

SCHUMPETER AND ECONOMIC MAN

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Sixty years ago, William Waters argued that it was Schumpeter who revealed the inadequacy of *homo economicus* – economic man -- as the efficient cause of economic activity. But Schumpeter did not leave it there. He, according to Waters, re-established the human person as the true efficient cause, principally in terms of entrepreneurship.

We wish to give recognition to the great man who restored the human person as the dynamic factor in the explanation of economic activity. [Waters 1952, p.14].

Those who knew Waters personally have no reason to question the conclusions and assertions he made about Schumpeter, even though they were made in his doctoral dissertation. Waters was a careful scholar, never given over to the kind of overstatement and stretching of evidence that doctoral students often engage in to drive home their argument.

For others, however, more proof may be called for and the development of the evidence necessary to back Waters' argument prompted this undertaking. Much of the evidence was available to Waters when he was writing his dissertation and that evidence is explored at considerable length. Some of the evidence, however, emerged after Waters completed his degree and therefore is not referenced in his dissertation.¹

This paper addresses two intertwined questions. What evidence supports the claim that Schumpeter rejected *homo economicus*? What evidence indicates that Schumpeter actually embraced the human person as a replacement for *homo economicus*? The evidence is presented in four sections: Schumpeter's rejection of *homo economicus*; Schumpeter on economic agency; Schumpeter, a precursor of personalist economics; and final remarks. To carry out this assignment, Schumpeter is quoted at considerable length.

SCHUMPETER'S REJECTION OF *HOMO ECONOMICUS*

The earliest evidence we have found that demonstrates Schumpeter's rejection of *homo economicus* is his 1940 article "The Meaning of Rationality in the Social Sciences." His criticism centers on Bentham's pleasure-pain calculus and the defense of utilitarianism that is grounded in the greatest-happiness-of-the-greatest-number argument.

Patrick Welch made numerous helpful suggestions on an earlier version of this working paper. Nevertheless, the author is entirely responsible for any remaining errors.

¹ In his 1952 dissertation Waters cites the following three books by Schumpeter: *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*; *Capitalism, Socialism, and Democracy*; and *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit Interest, and the Business Cycle*. In addition he cited the following six articles: "The Analysis of Economic Change"; "Creative Response in Economic History"; "Economic Theory and Entrepreneurial History"; and "The Instability of Capitalism"; "Science and Ideology"; and "Theoretical Problems of Economic Growth." Full citations are found in the references section of this paper.

... there is no real “force” that tends to realize the greatest happiness of the greatest number of people which has therefore to be realized, if at all, as a by-product of “forces” aiming at other goals. This is in fact what Bentham tried to deduce from the action of unfettered self-interests in a way so uncritical as to arouse the just criticism of the historical school. These critics were, however, primarily moved to contempt by the philosophy of life that was at the back of his value judgments and by that union of rationalism and hedonism which was of the essence of that philosophy: logically, rationalism and hedonism have nothing to do with each other; but Benthamite rationalism is essentially hedonistic, reducing as it does to a logic turning on pleasure and pain, to a logic that makes a last desperate attempt to conquer the world of ultimate ends. [Schumpeter 1940, p. 333].

In the same place Schumpeter acknowledges that Pareto accepted *homo economicus* but Marshall did not. [Schumpeter 1940, pp. 336-337]. The problem with *homo economicus*, according to Schumpeter, is that economic change is not incorporated in its representation of the economic agent. Here he insists that economic agency must include entrepreneurs who “are certainly not economic men in the theoretical sense.” [Schumpeter 1940, p. 408].

Five years later Schumpeter in “The Future of Private Enterprise in the Face of Modern Socialistic Tendencies” attacked the utilitarianism that supplies the philosophical foundations for *homo economicus*. [Schumpeter 1945, pp. 403-404]. He did not, however, argue clearly and explicitly for a different philosophical foundation. Nevertheless his reference to a “spirit of social irresponsibility” that is embedded in utilitarianism suggests that Schumpeter is leaning in the direction of a philosophy that encompasses human sociality.

