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Rationality, behavior, institutional and economic change in Schumpeter

by

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Introduction

In 1940 Schumpeter wrote a paper entitled: “The Meaning of Rationality in the Social Sciences”. This paper was written for one of the meetings of a interdisciplinary group¹ that Schumpeter took the initiative to start, including the sociologists Wilbert E. Moore and Talcott Parsons, the economists Wassily Leontief, Paul Sweezy and Gottfried Haberler, the

¹ As noted by Swedberg (2006), Schumpeter’s decision to have a seminar on rationality at Harvard in 1939–40 was triggered in 1939 by a paper on rationality by Chester Barnard. In fact, there were about 10 meetings, starting in October 1939 and ending in April 1940. An attempt to put together a book from the papers that were presented at the seminar failed, partly because Parsons, who had been appointed co-editor by Schumpeter, lost interest. Parsons later confessed that he, in fact, let the project die (Swedberg 2006: 72). Schumpeter’s paper from the seminar entitled “the meaning of rationality on the social sciences” was many years later published by Swedberg (1991), while Parsons’ paper entitled “an approach to the analysis of the role of rationality in social action” has remained unpublished.

psychologist Mac Grannahan and other Harvard scholars (Swedberg, 2006). In this paper, Schumpeter develops his own conception of rationality in economics, more than in the broader field of social sciences. First of all his arguments are essentially of a *methodological nature*, and they turn out, interestingly, to anticipate some important debates concerning the defense of the producer's maximization assumption (Alchian, 1950; Friedman, 1953), even if Schumpeter is very reluctant to use the 'natural selection' analogy, thus making his conception of rationality very topical. Second, Schumpeter's conception of rationality needs to be linked with his specific methodological approach, both individualistic and holistic, of institutional change, which implies a very specific relationship between institutionalism and evolutionism.

In this contribution, we first present the arguments developed by Schumpeter in his paper on rationality (section 1), then we analyze the relationships between individuals and collective or social entities in the light of Schumpeter's conception of rationality (section 2) and finally we examine the reason why it is possible to champion an institutionalist interpretation of Schumpeter's theory of economic evolution (section 3).

1. Schumpeter's conception of rationality²

At the very beginning of his paper, Schumpeter defines, following Kirchhoff's definition of mechanics, what he considers being a science: "I shall define science in general as the endeavor to describe phenomena we happen to be interested in, in the way most economical with reference to an assigned degree of accuracy." (Schumpeter [1940] 1991, p.316). The idea of the most economical way of description is an application of the Okham's razor principle, which, according to Schumpeter, should not imply that logical reasoning should confine to verifiable "facts" or to empirical cognition as the following example given by our author illustrates: "if the hypothesis that planets are moved by angels opened the shortest way to describing their motion, there could be no objection to it on grounds of scientific rationality." (ibid pp. 316-17)

Schumpeter emphasizes that "both the scientific attitude and that aversion to extra-empirical cognition are, of course, sociologically related." (ibid p. 317). More precisely, he points out that "[t]hey are both the products of 'rationalist' civilizations" but should logically be kept distinct" (ibid). This conception of science lends support to the idea that science is

² This section takes some materials from Garrouste (2006).

historically determined and is not *necessarily* an empirical enterprise. He also stresses that “[s]cientific rationality is also relative to the horizon of the analyst, that is, to the information and mental equipment at his command. What behavior is [therefore] rational for a given analyst or observer can only be determined if we know what he knows.” (ibid). This idea of ‘historical relativism’ is recurrent in Schumpeter’s analysis and has also to be related to the distinction he makes between ‘rationality of the method’ and ‘rationalism’ (see Figure 1). This distinction emphasizes the potential discordance between what can be regarded as rational from the viewpoint of the method that is used at a given time and how this method is looked back retrospectively by a current observer³. This aspect can also be related to Schumpeter’s method of analysis, as developed in the introduction of his *History of Economic Analysis*. Schumpeter, indeed, emphasizes that sociological and historical matters should constitute full-fledged components of economic analysis.

These methodological remarks concern the scientific procedure as it applies to every kind of science and, with regard to rationality, they only relate to what Schumpeter refers as “the rationality of the observer”, i.e., the rationality of the analyst (see Figure 1). Schumpeter’s aim, however, is to tackle the problem of rationality in the social science, and in this perspective, he contrasts the former type of rationality with the “rationality of the observed” and highlights several problems related to the latter.

First, Schumpeter raises the question of the status to be given to the ends of any individual action. He points out that “all that can be legitimately claimed for them [i.e., the ends], on the scientific pale, reduces to, first, the task of working out the consequences that action taken in order to realize any given ultimate end would have; second, the task of explaining why given people at any given time and place should feel about any given ultimate ends as they actually do.” (ibid p. 318). This issue is taken up by Schumpeter. In compliance with Paul Sweezy, he emphasizes the idea that we have to face an infinite regression when we try to define ultimate ends, just because value judgments need to be based on other value judgments. He however considers that “it is quite true that ordinarily we do not meet with ultimate values and that the valuations we do meet are usually intermediate ones, i.e., really refer to means to an end not itself under discussion.” (ibid p. 318).

Second, Schumpeter stresses the differences and relations between the rationality of the analytical procedure and the rationality of the result. According to him, rationality and truth are not congruent even if there is a relation between them. It is interesting to note that he

³ This aspect is also very close to what Boudon calls to-day ‘good reasons’ (see Arena 2006).

seems to disagree with the Friedman's argument (1953) that is rooted in the 'if then' logical properties⁴ when he indicates that rationality of procedure does not warrant the rationality of the result "*unless we include correctness and adequacy of both the material and the equipment at the command of the analyst which we cannot do if we admit varying horizons.*" (ibid p. 319). Schumpeter considers however that rationality of procedure is a necessary (but not sufficient) condition for the rationality of the result.

Third, he emphasizes the idea that "rationality in the social sciences emanates from the analyst" (ibid p. 319). More precisely, what Schumpeter means by this statement is that, in contrast to other sciences, social sciences are characterized by the fact that the analyst does not confine himself to draw causal relationships between objects and elaborate concepts based on these relationships in order to build theories or models, but that he must, in many cases⁵, also understand the meaning of individual actions and, therefore, set up norms of behaviour (ibid p. 322). In other words, the analyst is compelled to assume some kind of rationality in the real economic or social world even if true individuals do not display or do not conform to such rationality. This point is exemplified by the following quotation: "we will emphasize at once that this observer's rationality has in itself nothing whatever to do with the presence or absence of rationality in the human types or human actions observed, or even with the applicability of the concept of rationality to the subject under investigation" (ibid p. 319).

