

UNIVERSITY OF SANTO TOMAS FACULTY OF ARTS AND LETTERS

**THE SOCIAL ONTOLOGY OF ECONOMIC LIFE:  
AN EXPLORATION OF  
JOSEPH SCHUMPETER'S THEORY OF THE  
ENTREPRENEUR AND CREATIVE DESTRUCTION**

A thesis  
submitted to the  
Faculty of Arts and Letters  
University of Santo Tomas

In partial fulfillment  
of the requirements for the degree  
Bachelor of Arts in Philosophy

By

Donneth Jay R. Casillan  
December 19, 2023



## CERTIFICATE OF ORIGINALITY (FORM 12: TURNITIN CERTIFICATE)

This is to certify that the Thesis Draft titled, **“The Social Ontology of Economic Life: An Exploration of Joseph Schumpeter’s Theory of the Entrepreneur and Creative Destruction”** submitted by **Donneth Jay R. Casillan** in partial fulfillment of the requirements for the degree Bachelor of Arts (B.A.) major in Philosophy, has passed the Originality Screening required by the Faculty of Arts and Letters through TURNITIN.

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**APPROVAL SHEET**  
**(FORM 13: APPROVAL SHEET)**

This thesis titled,

**“The Social Ontology of Economic Life: An Exploration of  
Joseph Schumpeter’s Theory of the Entrepreneur and  
Creative Destruction”**

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<b>University IP/Research Registry</b>			
<b>Project/ Thesis/Dissertation Title:</b>		The Social Ontology of Economic Life: An Exploration of Joseph Schumpeter’s Theory of the Entrepreneur and Creative Destruction.	
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		<b>College/Faculty:</b>	Arts and Letters
<b>Brief description (Including synthesis of extensive review of literature):</b>		This thesis imparts an exposition of Joseph Schumpeter’s understanding of social reality, a narrowed discipline of metaphysics more prevalently known as Social Ontology. For Joseph Schumpeter, our social reality is comprised of Social Process and Economic Process. Much of philosophical discussions in academic community, particularly in the university setting in the Philippines, is geared towards discussions about Social Processes such as Political Science, Sociology, Psychology, and Religion. There has been a scarce philosophical discourse about economic processes and hence an attempt of interdisciplinary approach (both Philosophy and Economics) of exploring Joseph Schumpeter’s Social Ontology of Economic Life is imminent for this manuscript. This research covers the exposition of the ontology of economic elements such as Capital, Profit, Credit, Interest on Capital, Business Cycle, Economic Prosperity and Depression, and money to name a few. These economic elements are significant in understanding Joseph Schumpeter’s first essence of economic development which is innovation. The second essence is the need to have a carrier of innovation in which the entrepreneur plays a vital function in fulfilling the phenomenon of Creative Destruction. A phenomenon of replacing the old methods by new methods of an economic process. Which brings to the third and last essence of economic development which are the means. The means serve as an institutional framework in implementing economic policies or mechanism in a certain social institution. The institutional society covered in this research are Capitalist and Socialist society. The exposition of the three elements of economic development in this paper is a culmination of Joseph Schumpeter’s social ontology of economic life.	
<b>Keyword(s):</b>		Joseph Schumpeter, Entrepreneur, Business Philosophy, Philosophy of Money, Social Ontology	
<b>Significance of the project/study:</b>		Schumpeter's concept of entrepreneurship provides a practical framework for creating new innovations and disrupting existing industries that can be used in actual practice or in academic fields. The findings of this research will demonstrate that the ideas of being an entrepreneur and leadership are connected, even though both fields require a degree of knowledge, creative function, and moral character. By incorporating these principles, businesses may foster a more realistic approach to operating a company that helps both society and the economy.	
<b>Expected Output:</b>		I hope that this thesis will initiate a worthy discussion between different academic disciplines, specifically at the Department of Philosophy and Economics at the University of Santo Tomas Faculty, where it appears that no one has yet posited or even considered Joseph Schumpeter as a philosopher or his theory of entrepreneur and creative destruction as concepts of philosophy.	
<b>Certification from Adviser:</b>		I hereby certify that the proponent/s have submitted to me their synthesized review of literature as part of the requirements for the submission of the accomplished IP/Research Registry Form. <div> <b>FRANZ GIUSEPPE CORTEZ</b> Signature over Printed Name <b>FEB. 22, 2024</b> Date</div>	



## ACKNOWLEDGEMENT

I am immensely thankful for the individuals who have supported and encouraged me to complete the journey of finishing my thesis. My journey towards completing my thesis would not have been possible without those who contributed, directly or indirectly, in bringing my thesis to fruition.

First, my deepest gratitude goes to my adviser, Prof. Franz Giuseppe Cortez, Ph.D., for the generosity of his wisdom, his time, and his guidance in steering me in the proper direction of my thesis toward coherence and clarity. My collaborative dialogue with Professor Franz about Social Ontology and Metaphysics was pivotal to my paper in bringing out the significance of Joseph Schumpeter's arguably philosophical orientation and way of thinking. Furthermore, I initially did not intend to highlight Schumpeter's concept of 'creative destruction' because I thought it unnecessary. Thankfully, his savant understanding of philosophy, the concept of 'creative destruction' was added in the fourth chapter of my manuscript. The 'creative destruction' became essential in my thesis because it allowed me to highlight examples of social constructs to portray the context of the 'social ontology.'

Second, my sincere appreciation goes to my thesis coordinator, Ma'am Paula Nicole C. Eugenio, M.A., for her dedicated support throughout the finalization of my thesis. I would like to commend her remarkable level of patience with me as I was approaching the culmination of my manuscript in a condensed timeframe. She is an example of excellence in having such patience as an educator in which one should be measured. Moreover, I would also like to acknowledge her as one of the members of the panel during my thesis oral defense. Her astute remarks and recommendations, specifically when she pointed out that my manuscript initially appeared to be leaning on the exposition of economic theories rather than focusing on having academic philosophical inquiry for my paper, were integral to my thesis.

Third, I can not thank Sir Anton Heinrich Rennesland, Ph.D. enough, as the chairperson of the panel examiners for my thesis oral defense. His perspicacious feedback and suggestions about plugging in a few expositions of Karl Marx's and Max Weber's economic and philosophical theories into my paper provide a better depiction of Schumpeter's philosophical method of inquiry. Had he not pointed out and called me out about this, I would not have discovered and highlighted Joseph Schumpeter's 'methodological individualism' as an additional argument to consider Schumpeter as a philosopher.

Fourth, I do not always get second-time opportunities in life, let alone a second chance at finishing my degree in philosophy. I would like to express my gratitude to the Chair of the Department of Philosophy, Professor Marella Ada M. Bolaños, Ph.D., to the former Dean of the Faculty of Arts and Letters, Atty. Jacqueline O. Lopez-Kaw, DCL, and to the Dean of the Faculty of Arts and Letters, Professor Melanie D. Turingan, Ph.D., for being the conduits of my second chance so I can finish my degree (B.A) in Philosophy as a Thomasian. In this second chance, I resolved to finish my manuscript relentlessly.

Fifth, it is also imperative that I acknowledge the educators and formators who have strongly influenced me to be passionate about studying philosophy. I would like to thank Fr. Pedro V. Salgado, O.P.<sup>†</sup>, Fr. Enrico D. Gonzales, O.P.<sup>†</sup>, Prof. Florentino H. Hornedo, Ph.D.<sup>†</sup>, Fr. Ramon T. Salibay, O.P., S.Th.L.-M.A., Fr. Roberto Pinto, O.P., Fr. Isaias D. Tiongco, O.P., JCD, Fr. Gerard Francisco P. Timoner, III, O.P., S.Th.L.-M.A., Fr. Honorato Castigador, O.P., Ph.L., S.Th.L., JCL, Fr. Herminio V. Dagohoy, O.P. Ph.D., Fr. Richard G. Ang, O.P. Ph.D., Fr. Luis S. David, S.J., Prof. Fleurdeliz A. Albela, Ph.D., Fr. Ranhilio Callangan Aquino, Ph.D., JurD, SJD, and Mons. Gary Noel S. Formoso, PC, JCD., They have taught me the most fundamental and most important subject in Philosophy—humility. I am forever indebted to them for teaching me this subject. Without it, failure in my academic program would have been inevitable.

Special thanks to Prof. John Smithin, Ph.D. of York University, Toronto, Canada, and Torrey Byles, M.S. of Southern Oregon University for making sure that I am coherent with economic views in conjunction with my attempt to explore an interdisciplinary philosophical exposition of Joseph Schumpeter's economic theories.