In his presidential address at the 1948 meeting of the American Economic Association, Schumpeter took a gentle swipe at utilitarianism and *homo economicus* but did not engage them fully because his central purpose was to expose how ideology and vision enter into economic analysis and economic theory and why ideology that originates in the prescientific cognitive act “... is ... the prerequisite of our scientific work.” [Schumpeter 1949c, p. 345, 354, 359].

In his 1946 article “Comments on a Plan for the Study of Entrepreneurship,” Schumpeter continues his attack on the conventional way of thinking about economic affairs that regards change as inconsequential.

For economic life most obviously is not the *passive* process, consisting in smooth and uniquely determined adaptation to changing data, which it should be according to that [static] schema. If we insist that it is and that the convulsions and revolutions which we actually observe are nothing but “transitional phenomena” and have no influence upon long-run results, we are obliterating problems rather than resolving them. Moreover, we are distorting the picture of the most ordinary business practice. For, in capitalist society, economic behavior is at every point of time dominated by the effects, actual or anticipated, of technological or commercial change and cannot be understood without it. Everyone would behave differently if the main consideration were adaptation to stable conditions. [Schumpeter 1946, p.407; emphasis added].

Notice Schumpeter's use of "passive" to describe conventional economic theory. Taken as a whole this passage indicates that he means conventional economic theory is flawed and is out of touch with economic realities because it is based on the passive behavior of economic agents.

More is revealed about Schumpeter's views on conventional economic theory following his death in 1950. Once again Pareto comes under attack by Schumpeter who found fault with his physical-science perspective on economic activity that essentially diminishes the human factor and accused him of being delusional. [Schumpeter 1951, p. 136]. In the same place, Schumpeter called attention to (a) the dichotomy between the premise of conventional economic theory that *homo economicus* is entirely rational in all decision-making and the reality accepted by conventional economists that "habit, impulse, sense of duty, and imitation" enter into economic decision-making, and (b) the failure of Pareto's psycho-sociology to successfully rationalize the two. [Schumpeter 1951, p. 138].

In the following, Schumpeter identified the reason for the continued use of *homo economicus*: the easy acceptance of and failure to re-examine dated concepts notably the 18th century ideas of Bentham that are foundational to economic agency.

We are in the habit when discussing questions of policy of accepting at face value the slogans of our own, and indeed, of a by-gone time. We reason exactly as if the Benthamite creed of the eighteenth century had been valid. [Schumpeter 1951, pp. 141-142; emphasis added].

SCHUMPETER ON ECONOMIC AGENCY: FROM PASSIVE TO ACTIVE

In his *Economic Doctrine and Method*, translated by Aris and published in 1954, Schumpeter attacked utilitarianism more aggressively and suggested that conventional economists are easily satisfied with that philosophy in spite of its "radical lack of understanding for everything that moves man ..." the pleasure/pain calculus, and the self-interest of economic man that goes back to the very beginnings of economics as an independent discipline. [Schumpeter 1954a, pp. 87-88].

Well before Schumpeter, conventional theory was taken to task by the historical school.

In its early stages the historical school directed its attack in the first place with almost complete success against the political and social philosophical theses of the old school of economists, against Manchester Liberalism, individualism, rationalism, etc. [Schumpeter 1954a, p. 168].

Herein Schumpeter uses "actions," "actors," and "act" that implicitly reject the passivity implied by conventional economists who use instead "calculations," "agent," and "behave."

He uses "action," along with "act" and "activity" in his explanation as to why entrepreneurship declines with the passage of time.

The entrepreneurial performance involves, on the one hand, the ability to perceive new opportunities that cannot be proved at the moment at which *action* has to be taken, and, on the other hand, will power adequate to break down the resistance that the social environment offers to change. But the range of the provable expands, and *action* upon flashes or hunches is increasingly replaced by *action* that is based upon “figuring out.” [Schumpeter 1947b, p. 157; emphasis added].

And here where he addresses the problem of economic change.

Economic historians and economic theorists can make an interesting and socially valuable journey together, if they will. It would be an investigation into the sadly neglected area of economic change.

... practically all the economists of the nineteenth century and many of the twentieth have believed uncritically that all that is needed to explain a given historical development is to indicate conditioning or causal factors, such as an increase in population or supply of capital. But this is sufficient only in the rarest of cases. As a rule, no factor *acts* in a uniquely determined way and, whenever it does not, the necessity arises of going into the details of its *modus operandi*, into the mechanisms through which it *acts*. [Schumpeter 1947b, p. 149; emphasis added].