Schumpeter illustrates this point by referring to the classic case of monopoly and to its traditional modeling by means of the marginal revenue and marginal cost curves. He highlights that the optimization programme needs not to be actually followed by a businessman in order for the maximization procedure to hold: "(...) nothing of this is necessary for the model to have sense and to be useful. For a man's behavior may conform to it and be economically described by it, even if its contents are as foreign to his mind as the law of gravitation is foreign to a stone." (ibid p. 321)⁶.

⁴ The proposition 'if then' is true when the consequent is true and the precedent is false. In other words, it is possible to deduce a true property from a false one.

⁵ Except for the cases of theories or models based on objective and quantitative relationships, such as those derived from data analysis, for instance, or founded on objective and quantitative relationships, such as data analysis, for instance (ibid pp. 319-20). These exceptions also refer to two components (the set of theories based on logical arguments and the set of theories founded on observations) of the typology of economic theories made by Schumpeter in the second chapter of his *History of Economic Analysis*.

⁶ It is interesting to note that this passage is perfectly in line with what Alchian (1950) and Friedman (1953) assume when they consider that producers need not consciously maximize profit and that they are able or not to calculate marginal revenue and marginal cost. It suffices to say that they need to do so if they want to survive.

Such a procedure, ending in a model, provides a standard and then a description. This standard can thus be used to compare actual behavior or it might. It helps “to describe actual behavior by giving its rationale” (ibid p. 322). Following Schumpeter’s terminology, this kind of rationality can be described as “objective rationality (rationality in the object) seen through the rationality of the observer.” (ibid p. 322).

In sum, Schumpeter’s conception of rationality in the social sciences articulates two levels of rationality of the observer. The first one, i.e., the “rationality of the observer”, defines the usual rational procedure in sciences in general, while the second one emphasizes the specificity of social sciences, i.e., the fact that the analyst must set up norms of behavior that relate to the “rationality of the observed”, but that are the emanation of the analyst, in his endeavor to understand (in the German sense of *Verstehen*) the logic of individual actions. Schumpeter’s distinction between the ‘rationality of the observer’ and the ‘rationality of the observed’ also reveals the singularity of his methodological approach. In particular, Schumpeter’s conception of rationality is not based on the idea that there is some ‘essential’ rationality lying behind the existence of social reality, namely, behind the actions of concrete interacting men. His conception is therefore far from Menger’s one, according to which the exact orientation of research in economics has to reveal the essence of social phenomena (‘exact types’ and ‘exact relationships’ between them) that is hidden behind real phenomena (‘real types’ and ‘real relationships’ between them). For Schumpeter, there are sociological as well as historical dimensions that determine *the ways the observer casts some rationality on the observed*. This assumption is essential and underlies Schumpeter’s conception of rationality in the social science. Several remarks by Schumpeter confirm this interpretation.

First, as already emphasized by us, Schumpeter claims that if the observer “has succeeded in ‘understanding’ the end of the observed and if he has correctly set out its implications then he has (...) derived a ‘norm’ which is ‘valid’, whether there are any facts conforming to it or not (whether it is ‘verified by facts’ or not)”. That this norm is “visualized as something capable of being realized” is sufficient condition of rationality at this stage. It corresponds to Schumpeter calls “rationality in the object”, a kind of rationality that distinguishes social sciences from physical sciences or sciences in general (ibid p. 323).

Second, Schumpeter reminds us that “the observer needs to understand the end even if he does not share it”. This remark is clearly related to the idea of historical or sociological

relativism in Schumpeter's methodological approach. Schumpeter here stresses the problem of the "infinite variety of cognate ends", which often bias the judgment of the observer as regards the rationality of the observed: "[m]any types of behavior are looked upon as irrational (not conforming the schema of rational action), and the range of rationality in action is in consequence often underestimated because the tests of rationality have been made by means of models that failed to fit, not because they are rational but because they did not capture the right type of 'Zweckrationalität' [rationality of end]." (ibid p. 324). This assertion relates to Schumpeter's statement that "rationality in social sciences emanates from the analyst". At first sight, one may consider that it is contradictory to suppose, on the one hand, that the analyst, by means of the description of the world he proposes, does create rationality and to consider, on the other hand, that he is likely to fail in the way he describes the world because he misses some aspects of individuals' rationality. This contradiction is however removed if one interprets correctly Schumpeter's conception of rationality as a multi-level analysis of rationality (see below).

Third, Schumpeter calls the reader's attention to the problem of conflicting ends (ibid p. 324). This issue is essential not only because it anticipates some recent results⁷ in terms of utility functions or some of the developments of both the so-called *Public Choice* approach and agency theory, but also because it foregrounds the fact that individuals usually pursue several and often conflicting ends. Schumpeter gives two instances of this problem, referring to conflicts between the interest of the executives and the interest of a business corporation or between the interest of the working class and the interest of trade union officers (ibid p. 325). It also relates, as we will emphasize in the next section, to Schumpeter's analysis of social classes, more peculiarly to his distinction between self-interest and class-interest. This feature also clashes with the usual Austrian perspective and, again, reveals the specificity of Schumpeter's overall approach to economic theory.

Fourth, Schumpeter stresses again the distinction between rational behavior and rational results. The case of economic crises, which Schumpeter refers to, exemplifies the possibility that, even though individuals do act rationally, the collective result may be entirely irrational. It should be noted that this feature is perfectly in line with the usual Austrian assumption of 'unintended consequences of voluntary actions'. Moreover, it fits with contemporary dynamic models that show that evolutionary processes can end up in suboptimal outcomes.

⁷ Page 330 Schumpeter explicitly writes that businessmen may be altruistic (even if based on 'egoistical' wish). This point sounds very modern if related to recent results in experimental economics.

Fifth, Schumpeter insists on the necessity, in order for the analyst to evaluate the right rationality of end,, to “put himself” into places far distant from his time place and social location” or “to transplant himself into another cultural world” (ibid p. 325). Here again, the idea of historical and sociological relativism is foregrounded by Schumpeter and exploited as an argument to criticize Max Weber’s denying of ancient Chinese rationality.

All these remarks concern the double dimension of the rationality of the observer (scientific rational procedure and rationality in the object) in the social sciences. However, Schumpeter does not neglect the existence of a third type of rationality, namely “subjective rationality” (of the observed), even if he gives the reader the impression that he treats it as secondary. Two reasons may explain Schumpeter’s attitude.

First, he argues on logical grounds that objective rationality (or rationality in the object) does not imply a one-to-one relation to the subjective one. First, “it is not necessary that the subjective rationality of actors works in the same way as the rationality of the observer” (ibid p. 328). The case of the Cournot-Marshall monopoly is a good example of this absence of conformity. Second, “it might be objective that whatever we may find out by means of subjective rationality can always be embodied in our ‘objective rational’ models so that there is no reason after all to stress what the subjective rationality might be in the actors we observe.” (ibid p. 328)

Second, in compliance with his ‘institutionalist’ conception of individual behavior (see above), he considers that to focus on subjective rationality leads to overestimate the range of conscious and deliberate behaviour. He refers in this respect to Marshall and Wicksell, stating that the way they expressed themselves suggests “excessive reliance on subjective rationality” (ibid p. 336). In other terms, according to Schumpeter, workers in the social science often go too far by assuming implicitly or explicitly that individuals “are themselves actuated by clearly perceived motives, and regulate their behavior with conscious rationality working in the full daylight of their ego’s” (subjective rationality), whereas the supposedly “conscious motives that a man will tell himself and others are largely [*ex post*] rationalizations of unconscious or innate impulses.” (ibid p. 326).

