

Joseph Alois Schumpeter (1883-1950)



3 generations of Austrian Economics



- **First Generation :**

Carl Menger (1840-1921)

- **Second Generation :**

Ludwig von Mises (1881-1973)

Joseph Schumpeter (1883-1950)

- **Third Generation :**

Friedrich Hayek (1899 –1992)

Oskar Morgenstern (1902-1977)

Fritz Machlup (1902-1983)

Paul Rosenstein-Rodan (1902-1985)

Gottfried Haberler (1901-1995)

Vienna Circle

(a group of philosophers, mathematicians etc.)

- The “Vienna Circle” nurtured second-generation Austrians, most notably **Ludwig von Mises** (1881-1973) and **Joseph Scumpeter** (1883-1950) both of whom emigrated to America.
- The **Vienna Circle** ([German](#): *Wiener Kreis*) of [Logical Empiricism](#) was a group of elite [philosophers](#) and [scientists](#) drawn from the [natural](#) and [social sciences](#), [logic](#) and [mathematics](#) who met regularly from 1924 to 1936 at the [University of Vienna](#), chaired by [Moritz Schlick](#). The Vienna Circle's influence on [20th-century philosophy](#), especially [philosophy of science](#) and [analytic philosophy](#), is immense up to the present day
- **The "First Vienna Circle" (1907–1912)**: The pre-history of the Vienna Circle began with meetings on the [philosophy of science](#) and [epistemology](#) from 1908 promoted by [Philipp Frank](#), [Hans Hahn](#) and [Otto Neurath](#).
- The formation of *the* Vienna Circle began with Hahn returning to Vienna in 1921. Together with the mathematician [Kurt Reidemeister](#) he organized seminars on [Ludwig Wittgenstein](#)'s [Tractatus logico-philosophicus](#) and on Whitehead and Russell's [Principia Mathematica](#).
- Carnap's *Logical Structure of the World* was intensely discussed in the Circle.

Vienna Circle

- <https://www.youtube.com/watch?v=zk6-NqWHsQw>
- <https://www.youtube.com/watch?v=jR1cDjuTkPM>

4 major points

4 major points of emphasis that distinguish Austrian economics from mainstream neoclassical analysis :

1. Radical subjectivism
2. Methodological individualism
3. Purposiveness in human action
4. Causal–geneticism

1. Radical subjectivism

- **Choice, knowledge, error**

All underlying permanent relations of economic theory are consequences **of human choice**.

- All decisions are by their very nature **subjective** (intensity of one's preferences and expectations)
- Decision making: entrepreneurship
- Break with Marshall and Jevons

Primacy of **utility** and the denial of costs as a coterminous element (with utility) in the determination of value.

2. Methodological individualism

- To study economic phenomena at the level of individual
- But what about collective decision making?
- There are two things to consider in response to this question.
- First, any collective **decision-making body is composed of persons** whose individual decisions make up collective judgement.
- Second, **the nature of aggregates** only matter where individual considerations don't matter, yet for Austrians always matter.

3. Purposiveness in human action

- Anti-Benthamite

Bentham saw people as being passively pushed about by pleasure and pain. But for Austrians, all choices are **forward-looking**, consequently **expectations** are very important economic variables.

- Individual choice is not the consequence of some mere gravitational pull toward utility. Rather, individuals act with a **purpose**, even if that purpose is frequently frustrated by **error** or **imperfect knowledge**.

4. Causal–geneticism

- Economics is causal-genetic

Economics emphasizes **essences** rather than **functional relationships**, so real understanding of basic economic relations

Austrian themes

- Money
- Credit
- The trade cycle
- The nature of competition

2 types of value of money

Focus on money supply

Objective exchange value: money's value derived from the value of the goods it can buy

Subjective exchange value: subjective use value of its own because it can be held for future exchange. Today we call it the purchasing power of money.

On Money

- Mises rejected the macroeconomic approach to the monetary theory in favor of the **individualistic approach**. All valuation is done by individuals therefore the key to understanding the value of money must be in **the mind of the individual**. Mises focused his monetary analysis on the effects of changes in the stock of money on economic activity.

Friedrich August Hayek (1899 – 1992)



- Built a **theory of business cycles** based upon changes in the **supply of money**
- Broke with the quantity theory tradition because it ignored **the effect of money on relative prices**

Joseph Schumpeter (1883-1950)



- Third-generation of Austrian Economics
- Student of Bohm-Bawerk's at the University of Vienna
- Later emigrated to the United States in order to avoid Hitler's onslaught

Work

- *The Theory of Economic Development* (1911) (translated into English in 1934)
- *Business Cycles* (1939)
- *Capitalism, Socialism and Democracy* (1942)