Sixth, I would also like to convey my thanks to three very intelligent peers, Atty. Ronald F. Valdez, Fr. Jun Arvie Bello, JCL, and Ilaw Gelmar Cruz, M.R.S., who have constantly challenged me intellectually while I was away from the academic community for quite some time. Thanks to them, they have been generous with their time and relentless in sparking intellectual and philosophical debates with me. I feel humbled to be in the company of their intellect, and I do not think I am worthy to be associated with such brilliant minds far superior to mine. Nevertheless, it is essential to mention that they would not have fueled my intellectual passion for philosophy without them.

Seventh, I am expressing my thanks to my academic role model, who has made a huge impact on me from my secondary education up until the present time, Atty. Eldric Peredo. He served as a beacon of knowledge and inadvertently instilled in me the drive and love for academic excellence.

Eighth, to my friends who never treated me less than who I am despite my recent academic shortcomings, and to my family members: the Cancino Family, the Rubang Family, the Gandia Family, and the Casillan Family, who extended their moral support so I can finish this academic journey.

Ninth, to my mother-in-law, Evelyn Gandia Ricasa, for devoting her time and effort to coordinating with the admin office of the Faculty of Arts and Letters on my behalf so I can settle all requirements, ensuring there is no delay in completing my studies. I am very thankful to her for bringing her daughter into this world. Because of her daughter, my sense of purpose in my academic studies has been renewed. She should be very proud of what her daughter has become. I am very grateful to be married to her daughter, who has been raised well by her.

Tenth, I give the flowers to my loving wife, Kristianne Ricasa-Casillan, for being my muse from the beginning until the completion of crafting my thesis. She has always been there for me to keep me in check whenever I encounter mental and psychological roadblocks that might be hindering me from completing my thesis. A lot of quality time has been taken away from her because of the whole process of my thesis development. In this regard, I am very grateful for her sacrifices so I can work better and focus more on finalizing my manuscript.

Finally, I am thankful to God, for without Him, I accomplish nothing.

**DEDICATION**

*For Prof. Delia Rubang Casillan, Ed.D.  
My ultimate teacher.*



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## **The Social Ontology of Economic Life: An Exploration of Joseph Schumpeter's Theory of the Entrepreneur and Creative Destruction**

*Donneth Jay R. Casillan*

### **Abstract**

The central theme of this thesis is to explore Joseph Schumpeter's theory on the 'Entrepreneur' and 'Creative Destruction' by addressing the primary problem: "What is the Social Ontology of an Economic Life?" To address the question, I will deeply probe key concepts such as *Capital, Profit, Credit, Interest on Capital, Business Cycle, Economic Prosperity and Depression, Capitalism, Socialism, Democracy, Innovation, Economic Development, Money, and Entrepreneur* —all of which Joseph Schumpeter considers as essential to understanding the very nature of economic life. Both academic and non-academic individuals rarely questioned and reflected on each concept's ontology and how they are interrelated. Although the concepts mentioned earlier are already being discussed in scientific studies, the peripeteia of interdisciplinary studies has never been considered in a university setting in the Philippines. For this reason, I would like to impress upon the members of the scholarly community, especially those from higher education, to mull over the earlier-mentioned subjects and consider including them in Academic Philosophy. There is merit to the presentation of this thesis, as it presents a different angle of perspective. It is not only religion, politics, and social behaviors that shape society, but another driver of change is economics. By the end of the conclusion of this thesis, with a sense of optimism, we will have a better understanding of the place we live in (both social and economic state), and with a hopeful perspective, this paper will encourage individuals not just to have a positive outlook in life but to view and live a meaningful life.

**Keywords:** Joseph Schumpeter, Entrepreneur, Business Philosophy, Philosophy of Money, Social Ontology

## **Chapter One**

### **Introduction**

The Indian economic miracle really started in 1991. Before that, there was a phrase that was known around the world as the Hindu rate of growth, which never went beyond 3%. The government suddenly ran out of foreign exchange reserves for various reasons, resulting in a crisis in '91. Narasimha Rao was then India's new Prime Minister. Since his background was incomparable to the legacy of the Gandhi family before him, he depended on the ministers in his cabinet, urged them, and implored them to use this crisis and turn it into an opportunity. He instructed his finance minister to show all the plans for liberalization he had. When the then Finance Minister Manmohan Singh came back with some plans, the prime minister told him not to use them, and he clarified that what he meant to have were the ones that they really wanted to put into motion and put up on a shelf thinking they weren't possible. So they started out with a clean sheet and removed in one fell swoop all licensing, regulations, and the bureaucracy that surrounded business at that time. In India, when one talks about the start of the economic miracle, everyone will be able to point to the time when the change started. It taught Prime Minister Rao to never waste a good crisis. It led him to think that people should always try to imagine what they need to do without worrying about legacies and start from a clean sheet of paper. So, his desire to turn crisis into opportunity and break free from the past really started the miracle.

<sup>1</sup> In the UAE, government agencies back Emirati entrepreneurs through special support programs and provide a stimulating environment for national small and medium enterprises. The UAE law pertaining to SMEs allocates small and medium-sized companies with thoughtful support, and the amendments to the Commercial Companies Law encourage Emirati entrepreneurs to invest directly in the local market and take 100% ownership of companies. <sup>2</sup> One of the primary actions of the UAE government to strengthen the country during the COVID-19 pandemic was to support businesses. On March 22, 2020, the UAE Cabinet said that it would help the economy financially by giving Dh 126 billion. The support is said to have three goals: (i) to lower the cost of doing business in the UAE, (ii) to help small businesses, and (iii) to speed up the implementation of large government infrastructure projects. <sup>3</sup> Meanwhile, in towns all around the United States, small, micro, and solo enterprises are facing a range of difficulties as a direct result of the COVID-19 public health issue and the subsequent economic catastrophe. Small businesses around the country are receiving essential assistance from the Department of the Treasury, which is allowing the urgent

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<sup>1</sup> Aghion, Philippe, Robin Burgess, Stephen J. Redding, and Fabrizio Zilibotti. "The Unequal Effects of Liberalization: Evidence from Dismantling the License Raj in India." *The American Economic Review* 98, no. 4 (2008): 1397–1412. <http://www.jstor.org/stable/29730127>, 1409.

<sup>2</sup> "Entrepreneurship Support Entities," Ministry of Economy UAE, accessed March 11, 2023, [https://www.moec.gov.ae/en/entrepreneurship-support-entities?p\\_1\\_back\\_url=%2Fen%2Fsearch-results%3Fq%3Dsupport](https://www.moec.gov.ae/en/entrepreneurship-support-entities?p_1_back_url=%2Fen%2Fsearch-results%3Fq%3Dsupport)

<sup>3</sup> "United Arab Emirates Business Support Guidance," Simmons & Simmons (Simmons & Simmons Middle East LLC, 2021), <https://www.simmons-simmons.com/en/features/coronavirus-covid-19/ck76fc4rv1qwx0a61skbmyunc/government-and-regulatory-covid-19/ck8a77u3w14qg0a98se7bkm2r/government-measures-to-support-business/ck8hlwxhj15vq0929uzqvnvks/uae-business-support-guidance-covid-19->

deployment of finance and support to assist these organizations in not just surviving the current economic climate but also recovering on a solid footing.<sup>4</sup>

The instances mentioned were the periods when each country's corresponding government actively sought out entrepreneurs during times of unrest to take a proactive attitude in establishing, scaling, and beginning a business. Why would the government encourage more people to become self-employed and start their own businesses during turbulent times? Is it because having more businesses presupposes that there will be more available jobs in the country? It appears that the increase in the number of businesses set up increases the possibilities for people to find work. With more jobs created, the economy tends to improve. This assumption further supports the idea that entrepreneurship is a very profound concept that is worthy of mention and discussion within the philosophical domain.

Business ethics has gradually become one of the most central interests in philosophy. Business in this regard is being discussed in the context of interrelationships and exchanges between people.<sup>5</sup> Hence, in the field of the humanities, particularly in the field of philosophy, questions of morality arise from these exchanges between individuals or groups of human beings. Entrepreneurship, a distinctly human enterprise, is often posited as a catalyst for a

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<sup>4</sup> "Assistance for Small Businesses," U.S. Department of the Treasury, April 13, 2021, <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses>.