Nevertheless, Schumpeter does not dispose of the problem of subjective rationality and of its relation with objective objectivity, in particular, the question as to whether subjective objectivity is in conformity with objective subjectivity or not.

For him, the distinction between objective and subjective rationality is still relevant when it permits to avoid redundant assumptions as regards individual behavior or when one uses models based on rationality as ‘interpretative schema’. In these conditions, the ultimate objective finality (as founded on the speculative knowledge (*‘Erkenntnisgrund’*) of the observer becomes an ‘explanatory hypothesis’ of the actual individual’s behavior (*‘Realgrund’*). If for any reason this hypothesis is not justified, then the conformity between subjective and objective rationality becomes a puzzle to be solved. Symmetrically, conformity between objective and subjective rationality permits to establish diagnostic as well as previsions.

Furthermore, when rational schemata based on objective rationality fail to capture adequately actual behavior, “(...) deficiency in subjective rationality may directly be the reason we seek, or one of these reasons”. It is nevertheless true that “(...) investigation of subjective rationality may put us on to the track of other reasons and even help us to identify the right ‘objectively rational model’.” (ibid p. 329).

Schumpeter’s conception of rationality can be summarized by emphasizing on the two levels that it involves.

The first level is provided by the distinction between two kinds of rationality: the ‘rationality of the observer’ and the ‘rationality in the observed’ (see level I/II on Figure 1)⁸. This first level permits him to establish the borderline between natural sciences, on the one hand, and social sciences, where the relationships between the analyst (the observer) and the social reality (the observed) become fundamental, on the other hand. In other terms, Schumpeter’s overall schema of rationality is to be considered as a general framework of rational models that is not confined to the problem of rationality in the social sciences, but also include rational models belonging to the natural sciences. This is exemplified by the fact that in many passages of his paper, Schumpeter analyzes the differences between natural (mostly physics) and social sciences (mostly economics). As we have emphasized, this first distinction also underlines the specificity of social sciences with respect to rationality, i.e., the fact that in the social sciences the observer needs to be ‘rational’ in a double sense: he has to make use of logical reasoning in order to set up models, but also has to understand the ends that individuals pursue. Social sciences share however the characteristics and then the

⁸ This Figure is a slightly modified reproduction of Swedberg (2001), who inserts this figure used by Schumpeter in a talk he gave on “rationality in economics” on October 27 and November 13, 1939.

properties of rational schemata in the natural sciences, namely, the necessity to offer an accurate description of the (social) reality, the use of logical tools in order to develop arguments and historical and sociological relativism. Those elements that are common to both the social and the natural sciences are located on the left of the dotted bold vertical line on Figure 1, while on the right side of this line, the specificity of the social sciences in terms of rationality is sketched out .

The second level of Schumpeter's analysis of rationality concentrates on rationality in the social sciences *per se*. This level now consists in the distinction between 'objective rationality' and 'subjective rationality' (this level is identified by the continuous ellipse and the distinction by means of the dotted fine vertical line on Figure 1). This level of analysis permits Schumpeter to stress the importance of the notion of subjective rationality and its relationships with the notion of objective rationality. The fact that this distinction corresponds to the one made, respectively, between consciousness and subconsciousness is perfectly justified since, as we have underlined, 'objective rationality' is assigned to individuals' behavior *by* the analyst. In other words, the rationality of the observed is seen through the rationality of the observer. At the opposite, 'subjective rationality' is necessarily conscious since it is an understandable and explicit account (in terms of means and ends) of the effective behavior of individuals.. In other words, individuals are 'objectively rational' when the analyst correctly (that is logically or on the basis of data) describes their behavior even if individuals do not know that they 'have' to behave in this way; while they are 'subjectively rational' when they have 'good reasons' to behave as they actually do, and that those 'good reasons' can be made explicit.

We shall now investigate in more details how Schumpeter's conception of rationality relates to his overall methodological approach and his vision of economic evolution.

This inquiry will be carried out in two successive steps. First, we will concentrate on Schumpeter's conception of social classes and its evolution and show how it can be easily connected to the issue of conflicting ends as developed in his 1940 article on rationality (Section 2).

Then, we will attempt to sketch out a preliminary picture of how institutional change may occur in Schumpeter's overall framework, by focusing, in this perspective, on how it can be related both his conception of rationality and his dynamic analysis of social classes (Section 3).

