The Creative Response in Economic History

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The Journal of Economic History, Vol. 7, No. 2. (Nov., 1947), pp. 149-159.

THE JOURNAL OF ECONOMIC HISTORY

VOL. VII NOVEMBER 1947 NO. 2

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I

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.

As anyone familiar with the history of economic thought will immediately recognize, 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 the 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. Examples will illustrate this. Sometimes an increase in population actually has no other effect than that predicated by classical theory—a fall in per capita real income;[1] but, at other times, it may have an energizing effect that induces new developments with the result that per capita real income rises. Or a protective duty may have no other effect than to increase the price of the protected commodity and, in consequence, its output; but it may also induce a complete reorganization of the protected industry which eventually results in an increase in output so great as to reduce the price below its initial level.

What has not been adequately appreciated among theorists is the

[1] Even within the assumptions of classical theory this is not necessarily true; but we need not go into this.

distinction between different kinds of reaction to changes in "condition." Whenever an economy or a sector of an economy adapts itself to a change in its data in the way that traditional theory describes, whenever, that is, an economy reacts to an increase in population by simply adding the new brains and hands to the working force in the existing employments, or an industry reacts to a protective duty by expansion within its existing practice, we may speak of the development as *adaptive response*. And whenever the economy or an industry or some firms in an industry do something else, something that is outside of the range of existing practice, we may speak of *creative response*.

Creative response has at least three essential characteristics. First, from the standpoint of the observer who is in full possession of all relevant facts, it can always be understood *ex post*; but it can practically never be understood *ex ante*; that is to say, it cannot be predicted by applying the ordinary rules of inference from the pre-existing facts. This is why the "how" in what has been called above the "mechanisms" must be investigated in each case. Secondly, creative response shapes the whole course of subsequent events and their "long-run" outcome. It is not true that both types of responses dominate only what the economist loves to call "transitions," leaving the ultimate outcome to be determined by the initial data. Creative response changes social and economic situations for good, or, to put it differently, it creates situations from which there is no bridge to those situations that might have emerged in its absence. This is why creative response is an essential element in the historical process; no deterministic credo avails against this. Thirdly, creative response—the frequency of its occurrence in a group, its intensity and success or failure—has obviously something, be that much or little, to do (a) with quality of the personnel available in a society, (b) with relative quality of personnel, that is, with quality available to a particular field of activity relative to quality available, at the same time, to others, and (c) with individual decisions, actions, and patterns of behavior. Accordingly, a study of creative response in business becomes coterminous with a study of entrepreneurship. The mechanisms of economic change in capitalist society pivot on entrepreneurial activity.[2] Whether we emphasize opportunity or conditions, the responses of individuals or of groups, it is patently true that in capitalist society objective opportunities or conditions act through

[2] The function itself is not absent from other forms of society; but capitalist entrepreneurship is a sufficiently distinct phenomenon to be singled out.

entrepreneurial activity, analysis of which is at the very least a highly important avenue to the investigation of economic changes in the capitalist epoch.[3] This is compatible with widely different views about its importance as an "ultimate cause."

Seen in this light, the entrepreneur and his function are not difficult to conceptualize: the defining characteristic is simply the doing of new things or the doing of things that are already being done in a new way (innovation).[4] It is but natural, and in fact it is an advantage, that such a definition does not draw any sharp line between what is and what is not "enterprise." For actual life itself knows no such sharp division, though it shows up the type well enough. It should be observed at once that the "new thing" need not be spectacular or of historic importance. It need not be Bessemer steel or the explosion motor. It can be the Deerfoot sausage. To see the phenomenon even in the humblest levels of the business world is quite essential though it may be difficult to find the humble entrepreneurs historically.

Distinction from other functions with which enterpreneurship is frequently but not necessarily associated—just as "farmership" is frequently but not necessarily associated with the ownership of land and with the activity of a farm hand—does not present conceptual difficulties either. One necessary distinction is that between enterprise and management: evidently it is one thing to set up a concern embodying a new idea and another thing to head the administration of a going concern, however much the two may shade off into each other. Again, it is essential to note that the entrepreneurial function, though facilitated by the ownership of means, is not identical with that of the capitalist.[5] New light is urgently needed on the relation between the

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[3] Arthur H. Cole has opened new vistas in this area in his presidential address before the Economic History Association, "An Approach to the Study of Entrepreneurship," THE TASKS OF ECONOMIC HISTORY (Supplemental Issue of THE JOURNAL OF ECONOMIC HISTORY), VI (1946), 1–15.

