consequence that it is rare for a person to keep the character of entrepreneur throughout their life, as it is for a businessperson not to be an entrepreneur, nor even for a moment and in a modest way, during his entire lifetime”.

entrepreneurs, and entrepreneurs were not capitalists. As Schumpeter acknowledged, it became gradually clear “that the connection between ownership and getting the physical structure of an industry going was not compulsory”. Therefore, the theory of entrepreneurial risk should also be different: If owning or ensuring capital does not define the function of the entrepreneur, then taking risk is not their function either¹⁶. As Schumpeter argued, “the capitalist bears the risk and it is him who loses his money in the event of bankruptcy” (Schumpeter, 1996: 236). Some authors consider that Schumpeter’s position was, to say the least, ambiguous: “It can only be understood if we consider that entrepreneurs do not take risks because they are superior individuals who know the future” (Kanbur, 1980, cit. Redondo, 1997: 102). By separating, at least in theory, the capitalist and the entrepreneur, Schumpeter excluded from the entrepreneurial function all those who simply run their already established businesses. He did, however, have a romantic view of the innovative entrepreneur and of them putting the economy out of equilibrium, only achieved by exceptional individuals whose motivations are immune to pure and earthly hedonistic calculations (Redondo, 1997: 108). This subjective and idealistic view diverged from the assumptions of the entrepreneur who plays on uncertainty and takes risks, compounding his innovative and deranging function in the economy. Schumpeter’s theoretical position has been very difficult to sustain within enterprise theories. In fact, as some acknowledge, Schumpeter himself recognised the difficulty in finding entrepreneurs who did not mix the function of entrepreneur with other activities.

Despite this particular caution in characterising the entrepreneurial role¹⁷, namely the concern in admitting that one same person can take on various functions, and that once an entrepreneur does not mean always an entrepreneur, many authors point out strong contradictions in this entrepreneur model (Redondo, 1997: 109). By not admitting that it is the entrepreneur who bears the risk, Schumpeter, for example, never questioned what becomes of the “aspiring entrepreneur who possesses no wealth to settle his credit” (Idem: 106-107), or what happens to the

¹⁶ In Schumpeter’s opinion (1944: 121), “the definition of entrepreneur made in terms of profit, instead of the function that creates said profit, is not brilliant”. Schumpeter had, moreover, another objection in this regard: “We see that the profit does not ‘necessarily’ fall on the entrepreneur, in the same sense that the marginal product of the work falls on the worker”.

¹⁷ In this regard, Schumpeter (1996: 246) wanted to make one thing clear: “when we speak of an entrepreneur we are thinking more of a role than of a physical person, but even if we look at individuals who, at least in point in their lives, carried out entrepreneurial roles, we should add that they do not constitute a social class”.

innovative entrepreneur who needs to mortgage assets to access credit. Schumpeter, on the other hand, believed that only winning entrepreneurs existed, “forgetting all ‘entrepreneurs’ who proposed new combinations, but which turned out to be worse than the existing ones” (Redondo, 1997: 107). Unless, as Kanbur (1980) ironically observed, as quoted by Redondo (Idem: 107), Schumpeter “is thinking of entrepreneurs as omniscient geniuses, of or a minority of exceptional and superior individuals”.

The idealisation of the Schumpeterian entrepreneur can perhaps be explained in the historical context in which it was theorised. Many authors point out the influences of Weber’s charismatic leader¹⁸, but also Nietzsche’s philosophy (Santarelli and Pesciarelli, 1990). Toynbee (1971) also described Schumpeter’s romantic vision of the entrepreneur “as coinciding with the rise of civilisation: in a hostile environment, the bolder and more entrepreneurial leaders lead the people to new ground” (Idem: 110). In Schumpeter’s view, it was not a matter of gradual evolution, rather than of economic mutations driven by brilliant individuals.