<sup>5</sup> SOARES, CONCEIÇÃO. "The Ontological Ground of Business Ethics." *Revista Portuguesa de Filosofia* 74, no. 2/3 (2018): 385–408. <http://www.jstor.org/stable/26509990>.

nation's economic expansion. The traditional concept of entrepreneurship as a solely business-oriented activity is being considered only worth discussing in the fields of economics and social sciences. On the other hand, this notion of entrepreneurship is now being challenged, and there is a growing recognition of the importance of interdisciplinary perspectives in entrepreneurship. Entrepreneurship is itself a natural business phenomenon. It is a central component of doing business. It demonstrates that a firm is healthy when entrepreneurial abilities and management are used to change and learn. It is to fulfill fundamental human needs in society, resulting in economic growth and profits for the individual or group of individuals dealing as entrepreneurs and their enterprises. Also, it is the creation of new endeavors by a group of individuals who achieve the goal of providing new goods or services with added value in terms of finances and economics. As a result, understanding the meaning of entrepreneurship, the types and sources of entrepreneurship, and the ability to manage entrepreneurship will be valuable to any corporate organization. Toma et al. argued that in order to effectively address these transforming forces, governments, public and private organizations, and the general public are becoming increasingly conscious of the value and importance of entrepreneurship.

<sup>6</sup> It is, therefore, a phenomenon that is not exclusive to one facet and can be

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<sup>6</sup> Sorin-George Toma, Ana-Maria Grigore, and Paul Marinescu, "Economic Development and Entrepreneurship," *Procedia Economics and Finance*, Vol. 8 (2014): 436-443, ISSN 2212-5671, doi:10.1016/S2212-5671(14)00111-7, <https://www.sciencedirect.com/science/article/pii/S2212567114001117>. 436.

examined as a process, a resource, or a state of mind. In line with the Schumpeterian view, one of the most important components of a country's economic region's development depends on the entrepreneurial process. Furthermore, entrepreneurs are essential in market economies because they can act as the country's economic development wheels. They stimulate new employment by developing new products and services, resulting in an acceleration of economic development. Nevertheless, researchers have indicated conflicting opinions about the connection between economic development stages and entrepreneurship across time. The role of entrepreneurs in a society is important because it is, after all, a human function.

Despite initial appearances of disparity, entrepreneurship and philosophy share a profound commonality, with the latter nurturing a climate conducive to analytical reasoning, innovation, and moral judgment, which are instrumental in the triumph of entrepreneurial endeavors. Philosophers' unique perspectives can provide valuable insights into entrepreneurial practices and improve entrepreneurial thinking. Philosophers have a unique perspective on the world and can provide valuable input into ethical decision-making and leadership.

Although the positive output of plugging philosophical viewpoints into entrepreneurship is very promising, more research must be done on the topic. The growing recognition of the value of cross-disciplinary perspectives in the realm of entrepreneurship has overlooked the crucial role philosophy can play. This



omission becomes even more glaring given the scarcity of philosophical discourse on critical aspects such as leadership, business management, monetary considerations, and the entire entrepreneurial landscape. This research aims to fill this gap by providing insights into how philosophy can enhance entrepreneurial thinking and practice.

I acknowledge the importance of entrepreneurship and the contribution of capitalism to a democratic society. Moreover, in line with the thesis topic, it shows a propensity to present a new perspective (Joseph Schumpeter's) on understanding socialism, capitalism, and democracy. It can, therefore, be assumed that this paper can contribute to understanding Schumpeter's theories from a different angle by establishing a philosophical dimension to his theory of entrepreneurship. An implication of this is the possibility of introducing other scholars and individuals who may have contributed to considering their works as philosophy in the business domain. By exploring the connection between philosophy and entrepreneurship and incorporating both disciplinary fields, businesses can create a more ethical and sustainable model that benefits society and the economy.

**This thesis aims to explore the social ontology of economic life.** Since the whole exposition of my thesis answers the question 'What is the social ontology of economic life?' through the lens of Schumpeter's concept of entrepreneur and creative destruction, it is necessary then to set the parameters in

defining what ‘social ontology’ is. Once the query at hand has been addressed, it is also imperative to highlight Schumpeter’s ontology of economic elements and agents such as capital, credit, entrepreneurial profit, and business cycles. In parallel with answering the question of Schumpeter’s ontology of economic elements, I will also attempt to build a strong case in answering whether Schumpeter must be considered a philosopher. Meanwhile, an additional challenge that needs addressing in order to elucidate the main problem of my thesis is to set out the meaning of what an entrepreneur is. This investigation seeks to explore the distinct insights that Joseph Schumpeter's perspectives could infuse into entrepreneurial pursuits and how philosophical underpinnings could enhance entrepreneurial cognition and execution. Lastly, to forge a connection between ontology and the construction of social realities, I will also attempt to explain Schumpeter’s social ontology of money and provide a depiction of his concept of ‘creative destruction. Providing a satisfactory resolution to this corollary problem will be a key to the main issue of my thesis.

The primary focal points of this inquiry are Schumpeter's seminal works, *Theory of Economic Development* and *Capitalism, Socialism and Democracy*, which form the nucleus of our exploration. While other scholars and their works could contribute to the discourse on this subject, the spotlight of this study remains firmly affixed to these two particular books. The focus of the study will be limited to Schumpeter’s concept of the entrepreneur and entrepreneurial

function and its relation to the fulfillment of the ‘creative destruction’ phenomenon. In this study, we will find the connection between philosophical thought and business through the lens of the nature or ontology of economic life. Albeit, the whole study is limited to presenting Joseph Schumpeter’s *Theory of Economic Development and Capitalism, Socialism, and Democracy*, other primary sources, several articles, related literature, and even Schumpeter’s unpublished material, *The History of Economic Analysis*, and his *Treatise on Money* will be discussed to reinforce findings and arguments.

This study will review previous literature on the relationship between philosophy and entrepreneurship. It will identify existing research gaps, presenting a theoretical framework for integrating philosophical perspectives into entrepreneurial thinking and practice. The framework will be implemented in case studies of successful entrepreneurial ventures led by individuals or firms that qualify to have the attributes of philosophers to provide empirical evidence of the benefits of incorporating philosophical perspectives into entrepreneurship. Practical applications of philosophy in various domains of society, particularly in the realm of entrepreneurship, provide valuable philosophical insights.

The overall structure of the study takes the form of five chapters, including this introductory chapter. Chapter two begins by laying out the framework for answering the question: Is Joseph Schumpeter a philosopher? The third chapter is concerned with an exposition of Schumpeter’s concept of

entrepreneurship. The fourth section presents the findings of the research focusing on the integration of entrepreneurial concepts and leadership by exploring his Social Ontology of Money and his concept of Creative Destruction. The final chapter draws upon the entire thesis, tying up the various theoretical and empirical strands in order to present the importance of having an entrepreneur leading to the growth of the economy in a society, which includes a discussion of the implications of the findings for future research into this area. This paper will also explore the relationship between entrepreneurial function and leadership function in the hope that the two concepts can be combined to create a practical approach to the area of philosophy. The study will emphasize the significance of how economic elements and agents (which will be discussed in chapters two and three), as we will put it as Schumpeter's ontology, will be contextualized in understanding the 'social ontology' of economic life. Furthermore, the findings of this study will show the relevance of Joseph Schumpeter's books on his *Theory of Economic Development* and *Capitalism, Socialism, and Democracy* in filling in the void between the fields of philosophy and business. Schumpeter's concept of entrepreneurship provides a practical framework for creating new innovations and disrupting existing industries that can be used in actual practice or in academic fields.

The findings of this research will demonstrate that the ideas of being an entrepreneur and leadership are connected, even though both fields require a

degree of knowledge, creative function, and moral character. By incorporating these principles, businesses may foster a more realistic approach to operating a company that helps both society and the economy. I hope that this thesis will initiate a worthy discussion between different academic disciplines, specifically at the Department of Philosophy at the University of Santo Tomas Faculty, where it appears that no one has yet posited or even considered Joseph Schumpeter as a philosopher or his theory of entrepreneur and creative destruction as concepts of philosophy. As Frost put it, the business world and the academic study of the past are not in competition with one another. On the contrary, the business world, which is a human effort, functions far more effectively when it is housed inside a humanities ecosystem.<sup>7</sup>

## **Review of Related Literature**

### **I. Social Ontology**

Since the objective of this thesis is to identify the 'social ontology' of economic life, it is important then that I lay down the framework of what I mean by social ontology. In a historical context, the trace of the instance when this term was coined is unknown. However, as far as my research is concerned, I can reference this term as far back as 1978 when Carol C. Gould published her book

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<sup>7</sup> Susan M. Frost, "The Humanities Biosphere: New Thinking for Twenty-First Century Capitalism," in *Extraordinary Partnerships: How the Arts and Humanities Are Transforming America*, ed. Christine Henseler (Lever Press, 2020), 194, <http://www.jstor.org/stable/10.3998/mpub.11649046.15>.

in an attempt to study Karl Marx's social ontology, highlighting the concept of Individuality and Community through Marx's theory of Social Reality. For Gould, Marx's metaphysical inquiry is a "systematic account of the fundamental entities and structures of social existence...and of the basic nature of social interactions and social change."<sup>8</sup> What she meant about social existence are those of individuals, organizations, and processes that constitute a society.<sup>9</sup> Meanwhile, what she meant about social interactions and social change was the historical evolution of society—now popularly known as historical materialism. For Gould, the combination of these two senses of metaphysical inquiry makes a synthesis of understanding the nature of reality. Therefore, synthesizing these two senses, she invoked the term 'social ontology.' She defined social ontology as "an analysis of the nature of social reality by means of socially interpreted categories."<sup>10</sup> Therefore, the main object of metaphysics for Marx, according to Gould, is the social reality. When we say social reality, it also says that its nature is social change because Marx's method of inquiry of reality is historical materialism. Therefore, Gould concluded that Marx's philosophical ontology is "inseparable from the applied description of social and historical development."<sup>11</sup> Additionally, Ikäheimo and Laitinen had a simplified way of defining the term. For them, social

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<sup>8</sup> Carol C. Gould, *Marx's Social Ontology: Individuality and Community in Marx's Theory of Social Reality* (Cambridge, Massachusetts, and London, England: The MIT Press, 1978), xi.