[4] An exact definition can be provided by means of the concept of production functions. On this, see Oscar Lange, "A Note on Innovations," *Review of Economic Statistics,* XXV (1943), 19–25.

[5] It is sometimes held that entrepreneurship, although it did not require antecedent ownership of capital (or very little of it) in the early days of capitalism, tends to become dependent upon it as time goes on, especially in the epoch of giant corporations. Nothing could be further from the truth. In the course of the nineteenth century, it became increasingly easier to obtain other people's money by methods other than the partnership, and in our own time promotion within the shell of existing corporations offers a much more convenient access to the entrepreneurial functions than existed in the world of owner-managed firms. Many a would-be entrepreneur of today does not found a firm, not because he could not do so, but simply because he prefers the other method.

two, especially because of the cant phrases that are current on this topic. In the third place, it is particularly important to distinguish the entrepreneur from the "inventor." Many inventors have become entrepreneurs and the relative frequency of this case is no doubt an interesting subject to investigate, but there is no necessary connection between the two functions. The inventor produces ideas, the entrepreneur "gets things done," which may but need not embody anything that is scientifically new. Moreover, an idea or scientific principle is not, by itself, of any importance for economic practice: the fact that Greek science had probably produced all that is necessary in order to construct a steam engine did not help the Greeks or Romans to build a steam engine; the fact that Leibnitz suggested the idea of the Suez Canal exerted no influence whatever on economic history for two hundred years. And as different as the functions are the two sociological and psychological types.[6] Finally, "getting new things done" is not only a distinct process but it is a process which produces consequences that are an essential part of capitalist reality. The whole economic history of capitalism would be different from what it is if new ideas had been currently and smoothly adopted, as a matter of course, by all firms to whose business they were relevant. But they were not. It is in most cases only one man or a few men who see the new possibility and are able to cope with the resistances and difficulties which action always meets with outside of the ruts of established practice. This accounts for the large gains that success often entails, as well as for the losses and vicissitudes of failure. These things are important. If, in every individual case, the difficulties may indeed be called transitional, they are transitional difficulties which are never absent in the economy as a whole and which dominate the atmosphere of capitalist life permanently. Hence it seems appropriate to keep "invention" distinct from "innovation."

The definition that equates enterprise to innovation is a very abstract one. Some classifications that are richer in content may be noticed because of their possible use in drawing up plans for specific pieces of research. There is the obvious classification—historical and systematic—of the phenomena of enterprise according to institutional forms, such as the medieval trading company, the later "chartered companies," the partnership, the modern "corporation," and the like, on all of which

[6] The relation between the two has attracted interest before. See, e.g., F. W. Taussig, *Inventors and Money-Makers* (New York: The Macmillan Company, 1915).

there exists a vast amount of historical work.[7] The interaction of institutional forms and entrepreneurial activity, the "shaping" influence of the former and the "bursting" influence of the latter, is, as has already been intimated, a major topic for further inquiry. Closely connected with this classification is the old one according to fields of activity—commerce, industry, finance [8]—which has been refined by the following distinctions: enterprise that introduces "new" commodities; enterprise that introduces technological novelties into the production of "old" commodities; enterprise that introduces new commercial combinations such as the opening up of new markets for products or new sources of supply of materials; enterprise that consists in reorganizing an industry, for instance, by making a monopoly out of it.[9]

But there are other classifications that may prove helpful. We may classify entrepreneurs according to origins and sociological types: feudal lords and aristocratic landowners, civil servants—particularly important, for instance, in Germany after the Thirty Years' War, especially in mining—farmers, workmen, artisans, members of the learned professions, all embarked upon enterprise as has often been noticed, and it is highly interesting from several points of view to clear up this matter. Or we may try to classify entrepreneurial performances according to the precise nature of the "function" filled and the aptitudes (some may even add motivation) involved. Since all this presumably changed significantly in the course of the capitalist epoch, economic historians are particularly qualified for work on this line.