Paradoxically, as in other parts of his life and work, it seems almost absurd that Schumpeter is one of the most important economists to ascribe attention to the entrepreneur in the economic process and, at the same time, is also the main theorist to declare the extinction of the entrepreneur (or the entrepreneurial function) within the development of capitalism. His idealised vision of the innovative entrepreneur in the economy, identified as having a certain past heroism, contributed to Schumpeter’s pessimistic view of the survival of this function¹⁹. In 1942, when resuming his theory of innovation in *Capitalism, Socialism and Democracy*, “Schumpeter adopted a pessimistic tone, lamenting the devaluation of the function of the entrepreneur in mature capitalism, in which business organisations buried deep in bureaucratic red tape-bound innovation became the norm” (Louçã e Caldas, 2009: 296). For

¹⁸ Richard Swedberg (1996: XXIII-XXIV) notes that Carlin (1956: 27-42) stressed in his study that “Weber’s charismatic leader and Schumpeter’s entrepreneur had a lot in common. They both “do unpredictable and ‘irrational’ things. And in line with Weber, who saw the future of society as a terrible ‘iron cage’, Schumpeter had nightmares about the society he saw being transformed into a ‘Walrasian’ society”.

¹⁹ It should be stressed that when Schumpeter addresses the “Crumbling Walls” in *Capitalism, Socialism and Democracy*, the walls of capitalism, that is, relating this crumbling to *The Obsolescence of the Entrepreneurial Function*, he used an analogy of an idealised past: “Of old, roughly up to and including the Napoleonic Wars, generalship meant leadership and success meant the personal success of the man in command who earned corresponding ‘profits’ in terms of social prestige. The technique of warfare and the structure of armies being what they were, the individual decision and driving power of the leading man – even his actual presence on a showy horse – were essential elements in the strategical and tactical situations. Napoleon’s presence was, and had to be, actually felt on his battlefields. This is no longer so. Rationalized and specialized office work will eventually blot out personality, the calculable result, the ‘vision’. The leading man no longer has the opportunity to fling himself into the fray. He is becoming just another office worker – and one who is not always difficult to replace” (Schumpeter, 2018: 186).

Schumpeter, the development of capitalism and progressive automation diminished the entrepreneurial function. Being attentive to the development of capitalism, which he admired and defended, he found that as it progressed, the function of the entrepreneur, as he understood it, faded out of sight. By smothering in red tape and centralising the innovation systems, rendering it a routinary process in close liaison with professionalised research departments, large enterprises eventually replaced, in Schumpeter's opinion, the "individual impetus of the entrepreneur in the search for the new" (Costa, 2006: 11). As Schumpeter saw it, large automated and bureaucratised enterprises not only expropriated small owners, but also pushed the bourgeoisie into losing their role in society, contributing to an even greater socialisation of production. The death of capitalism and its replacement by socialism was, therefore, inevitable, not through class struggle, as Karl Marx had predicted, but with the end of creative individualism embodied in the innovative entrepreneur. The function of entrepreneurs, as Schumpeter notes, was essential for "the bourgeois society and for the survival of the capitalist order" (Schumpeter, 2018: 184). Schumpeter argues in *Capitalism, Socialism and Democracy* that, economically and sociologically, the bourgeoisie depends "on the entrepreneur and, as a class, lives and will die with him" (Idem: 187).

As a result of the gradual automation of production, Schumpeter's prognosis regarding the bourgeoisie and capitalism was clearly pessimistic: "The economic basis of the industrial bourgeoisie will be reduced eventually to wages" and capitalism will tend to "break to pieces under the pressure of its own success" (Idem: 187-188). He concluded, "true peacemakers of socialism were not the intellectuals²⁰ or agitators who preached it but the Vanderbilts, Carnegies and Rochfellers. This result may not in every respect be to the taste of socialists (...), but as far as prognosis goes, it does not differ from theirs" (Schumpeter, 2018: 188).