Commenting on *Capitalism, Socialism, Democracy*, Samuels underscores the role of human action in Schumpeter’s thinking about economic affairs.

... [Schumpeter’s candor] seems also to be attributable to his profound consciousness that socioeconomic arrangements were the result of *human action*, choice, and policy, that natural laws and verities ... did not of themselves dictate the course of social evolution. [Samuels 1985, p. 64; emphasis added].

In his biography of Schumpeter, Swedberg also uses “actors” rather than “agents”.²

A common problem with economics, [Schumpeter] said, was that economists much too often assume that economic *actors* behave in consciously rational manner ... In many cases, however, it was not only wrong to make this assumption, it was also unnecessary. [Swedberg 1991b, pp. 126-127; emphasis added].

Crediting Mill and the French before him, Schumpeter identified in the entrepreneur the characteristic that is missing in *homo economicus*.

It was John Stuart Mill who first introduced into English economics the ‘point of view of the entrepreneur’ which had been first upheld by the French. Even this, however, was not done in order to honour the entrepreneur or because his welfare

² Hanusch and Pyka also use “actor” in their huge collection of essays on neo-Schumpeterian economics. [Hanusch and Pyka 2007, p. 4]. However, the index to their collection does not include economic man, *homo economicus*, individualism, or utilitarianism. It is particularly disappointing that Perlman, who wrote an introduction to a 1994 printing of Schumpeter’s *History of Economic Analysis*, had nothing to add about Schumpeter and economic agency in the Hanusch-Pyka collection (see Perlman 2007, pp. 27-54).

was considered especially important but simply because the entrepreneur stands at a place in the economy from which it is possible to have a wide view over its processes and because his deliberations form a very important motive force in the economic nexus. [Schumpeter 1954a, p. 107].

Nothing, according to Schumpeter, drives home the distinction between “*mere economic man and the entrepreneur*” more forcefully than the development of the U.S. automobile industry in the early 1900s. [McCraw 2007, p. 267; emphasis added].³

Schumpeter’s disdain for the way in which economic agents are represented by conventional economic theory as “*clotheslines on which to hang propositions of economic logic*” is nowhere more evident than in his *History of Economic Analysis* published in 1954.

... with the improving rigor of presentation, these *clotheslines* stood out even more visibly than they had in the works of the preceding period.⁴ Critics sneered. They saw that all this was poor sociology and even poorer psychology. Like their predecessors in the first half of the nineteenth century, they failed to see that, for a limited range of problems, this was at the same time sound methodology. [Schumpeter 1954b, pp. 886-887; emphasis added].

However, Schumpeter does not leave us without any general direction for the reconstruction of economic man.

The impossibility of universally applicable, practical maxims was fully recognized as *was the necessity of studying actual human behavior in all its local and temporal varieties* -- which should have taken off the curse from the economic man for all times. [Schumpeter 1954b, p. 452; emphasis in original].

According to Swedberg, in Schumpeter’s representation of the economic agent, change and entrepreneurship are to be emphasized, rationality and consumer sovereignty de-emphasized, and hedonism rejected.

Schumpeter states ... that the entrepreneur is no “*homo economicus*.” The entrepreneur is not driven by a desire for hedonistic enjoyment but by a different set of motives, such as “*the joy of creating*,” “*the will to conquer*,” and “*the dream ... to found a private kingdom*.” ...in Schumpeter’s theory of economic development the consumers and their tastes play a different role than in conventional economic theory. To Schumpeter, it is “*the producer who as a rule initiates economic change, and consumers are educated by him if necessary; they are, as it were, taught to want new things, or things which differ in some respect or other from those which they*

³ McCraw’s 2007 biography of Schumpeter “is not concerned with Schumpeter’s economic thinking...” [McCraw 2007, p.xi]. As with Hanusch and Pyka, McCraw’s book’s index contains no entries for economic man, *homo economicus*, individualism, or utilitarianism. For those reasons, neither McCraw nor the Hanusch-Pyka collection is instructive for our purposes herein.