Though the phrase "getting a new thing done" may be adequately comprehensive, it covers a great many different activities which, as the observer stresses one more than another or as his material displays one

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[7] Gustav von Schmoller introduced the subject into his general treatise (*Grundriss*) of 1904. But the novelty consisted only in the systematic use he made of the result of historical research. Less systematically, the subject had entered general treatises before.

[8] Financial institutions and practices enter our circle of problems in three ways: they are "auxiliary and conditioning"; banking may be the object of entrepreneurial activity, that is to say, the introduction of new banking practices may constitute enterprise; and bankers (or other "financiers") may use the means at their command in order to embark upon commercial and industrial enterprise themselves (for example, John Law). See the recent book by Fritz Redlich, *The Molding of American Banking—Men and Ideas* (New York: Hafner Publishing Company, 1947).

[9] This case emphasizes the desirability, present also in others, of divesting our idea of entrepreneurial performance of any preconceived value judgment. Whether a given entrepreneurial success benefits or injures society or a particular group within society is a question that must be decided on the merits of each case. Enterprise that results in a monopoly position, even if undertaken for the sole purpose of securing monopoly gains, is not necessarily antisocial in its total effect although it often is.

more than another, may, locally, temporarily, or generally, lend different colors to entrepreneurship. In some cases, or to some observers, it may be the activity of "setting up" or "organizing" that stands out from the others; in other cases, or for other observers, it may be the breaking down of the resistances of the environment; in still other cases, or for still other observers, simply leadership or, again, salesmanship. Thus, it seems to me, there was a type of entrepreneur in early capitalist industry that is best described as a "fixer." Modern history furnishes many instances of entrepreneurship vested in a company promotor.[10] The typical industrial entrepreneur of the nineteenth century was perhaps the man who put into practice a novel method of production by embodying it in a new firm and who then settled down into a position of owner-manager of a company, if he was successful, or of stockholding president of a company, getting old and conservative in the process. In the large-scale corporation of today, the question that is never quite absent arises with a vengeance, namely, who should be considered as the entrepreneur. In a well-known book, R. A. Gordon has presented much interesting material bearing upon this question.[11]

II

The economic nature, amount, and distribution of the returns to entrepreneurial activity constitute another set of problems on which investigation may be expected to shed much-needed light. Conceptual difficulties confront us here even before we come up against the still more formidable difficulties of fact finding. For the "profit" of the English classics, which was analyzed by J. S. Mill into wages of management, premiums for risk, and interest on owned capital, was a return to normal business activity and something quite different from, though influenced by, the gain of successful enterprise in our sense of the term. What the latter is can best be explained by considering a special case. Suppose that a man, realizing the possibility of producing acceptable caviar from sawdust, sets up the Excelsior Caviar concern and makes it a success. If this concern is too small to influence the prices of either the product or the factors of production, he will sell the

[10] In a sense, the promotor who does nothing but "set up" new business concerns might be considered as the purest type of entrepreneur. Actually, he is mostly not more than a financial agent who has little, if any, title to entrepreneurship—no more than the lawyer who does the legal work involved. But there are important exceptions to this.

[11] Robert A. Gordon, *Business Leadership in the Large Corporation* (Washington, D.C.: The Brookings Institution, 1945).

former and buy the latter at current prices. If, however, he turns out the unit of caviar more cheaply than his competitors, owing to his use of a much cheaper raw material, he will for a time, that is, until other firms copy his method, make (essentially temporary) surplus gains. These gains are attributable to personal exertion. Hence they might be called wages. They may with equal justice be attributed to the fact that, for a time, his method is exclusively his own. Hence they might also be called monopoly gains. But whether we elect to call them wages or monopoly gains, we must add immediately that they are a special kind of wages or monopoly gains that differ in important respects from what we usually mean to denote by these terms. And so we had better call them simply entrepreneurial gains or profit. However, it should be observed that if this venture means a "fortune," this fortune does not typically arise from the actual net receipts being saved up and invested in the same or some other business. Essentially, it emerges as a *capital* gain, that is, as the discounted value of the stream of prospective excess returns.