Schumpeter's overall conception of economics and politics is rather pessimistic, in that it predicted the end of capitalism and its replacement by socialism, which he did not desire. It is also in this sense that he clearly departed from Marx – whom he always seemed to consider in his

²⁰ It should be noted that when Schumpeter theorised about the death of capitalism, he pointed out the intellectuals as his main ideological opponents, who, in his view, using their positions and knowledge, disseminated ideas that were almost always hostile to the capitalist system.

prophecies²¹ – who, as we know, had a much more optimistic view of history and of what could follow capitalism. There is, therefore, no doubt that the evolution and transformations of capitalism were always at the heart of his concerns. However, many of his theories, in particular those linked to the loss of importance of the entrepreneurial function in mature capitalist economies, contain some contradictions (Louçã, 2018: XI): “On the one hand, they criticise the gigantism and anonymity of the economic organisation of large enterprises, as entrepreneurs are replaced by bureaucrats and the direct responsibility of owners is replaced by the abstract value of shares; on the other hand, they defend monopoly as the most appropriate system to promote investment and, in particular, for risking a high level of investment in research”. Some authors, aware of these contradictions and of a certain theoretical pessimism, have sought to free themselves from the idealised and romantic figure of the Schumpeterian entrepreneur, giving a more realistic and optimist vision of his function. Indeed, institutionalist and neo-Schumpeterian economists continue seeking to renew the legacy of the Austrian economist, demonstrating that the radical innovations (technological, institutional, and social) remain truly relevant to the development of societies.

Conclusion

Schumpeter's ambitious research agenda aimed primarily at creating a general theory that would overcome the limitations of Léon Walras's theoretical assumptions. Thus, he explained the dynamics of capitalism, by including the two main strands of the economy, equilibrium and disequilibrium, in the economic analysis. Schumpeter did not seek to break away from Léon Walras's theoretical paradigm, he rather introduced (static) moments of equilibrium and (dynamic) moments of disequilibrium in his model. He further stated that there was a very important qualitative undertone in this whole process: The equilibrium of the economy should, in his opinion, be considered, but this was less important than its dynamic aspect.

²¹ James Tobin (Nobel Memorial Prize in Economic Sciences in 1981), a connoisseur of Schumpeter's work and his student at Harvard, says that Schumpeter always had the ambition of developing a theory of history of breadth and depth similar to Marx's theory and – in the same way as the latter in relation to Hegel – and of turning Marxism “upside down” (Tobin, 1991, cit. por Costa, 1991: 9).

Schumpeter basically assumed the role of the marginalist theoretical model in analysing the static economy in equilibrium and focused on the factors that explain disequilibrium. This is where innovations and the innovative entrepreneur – core elements in explaining disequilibrium in the economy – emerge. The entrepreneurial function is therefore vital to break the economy's stationary equilibrium, the relationship between "creative destruction" caused by innovations and economic development being very close. Moreover, profit results from the relationship between the activity of the innovative entrepreneur (non-capitalist) and the disequilibrium of the economy, ending up distinguishing the function of the entrepreneur from that of the capitalist. In addition to redeeming the figure of the entrepreneur and of the capitalist function, the originality of Schumpeter's theoretical model lies in the central function of the entrepreneur in the disequilibrium process: Entrepreneurs (and enterprises, in which new combinations occur the most) do not simply respond to the successive disequilibria of the economies; they are the ones who, through new combinations, cause their constant disequilibria, and these, which originate within the very economic mechanism, are at the root of change and development.

We thus note that the "heroic figure" of the entrepreneur is quite different from the capitalist theorised by classical and neoclassical economists. The theoretical matrix of the Schumpeterian entrepreneur owes much to Jean-Baptiste Say, especially his notion of the activity of the entrepreneur as the main agent of combinations, in the planning and management of the enterprise. As Calazans (1992:656) contends, Schumpeter built his concept of entrepreneur under various influences (Say, Durkheim, Walras, Pareto), always criticising the inability of classical (including Marx) and neoclassical economists to understand the relevance of entrepreneurs in capitalist evolution. It is to Schumpeter's credit, however, and as we have explained, that he introduced the entrepreneur in economic theory, but did not go uncriticised for the excessive outmoded romanticism he put into the entrepreneurial function, for the contradictions in the description of the entrepreneur's risk and, most of all, for the weaknesses in defining the entrepreneurial function. It is perhaps this excessive romanticism that will prevent him from updating the entrepreneurial function within the framework of mature capitalism, falling into a state of pessimism that is difficult to understand when he

relates the death of capitalism with the extinction of the entrepreneurial functions (not of entrepreneurs/capitalists).

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