

the  
theory  
of  
economic  
development

Joseph A.  
Schumpeter

# THE THEORY OF ECONOMIC DEVELOPMENT

*An Inquiry into Profits, Capital, Credit, Interest,  
and the Business Cycle*

JOSEPH A. SCHUMPETER

TRANSLATED BY

REDVERS OPIE



A GALAXY BOOK

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## TRANSLATOR'S NOTE

MY CHIEF aim has been to convey the meaning as accurately as possible, and to this end I have not hesitated to use a clumsy phrase in cases where there was no current English equivalent of the German word. After considerable reflection I decided upon "circular flow" for "Kreislauf," for reasons which it would take too long to relate. There are inelegancies which have nothing to do with the technical side of translating. To eradicate these would have meant rewriting the whole, and it did not seem expedient to do so. Professor Schumpeter is so much at home in the English language that he would inevitably have left his mark on the translation even if he had not given his time as freely as he did to the more difficult points involved. For this reason, as well as for those mentioned in the preface, the book is more than a translation.

The title of the German original is *Theorie der wirtschaftlichen Entwicklung*.

REDVERS OPIE

## PREFACE TO THE ENGLISH EDITION

SOME of the ideas submitted in this book go back as far as 1907; all of them had been worked out by 1909, when the general framework of this analysis of the purely economic features of capitalistic society took the shape which has remained substantially unaltered ever since. The book was published for the first time, in German, in the fall of 1911. When, after it had been out of print for ten years, I consented, not without some reluctance, to a second edition, I omitted the seventh chapter, rewrote the second and the sixth, and shortened and added here and there. This was in 1926. The third German edition is merely a reprint of the second, from which also the present English version has been made.

I should be passing a very damaging verdict on what I have done and thought since the book first appeared, if I were to say that my failure to make alterations of other than expository consequence was caused by a belief that it is satisfactory in every detail. Although I do consider both the outlines — what might be termed the “vision” — and the results as correct in the main, there are many points on which I now have another opinion. To mention but one, by way of example: when the theory of the business cycle, which the reader finds in the sixth chapter, was first worked out, I took it for granted that there was a single wave-like movement, viz. that discovered by Juglar. I am convinced now that there are at least three such movements, probably more, and that the most important problem which at present faces theorists of the cycle consists precisely in isolating them and in describing the phenomena incident to their interaction. But this element has not been introduced into the later editions. For books, like children, become independent beings when once they leave the parents’ home. They lead their own lives, while the authors lead their own also. It will not do to interfere with those

who have become strangers to the house. This book has fought its own way, and rightly or wrongly has won its place in the German literature of its time and field. It had seemed to me best to leave it undisturbed as much as possible. I should hardly have thought of an English translation but for the suggestion and encouragement of my eminent friend Professor Taussig.

For similar reasons, I have not followed the example of my great teacher Böhm-Bawerk, who with infinite care took notice of every objection or critique and embodied his own comments in his later editions. It is not any want of respect towards those who did me the honor of careful criticism of my argument that leads me to limit controversy to the minimum. I have to confess, however, that I have never come across an objection on essential points which carried conviction to my mind.

In aim and method, this book is frankly "theoretical." This is no place for a *professio fidei* on method. Perhaps I think somewhat differently now about the relation between "factual" and "theoretical" research than I did in 1911. But my conviction stands that our science cannot, any more than others, dispense with that refined common-sense which we call "theory" and which provides us with the tools for approaching both facts and practical problems. However important may be the bearing of new masses of unanalysed, especially statistical, facts upon our theoretic apparatus — and undoubtedly increasing wealth of factual material must continually suggest new theoretical patterns, and thereby currently and silently improve any existing theoretical structure — at any given stage *some* theoretical knowledge is a prerequisite to dealing with new facts, that is with facts not already embodied in existing theorems. If this knowledge remains rudimentary and subconscious, it may be bad theory but it will not cease to be theory. I have not been able to convince myself, for example, that such questions as the source of interest are either unimportant or uninteresting. They could be made so, at all events, only by the fault of the author. I hope, however, to supply before long the detailed material which is here missing

by more "realistic" studies in money and credit, interest, and cycles.

The argument of the book forms one connected whole. This is not due to any preconceived plan. When I began to work on the theories of interest and of the cycle, nearly a quarter of a century ago, I did not suspect that these subjects would link up with each other and prove closely related to entrepreneurs' profits, money, credit, and the like, in precisely the way in which the current of the argument led me. But it soon became clear that all these phenomena — and many secondary ones — were but incidents of a distinct process, and that certain simple principles which would explain them would explain also that process itself. The conclusion suggested itself that this body of theory might usefully be contrasted with the theory of equilibrium, which explicitly or implicitly always has been and still is the centre of traditional theory. I at first used the terms "statics" and "dynamics" for these two structures, but have now (in deference to Professor Frisch) definitively ceased to use them in this sense. They have been replaced by others, which are perhaps clumsy. But I keep to the distinction, having repeatedly found it helpful in my current work. This has proved to be so even beyond the boundaries of economics, in what may be called the theory of cultural evolution, which in important points presents striking analogies with the economic theory of this book. The distinction itself has met with much adverse criticism. But is it really untrue to life or artificial to keep separate the phenomena incidental to running a firm and the phenomena incidental to creating a new one? And has it necessarily anything to do with a "mechanical analogy"? Those who have a taste for delving into the history of terms should rather, if they feel so inclined, speak of a zoological analogy; for the terms static and dynamic were, although in a different sense, introduced into economics by John Stuart Mill. Mill probably had them from Comte, who, in turn, tells us that he borrowed them from the zoologist de Blainville.

