

Review Essay

Prophet of Innovation: Joseph Schumpeter and Creative Destruction. *By Thomas K. McCraw*. Cambridge, Mass.: The Belknap Press of Harvard University Press, 2007. xi + 699 pp. Index, notes, photographs. Cloth, \$35.00. ISBN: 0-674-02523-7.

Reviewed by Richard M. Abrams

Thomas McCraw, Isidor Straus Professor of Business History, Emeritus at Harvard Business School, has now added to his long and distinguished list of prize-winning and prize-worthy studies of U.S. and international business history with this remarkable biography of Joseph Alois Schumpeter, whom he describes as “one of the greatest economists who ever lived, and an electrifying personality as well.”

I think “astonishing” rather than “electrifying” more accurately describes his subject’s personality. A great economist and social scientist, Schumpeter was also a womanizer, a bigamist, a chronic depressive, and a poseur, as well as a workaholic, a showman, and a revered teacher. With access to a vast trove of private documents—Schumpeter, it seems, rarely tossed anything out, and he kept a diary besides—McCraw tells it all, or almost all, in vivid detail. The book is much more than a biography of the man and his work. In the course of presenting in detail Schumpeter’s scholarly writings, McCraw takes the reader on a valuable excursion through most of modern U.S. and European economic and business history. He also lets us peek into the personal and social life of a man who was both an academic aristocrat and a bourgeois pretender.

Beginning in the eighteenth century, and for more than a century afterward, some of the greatest cultural and intellectual figures in the history of the western world were born and educated within the borders of the Austrian (later, Austro-Hungarian) Empire. The empire came to an end in 1918, when the victors at Versailles decided to assert the principles of democratic “self-determination,” liberating the mostly Slavic populations from the defeated Austrians. They resurrected Poland—disassembled by the Great Powers in the 1790s—by adding to the old duchy of Warsaw territories taken from Prussia, Russia, Galicia, and the Ukraine, at the same time inventing the political

hodgepodes called Czechoslovakia and Yugoslavia. From within the borders of the empire had come the likes of Wolfgang Amadeus Mozart, Joseph Haydn, Franz Liszt, Franz Schubert, Bedřich Smětana, Fritz Kreisler, Antonin Dvorak, Gustav Mahler, Arnold Schoenberg, Edward Teller, Isidor Rabi, John von Neumann, Leó Szilárd, Stanislaw Ulam, Nikola Tesla, Sigmund Freud, Karl Mannheim, Franz Kafka, Eugen von Böhm-Bawerk, Ludwig von Mises, Friedrich Hayek, and not least, Joseph Schumpeter.

Has truncated Austria or any of the former parts of its empire produced anyone comparable since? To reflect on this question is to make one's way partly into Schumpeter's psyche. There is in the man's economic thinking a powerful strain of antidemocratic pessimism that expresses nostalgia for the (ethnically stratified) civilization that cultivated his genius.

Joseph Schumpeter was born in 1883 into a prosperous German-speaking textiles family in Triesch, a tiny town in what is now the Czech Republic, where the great majority of the denizens were working-class Slavs, whom families like the Schumpeters regarded with some disdain. His mother, Johanna, was widowed young, when "Jozsi" was but four. A determined social climber, intent to elevate herself as well as her only child, Johanna left her comfortable family base for Graz, where she married a much older but titled gentleman, primarily, it seems, in order to provide her son with a titled stepfather. Soon afterward, she moved the family to Vienna, where the presence of a far more cosmopolitan environment, elite prep schools, and a university she believed (correctly) offered much better opportunities for her ambitions for her son. Soon enough, her second husband made her a widow again. But not to worry: with status gained, young Joseph went on to claim family origins rather more exalted than they were in fact.

His social pretensions, expressed in his physical posture and studied speech, paid off in contacts with influential people in finance and government. After the disaster of World War I, he tried his hand at banking—another disaster—and served briefly, and nearly as unsuccessfully, as finance minister for the new Austrian republic. He retreated into academia. His banking fiasco left him deeply in debt, an obligation that he honorably repaid over a great many years.