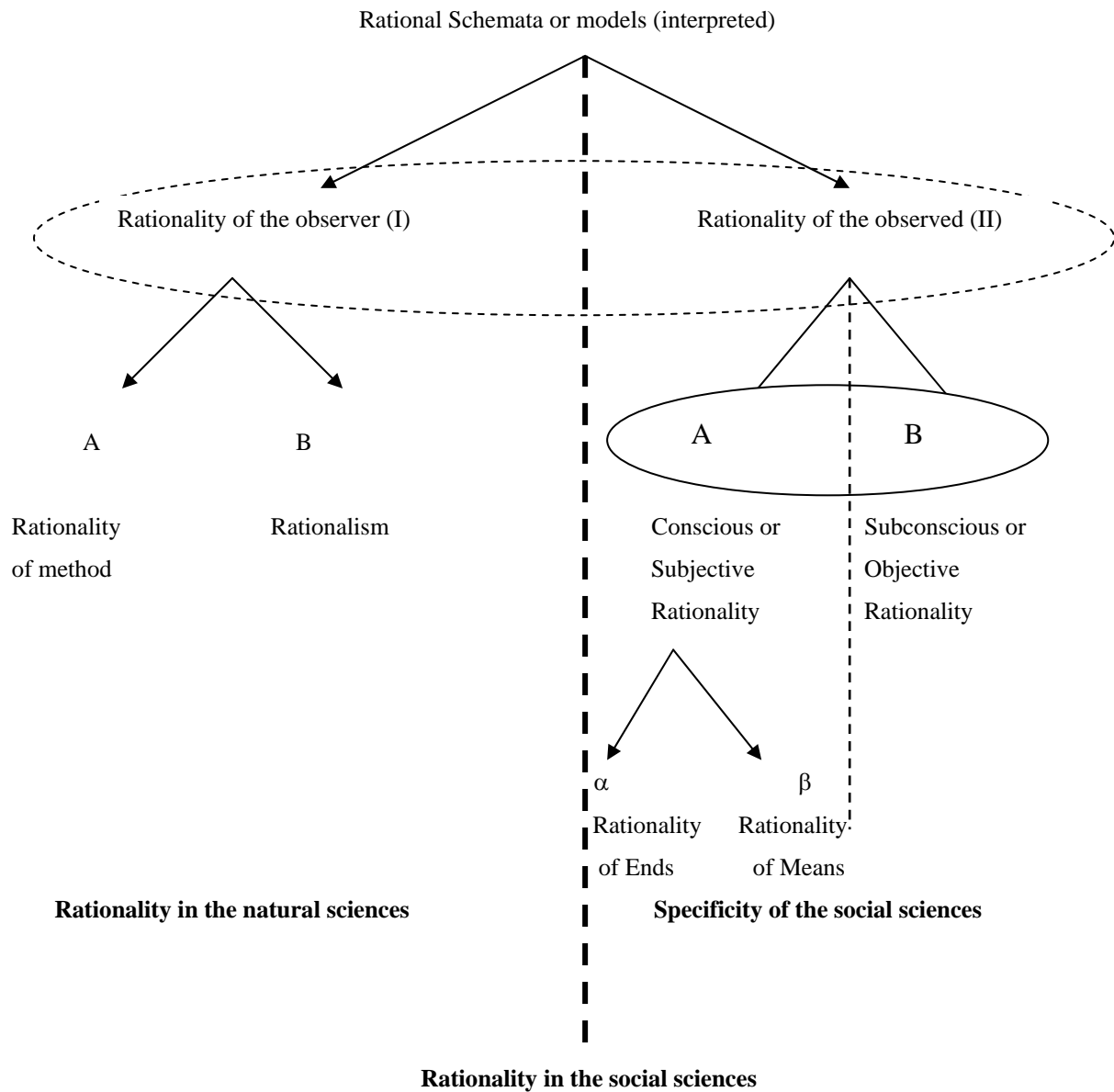


Figure 1

2. The nature and the role of social entities and Schumpeter's conception of rationality

As we have emphasized in the previous section, Schumpeter raises the issue of conflicting ends as an illustration of methodological problems associated with the notion of rationality in the social sciences. Furthermore, with respect to this issue, Schumpeter also warns the reader against the use of flawed schemata of rationality based on a unique identified end, indicating that in many cases, actual behavior fail to confirm such rational schemata, not

because individuals behave in an irrational manner, but because they often pursue several and often conflicting ends that have not been identified and prioritized correctly by the social scientist. As we will develop in this section, there is a connection between the problem of conflicting ends and Schumpeter's contribution to economic sociology, in particular, his analysis of social classes as social entities. This connection favors an institutionalist interpretation of Schumpeter's theory of economic evolution, in which conflicts between self-interest and class-interest play an important role.

In his 1940 paper, Schumpeter suggests that the problem of conflicting ends may originate in the divergence in terms of motivations between individual rationality (in the sense of self-interest) and 'collective rationality' (in the sense of class-interest). This is one of the main reasons why, according to Schumpeter, the observer needs to understand individuals' ends when he wants to set up logically constructed theories in the social sciences. More precisely, Schumpeter argues that the analyst or observer has to get a comprehension of individuals' ends because those ends which determine the means used to satisfy them impact on the result of individual and collective action, even if there is some irreducible indeterminacy in this result. From a different perspective, the possibility of conflicting ends permits to conceive not only the fact that non economic ends can be important for the cohesion of social classes but also that some non commonly shared economic ends can be followed by individuals. As we will develop below, innovations are due to the fact that entrepreneurs display a kind of behavior that differs from the usual maximizing (or even satisfying) economic behavior.

This 'subjectivist' conception of individual's behavior is, of course, in line with the Austrian tradition, but, more importantly, it is consistent with Schumpeter's idea that entrepreneurs, even though they are perfectly rational, follow some non commonly shared specific economic ends. In this way, entrepreneurs are conceived as rational but, just because they do not follow shared economic ends, they do introduce disequilibrium into the stationary circular flow, thus permitting qualitative change to ensue. In other terms, the idea of non commonly shared ends permits to put together the propositions that a stationary economic equilibrium is possible and that this equilibrium can be destabilized by some rational agents. As Schumpeter stresses, this conception is not based on some psychological arguments. It is more relevant to say that it is due to his conception of individual rationality.

To put in a nutshell, the main argument we have emphasized so far is the fact that individual behavior is determined by a bundle of ends. This behavior is however

contextualized insofar as individuals have to realize some functions that are socially defined. We will see below that their capacities to perform those functions make them evolving inside the society, improving or worsening their social positions accordingly. It is their very aptitude to perform those social functions that permit them to increase their position inside the social structure. The effectiveness of their actions is also conditioned by the social environment: in some cases there can be some resistance to novelty due to established social values, behavioral routines, etc. In this case, leadership is a main aptitude they have to possess in order to break with old habits or tradition.

But before analyzing Schumpeter's approach of the relationships between individual behaviors and the social structure, we need to make a detour *via* his analysis of the nature, function and evolution of social classes.

According to Schumpeter, social classes can be conceived either as social organisms that act as such, i.e., social entities *per se* or as creation of researchers. The problem is that those two conceptions of social classes are often confused. More precisely, in his 1927 Essay on social classes, Schumpeter identifies four problems that arise when sociological scientists try to define social classes: the nature of classes (and their functions), class cohesion, class formation (that explains why the social whole is not homogenous) and “the concrete causes and conditions of an individually determined, historically given class structure” (Schumpeter (1991) [1927] p. 233). This last problem is important because it reinforces the idea that classes are historically dependent entities. In sum, for Schumpeter groups or social classes are not in general to be explained by purpose. Mostly, sociological location and history are necessary to understand their nature and behavior. Finally, Schumpeter considers that, although there is no such thing as classless society, it is nevertheless possible to identify principles that explain the formation, nature and basic laws of classes

As far as the relationships between individual rationality and social entities are concerned, Schumpeter first stresses that “the class membership of an individual is a primary fact, originally quite independent of his will. But he does not always confirm that allegiance by his conduct.” (ibid p. 236).

In the first part of this quotation, Schumpeter specifies the unit of selection that underlies his conception of social classes: family is conceived as the definite *unit of selection*. Individuals belong to families and family is then the primary and relevant level of analysis of the process of selection: “[w]e see, therefore, that families *do* surmount class barriers, as *individuals* rather than as a class – though quite often in groups – and that they do this in a

manner which we can, even today, study in a sufficient number of individual cases, as well as in all important groups of cases.” (ibid p. 251).