<sup>9</sup> *Ibid.*, xv.

<sup>10</sup> *Ibid.*, xvi.

<sup>11</sup> *Ibid.*, 27.

ontology is interested in both “what is socially constituted and in who or what does the constituting.”<sup>12</sup> This means that to understand the nature of reality is to understand the interdependency of the three concepts: (1) persons themselves, or personhood; (2) collectives of persons (groups, collective agents, communities, societies, etc.); and (3) institutions or institutional structures (systems of norms, organizations, etc.).<sup>13</sup> Michael Eldred’s theory of social ontology is similar to this. He posited that social ontology investigates the ‘whoness’ compared to what scholars define as a metaphysical inquiry, which is understanding the ‘whatness’ of a reality. For Eldred, social ontology is not just understanding the ‘whoness,’ but the ‘whos’ in the “mutually estimative, societing movement of social life.”<sup>14</sup> Meanwhile, Frederick Neuhouser also used the term ‘social ontology’ to describe Hegel’s metaphysics as an explanation of “how he [Hegel] conceives life most relevant to his understanding of human society.”<sup>15</sup> Having said all the recent definitions and how social ontology is described, this presupposes that understanding the nature of reality in this context is subjective because its nature of existence is dependent upon the subject’s conception of reality and how this reality is connected to the society that the subject associates to. As Torrey Byles

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<sup>12</sup> Heikki Ikäheimo and Arto Laitinen, eds., *Recognition and Social Ontology, Social and Critical Theory* 11 (Leiden: Brill, 2011), 3.

<sup>13</sup> *Ibid.*

<sup>14</sup> Michael Eldred, *Social Ontology of Whoness: Rethinking Core Phenomena of Political Philosophy* (Berlin/Boston: Walter de Gruyter GmbH, 2019), 154.

<sup>15</sup> Frederick Neuhouser, "Hegelian Social Ontology," in *I that is We, We that is I: Perspectives on Contemporary Hegel Social Ontology, Recognition, Naturalism, and the Critique of Kantian Constructivism*, ed. Italo Testa and Luigi Ruggiu, *Critical Studies in German Idealism* 17 (Leiden, The Netherlands: Koninklijke Brill, 2016), 34.

describes it, social ontology suggests a “liminal realm” of understanding the nature of reality as an “intersubjectivity, in between subject and object, and individual and collective.”<sup>16</sup> Byles uses this term to explain the social ontology of money. He depicted that in the spectrum of consciousness, there are three ranges of the conception of reality: (1) Epistemology—which presupposes an objective understanding of reality; (2) Ontology—which presupposes a subjective understanding of reality; (3) Social Ontology—which presupposes intersubjective understanding of reality.<sup>17</sup> The object of social ontology is understanding the nature of reality of a social process, individual, or institution. Meanwhile, the subject is the observer or the individual having a conception of the nature of reality. The existence of the social constructs such as economic activities, elements, or agents are “dependent on the mind of the observer, and [do] not exist independently of observation.”<sup>18</sup> Hence, identifying the social ontology of economic life is an exposition of how Joseph Schumpeter, as the observer, highlights what constitutes social and economic constructs such as Capital, Credit, Entrepreneurial Profit, Interest on Capital, Business Cycles, etc. These concepts are observer-dependent. Furthermore, social ontology also explains what constitutes the nature of economic life and how it relates to certain institutions, norms, or organizations. In this case, how do these observer-dependent concepts

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<sup>16</sup> Torrey Byles, “*The Speech Foundations of Money and Property: A Look at Searle and Ostrom*,” *Aurora Philosophy Journal* 1, no. 1 (2022): 16, ISSN 2816-3958.

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*, 10.



connect to social institutions such as Capitalism and Socialism (which happen to be also concepts that are observer-dependent)? A question may be raised on this matter: Why social ontology? Allow me to curate the same answer by Tony Lawson when he rhetorically raised the same question in his exposition of *The Nature of Social Reality: Issues in Social Ontology*. For Lawson, the ‘social realm’—those phenomena whose existence depends necessarily on human beings and their interactions, is a phenomenon of interest, and “understanding its nature or essential properties allows us to relate to or interact with it in more knowledgeable and competent ways than would otherwise be the case.”<sup>19</sup> Hence, social ontology becomes a narrowed discipline of metaphysics having the social constructs as its object.

## **II. Philosophy on Entrepreneurship**

The philosophers of the ancient Greek, medieval, contemporary, and modern periods were interested in rigorous questions such as: How did the universe come to be? What is the teleology of our existence? How to live a good life? What is the perfect government in society? What is the unchanging element that constitutes our very existence? What is beauty? What is the truth? What is and what is not?’ Many more questions have evolved around our universe and around human existence. Basically, this paved the way for the birth of branches of

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<sup>19</sup> Tony Lawson, *The Nature of Social Reality: Issues in Social Ontology* (New York: Routledge, 2019), 3.

philosophy now being studied academically, such as metaphysics, epistemology, ethics, political philosophy, social philosophy, and other scholastic philosophical disciplines. However, only a handful of individuals philosophically discuss the economy, social classes, government, money profits, and business or entrepreneurship. In John E. Elliott's book introduction, he stressed the importance of understanding Joseph Schumpeter's central work on *The Theory of Economic Development* by acknowledging the periods in the development of economic thought. One period to acknowledge is the era of classical political economy during the late eighteenth century to mid-nineteenth century, wherein "several were philosophers as well as social scientists" associated with his [Schumpeter's] writings.<sup>20</sup> Although these Economic philosophers raised questions about the economy, social classes, and labor, none delved deeply into business or entrepreneurship, just like Joseph Schumpeter argued in his works. Meanwhile, the question still remains to be answered as to whether or not Schumpeter is to be considered a philosopher in the second chapter of this research.

It can be debated and argued that the first philosophical exposition of the concept of entrepreneurship or business can be traced back to Plato's second book *The Republic*, when Socrates suggested Adeimantus imagine the initial process of

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<sup>20</sup> *Ibid.*, Mentioned as significant philosophers during this period were John Stuart Mill, Adam Smith, and Karl Marx.

creating an ideal state<sup>21</sup> wherein the first main classes of individuals or citizens highlighted are: the philosopher guardians,<sup>22</sup> the working class,<sup>23</sup> and the traders and merchants.<sup>24</sup> As the famous quote of the British philosopher Alfred North Whitehead said: "All of Western philosophy is but a footnote to Plato." This affirms the quote of Whitehead and strongly suggests that philosophical discussions on Plato's ideal state have been further posited about the concept of the philosopher guardians, connecting to questions such as what kind of government suits best. What kind of normative behavior must the government impose on society? In connection with Plato's working class, questions have been raised, such as, What drives the wealth of a nation? What is power? Is there power in the minority? How does the minority represent the common good of society? Meanwhile, with Plato's initial characters in the creation of an ideal state, very few scholastic philosophical discussions have represented the traders and merchants, or now what we call "entrepreneurs." On the other hand, the majority of philosophical discussion in connection to entrepreneurship is business ethics. Helms and Dobson incorporated Heidegger's philosophy into business, whereby his philosophy offers a "deeper conceptualization of business activities—like all

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<sup>21</sup> Plato, *The Republic: The Influential Classic*, intro. Tom Butler-Bowdon (Chichester, West Sussex: Capstone Publishing Ltd., 2012), 61-70.

<sup>22</sup> *Ibid.*, 71. Fast forward to Karl Marx's social and political theories regarding society, and philosopher guardians can arguably be associated with the "Bourgeois"

<sup>23</sup> The working class can be associated with Karl Marx's social class as "Proletarians."