Jozsi's social life competed seriously with his dedication to the study of economics and his ambitions to justify the field as a precise science. Late in life, he

made up a list of things that, in his sad eyes, had diverted him from becoming the greatest of all economists. At the top of the list he wrote, “Women.” As a youth (and much later, too), he “played the field” extensively and seemed to have chosen an uncommitted bachelor’s life, until he precipitously married Gladys Ricarde, an upper-class Englishwoman with whom he would have a short-lived relationship. Perhaps, McCraw writes, the marriage was part of his effort “to reinvent himself as a continental aristocrat and an English gentleman” (p. 60).

Meanwhile, his *Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest and the Business Cycle* (1911), among other works, established him as a leading economist. In 1913, he was invited to spend a year at Columbia University in New York. For reasons unexplained (but about which one might guess), his wife chose to return to England rather than accompany him to the United States, nor did she return to him in Austria. He never saw her again. For ten years, Schumpeter “pursued no serious relationships with women he might regard as his peers” but “took mistresses and consorted with other amenable sex partners” (p. 123). Eventually, he fell in love with the daughter of the concierge of his apartment building in Vienna, a young woman twenty years his junior but who already had had an affair with a married man (among others) whose child she had aborted. After several years spent in an erratic relationship with Annie Reisinger, he suddenly proposed to her, and the two were married—never mind that he remained legally married to Gladys. Although angered when she learned of the marriage, the Englishwoman chose not to pursue the matter.

When he left Vienna to teach in Germany, Jozsi conspired with Annie to concoct phony personas for them both, employing what McCraw calls a pattern of “white lies” to support his need for social recognition. Unhappily, Annie died during a premature childbirth a year later. Within a week, Schumpeter lost not only his wife and newborn child but also his beloved mother. He mourned them almost daily the rest of his life, through at least one long affair and then a third marriage, entering in his diary invocations to both Annie and Johanna, thanking them for helping him with his work and with his chronic depression, “for everything, O for all the help, everyday” (p. 224). His research and writing, as well as his meticulous devotion to classroom lectures, seem to have fed off his depression. Over many years spent in sorrow, he produced an amazing output of

brilliantly challenging articles and reviews, plus *Business Cycles* (1939) and his classic *Capitalism, Socialism, and Democracy* (1942). His *History of Economic Analysis* was completed and published posthumously in 1954 by his third wife, Elizabeth Boody.

Schumpeter was an aggressive champion of capitalism, attributing to it most of the material wonders of the modern world. The essence of capitalism, he argued, was contained in two elements: entrepreneurship and credit. The innovative energies of individuals and the development of credit instruments, he stated, distinguish capitalism from other forms of political economy. He clearly anticipated, and undoubtedly inspired, the school of entrepreneurial history that got its start at Harvard in the late 1930s. As much a sociologist and historian as he was an economist, Schumpeter chided scholars whose models of economic behavior were “static.” He insisted on focusing on the ever-changing nature of capitalism, its bypassing and bulldozing of old structures, old behavior, and old technology, and what he called “creative destruction.” Models based on the establishment of equilibrium missed capitalism’s central characteristic, and its virtue.

There is something cold-blooded about Schumpeter’s vision. He prided himself on his “scientific” study of economic behavior. He claimed that he tried to avoid promoting policies. Whereas modern critics of “consumerism” deplore the unending quest for “more,” as early as 1911 Schumpeter was joyfully remarking on how the insatiability of wants that entrepreneurs manage to persuade consumers to see as needs was the foundation of capitalism. “The list of human desires,” he wrote, “is not inherently large but, if properly stimulated, can become insatiable” (p.73). But more to the point, in extolling creative destruction, Schumpeter acknowledged that the dynamic features of capitalism necessarily cause suffering in the short run, but he offered little sympathy to the “losers,” because he considered the capitalist system to be essential for long-term prosperity. One finds none of the distress expressed by his contemporary, Karl Polanyi, who, in his masterpiece, *The Great Transformation* (1944), could only reluctantly grant the benefits arising from such costs. (McCraw echoes Schumpeter’s sanguinity, finding it unimaginable that people might resist capitalism. “They would rather be ruined than changed,” he writes [p.145].)