The second part of the quotation, however, stresses the fact that individuals are in *a given economic and social context* the *active units of evolution*: “[o]nly the physical individual, not the family, is class-born.” (ibid p. 252). More precisely, only individuals permit the modifications of 1) the position of individuals’ families inside a class, 2) the families’ capability to cross the boundaries of classes and 3) finally the rise and fall of classes. In fact, “it is always ‘behavior’ and ‘aptitude’ that explain shifts in the relative positions which originally existed.” (ibid p. 246). The shifts that characterize the evolution of class structure need to be linked with the importance of the “method of striking out along unconventional paths” which is, with chance and success “along wonted and ordained lines” the most important element that explains rising higher classes: “[t]his has always been the case, but never so much as in the world of capitalism.” (ibid p. 253). This idea strengthens the fact that individuals possess all the same basic characteristics⁹ that make them adaptable to specific historical contexts. Capitalism is not creating new individuals not existing before but permits individuals to manifest differently their aptitudes. “Because of the limited opportunities open to working-class families, this is virtually the only method by which they can make the great leap out of their class.” (ibid).

If individuals are, due to their aptitudes, able to change the relative position of their families inside a given social and economic context, the principle of selection that makes them successful in their enterprise is defined by the extent to which they have the capacities to perform some specific social functions. Accordingly, *the functional adequacy of behaviors is the relevant principle of selection*. This functional vision of the class structure is perfectly illustrated by the following quotation (italics original):

“Just as the manorial system corresponds to the type of the knightly warrior-politician and warrior-administrator, so the system of large landed estates corresponds to the type of the aristocratic businessman.” (ibid p. 268)

⁹ In Schumpeter (1991 [1927]), we find some development concerning the inheritance of mental characteristics: “[a]s for mental characteristics, we have as yet only data in the field of defects, though these are in a state of fruitful evolution. For obvious reasons, it is difficult and dangerous to go beyond them, in the field of statistics as well as genealogy. Again, therefore, we emphasize that while it may be hopeless to pass considered judgement significance of a class – and incidentally, on most other basic questions of the social order, past or future – until this point has been settled, the basic idea of the class theory here presented is quite independent of it.” (Schumpeter 1991 [1927] p. 216). This statement by Schumpeter can be explained by his reluctance to introduce some psychological arguments in his class theory as well as in his theory of economic evolution.

Consequently “the social importance of class members varies with (...) two basic elements – the importance of the class function and the degree of success in carrying out that function.” (ibid p. 272). However, the adequacy between class structure and social functions first, is not an automatic and direct relation; second, is determined by an economic logic and third, is a long and slow process.

First, the process of evolution of classes and class structure is not straightforward in the sense that there exists no direct relationship between the existence of a class and its actual function. In particular, classes can survive even if the conditions that explain their existence have disappeared: “[c]lasses, once they have come into being, harden in their mold and perpetuate themselves, even when the social conditions that created them have disappeared.” (ibid p. 237). This social inertia corresponds to the existence of a kind of ‘hysteresis effect’ (“the cause has disappeared but the effect remains”). Moreover, the processes of translation of social functions into institutional rules are heterogeneous and have different lags depending of the kinds of rules concerned: “the ‘superstructure’ of law, custom, and so forth is always the last to change, always lags behind changes in the actual life situation.” (ibid p. 262). Finally, the members of a declining class can use some stratagems in order to slow down the decline of their social position insofar as the “survival of some conspicuous externals serve to slow down the full effect of the internal [and necessary] change (ibid p. 266). To sum up, “there is an understandable tendency to continue the old functions in form rather than in substance.” (ibid p. 264). Success can explain this inertia. More precisely, “success, once achieved, exerts a continuing effect, without further accomplishment, for two reasons: first of all, the prestige it engenders assumes a life of its own. It does not necessarily vanish when its basis fades away – nor, for that matter, does its basis readily disappear. *This is the very heart and soul of the independent organic existence of “class”*. In the second place, in the vast majority of cases, success brings in its wake important functional positions and other powers over material resources. The position of the physical individual becomes entrenched, and with it that of the family.” (ibid p. 278-79).

Second, the ‘ultimate causes’ of the evolution of social functions are economic ones, even if sometimes they do not appear as conspicuous or immediate: “(...) such causes, on their part, can always be reduced to those basic elements, just as, according to the economic interpretation of history, the flow of social events is always, ultimately shaped by the inner logic of the economic machine, though very often this influence is anything but direct.” (ibid p. 272). Social functions are then in their very definition and evolution determined by

economic factors¹⁰. Those economic ultimate causes are however not directly leading the actual evolution of class structure as the previous point showed it. Consequently, there is a sort of disconnection between the fundamental economic causes and the apparent evolution of class structure. This feature is also emphasized in Schumpeter's *Theory of Economic Evolution*, where the author assesses on the one hand, "the fundamental dependence of the economic aspect of things on everything else", and on the other hand, that, as a consequence, "it is not possible to explain *economic* change by previous *economic* conditions alone" so that "we can state that the economic world is relatively autonomous because it takes up such a great part of a nation's life, and forms or conditions a great part of the remainder" (Schumpeter 1934 p. 58)

Third, the 'functional' evolution is not a fast and 'punctuated' equilibrium phenomenon. In fact, even if some accidents such as revolutions or wars can accelerate the social evolutionary process¹¹, the quick changes are mainly due to the failure of the incumbent upper classes to remain at their positions and then to perform their (or some new) social functions: "[f]rom the viewpoint of class history and class theory, we are concerned, first, with the fact that class functions and their relative social necessity change only slowly." (ibid p. 276).