<sup>24</sup> The traders and merchants can be associated with what we now call "entrepreneurs."

human activities—as having some features in common with art.”<sup>25</sup> It can be postulated in their conclusion that Heidegger’s philosophy facilitates the extension to companies as bodies that engage in the activities of ‘*techne*’ and ‘*poiesis*’<sup>26</sup> and additionally, they likened business activities and movements to ‘language speaks’<sup>27</sup> and identifying actions whether they are ‘authentic’ or not.<sup>28</sup> Conversely, Rev. Fr. William J. Byron argued that philosophy can be incorporated with entrepreneurship. Not only that, even theology can be integrated with business. It may come as a surprise, but business or entrepreneurship presents a dimension of philosophy and theology. This may raise a very interesting discussion if one should attempt to study an interdisciplinary discourse on business further. How does entrepreneurship become philosophical and, at the same time, theological disciplines then? Fr. Byron presents a different angle of perspective in this domain. Business becomes philosophical and theological when one studies entrepreneurship's teleology of ‘to be’ and ‘to do.’ One must pursue an inquiry into the purpose of business that goes beyond the meaning of the subject itself.<sup>29</sup> In other words, entrepreneurship becomes philosophical and

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<sup>25</sup> Eleanor Helms and John Dobson, "Heidegger's Critique of Technology and the Contemporary Return to Artisan Business Activity," *Philosophy of Management* 15, no. 3 (2016): 203-220, <https://doi.org/10.1007/s40926-016-0025-y>, 7.

<sup>26</sup> In Heidegger's philosophy, he used the term ‘*techne*’ to refer to knowledge or skill being used for producing something, while he used the term ‘*poiesis*’ in reference to creativity in producing something into being.

<sup>27</sup> For Heidegger, language is a way of ‘being in the world’. The only way to understand ourselves and the world we live in is through the significance of understanding language.

<sup>28</sup> Eleanor Helms and John Dobson, "Heidegger's Critique of Technology and the Contemporary Return to Artisan Business Activity," *Philosophy of Management* 15, no. 3 (2016): 203-220, <https://doi.org/10.1007/s40926-016-0025-y>, 7.

<sup>29</sup> William J. Byron, "Twin Towers: A Philosophy and Theology of Business," *Journal of Business Ethics* 7, no. 7 (1988): 525–30, 525-526. <http://www.jstor.org/stable/25071795>.

theological if the purpose itself is philosophical and theological. One can be too quick to judge a person who does business for the sole purpose of making a profit. However, this is just a characteristic of doing business.<sup>30</sup> If one engages in such an inquiry (understanding the deeper purpose of business activity), individuals find themselves philosophizing in the field of ethics, or what scholars call business ethics. Business ethics raises normative questions about how an individual does business and ought to do business. 'To do' business means having a responsibility to understand ethics. To be an entrepreneur, one has the responsibility to pursue profit for self-interest or to help increase the welfare of others. These two ethical questions appeal to being selfish or altruistic, which are two philosophical schools of thought. Being selfish means doing business activities for one's own life. The focus is on the individual's life who is engaged in such activity and not on the social results of the venture.<sup>31</sup> This line of ethical thinking is associated with objectivist philosophy.<sup>32</sup> One of the famous tenets of objectivism is optimizing profit in the pursuit of one's own reasonable and rational interests. In other words, capitalism is the better choice for a government's economy. Peikoff explained objectivism in relation to entrepreneurship as an ethical norm by referencing a phrase from the Declaration of Independence of the United States of America: "that all men have an

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<sup>30</sup> *Ibid.*, 526.

<sup>31</sup> Leonard Peikoff, "Why Businessmen Need Philosophy," in *Why Businessmen Need Philosophy: The Capitalist's Guide to the Ideas Behind Ayn Rand's Atlas Shrugged*, Revised and Expanded Edition, ed. Debi Ghate and Richard E. Ralston (New American Library, 2011), 23.

<sup>32</sup> Objectivism was made famous by the Russian-American philosopher Ayn Rand.

inalienable right to life, liberty, and the pursuit of happiness." Objectivism follows the tenet of pursuing happiness and holds that an individual "has the right to life for his own sake, his own personal interests, (and) his own happiness."<sup>33</sup> In short, one must be selfish in pursuing happiness so long as other people's rights are not violated. Nothing in the Declaration of Independence mentions pursuing happiness for other people's sake. Objectivism has become an ethical framework for entrepreneurs promoting individualism and independence. 'To do' business fosters individuals' autonomy in their activity because entrepreneurs call their own shots. The entrepreneur gets to pursue their own passion and be critical of it, and have the freedom to be creative with every business engagement. As Peikoff puts it, you get to be "selfish in the noblest sense," which is just natural in business because you make a profit first, and the "community" gets benefits second, becoming the byproduct of entrepreneurship.<sup>34</sup>

Another ethical framework that can be derived from entrepreneurship is Altruism.<sup>35</sup> The basis of the tenet for altruism is placing others above all else, but this may seem ideological for many, especially for the working class. One of the reasons why entrepreneurs often face criticism from the majority of society is due to the perceived contradiction in their actions. People view them as insincere

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<sup>33</sup> Leonard Peikoff, "Why Businessmen Need Philosophy," in *Why Businessmen Need Philosophy: The Capitalist's Guide to the Ideas Behind Ayn Rand's Atlas Shrugged*, Revised and Expanded Edition, ed. Debi Ghate and Richard E. Ralston (New American Library, 2011), 21.

<sup>34</sup> *Ibid.*, 22.

<sup>35</sup> Altruism is made famous by French philosopher Auguste Comte.

because, while entrepreneurs assert that their business pursuits aim to enhance the well-being of others, ultimately, their primary focus seems to be on maximizing profits. This is the exact sentiment of the proletariat against capitalists in Karl Marx's philosophy on Socialism. This raises ethical questions about the sincerity of the entrepreneurs' actions. However, why can not entrepreneurs be altruistic? Why can't they choose altruism as an ethical norm in doing business? Peikoff argues that altruism is a possible motive, and he even calls it a shameful motive, but it is impossible to succeed in business if one chooses to be altruistic.<sup>36</sup> This paradox then suddenly becomes a philosophical inquiry about entrepreneurship. This is the main reason why businessmen need philosophy because entrepreneurship raises a philosophical issue, an ethical issue between selfishness vs. altruism.<sup>37</sup> The Ethical question between selfishness and altruism is just one of the philosophical issues Peikoff presented. He also raised a connection between entrepreneurship and metaphysics because everyday entrepreneurs are presented with problems where they have to make crucial decisions, and part of arriving at a certain decision is identifying what is real and what is not.<sup>38</sup> He also invoked another philosophical issue, which is the validity of reason. Again, this is connected to entrepreneurs making decisions by way of critical thinking, and

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<sup>36</sup> Leonard Peikoff, "Why Businessmen Need Philosophy," in *Why Businessmen Need Philosophy: The Capitalist's Guide to the Ideas Behind Ayn Rand's Atlas Shrugged*, Revised and Expanded Edition, ed. Debi Ghate and Richard E. Ralston (New American Library, 2011), 24.

<sup>37</sup> *Ibid.*, 25.

<sup>38</sup> *Ibid.*, 28.

hence, he concluded that doing business is a philosophical activity because an entrepreneur taps into the faculty of Reason, and reason is a human faculty.<sup>39</sup>

Coming from a different angle of perspective, Lisa D. McNary begs to have differing views on what Peikoff presented in finding a connection between entrepreneurship and philosophy. She pointed out that Peikoff failed to answer the question, “at what point does the morality of being in business at any cost to earn a profit become immoral at the expense of humanity?”<sup>40</sup> McNary further highlighted that Peikoff failed to represent the true sense of objectivist philosophy in understanding entrepreneurship. She totally agrees that there is a connection between objectivism and entrepreneurship. Still, she is not convinced about how Peikoff led his arguments, and even the way the material was written lacks scholastic merit and does not represent Ayn Rand’s teaching at all. Peikoff’s lack of evidence to support his claims, like telling how businessmen will not succeed if an individual decides to become altruistic, only goes to show that his essay “scores high on passion but low on scholarship.”<sup>41</sup>

As McNary suggests, a better explanation of objectivist philosophy in relation to business is to understand Edwin A. Locke’s objectivist stance in his book *‘The Prime Movers: Traits of the Great Wealth Creators.’* Although Locke

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<sup>39</sup> *Ibid.*, 30.

<sup>40</sup> Lisa D. McNary, "Philosophy, Wealth-Creation, and Self-Esteem: Objectivist Writings on Business," *The Journal of Ayn Rand Studies* 4, no. 2 (Penn State University Press, 2003), 332. <http://www.jstor.org/stable/41560224>.