⁴ ... the use of [economic man] can be avoided without altering the meaning of the statements in which it occurs, -- instead of saying that economic man will do this or that, we can always say that this or that course of action would, e.g. maximize satisfaction or profit.

have been in the habit of using.” Schumpeter then concludes: “Therefore, while it is permissible and even necessary to consider consumers’ wants as an independent and indeed the fundamental force in a theory of the circular flows, we must take a different attitude as soon as we analyze *change*. [Swedberg 1991a, pp. 40-41; emphasis in original].

Heilbroner, himself a student of Schumpeter’s, in essence agrees with Swedberg’s assertion that to Schumpeter the entrepreneur is no *homo economicus*: “[The innovator] is obviously not a ‘normal’ businessman, following established routines.” Rather, entrepreneurs are “revolutionists of production.” [Heilbroner 1986, p. 296].

Also in need of repair is the mechanical nature of the conventional circular-flow concept.

Schumpeter’s notion of “the circular flow” constitutes the first step in his effort to recast economic theory in a more dynamic direction. The circular flow essentially depicts an isolated community, where the economic life remains the same year after year.

... A new approach was needed, namely a purely economic theory which could account for changes through an analysis of developments *internal* to the economic system, as opposed to changes in its social and political environment. What was needed was a way to analyze a *dynamic* economy, as opposed to a static one. [Swedberg 1991a, p. 40; emphasis in original].

Though appreciative of Walras’ equilibrium theory, Schumpeter rejected the passivity in his economic agent. In the preface to the Japanese edition of his *Theory of Economic Development* Schumpeter wrote the following:

[Walras] would have said ... that ... economic life is essentially *passive* and merely adapts itself to the natural and social influences which may be acting on it, so that the theory of the stationary process constitutes really the whole of theoretical economics ... I felt very strongly that this was wrong, and that there was a source of energy within the economic system which would of itself disrupt ... equilibrium. If this is so, then there must be a purely economic theory of economic change which does not merely rely on external factors ... (quoted in Haberler 1951, p. 41; emphasis added).

For Schumpeter, “... the only real equilibrium is a constant state of disequilibrium.” [McCraw 2007, p. 164]. His entrepreneur is anything but passive.

SCHUMPETER; A PRECURSOR OF PERSONALIST ECONOMICS

Schumpeter found nothing in utilitarianism, authoritarian statism, or democratic socialism to relieve the moral confusion and social irresponsibility of the age. However, he was an explicit advocate of corporate organization advocated in Pius XI’s encyclical *Quadragesimo Anno*. [Schumpeter 1945, pp. 403-404].

Notwithstanding his strong aversion to and attack on *homo economicus* and utilitarianism,⁵ to our knowledge Schumpeter never promoted person and personalism as replacements in writing. Indeed, the only one who identified Schumpeter as a personalist is William Waters.⁶ Schumpeter's personalism is linked to the entrepreneur who, according to Waters, is a personalist because

... (a) he stands alone in his struggle against both private and public opposition ...
(b) he is an individual in the sense that he is the member of no hierarchical class: class status demands a certain conservatism and respect for tradition that he, qua innovator, cannot be expected to give ... [and (c)] the entrepreneur is an originator and leader: he envisions changes within the economic community and realizes these changes by his active participation and leadership. [Waters1952, p. 144].

Waters calls Schumpeter “by philosophical preference a true personalist [who] seems to have made a conscious effort to conceal or deemphasize the influence of personal activity in economic life.” [Waters 1952, p. 125]. Given what has been noted about “actions,” “actors,” and “act” in Schumpeter's work, with some confirmation from Swedberg and Samuels, we are inclined to disagree with Waters on concealment/de-emphasis.

Schumpeter was not a personalist in the sense that he never directly challenged conventional theory on grounds of its insistence on the instrumental valuation of the economic agent.⁷ In this regard, we simply do not see in his work a strong advocacy stance for the sacred dignity of the economic agent. Furthermore we do not see in Schumpeter (a) an understanding of the effect that work has on the person who works, (b) the difference between economic development and integral human development, and (c) the ultimate objective of the economy – the human perfection espoused by Dempsey⁸ and Divine. [Dempsey 1958, p. 273; Divine 1960, Chapter 24, p. 8].