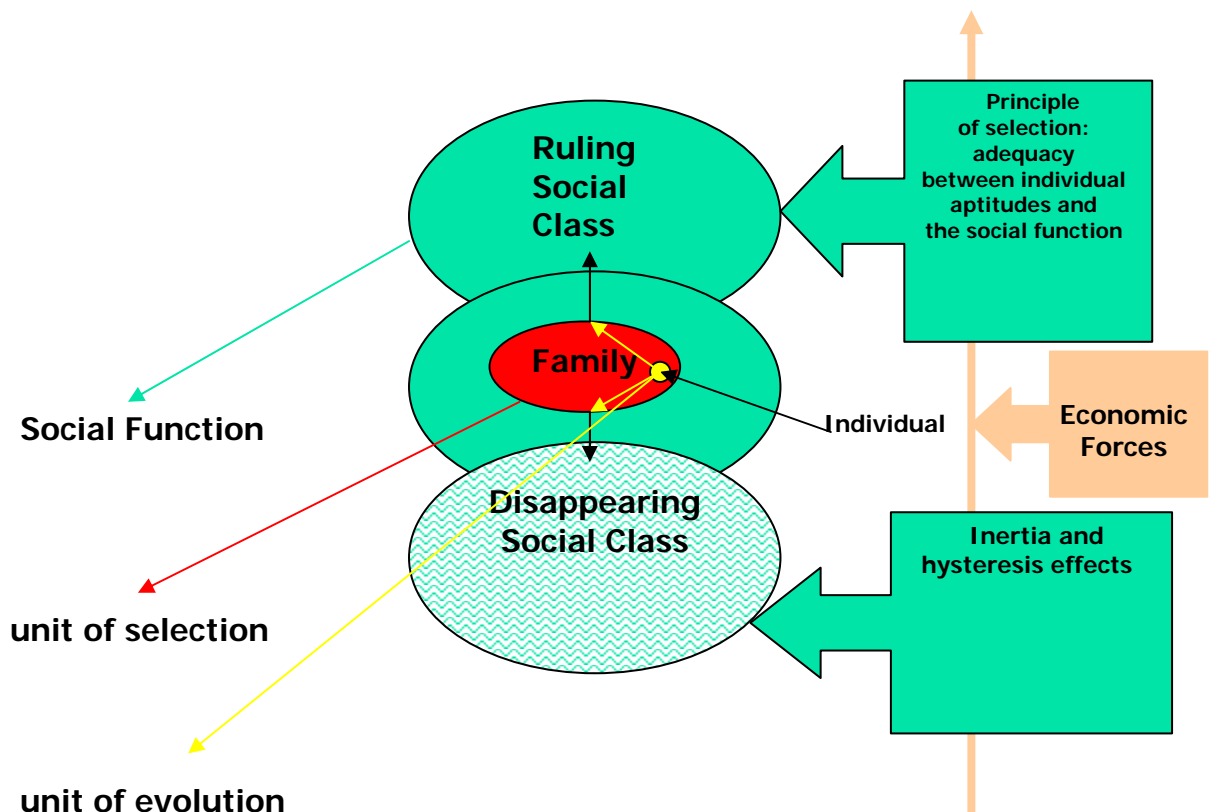
What seems important to remind at this stage in order to grasp the main features of social evolution in Schumpeter is that individuals are the units of the evolution of the structure of social classes. Their aptitude to satisfy necessary social functions makes their family, which is the unit of selection, evolving inside the social class structure. However, the evolution of the social class structure usually lags behind the evolution of the social functions, due to both inertia phenomena (comparable to hysteresis effects) and resistance from families to the evolution of their social status. Individuals' behaviors that are the mainspring of social evolution are nevertheless indirectly subjected to the evolution of the position of the family and the social class they belong to, the function of which, as we have emphasized is ultimately driven by economic forces. Finally, individuals' aptitudes and *in fine*, individuals' ends, which characterize their rationality, are the basic elements that explain the efficiency of their actions. If differences in individuals' aptitudes, and in particular, the aptitude for leadership explains the evolution of the family position in a given social class structure and of the relative position of the social classes themselves, they amount, in the final resort, to

¹⁰ This aspect sounds close to the Marxian assumption that social 'superstructure' is determined by economic 'infrastructure'.

¹¹ See, for instance, Young (1996).

differences in the individual's bundles of ends that motivate the acquisition of aptitudes (even if some aptitudes are partially given or socially inherited). In fact, for Schumpeter, individuals' aptitudes are embedded in an ethically homogeneous environment and are "probably distributed according to a normal curve." (ibid p. 276). As Schumpeter emphasizes: "our present purpose is served well enough by the fact, scarcely disputed, that individual differences do exist and that individual aptitudes do not fall into sharply marked categories, separated by empty space, but shade by imperceptible nuances from high to low." (ibid p. 277). Moreover, differences in aptitudes, such as the aptitude for leadership for instance, are defined as "special function[s], always clearly discernible in the actions of the individual and within a social whole. [They] emerge only with respect to ever new individual and social situations and would never exist if individual and national life always ran its course in the same way and by the same routine." (ibid. 278). It is therefore the abilities of some individuals to escape from routinized motivations that explain the emergence of new aptitudes and, finally, of new behaviors.

This feature is perfectly in line with the idea that individuals' rationality is related to a trade-off between a bundle of possible conflicting ends that results in a given behavior (which conveys the relation between means and ends). Furthermore, since the composition of the bundle of ends evolve through time, some ends are likely to emerge, while others may disappear, depending on the ability of individuals, i.e., their aptitudes, to perform some necessary social functions in a given economic environment. Moreover, as we shall now develop, the performance of individual actors also depends on the institutional and social context in which they are embedded. In particular, institutional change, and therefore, economic change, can be triggered if some agents have not only the aptitude, but also the energy to go beyond establish collective routines. In such a case, the element of novelty which is introduced in the society is likely to be diffused and to exert lasting effects on individuals' behaviors in the future.



3. The relationships between individual rationality and collective entities and Schumpeter's conception of institutional and economic change.

In this section, we argue that Schumpeter's theory of institutional and economic change needs to be analyzed in relation to his conception of the relationships between individual rationality and the dynamics of the social class structure.

According to Schumpeter, there is a correspondence, sometimes weak, between the economic and social functions and individuals' conflicting ends. This correspondence is effective as soon as individuals reveal some aptitudes to perform their economic and social functions. It is the reason why human motives are never strictly individual and that their effective behaviors are only the *symptom* of the existence of their class membership. Rather, they are always embedded in a social and historical context under which they have emerged. This characteristic is symptomatic of Schumpeter methodological approach. As Donzelli (1983: 639) reminds us, as early as in 1908 in his doctorate dissertation, Schumpeter devoted an entire chapter to a detailed discussion on methodological individualism vs. methodological holism, aiming not at establishing the superiority of either approach, but rather, at specifying

their respective arenas of application¹². In his 1927 essay on *Social Classes*, as already emphasized, Schumpeter attempts to evaluate the impact of social classes on individual motives and behaviors and assesses that social forces do have some autonomy vis-à-vis individual motives or ends. This feature does not imply, however, that individuals have no leeway in their actions. We indeed showed that, in Schumpeter, the construction process of social class rests on individuals' aptitudes and their adequacy with the social function they have to perform in a given society.

On the other hand, Schumpeter uses the notion of rationality for individuals but assumes the existence of classes as real and effective entities. As we wrote above, this last aspect is perfectly developed in Schumpeter ([1991] 1927) and the idea that classes or collective entities (families) can 'act' *as such* is fundamental. This aspect is also to be compared with Wieser's approach of the evolution of institutions (Festré, 2006). Wieser indeed emphasizes the idea that collective entities ('masses' and 'power strata' in Wieser (1926)) do exist. This feature allows both Wieser and Schumpeter to provide an analysis of the evolution of institutions and not only of their emergence inasmuch as these two levels (the individual and the collective one) do interact.