<sup>41</sup> *Ibid.*, 337



is a fully pledged psychologist, the book and his work are philosophical because he admitted in his preface that he was inspired by Ayn Rand's book entitled *Atlas Shrugged*, where in that book, Rand appropriates the term (Prime Mover) from Aristotle, who spoke of the same term in his '*Physics*' and '*Metaphysics*.' <sup>42</sup> Locke refers to 'wealth creation' as similar to entrepreneurship. As evidence of the philosophical dimension in business, Locke provided three elements that human functions tap into reason, <sup>43</sup> rights, and technology. 'Reason' for Locke, is the ultimate basis of wealth creation, which makes entrepreneurship philosophical.<sup>44</sup> He enumerated the periods where there was a realization of the significance of reason in the domain of philosophy, from Greek Philosophers, <sup>45</sup> to the irrelevance of divine intervention up to the age of enlightenment.<sup>46</sup> For Locke, the Age of Enlightenment played a significant role in stressing the importance of reason in the dimension of philosophy. It is because the philosophers of the Age of Reason paved the way for the philosophical framework of individualism, objectivism, and creative thinking, which was also critical in entrepreneurship. The dominance of philosophical and rational advocacy during this period brought about the realization that humans are autonomous beings. This era's political

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<sup>42</sup> *Ibid.*, 338.

<sup>43</sup> Peikoff raised the same virtue; however, he failed to elucidate a better philosophical explanation.

<sup>44</sup> Edwin A. Locke, *The Prime Movers: Traits of the Great Wealth Creators* (New York: AMACOM Books, 2000), 1.

<sup>45</sup> Locke argued that it was Aristotle who discovered and identified the nature of reason, which all the more reason to conclude that entrepreneurship has a philosophical dimension by virtue of it.

<sup>46</sup> Edwin A. Locke, *The Prime Movers: Traits of the Great Wealth Creators* (New York: Amacom Books, 2000), 3.

manifestation lay in the emergence of the idea of individual rights. John Locke, the foremost proponent of this theory, was the first to argue that humans are not bound to serve the state, but rather, it is the state's role to serve the people.<sup>47</sup> This concept of rights imposed a restriction on the reach of governmental power, asserting the autonomy of the individual over state sovereignty. These rights ensured the freedom for an individual to make choices guided by their own intellect, effectively liberating them from the oppressive control of others for the first time in history. The premise of individual rights proclaimed that each person had intrinsic worth, deserved respect in their own right, and was not just a means to an end. This crucial development allowed individuals to strive towards their personal pursuits of life, liberty, property, and happiness, free from the requirement of seeking anyone's consent. The ideology of individual rights firmly put forth the idea that people were not merely a means to an end for others; they were valuable in their own right. Hence, making it an ethical norm for an individual to pursue business for their own sake and engaging oneself in a discussion about one's right to do business becomes philosophically relevant. The third element is technology. Reason and Right are interconnected with the concept of technology to validate whether or not entrepreneurship is philosophical. It is because of these two elements that made technology possible. The guidance of scientific reasoning with an understanding of individuals' rights as their shield paved the way for the implementation of technology, resulting in the Industrial

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<sup>47</sup> *Ibid.*, 3.

Revolution and modern capitalism.<sup>48</sup> The result of combining reason with a strong orientation and understanding of an individual's rights makes the whole process philosophical. These three elements open up a whole new philosophical discourse about the relationship between freedom and wealth and a deeper understanding of economic and political freedom.<sup>49</sup>

Another consideration of philosophy on entrepreneurship is when we use significant entrepreneurs and highlight their thoughts, actions, results, and contributions to society as philosophical. We can use Steve Jobs as an example. A group of Ph.D. professors compiled essays as a philosophical examination of Steve Jobs as a person and his works. James Edwin Mahon raised a metaphysical question and inquiry on ethics about Jobs' view on reality: "Did Steve Jobs do anything morally wrong in distorting people's perception of reality?"<sup>50</sup> Steve Jobs is known for his demanding and authoritarian leadership, to the point that he would ask his peers and subordinates for unfathomable and "unrealistic" tasks. Stephen R.C. Hicks highlighted an interesting question raised by a Japanese team of investigators that came to the United States of America to study its school system, and the question was, "Why does (Japan) have so few innovators?"<sup>51</sup>

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<sup>48</sup> Edwin A. Locke, *The Prime Movers: Traits of the Great Wealth Creators* (New York: AMACOM Books, 2000), 4.

<sup>49</sup> *Ibid.*, 5-6.

<sup>50</sup> James Edwin Mahon, "The Reality Distortion Field of Steve Jobs," in *Steve Jobs and Philosophy: For Those Who Think Different*, ed. Shawn E. Klein, Popular Culture and Philosophy 89 (Chicago: Open Court, 2015), 8.

<sup>51</sup> Stephen R.C. Hicks, "How Can We Make Entrepreneurs?" in *Steve Jobs and Philosophy: For Those Who Think Different*, ed. Shawn E. Klein, Popular Culture and Philosophy 89 (Chicago: Open Court, 2015), 53.

Hicks went on to argue that the Japanese team of investigators' Socio-Philosophical inquiry was somehow misguided. A better philosophical question to ask is: How can society make entrepreneurs?<sup>52</sup> When philosophizing, it is not so much about finding the answers that matter; it is more about finding the right question in order to navigate a sound answer. Meanwhile, Christopher Ketcham made a satirical take on presenting an imaginary scenario whereby Heidegger is having a head-to-head debate against Steve Jobs, arguing about technology. Ketcham started by depicting Heidegger raising a question in the imaginary debate: *What is technology and our relationship to it?*<sup>53</sup> He went on further and asked questions such as

Have we become so enamored with technology in itself that it already has replaced some aspects of being human?", "Are we still masters of technology, or has technology begun to master us?", and "Does technology diminish our humanness, take away valuable abilities of thinking and doing?"<sup>54</sup>

Philosophy and entrepreneurship seem to share such similar characteristics that it seemed convincing to argue that the whole function of doing business is indeed philosophical, as this paper suggests. It may look like both fields are worlds apart but based on the recently presented arguments, both deal with similar questions that philosophers have continually asked up to the present, such as

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<sup>52</sup> An improvisation of the question that can be raised is: "How can society make good entrepreneurs?"

<sup>53</sup> Christopher Ketcham, "Jobs and Heidegger Square Off on Technology," in *Steve Jobs and Philosophy: For Those Who Think Different*, ed. Shawn E. Klein, Popular Culture and Philosophy 89 (Chicago: Open Court, 2015), 186.

<sup>54</sup> Ketcham acknowledged that the content of Heidegger's ideas in the imaginary interview came mainly from his essay: *"The Questions Concerning Technology"*

questions on humanity, reality, ethics, politics, society, and economics. In finding the answers, both fields require the same approach to arriving at great solutions: sound dialectic inquiry, rigorous examination of questions, creative thinking, and critical thinking. The arguments presented in this paper can be used to examine further whether or not Joseph Schumpeter's theory on entrepreneurship has philosophical merits. These arguments can be used as a baseline for the method and approach used in exploring the philosophical dimension of Schumpeter's theory.

### **III. Joseph Schumpeter's Theory of the 'Entrepreneur'**

In Joseph Schumpeter's magnum opus, *Capitalism, Socialism and Democracy*, he started his book with an exposition of the Marxian Doctrine. In the second chapter of the book 'Marx the Sociologist,' Schumpeter dismisses the assumption that Karl Marx was a philosopher.<sup>55</sup> Even though Karl Marx was known at his time to collaborate with German Philosopher Georg Wilhelm Friedrich Hegel, Schumpeter believes that it would be a mistake to reduce Karl Marx to a philosopher in order to understand his doctrines fully.<sup>56</sup> Schumpeter argued that only those with an academic philosophy background consider Karl Marx a philosopher. Academic philosophers will argue that his works are

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<sup>55</sup> At the present time, Karl Marx is considered one of the most influential philosophers of all time in the study of philosophy.

<sup>56</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, intro. Richard Swedberg (London: Routledge, 2003), 9.

philosophical, but Schumpeter elucidated that Marx's works were philosophical in the beginning, but eventually, in his succeeding materials, there were no traces of Hegelian metaphysics.<sup>57</sup> Had Schumpeter admitted in his book that Karl Marx was primarily a philosopher, it could have been easy to support the claim that Schumpeter's work was indeed philosophical and that his theories could also be easily classified as philosophical. Schumpeter insists on perceiving Karl Marx mainly as a sociologist and economist. However, this is the main basis of Schumpeter's argument in criticizing Karl Marx's shortcomings in "recognizing the phenomenon of social classes."<sup>58</sup> It is in acknowledging that Karl Marx, as a sociologist and economist, made him arrive at his conclusion about the history of class struggles.<sup>59</sup> This raises the assumption that if he had approached his method philosophically, he would have had different findings. Schumpeter further explains that Karl Marx focused on the concept of class struggle as the main identifier in our understanding of the history of our society. Schumpeter argued that the main driving force that shapes our understanding of the history of society is innovation and entrepreneurship.<sup>60</sup> Schumpeter agrees with Karl Marx that capitalism will cease to exist, but he does not agree that it is the rise of the proletariat against capitalism that will make the wall crumble. It is the whole capitalist evolution that will eventually destroy capitalism itself. The whole

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<sup>57</sup> *Ibid.*, 10.