⁵ Smithies [1951a, p. 137] stated that Schumpeter “had no Utilitarian blood in his veins.” Perlman in effect concurs (see Perlman 2007, p. 34).

⁶ In his *L'Homme Agent Du Development Economique*, which was published in 1951 but was not cited in Waters' dissertation completed in 1952, Taymans also identifies Schumpeter as a personalist. [Solterer 1954, pp. 81-82].

⁷ Ironically, conventional theory, which embraces the instrumental value of the economic agent is, in that regard, logically inconsistent with individualism's strong defense of the absolute dignity of the human person that totalitarianism denies. See Thornhill (1967, pp. 37-42) on individualism and the absolute dignity of the human person. See Crosby (2004, pp. 3-32) on the two sources of the absolute dignity of the human person, the first is extrinsic, the second intrinsic: (1) created and redeemed by God and (2) sharing with other humans the common nature of a rational being and, most importantly, unrepeatably himself/herself whose loss through death cannot be recouped in any other human being. In his argument Crosby refers to the death of Socrates. Many others come to mind: Beethoven, John Paul II, Einstein, Madame Curie, Mother Theresa, Florence Nightingale.

⁸ Schumpeter knew Dempsey well. He directed Dempsey's dissertation, which was published as *Interest and Usury*, and wrote a very complimentary introduction when it was published. No doubt Dempsey introduced Schumpeter to the Scholastics and their work on utility, interest, and money (see Dempsey1948).

Even so, Schumpeter is a precursor of personalist economics in the sense that (a) he openly rejected utilitarianism, economic liberalism, authoritarian statism, and democratic socialism, (b) explicitly discarded economic man especially because there is no room in that concept of economic agency for the entrepreneur who brings about change that demands an active economic agent not a passive one, and (c) embraced the promise of *Quadragesimo Anno* that is grounded in the “*action* of free men and ... the faith that inspires them.” [Schumpeter 1945, p. 405; emphasis added]. For those reasons, and given his encouragement of the development of a working model of a economic system that follows *Quadragesimo Anno* (see Waters 1961, pp. 136-137)⁹, Schumpeter saw the economic agent as the “efficient cause of endogenous economic change”¹⁰ who today we prefer to call the *acting person*. The *acting person* matures as a human being through acts of goodness in economic affairs and slips backward through acts of wickedness.

Notice how Schumpeter in 1934 explains the longevity of economic man in conventional theory and argues that the entrepreneur does not fit that mold.

... entrepreneurs are a special type, and their behavior a special problem, the motive power of a great number of significant phenomena. Hence, our position may be characterized by three corresponding pairs of opposites. First, by the opposition of two real processes: the circular flow or the tendency towards equilibrium on the one hand, a change in the channels of economic routine or a spontaneous change in the economic data arising from within the system on the other. Secondly, by the opposition of two theoretical *apparatuses*: statics and dynamics. Thirdly, by the opposition of two types of conduct, which, following reality, we can picture as two types of individuals: mere managers and entrepreneurs ... [Schumpeter (1934) 1949a, pp. 82-83; emphasis in original].

Schumpeter has supplied a working if not a full description of the entrepreneur in which “active, spontaneous, and eager to initiate change” replace “passive, deliberate, and comfortable with the way things are.” Also he has offered ample reason to reject *homo economicus* entirely but not a full description of its replacement. In describing the problems Schumpeter faced in articulating a full description of the replacement economic agent it is helpful to consider the young married couple who know what they don’t like in the apartment they have been living in, what they want in the new house they are about to build, and have just sat down with an architect to begin drafting a floor plan. What that new house will look like when they move in will reflect the details they must sort through with the architect in an evolving floor plan and the changes made with the contractor as the new house takes shape. In that sense, Schumpeter has just hired an architect -- those economists like the Dempsey, Divine, and Briefs who founded the Catholic Economic

⁹ In this article Waters showed how Schumpeter’s two main contributions -- the process by which capitalism evolves into socialism and the process of economic development -- are linked to Catholic social thought. Waters provides no additional insights regarding Schumpeter and the economic agent.