McCraw makes much of his subject's fierce rivalry with, and jealousy of, John Maynard Keynes (a rivalry that may have been one sided, as none of Keynes's biographers seems to have noticed it). He had applauded Keynes's *The Economic Consequences of the Peace* (1919), because he too believed that the Versailles Treaty counterproductively punished the Germans and Austrians. But Keynes's *General Theory of Employment, Interest, and Money* (1938) appeared just before Schumpeter's massive opus, *Business Cycles*, and it received most of the attention Schumpeter had craved. The public-policy elements in *General Theory* seemed timely for countries in the grip of the Depression, such as the United Kingdom and the United States, which added to its popularity and contributed to Schumpeter's view that the book was "unscientific." He believed Keynes failed to take into account capitalism's self-correcting dynamism. Probably few things highlight the contrast between the two eminent economists more than Schumpeter's insistence on taking the long view and Keynes's legendary remark, "In the long run we are all dead."

McCraw also makes much of Schumpeter's gnawing distress during the Second World War. He detested fascism, and he had no tolerance for anti-Semitism, but he underestimated Hitler's staying power and destructiveness. He resented wartime rhetoric that failed to distinguish between Germans and Nazis. He viewed the Soviet Union as a far greater threat, not so much because it was communist but—characteristically of a German-speaking émigré from central Europe—because it was Russian. He saw little difference between fascism and communism, except that, in his view, the Nazis at least left private entrepreneurship pretty much in place, whereas the Soviet socialist state absorbed all the centers of innovation. (He took no notice of fascism's utter rejection of the humane and rationalist principles of the Enlightenment that inspired both liberal and socialist theory.)

He hated Franklin Roosevelt's New Deal, because it seemed to him—and to many central European refugees—a prelude to an authoritarian corporatist state. And yet Schumpeter was no laissez-faire absolutist. Unlike colleagues such as Gottfried Haberler, Friedrich Hayek, and some others of "the Austrian school," Schumpeter had no problem with state intervention for purposes of moderating the swings of business cycles and providing other social needs when the market proved inadequate. But like them, he

distrusted government, especially one like the U.S. government that lacked a professional civil service with a noblesse tradition.

Schumpeter's magnum opus, *Capitalism, Socialism, and Democracy*, has been claimed by American conservatives, despite its inclusion of many features that make conservatives uncomfortable. There is nothing ambiguous about his exaltation of capitalism as superior to every other economic and social system. Nor is Schumpeter's preference for a minimalist state in doubt. On the other hand, one must deal with Schumpeter's pessimism about capitalism's staying power. His outlook was not based on any claim that the poor get poorer as the rich get richer—Schumpeter sank that canard early in his career—but on his observation that capitalism's very successes produce social forces that are hostile, or at best indifferent, to capitalism, while democratic politics will, in the long run, produce irresistible pressures to constrain the dynamic genius—the creative destruction—on which capitalism thrives.

Schumpeter had no faith in democracy. He opposed antimonopoly laws, because as he saw it, "Monopolization may increase the sphere of influence of the better, and decrease the sphere of influence of the inferior brains." Putting this still more plainly, he wrote, "The philosophical justification for capitalism is too detailed and complicated for the intellectual capacity of average citizens" (p. 358). He aptly noted the enormous popularity of anti-Semitism in Central and Eastern Europe. Had he been alive today, he would no doubt observe that similarly popular bigotry worldwide threatens the humane and ethical values that so many people once mistakenly identified with democracy. What the tripartite title of his book omitted was liberalism. Schumpeter was no democrat, but he was clearly a liberal, not only in his economic thinking but also in his inclinations. The respectful attention he gave to Karl Marx, his close friendship with Marxist economists such as Paul Sweezy, his readiness to give credit where credit was due—even to socialism, which he said was not necessarily less efficient economically than capitalism—all testify to his liberal credentials.

Thomas McCraw is to be congratulated for giving us a wonderful book about a remarkable man, and about modern economic history as well.

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