<sup>58</sup> *Ibid.*, 13.

<sup>59</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, intro. Richard Swedberg (London: Routledge, 2003), 14.

<sup>60</sup> *Ibid.*, 132.

process of economic progress, maturation of business development, and eventually making the whole business operation automated will destroy capitalism. As Schumpeter puts it, capitalism “tends to make it superfluous—to break to pieces under the pressure of its own success.”<sup>61</sup> This begs the question: What is the role of the entrepreneurs in this whole process? The role of entrepreneurs “is to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way.”<sup>62</sup> If we are to appropriate Karl Marx’s postulation of social classes, the Entrepreneurs do not look like they identify with the bourgeois or with the proletariat. On the other hand, it seemed like entrepreneurs can be identified with the bourgeois or with the proletariat, depending on the situation they are in. Entrepreneurs have to go through the whole capitalist evolution, which puts them in a risky position. Just as Karl Marx posits the inevitability of the rise of the proletariat against the capitalists, Schumpeter, on the other hand, posits the inevitability of the whole entrepreneurial function being doomed to fail. In Marxism, the proletariat is perceived as the victim, while in the Schumpeterian framework, the entrepreneur is perceived as the victim if the business fails, and even if the business succeeds, the entrepreneur will eventually be overthrown because of innovation or through

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<sup>61</sup> *Ibid.*, 134.

<sup>62</sup> *Ibid.*, 132.

bureaucratic management.<sup>63</sup> Approaching Schumpeter's theory on entrepreneurship through a contextual analysis suggests that his postulations are philosophical. It is philosophical by virtue of reason, right, and an element of technology that connects to the concept of innovation.<sup>64</sup> To reinforce this claim, let us also examine the questions raised by Schumpeter in his book *Capitalism, Socialism and Democracy*. The three main questions in the book suggest that his work is philosophical:

- 1. Can Capitalism Survive?**
- 2. Can Socialism Survive?**
- 3. Can Socialism or Capitalism Survive in Democracy?**

The questions that Schumpeter raised seemed to be very profound in their own philosophical merit. Moreover, his findings in answering his questions present a more convincing argument that his works are also philosophical. Now that a premise has been established that Schumpeter's theory on entrepreneurship is indeed philosophical and the findings presented were used to support the claim, we will delve into the second chapter of this paper and attempt to answer the question, "Is Joseph Schumpeter a Philosopher?"

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<sup>63</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, intro. Richard Swedberg (London: Routledge, 2003), 134.

<sup>64</sup> See Part I of this Chapter: Philosophy on Entrepreneurship.



## **Chapter Two: Methodological Individualism as a Philosophical Inquiry**

For philosophy scholars, it is very obvious that Joseph Schumpeter can and should indeed be considered a philosopher. However, to scholars of Economics, Sociology, and even Political Science, the homogenous thought that Schumpeter is a pure economist is inevitable. I would like to present three main reasons to raise the question of whether Joseph Schumpeter is a philosopher or not: (1) For the sake of readers with a non-philosophy background, I feel that it is necessary to dive a little deeper into how Schumpeter may be considered a philosopher. (2) I would like to present arguments that are worthy of discussion between different schools of discipline, specifically between the study of Economy and Philosophy. (3) There are already many materials written about the life of Joseph Schumpeter that are accessible online thanks to the internet; thus, including Schumpeter's biography for this thesis is not necessary. Conversely, since it is imperative to understand Schumpeter's life to raise a strong argument for considering him as a philosopher, I will, on some occasions, insert notable information about his life, but in the method of associating patterns of his way of thinking, works, and perhaps even his lifestyle to "doing philosophy."<sup>65</sup> That being the case, the inclusion of this chapter in this paper seems to be inherent.

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<sup>65</sup> Details of this concept will be further elaborated in the subsequent texts.

**Schumpeter's 'Philosophical Self' Doing Philosophy**

To put forth a starting point in making a case that Schumpeter should be considered a philosopher, it is proper to highlight what is generally accepted in the scholarly community as a "Philosopher" as a subject of study. Two factors may be taken into account: (1) One must be part of academia, mainly having taught or is currently teaching in a higher education setting, and simultaneously immersing themselves in rigorous research for the sake of publishing reading materials as part of his or her contribution to the specialization of the school of thought or discipline he or she is part of.. (2) At the same time, one's work or writing must be associated with the act of 'philosophizing.'<sup>66</sup> It is safe not to direct our attention to the first factor as Joseph Schumpeter definitely falls in that category since he has spent most of his time teaching Economics and even to highlight, he taught for eighteen years at Harvard University from 1932 until 1950.<sup>67</sup> I intend to focus on the second factor, and a further question must be raised: Was Joseph Schumpeter philosophizing?

In her book, *The Philosophical Child*, Jana Mohr Lone raised the same question but not directed to Joseph Schumpeter but in general: How does one Philosophize? And she reinforced this general question with a more specific one:

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<sup>66</sup> These mentioned factors are drawn from my observation (That indeed 'most' Philosophers being studied in the sphere of higher education are part of Academic community) and open to further interpretations and discussion.

<sup>67</sup> Gottfried Haberler, "Joseph Alois Schumpeter 1883–1950," *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 356, <https://doi.org/10.2307/1884555>.

*“Do children ask philosophical questions?”*<sup>68</sup> She argued that the moment we start engaging ourselves with such questions is the starting point of what she calls the “philosophical self.” This is the part of our self-realization that “many aspects of our existence are profoundly mysterious.”<sup>69</sup> Lone started with the assumption that philosophy is thought to be *“rooted in questions...–questions that seek to unveil the often unexamined assumptions behind what we think, and say and do.”*<sup>70</sup> This act of questioning allows an individual to be personal in his or her own right and to self-reflect a deeper understanding of one’s existence and the relation of one’s existence to one’s reality or the world as one knows it. That is why the act of philosophizing is an act of embarking on a quest to satisfy one’s curiosity. As Lone would put it, to do philosophy is to “[examine] your own questions and ideas in a reflective and open way,” not worrying about the constraint from the so-called “experts.”<sup>71</sup> Why should the act of philosophizing be free from any constraints from the experts or those who specialize in philosophy? As Professor Marella Bolaños echoed the same sentiment in her essay review on *Gareth Matthews and the Philosophy of Childhood*, the act of philosophizing is inherent to human beings, and it is only through formalizing the act by way of standardized education or conformity through social expectations “that

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<sup>68</sup> Jana Mohr Lone, *The Philosophical Child* (Lanham, Maryland: Rowman & Littlefield Publishers, Inc., 2012), 3.

<sup>69</sup> *Ibid.*, 5.

<sup>70</sup> *Ibid.*, 6.

<sup>71</sup> *Ibid.*, 8.

philosophy slips away.”<sup>72</sup> It is in this regard that I would like to maintain a consistent perspective as outlined by Jana Mohr Lone in her postulation about the concept of the ‘philosophical self’ in a hopeful manner that the argument is conclusive to having Joseph Schumpeter considered as a philosopher.

During his years in high school at Theresianum, although not too significant,<sup>73</sup> he was extensively educated in classical education, such as Latin and Greek, and was homeschooled in learning other languages, such as French, English, and Italian.<sup>74</sup> During his time as a Professor at Harvard University, together with his students, at times, he engaged in shared classic readings on the original Greek language.<sup>75</sup> One can quickly speculate that he must have read classical readings on Greek Philosophers. Having been brought up as a Catholic,<sup>76</sup> one can imagine that he may have read materials written in Latin by medieval philosophers. Although he “devoted his life to thinking, teaching, and writing,” he was never merely a “bookish sort of person.”<sup>77</sup> I believe that this biographical description is an understatement because even though this is the case, his approach in positing his economic theories strongly suggests hints of someone

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<sup>72</sup> Marella Ada V. Mancenido-Bolaños, "Review Essay Gareth Matthews and the Philosophy of Childhood," *Budhi: A Journal of Ideas and Culture* XXI.3 (2017): 97-114, <https://journals.ateneo.edu/ojs/index.php/budhi/article/viewFile/2862/2707>.

<sup>73</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 370, <https://doi.org/10.2307/1884555>.

<sup>74</sup> *Ibid.*, 335.