My cordial thanks are due to my friend Dr. Redvers Opie, who

with unparalleled kindness undertook the arduous task of translating a text which proved very refractory to the operation. We have decided to omit the two appendices to Chapters I and III of the original, and also passages or paragraphs here and there. In some places, the exposition has been modified and a number of pages have been rewritten. As the argument itself has nowhere been altered, I think it superfluous to give a list of the changes.

JOSEPH A. SCHUMPETER

CAMBRIDGE, MASSACHUSETTS

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THE THEORY OF  
ECONOMIC DEVELOPMENT



## CHAPTER I

### THE CIRCULAR FLOW OF ECONOMIC LIFE AS CONDITIONED BY GIVEN CIRCUMSTANCES<sup>1</sup>

THE social process is really one indivisible whole. Out of its great stream the classifying hand of the investigator artificially extracts economic facts. The designation of a fact as economic already involves an abstraction, the first of the many forced upon us by the technical conditions of mentally copying reality. A fact is never exclusively or purely economic; other — and often more important — aspects always exist. Nevertheless, we speak of economic facts in science just as in ordinary life, and with the same right; with the same right, too, with which we may write a history of literature even though the literature of a people is inseparably connected with all the other elements of its existence.

Social facts are, at least immediately, results of human conduct, economic facts results of economic conduct. And the latter may be defined as conduct directed towards the acquisition of goods. In this sense we also speak of an economic motive to action, of economic forces in social and economic life, and so forth. However, since we are concerned only with that economic conduct which is directed towards the acquisition of goods through exchange or production, we shall restrict the concept of it to these types of acquisition, while we shall leave that wider compass to the concepts of economic motive and economic force, because we need both of them outside the narrower field within which we shall speak of economic conduct.

The field of economic facts is thus first of all delimited by the concept of economic conduct. Everyone must, at least in part, act economically; everyone must either be an "economic subject" (*Wirtschaftssubjekt*) or be dependent upon one. As soon as the members of social groups become occupationally specialised, how-

<sup>1</sup> This title is chosen with reference to an expression used by Philippovich. Cf. his *Grundriss II. Bd.*, Introduction.

ever, we can distinguish classes of people, whose chief activity is economic conduct or business, from other classes in which the economic aspect of conduct is overshadowed by other aspects. In this case, economic life is represented by a special group of people, although all other members of society must also act economically. The activity of that group may then be said to constitute economic life, *κατ' ἐξοχήν*, and saying this no longer implies an abstraction, in spite of all the relations of economic life in this sense to other vital manifestations of the people.

As of economic facts in general, so we speak of economic development. The explanation of it is our object here. Before we turn to our argument, we shall provide ourselves in this chapter with the necessary principles, and familiarise ourselves with certain conceptual devices, which we shall need hereafter. Besides, what follows must be provided, so to speak, with cogs to grip the wheels of received theory. The armor of methodological commentaries I renounce completely. In this connection let it only be observed that what this chapter offers is indeed part of the main body of economic theory, but in essentials requires nothing from the reader that needs special justification to-day. Further, since only a few of the results of theory are necessary for our purpose, I have gladly used the proffered opportunity to convey what I have to say as simply and non-technically as possible. This involves the sacrifice of absolute correctness. I have, however, decided on such a course wherever the advantages of more correct formulation lie in points which are of no further importance for us. In this connection I refer to another book of mine.<sup>1</sup>

When we inquire about the general forms of economic phenomena, about their uniformities, or about a key to understanding them, we *ipso facto* indicate that we wish at that moment to consider them as something to be investigated, to be sought for, as the "unknown"; and that we wish to trace them to the relatively "known," just as any science deals with its object of inquiry. When we succeed in finding a definite causal relation between two phenomena, our problem is solved if the one which plays the

<sup>1</sup> Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie, henceforth cited as *Wesen*.



“causal” rôle is non-economic. We have then accomplished what we, as economists, are capable of in the case in question, and we must give place to other disciplines. If, on the other hand, the causal factor is itself economic in nature, we must continue our explanatory efforts until we ground upon a non-economic bottom. This is true for general theory as well as for concrete cases. If I could say, for example, that the phenomenon ground-rent is founded upon differences in the qualities of land, the economic explanation would be completed. If I can trace particular price movements to political regulations of commerce, then I have done what I can as an economic theorist, because political regulations of commerce do not aim immediately at the acquisition of goods through exchange or production, and hence do not fall within our concept of purely economic facts. Always we are concerned with describing the general forms of the causal links that connect economic with non-economic data. Experience teaches the possibility of this. Economic events have their logic, which every practical man knows, and which we have only consciously to formulate with precision. In doing so we shall, for the sake of simplicity, consider an isolated community; the essence of things, which alone is the concern of this book, we can see as well in this as we could in the more complicated case.

Hence we shall outline the leading characteristics of a mental picture of the economic mechanism. And, to that end, we shall primarily think of a commercially organised state, one in which private property, division of labor, and free competition prevail.

If someone who has never seen or heard of such a state were to observe that a farmer produces corn to be consumed as bread in a distant city, he would be impelled to ask how the farmer knew that this consumer wanted bread and just so much. He would assuredly be astonished to learn that the farmer did not know at all where or by whom it would be consumed. Furthermore, he could observe that all the people through whose hands the corn must go on its way to the final consumer knew nothing of the latter, with the possible exception of the ultimate sellers of bread; and even they must in general produce or buy before they know that this particular consumer will acquire it. The farmer could