Influences

- Marx
- Walras
- Weber
- Menger
- Wieser
- Bohm-Bawerk



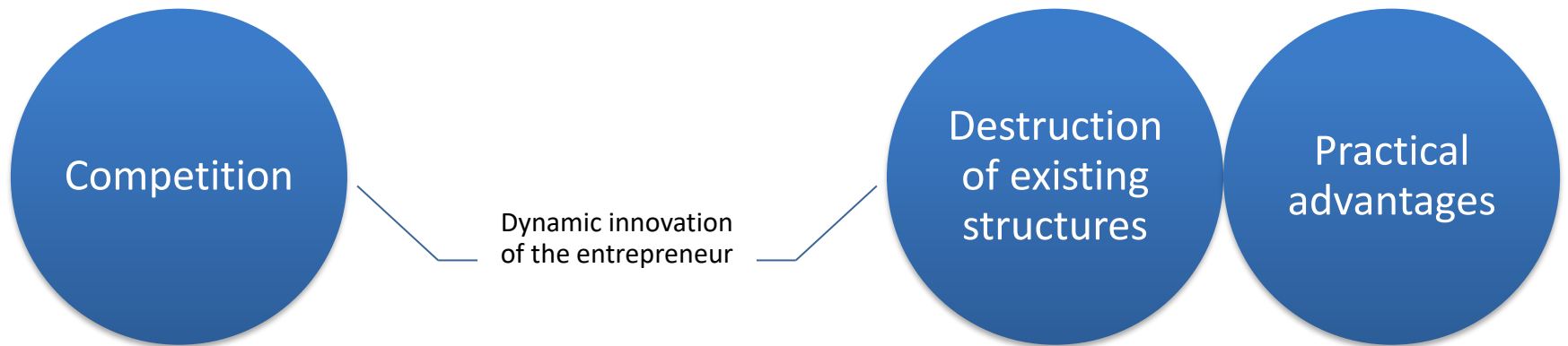
Disequilibrium

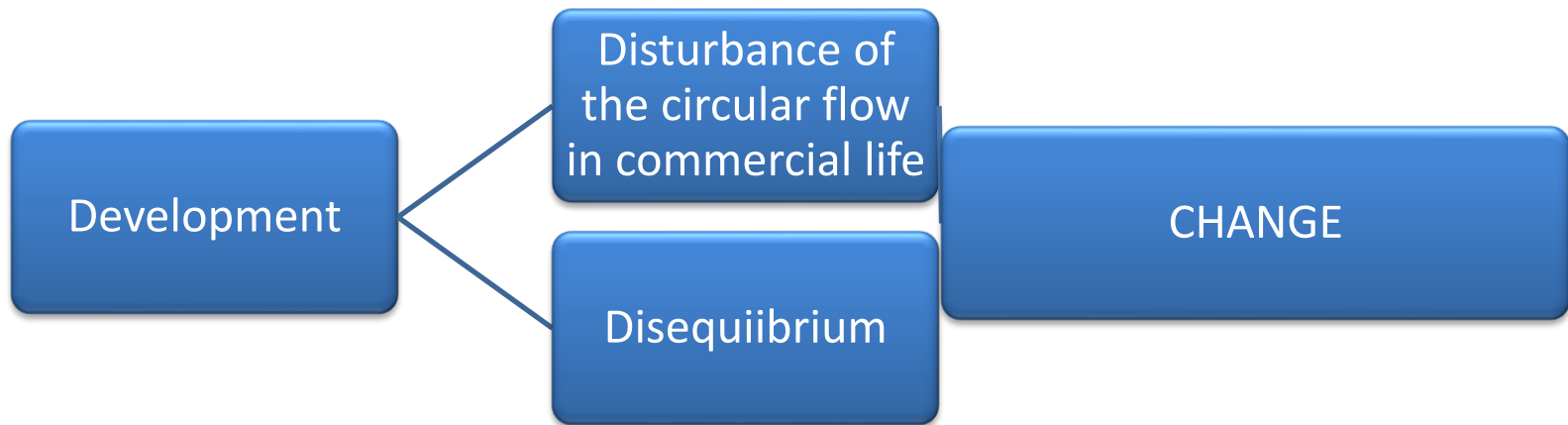
Ex: Change

Key notions

- **The notion of entrepreneur** – borrowed from Walras – key figure – *persona causa* of economic development
- The economic development as a dynamic process
- **The competition** – as a process involving mainly the dynamic innovations of the entrepreneur
- **Creative destruction** – how capitalism administers existing structures but now it creates and destroys them. He called this process “creative destruction” and maintained that it is the essence of economic development. Development is a disturbance of the circular flow. It occurs in industrial and commercial life, not in consumption. It a process defined by the carrying out of new combinations in production.

Creative destruction





Three elements of Schumpeter's theory:

- Circular flow (i. e. tendency toward equilibrium) on the one hand versus a change in economic routine or data on the other
- Statics versus dynamics
- Entrepreneurship versus management

Who is entrepreneur?

- capitalist, landowner, laborer, inventor?

... can be **any or all** of this

... not only manager but also the one who makes new combinations in production.

- Only by **way of new combinations** the economy can move from its stationary state and an economic change can happen. Thus, **innovation** is like an open sesame (a key that opens every door) in Schumpeter's theory.

What is innovation?

- For Schumpeter, **instead of quantities of factors**, we vary **the form of production function**, there we have an innovation (*Business Cycles*, p. 62).
- Schumpeter, classifying 5 types of innovation sets his focus on the technological innovation which mainly occurs in the real sector:
 - (1) The introduction of **a new good**
 - (2) The introduction of **a new method of production**
 - (3) The opening of **a new market**
 - (4) The conquest of **a new source of supply of raw materials or half-manufactured goods**
 - (5) The carrying out of **the new organization of any industry or the breaking up of a monopoly position.**

Business Cycle theory

- Method: Father of the term “**methodological individualism**” with a paper he wrote in 1908
- Theory: From the individual to the collective

There may be numerous institutional forces promoting or discouraging economic growth

- Taxes significantly affect the profit motive and economic progress.

Ex: fiscal policy > declining tax > supply

Conclusion

- The theory of subjective wants
- Money, credit, banking, business cycles, economic development, and the very nature of competition.
- Microeconomic foundations of macroeconomics principles.
- The monetarists and the Austrians are closer together than monetarists and the Keynesian They both believe in the quantity of money are the primary cause of aggregate instability.

The Documentary

The trailer:

https://www.youtube.com/watch?v=2G8n8V2FQzM&ab_channel=Schumpeter%3ATheManWhoDiscoveredCapitalism

You must see the documentary (on which there will be one question in the final)