Such an interpretation of Schumpeter challenges Perroux' one who, in the introduction of the "Théorie de l'Evolution Economique" (the French translation of the Schumpeter's most well-known book) writes that Schumpeter only gives us a theory of the emergence but not of evolution. This is perfectly right insofar as we suppose that Schumpeter's methodology is only an individualistic one. If however one considers that his methodology is both individualistic and holistic, then the emergence and the evolution of institutions and, more generally, of the evolution of the all economy can be reconciled on the basis of an institutionalist interpretation of Schumpeter's conception of economic development (Festré and Nasica, 2006). Institutions and institutional change indeed permit some behaviors to emerge but institutions have to be seen as the crystallization of individuals' behaviors. For instance, the emergence of bankers because they permit the creation and diffusion of credit (as an economic institution) in an economy supports the existence of entrepreneurs as innovators.

Accordingly, there is a phenomenon of composition of individuals' behaviors following specific (understandable) ends and connecting means with these ends, which permits the emergence of collective local ends that appear as constraints and can possibly enter in conflict with the ends of individuals who belong to those collective entities. Such an

¹² See R. Arena and A. Festré (2002), p. 650.

explanation is a possible way for creating compatibility between the existence of both individualism and holism in Schumpeter's works. It also permits to emphasize that his conception of the economic development is based on an institutionalist approach of evolution.

In sum, economic as well as social evolution is co-determined by individual as well as collective forces. Individuals' behaviors are not entirely determined by collective and social constraints. They can give up routines and social anchored behaviors. This possibility lies in the Schumpeterian conception of individuals' motives and then of conflicting ends. Nevertheless, those 'out of conventions' behaviors need to be socially approved in terms of the functions they can perform. What seems to be crucial for Schumpeter is that novelty, economic and institutional change cannot be grasped on purely individualistic terms. Moreover, this process involves a specific conception of individual behavior and rationality.

On one hand, some kind of *energy* is required, which leads him to privilege the captain of industry or the promoter form of entrepreneurship in his theoretical construction of economic development. The reference to *energy* as a decisive factor of evolution is frequent in Schumpeter's writings. In his essay entitled *The Sociology of Imperialisms*, Schumpeter refers to the "instinctive urge to domination" (Schumpeter 1951 [1919], p. 15) or to "activity urges springing from capacities and inclinations that had once been crucial to survival, though they had now outlived their usefulness" (ibid. p. 44). These 'urges' (or *Trieb*, ibid. p. 83) are defined by Schumpeter as human inclinations that have more to do with 'instinct' than with reason (ibid. p 83–4).

In his 1908 doctorate dissertation (*Habilitations-Schrift*) entitled *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* as well as in the first German edition of his TED, Schumpeter contrasts the energetic form of egoism to the hedonistic one (Schumpeter 1908: 86-87; Schumpeter 1912). 'Hedonistic egoism' describes Walrasian rational behavior whereas the notion of 'energetic egoism' is reserved to describe an active and 'volontarist' behavior based on a different kind of rationality (see Santanelli and Pesciarelli 1990 p. 684-7 and Arena 1992 pp. 133-5). This distinction permits, in particular, as we shall analyze, to contrast the purest form of entrepreneurship from other producers who essentially follow routines of behavior. This distinction must also be put in perspective with Schumpeter's 1940 article on rationality.

As we showed, in his 1940 paper on rationality, Schumpeter reasserts his reservations about the use of strict individualism within social sciences, which assumes: "that the individuals under research – sometimes even the 'people' as such – are themselves actuated by clearly perceived motives, and regulate their behavior with conscious rationality working in the full

daylight of the egos (subjective rationality). In doing so, those analysts, especially those of bygone generations, have almost overrated the actual range of consciously rational action” (Schumpeter 1991 [1940], p. 326)

On the other hand, something more is involved for novelty to operate. To understand Schumpeter’s attempt to deal with this difficult issue requires to look carefully at his early writings dedicated to economic sociology as well as to account, again, for his dualist, both individualistic and holistic, methodology. Contrary to what is usually stated in this literature (see for instance Perroux, *op. cit.*), we maintain that Schumpeter not only provided an explanation of the emergence of change but also offered some very insightful principles of how institutions, behavior may evolve. This explanation is linked in the very specific way Schumpeter deals with the notion of rationality which is based on the idea that individuals’ ends can result from conflicts between self-interests and class-interests. Those ends, which are different from instincts, impact on behaviors, which are then both individually and collectively determined. This conception of individuals’ behavior, as based on the relationships between an individual and social determination, permits first to avoid a purely instinct-based approach and second to justify a methodology that combine the individualistic approach with the holistic one. However, if aptitude and conscious behavior explain the variety in individual behaviors and the possibility of conflicting ends between self-interest and class-interest, unconscious or instinctive capacities also play a role in triggering changes in routines or behavior. For Schumpeter, the unconscious urges also involve creativity and entail permanent changes as well as self-reinforcing mechanisms in the sphere in which they appear. Referring to “warrior nations” (Schumpeter 1951 [1919] p. 49), Schumpeter argues that “the explanation lies, instead, in the vital needs of situations that molded peoples and classes into warriors – if they wanted to avoid extinction – and in the fact that psychological dispositions and social structures acquired in the past in such situations, once firmly established, tend to maintain themselves and to continue in effect long after they have lost their meaning and their life-preserving function.” (Schumpeter 1951 [1919] pp. 83–4). Schumpeter adds that history shows why and how these civilizations held in time. The maintenance of those civilizations indeed implies the crystallization of all “popular forces” that characterize this people, included “those in the ideological sphere” in order to constitute “a war machine that, once in motion, continues so long as there is steam behind it and it does not run up against a stone wall.” (Schumpeter 1951 [1919] p. 49).

But what explains the longevity of such civilizations is more the phenomenon of leadership than passive adaptation. In a footnote, Schumpeter writes: “this is no mere analogy

of the kind rightly held in contempt. We are dealing with the facts that every purposive organization by its mere existence adapts its members to its purpose.” (Schumpeter 1951 [1919] p. 49 fn.). Shionoya summarizes the role played by creative activity and novelty in Schumpeter, emphasizing that it inevitably entails some indeterminacy and some path-dependency. Moreover, creative activity is also related to Schumpeter’s method of analysis, in particular, to his recourse to economic sociology, implying notably the emphasis on the phenomenon of leadership. As emphasized by Shionoya:

“In the first place, creative activity cannot be predicted by applying the ordinary rules of inference from the pre-existing facts. It is so unique that the mechanism of the *modus operandi* must be examined on a case-by-case basis. Second, creative activity shapes the whole course of subsequent events and their long-term outcome, causes discontinuity from preceding situations. Third, creative activity is an enigma of human beings and has something to do with the distribution of talent and therefore with the phenomenon of leadership.” (Shionoya 1997 p. 175).