¹⁰ Waters’ felicitous phrase [1952, p. 143].

Association in 1941, and Waters and Danner who subsequently provided the critical leadership in developing personalist economics.

Danner's *The Economic Person* adds the kind of detail that is very instructive.

As the subject of economic science and analysis, human beings tend to lose their distinctiveness as individual persons and are seen simply as impersonal economic agents, placing acts that become the subject of economic analysis. Such is the implication of *homo economicus*. By contrast the concept of the 'economic person' is of a fully fledged and morally responsible human being, who may be viewed as analyzing and studying economics but mainly as doing economics.

That is, the economic person as doing economics – buying and selling, employed and employing, borrowing and lending, innovating and investing – engages in activities necessitated by the human condition as an *embodied spirit*.... Economic praxis, therefore, is both necessary and social, and the economic person as distinguished from the abstract *homo economicus*, must act in concert with other persons and is morally responsible for his/her actions. [Danner 2002, p. viii; emphasis in original].

Others descriptors, more general in nature and based on John Paul's dissertation *The Acting Person* are: activity centered, decision-making, self-determining, able to discern the difference between good and evil, intelligent-free-responsible, united with others. [Rourke and Rourke 2005, pp. 11-12].

We agree with Schumpeter that "entrepreneurs are certainly not economic men in the theoretical sense." [Schumpeter 1940, p. 408]. However, we do not accept his argument that there are "two types of individuals: merchants and entrepreneurs." [Schumpeter (1934) 1949a, p. 83] There is only one type of economic agent who, paraphrasing Danner, represents all kinds of economic activities including buying-selling-bartering, hiring-employing-producing, saving-investing-building, borrowing-lending-innovating. All of these activities are characteristic of the *acting person* and the entrepreneur is the quintessential *acting person*.

FINAL REMARKS

In this paper two intertwined questions are addressed. What evidence supports the claim that Schumpeter rejected *homo economicus*? What evidence indicates that Schumpeter actually embraced the human person -- the *acting person* -- as a replacement for *homo economicus*?

As to the first question, there is no doubt that Schumpeter rejected *homo economicus*. Regarding the second, the evidence does not indicate that Schumpeter proposed replacing *homo economicus* with what today we refer to as the *acting person*. By insisting repeatedly on the critical role of the active, spontaneous, and eager-to-initiate-change entrepreneur in economic affairs, Schumpeter was in fact a precursor of personalist economics. In 1951 several of Schumpeter's colleagues and former students at Harvard -- Harris, Smithies, Haberler, Samuelson, Tinbergen, Hansen, Machlup, Sweezy, and others

– prepared a collection of essays to honor his life’s work (see Harris 1951a). In his introductory remarks editor Harris, who knew Schumpeter as a friend and colleague for 20 years [Harris 1951b, p. 4], commented on his work-alone routine.

In view of his generous criticisms of the work of his students and colleagues, I could never understand his failure to ask counsel from his friends. He never, to my knowledge, asked anyone to read his manuscripts, though he sometimes would ask help on some particular problem. [Harris 1951b, p. 5].

It is remarkable that even though Stolper [1951, p. 108] in that collection identified Schumpeter’s intellectual ancestors not as Hume, Locke, Hobbes, and Smith but Plato, Aquinas, Augustine, and Thucydides, there is barely a hint anywhere in that collection that Schumpeter rejected *homo economicus* and no mention at all that he was struggling to find a better representation of the economic agent. What is even more remarkable is that one year later Waters, still a graduate student, identified so clearly in Schumpeter “the great man who *restored the human person* as the dynamic factor in the explanation of economic activity.” [Waters 1952, p. 14; emphasis added].

Even though Schumpeter worked alone as confirmed by Harris and Smithies (see Smithies 1951b, p. 23), his writings both published and unpublished along with his ideas must have been well-known to his colleagues and friends at Harvard. Why, then, did they not see what Waters at virtually the same time saw so clearly? We suggest that the answer is found in Schumpeter’s presidential address to the American Economic Association. Schumpeter and Waters shared the same ideological bias that Schumpeter characterized as “truthful statements about what a man thinks he sees.” [Schumpeter 1949c, p. 349]. The others did not.

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