In this simple case, which, however, does constitute a type, the investigator is not confronted with difficulties other than those involved in fact finding. Also, it is clear what happens with that surplus gain: in this case the entrepreneurial gain goes to the entrepreneur,[12] and we can also see, if we have the facts, how, to use a current phrase, the "fruits of the progress involved are handed to consumers and workmen." The speed of this process of "handing on" varies widely, but it would always work, in isolated cases like the one under discussion, through a fall in the price of the product to the new level of costs, which is bound to occur whenever competition steps up to the successful concern. But even here we meet the practice of innovators striving to keep their returns alive by means of patents and in other ways. The gains described above shade off into gains from purposive restriction of competition and create difficulties of diagnosis that are sometimes insurmountable.[13] Cumulation of carefully analyzed historical cases is

[12] It should be obvious that this does not mean that the whole social gain resulting from the enterprise goes to the entrepreneur. But the question of appraisal of social gains from entrepreneurship, absolute and relative to the entrepreneurial shares in them, and of the social costs involved in a system that relies on business interests to carry out its innovations, is so complex and perhaps even hopeless that I beg to excuse myself from entering into it.

[13] Still more difficult is, of course, responsible appraisal, that is to say, appraisal that is not content with popular slogans. Measures to keep surplus gains alive no doubt slow up the process of "handing on the fruits of progress." But the knowledge that such measures are available may be necessary in order to induce anyone to embark upon certain ventures. There

the best means of shedding light on these things, of supplying the theorist with strategic assumptions, and banishing slogans.

If innovations are neither individually small nor isolated events, complications crowd upon us. Entrepreneurial activity then affects wage and interest rates from the outset and becomes a factor—the fundamental factor in my opinion—in booms and depressions. This is one reason, but not the only one, why entrepreneurial gains are not net returns (1) to the whole set of people who attempt entrepreneurial ventures, (2) to the industrial sector in which innovation occurs, (3) to the capitalist interests that finance entrepreneurial activity and to the capitalist class as a whole.

Concerning the first point, I might have made my special case more realistic by assuming that several or many people try their hands at producing that caviar but that all but one fail to produce a salable product before the success of this one presents an example to copy. The gains of the successful entrepreneur and of the capitalists who finance him—for whenever capital finances enterprise the interest is paid out of the entrepreneurial gains, a fact that is very important for our grasp of the interest phenomenon—should be related not to his effort and their loan but to the effort and the loans of all the entrepreneurs and capitalists who made attempts and lost. The presence of gains to enterprise so great as to impress us as spectacular and, from the standpoint of society, irrational is then seen to be compatible with a negative return to entrepreneurs and financing capitalists as a group.[14]

It is similarly clear that entrepreneurial gain is not a net accretion to the returns of the industrial sector in which it occurs. The impact of the new product or method spells losses to the "old" firms. The competition of the man with a significantly lower cost curve is, in fact, the really effective competition that in the end revolutionizes the industry. Detailed investigation of this process which may take many forms might teach us much about the actual working of capitalism that we are but dimly perceiving as yet.

also may be other compensating advantages to such measures, particularly where rapid introduction into general use of new methods would involve severe dislocations of labor, and where entrepreneurial gains are important sources of venture capital.

[14] Whether this actually is so in any particular case is, of course, extremely difficult to establish. The successes stand out, statistically and otherwise; the failures are apt to escape notice. This is one of the reasons why economists seem so much impressed by peak successes. Another reason for faulty appraisal is neglect of the fact that spectacular gains may stimulate more effectively than would the same sum if more equally distributed. This is a question that no speculation can decide. Only collection of facts can tell us how we are to frame our theory.

Concerning the third point, while we have a fair amount of information about how the working class fares in the process of economic change, in respect to both real wages and employment, we know much less about that elusive entity, capital, that is being incessantly destroyed and re-created. That the theorist's teaching, according to which capital "migrates" from declining to rising industries, is unrealistic is obvious: the capital "invested" in railroads does not migrate into trucking and air transportation but will perish in and with the railroads. Investigation into the histories of industries, concerns, and firms, including surveys of sectors in order to point out how long a typical firm stays in business and how and why it drops out, might dispel many a preconceived notion on this subject.

III

Finally, I should like to touch one more set of problems on which we may expect light from historical analysis, namely, the problems that come within the range of the question: does the importance of the entrepreneurial function decline as time goes on? There are serious reasons for believing that it does. 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." And modern milieus may offer less resistance to new methods and new goods than used to be the case. So far as this is so, the element of personal intuition and force would be less essential than it was: it could be expected to yield its place to the teamwork of specialists; in other words, improvement could be expected to become more and more automatic. Our impression to this effect is reinforced by parallel phenomena in other fields of activity. For instance, a modern commander no doubt means less in the outcome of a war than commanders meant of old, and for the same reasons; campaigns have become more calculable than they used to be and there is less scope for personal leadership.