Schumpeter’s claim for the use of economic sociology within his overall methodological approach reinforces his reluctance to a pure individualist approach to social sciences, in particular, if it is associated with a universal alleged objective rational behavior. The recourse to economic sociology indeed permits to assess a key role for leadership as a recurrent characteristic for institutional and economic change to occur. As we have emphasized, leadership is associated with the motivation of breaking up with routines that is rendered possible by the excess of energy that characterize them on the one hand. The success of their action, on the other hand, depends not only on their intrinsic characteristics, but on it being accepted by the community of followers or imitators. This process is based on self-organization and self-reinforcement, and is based on the phenomenon of social imitation, that takes place on a multi-level basis (family, own class, class structure). Finally, economic sociology plays the role of a conceptual bridge between history and economic theory. It indeed permits to discern amongst the varied origins and institutional settings that shape the social world similar patterns of behaviors that characterize normative phenomena, such as leadership or entrepreneurship.

The relationships between individual rationality and class structure, in the light of Schumpeter’s economic sociology, can be exemplified by Schumpeter’s conception of entrepreneurship. In a 1928 paper entitled “*Unternehmer*” (“Entrepreneur”), Schumpeter provides a typology of individual-level forms of entrepreneurship. In this article, he

distinguishes between four “types of modern entrepreneurship” (Schumpeter, 1928: 483-5; translation by Becker and Knudsen, 2003: 251-4): the factory owner and merchant; the modern captain of industry; the manager who actually carries out the entrepreneurial function and the ‘founder’ (promoter)

Schumpeter distinguishes those four types from a multi-criteria perspective according to a) the selection process; b) the functions (or managerial roles) fulfilled; c) the social position; d) the relationship between entrepreneurial position and capital; e) the (both individual and social) values, i.e., in other terms, following Schumpeter’s terminology in his 1940 paper on rationality, conflicting ends; f) the motivation; g) the competence (aptitude) in particular business matters¹³. In what follows, we will focus in particular on four of those criteria, namely, the motivation, the aptitudes, the function and the social position of the different types of entrepreneurs, as summarized in Figure 3. Our main point is to say that conflicting ends generate motivations that produce aptitudes.

Criteria	Factory owner and merchant	Manager	Modern captain of industry	Founder or promoter
Motivation	Present and future care of the family Non-rational love for the firm Social feeling oriented towards voluntary care	Sufficient income Good professional performance Applause of the colleague and the public Personal reputation	Power Will to win Performance Urge to action	Seeking and carrying out of new activities Intrinsic motivation (gratification from what he has done)
Aptitude	Bourgeois properness Business acumen Family spirit Autocracy Conservatism	Recognition of others Attainment of moral values	Solving problems	Starting new businesses
Function	Unite many heterogeneous functions (planning, the arrangement of factors of production, the fixation of prices, the implementation of production...)	Middleman-functions between the different stakeholders	Coordinate the general direction of the business policy of his companies Decide in dangerous situations Creates novelty	Focused on the entrepreneurial function (+ functions of secondary importance: legal and financial matters.
Social position	A definite social position similar to the one of capitalists	No particular social position (division of ownership and control)	Ability of command and domination (leadership)	No social reference point Often low social and moral status

Figure 3. The different types of entrepreneurs

¹³ These criteria have been provided by Becker and Knudsen (2004) by way of inference from Schumpeter’s 1928 article.

Regarding the criterion of aptitudes, the different types of entrepreneurs are described by Schumpeter as follows: the factory owner and merchant is characterized by bourgeois properness, business acumen, family spirit, autocracy and conservatism; the manager is motivated by recognition of others (reputation) and attainment of moral values; the promoter is competent in starting new businesses and not so much in running them once started; the captain of industry is interested in solving problems, more than in business and, against his will, he is the pioneer of the planned economy. From the perspective of conflicting ends, one can consider that aptitudes are the product, embodied in actual behavior, of the trade-off between conflicting ends.

The analysis of the criterion of the *motivation* of the different types of entrepreneurs permits to illustrate the problem of conflict between self-interest and class-interest from the perspective of Schumpeter's conception of rationality and to stress the idea that conflicting ends produce motivation that result in aptitude. In this respect, the factory owner's attention is turned towards the present and future care of his family and towards a 'non-rational' love for the firm and his social feeling is oriented towards acts of voluntary care. The manager's motivation is described as an intermediate form of self-interest: sufficient income and orientation towards the idea of good professional performance, applause of the colleagues and the public, as well as personal reputation. The promoter's motivation is oriented towards the seeking and carrying out of new activities, i.e. intrinsic motivation and gratification from doing that. Finally, the captain of industry is described as someone, who does not only follow his own interests or his family interests, who is not simply oriented towards profit as such, but also towards power, performance, the will to win, and the urge to action.

From the viewpoint of their *functions*, the four kinds of entrepreneurs are associated with the following characteristics. The factory owner and merchant appears to unite many heterogeneous functions (planning, the arrangement of factors of production, the fixation of prices, the implementation of production); the manager performs many, amongst which middleman-functions that sometimes lead to new combinations; the promoter is completely focused on the entrepreneurial function even if he also regularly carries out legal work and tends to matters of technical finance; the modern captain of industry is the purest type of entrepreneur since he does not fulfill accessory functions (as the other types of entrepreneurs do) but coordinates the general direction of the business policy of his companies, creates novelty, and decides in dangerous situations. It is therefore no surprise that the modern captain of industry is the type of entrepreneurship designed for economic change.

If we finally turn to the criteria of *social position* in Schumpeter's 1928 paper on entrepreneurship, one can detect the expression of the crucial role of leadership for economic change to occur, i.e., the ability of command and domination, which all the types of entrepreneurs, except the captain of industry, are deprived of. This ability is partly individual and partly social, in compliance to our previous discussion on individual rationality and social classes. Moreover, it is not limited to the problem of modern entrepreneurship. It also characterizes other historical phenomena, such as imperialism (see Schumpeter 1951 [1919]).

Conclusion

Schumpeter's writings are marked by his constant interest in individual behaviors and rationality. Moreover, in his early writings on economic sociology (1951 [1919] and [1927]) he constantly stressed the fact that individuals have to perform "necessary social functions". His conception of social classes is based on the idea that class structure emerges and evolves because individuals, motivated by conflicting ends, perform differently, according to their specific aptitudes and the social functions corresponding to the class their families belong to. This correspondence is however not a perfect and automatic one: first, because it is subject to lags, due both to historical inertia and to the existence of delays in the speed of change of the different institutional rules; second, it is relative to the behavior of individuals that are not always fulfilling routines, i.e., 'conventional paths', but innovate in terms of behavior instead.

This very specific conception of institutional change, which is both individualistic and holistic, explains why Schumpeter is so difficult to rank among the economists of the Austrian tradition, even though he really contributed to the development of some key tenets of this School. What makes also Schumpeter's conception of economic and social change very modern is the fact that institutions are conceived as a multi-level set of rules, each subset having its own logic in terms of functions as well as in terms of evolution. From the perspective of recent economic literature devoted to the relationships between institutional framework and economic development, Schumpeter's works definitely give us fruitful insights.

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