But this is at present only an impression. It is for the historian to establish or to refute it. If, however, it should stand up under research, this would be a result of the utmost importance. We should be led to expect that the whole mechanism of economic development will change significantly. Among other things, the economy would progressively bureaucratize itself. There are, in fact, many symptoms of this. And consequences would extend far beyond the field of economic phenomena. Just as warrior classes have declined in importance ever since warfare—and especially the management of armies in the field—began to be increasingly "mechanized," so the business class may decline in importance, as its most vital figure, the entrepreneur, progressively loses his most essential function. This would mean a different social structure.

Therefore, the sociology of enterprise reaches much further than is implied in questions concerning the conditions that produce and shape, favor or inhibit entrepreneurial activity. It extends to the structure and the very foundations of, at least, capitalist society or the capitalist sector of any given society. The quickest way of showing this starts from recognition of the facts that, just as the rise of the bourgeois class as a whole is associated with success in commercial, industrial, and financial enterprise, so the rise of an individual family to "capitalist" status within that class is typically [15] associated with entrepreneurial success; and that the elimination of a family from the "capitalist" class is typically associated with the loss of those attitudes and aptitudes of industrial leadership or alertness that enter our picture of the entrepreneurial type of businessman.

Now these facts, if they are facts, might teach us a lot about such fundamental problems as the nature of the class structure of capitalist society; the sort of class civilization which it develops and which differs so characteristically from the class civilization of feudal society; its schema of values; its politics, especially its attitudes to state and church and war; its performance and failures; its degree of durability. But a great deal of work needs to be done in order to arrive at scientifically defensible opinions about all these and cognate things. First of all, these "facts" must be established. How far is it really true, for instance, that entrepreneurs, while not forming a social class themselves but originating in almost all existing strata, do "feed" or renew the capitalist stratum? To put it differently, does the latter recruit itself through entrepreneurial successes? Or, to put it still differently,

[15] That is to say, successful entrepreneurship is that method of rising in the social scale that is characteristic of the capitalist blueprint. It is, of course, not the only method. First, there are other possibilities within the economic sphere, such as possession of an appreciating natural agent (for example, urban land) or mere speculation or even, occasionally, success in mere administration that need not partake of the specifically entrepreneurial element. Secondly, there are possibilities outside the business sphere, for business success is no more the only method of rising in capitalist society than knightly service was in feudal society.

does the "typical" history of industrial families lead back to entrepreneurial performances that "created" a concern which then, for a time, yielded capitalistic surpluses by being merely "administrated" with more or less efficiency? How much statistical truth is there in the slogan: "Three generations from overalls to overalls"? Secondly, what is, as measured by observable results, the economic and cultural, also political, importance of the further fact that, though the entrepreneurial function cannot be transmitted by inheritance, except, possibly, by biological inheritance, the financial or industrial position that has been created can? How much truth is there in the contention that the industrial family interest is, in capitalist society, the guardian of the nation's economic future?

These questions, which could be readily multiplied, have often attracted attention. Every textbook of economic history contains some material about the origins of entrepreneurs of historical standing, and a number of studies have been inspired by full awareness of the importance of the answers for our understanding of capitalist society and of the ways in which it works.[16] But these studies are few and that attention has been desultory. We do not know enough in order to form valid generalizations or even enough to be sure whether there are any generalizations to form. As it is, most of us as economists have some opinions on these matters. But these opinions have more to do with our preconceived ideas or ideals than with solid fact, and our habit of illustrating them by stray instances that have come under our notice is obviously but a poor substitute for serious research. Veblen's—or, for that matter, Bucharin's—*Theory of the Leisure Class* exemplifies well what I mean. It is brilliant and suggestive. But it is an impressionistic essay that does not come to grips with the real problems involved. Yet there is plenty of material. A great and profitable task awaits those who undertake it.

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[16] An example is the study by F. J. Marquis and S. J. Chapman on the managerial stratum of the Lancashire cotton industry in the *Journal of the Royal Statistical Society,* LXXV, Pt. III (1912), 293–306.

LINKED CITATIONS

[Footnotes]

[4] **A Note on Innovations**
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