<sup>75</sup> *Ibid.*

<sup>76</sup> See Joseph A. Schumpeter, *History of Economics Analysis*, ed. Elizabeth Boody Schumpeter, intro. Mark Perlman (Taylor & Francis e-Library: Routledge, 2006), xxv.

<sup>77</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 344, <https://doi.org/10.2307/1884555>.

having a philosophical background.<sup>78</sup> The most noticeable hint in his writings can be found in his three magnum opus: (1) *The Theory of Economic Development*, (2) *Capitalism, Socialism, and Democracy*, and (3) *History of Economic Analysis*. His exposition and argumentation in *The Theory of Economic Development* showcased the very foundation of all his economic principles and his method of investigation about ‘economic life.’ When we say the ‘foundation of all his economic principles,’ we mean Schumpeter’s philosophical exposition of metaphysics and epistemology in relation to understanding the whole mechanism of the economic life. The proclivity of most philosophers in terms of metaphysics is identifying what are ‘esse’ (Existence) and ‘essentia’ (Essence) of being or phenomenon. Meanwhile, Schumpeter was more interested in identifying the ‘*sui generis*’ or the salient feature of a phenomenon (in his case, the economic life). As Haberler describes him, in his entire life, he was eagerly invested in understanding the “theory of social relations and social philosophy and made important contributions to sociology and political philosophy.”<sup>79</sup> For most philosophers, to identify the ‘esse’ and ‘essentia’ of a being or a phenomenon, the method used is the principle of abstraction. The same method applies to Schumpeter in identifying the ‘*sui generis*’ of a phenomenon. For him, reality, as

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<sup>78</sup> In Schumpeter’s book *History of Economic Analysis*, it is conspicuous that he read *Summa Theologiae* by St. Thomas Aquinas (See Chapter 2: The Scholastic Doctors and the Philosophers of Natural Law), he also discussed the principle of Forms by Plato, Aristotle’s concept of similarity and contiguity, he also read Adam Smith’s *Systems of Moral Philosophy*, and also tackled topics on ethics such as Bentham’s Principle of Utility to name a few.

<sup>79</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 333, <https://doi.org/10.2307/1884555>.

far as society is concerned, is comprised of a ‘social process’ and an ‘economic process.’ Schumpeter’s method of abstraction is about simplifying the concept of a phenomenon and identifying every particular element and, eventually, understanding the phenomenon as a whole by distinguishing each concept’s or element’s purpose and recognizing how each of them interplay with each other.<sup>80</sup> He maintained that the social process is “one indivisible whole”<sup>81</sup> and that to understand the whole phenomenon of it must be studied universally. Be that as it may, in a historical context, economists (or other scholars) have studied the social process by purely identifying singular elements that constitute it. Schumpeter called them ‘economic facts,’ and whenever researchers do this study, he called this process an ‘abstraction.’<sup>82</sup> At the juncture of abstraction of a social process, and we find ourselves studying economic facts, it is important to note that such economic facts are governed by constraining factors, as he called it, ‘economic conducts.’<sup>83</sup> So what are these ‘economic conducts’ that everyone is expected of if one must be part of the economic process? First is the acquisition of goods through exchange or production. Second is having the right economic motive to

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<sup>80</sup> The problem that Schumpeter is trying to solve is a famous philosophical paradox called the ‘*problem of the One and the Many*’. It is a metaphysical problem most thinkers of “both East and West have grappled with down the ages.” See W. Norris Clarks, S.J., *The One and the Many: A Contemporary Thomistic Metaphysics* (Notre Dame, Indiana: University of Notre Dame Press, 2001), 72.

<sup>81</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 5.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*, 5-6.

action; and lastly, the possession of economic forces in social and economic life.<sup>84</sup> Just as Schumpeter only placed his emphasis on the economic conduct of acquisition of goods through exchange or production, I will also employ a parallel method. For Schumpeter, being involved in an economic process is inevitable. One way or another, we partake in this whole phenomenon whether we like it or not, and either we become the subject of an economic fact as he calls it ‘economic subject’ (Wirtschaftssubjekt) or dependent on it.<sup>85</sup> Therefore, in a social process, the social facts are “results of human conduct,” and when the social process is abstracted, this results in the extraction of the economic facts, which “results to economic conduct.” Everyone who is part of this economic process must ‘act economically’<sup>86</sup> and as soon as every member of the society buys into this conduct, this will result in identifying the class of people whose specialty is business or other class of people whose activity is to do other economic aspects of conduct—these activities of a group of people, according to Schumpeter, constitutes the ‘economic life.’<sup>87</sup>

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<sup>84</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 5-6.

<sup>85</sup> *Ibid.*

<sup>86</sup> The term used by Schumpeter as ‘act economically’ appears to be an enhanced rendition of J.S. Mill’s ‘economic man’. Although Mill was not the first one who coined the term, he was the first one who “extended the discussion of the method of political economy centered on specific motivations of human agents.” See M. Bee and M. Desmarais-Tremblay, "The Birth of Homo (Economicus): The Methodological Debate on the Economic Agent from J. S. Mill to V. Pareto," *Journal of the History of Economic Thought* 45, no. 1 (2023): 2, doi:10.1017/S1053837221000535.

<sup>87</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 5-6.

Now that we have established the philosophical foundation of Joseph Schumpeter's metaphysics in line with understanding the 'economic life,' we shall now find the '*sui generis*' or the salient feature of each economic facts and in view also of the supported assumption established earlier about the concept of the 'philosophical self', let us discuss unexamined principles '*behind what we think, say, or do*' that Schumpeter unveiled or questioned. We mean by unexamined principles because the subjects that Schumpeter tried to inquire about were topics tackled by neo-classist economists and philosophers but failed to highlight how each concept interplays to have a deeper understanding of economic life as a whole. This is what Schumpeter was able to recognize in his writing in his book *Theory of Economic Development*. His foregrounding of concepts such as Capital, Credit, Interest, Profit, and Business Cycles propelled his understanding that these subjects would "link up with each other and prove closely related"<sup>88</sup> to the entrepreneurial function.<sup>89</sup> Schumpeter was one of the first economists who introduced this concept and arguably the first economist who underscored the importance of the entrepreneur in economic life. There is no doubt that his interpretation of the structure of society is as metaphysical as John E. Elliott's description of Joseph Schumpeter's vision in his introduction to the *Theory of Economic Development*, as understanding the "basic features of that state of society, about what is and what is not important in order to understand its

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<sup>88</sup> *Ibid.*, 2.

<sup>89</sup> A more detailed analysis will be presented in Chapter 3 of this paper.



life at a given time” — Schumpeter puts it as the first element in having a comprehensive theory of a society while the second element is about the ‘theorist’s technique’ which is an “apparatus by which he conceptualizes his vision and which turns the latter into concrete propositions or ‘theories.’”<sup>90</sup>

## I. On Capital

Schumpeter sets up a philosophical question about this matter by asking: What is Capital? When we speak of capital, it can be associated with money or even interest. Historically, the concept of capital or even the term ‘capital’ was not present during the Greek times. To ‘*act economically*’ during the Greek times would mean having a “practical wisdom of household management’ or, as Plato put it, *Oeconomicus* ( *oikos* house, and *vóμος* law or rule).<sup>91</sup> The most analogous concept we can associate with the term capital is the possession or accumulation of wealth –as Aristotle put it, ‘*Chrematistics*’ and, in the words of Schumpeter, having “pecuniary aspects of business activity.”<sup>92</sup> We can, therefore, assume that if we are to introduce the term ‘capital’ to the Greek times, it can be synonymous with ‘wealth.’ For Aristotle, wealth is one example of a human good resulting from “that of a strategy victory.”<sup>93</sup> Aristotle further explained in the Fourth Book

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<sup>90</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), viii.

<sup>91</sup> Joseph A. Schumpeter, *History of Economic Analysis*, ed. Elizabeth Boody Schumpeter, intro. Mark Perlman (Taylor & Francis e-Library: Routledge, 2006), 50.

<sup>92</sup> *Ibid.*

<sup>93</sup> ‘Strategy victory’ is subject to interpretation, but it could mean success in ‘*Chrematistics*’. See Aristotle, *The Nichomachean Ethics*, trans. David Ross, rev. with an introduction and notes by Lesley Brown (New York: Oxford University Press, 2009), 3.

on Moral Virtue of his *Nichomachean Ethics* that wealth is a human good “whose value is measured by money.”<sup>94</sup> I believe that Aristotle’s definition of wealth contributed to the foundation for identifying the value of goods or what economists call it the ‘*Theory of Value.*’ Pinning down the value of a good has been a perennial problem for both economists and sociologists, and Schumpeter has also included his works as a contribution to the same theory. During Medieval times, philosopher St. Thomas Aquinas may also have tackled the same matter when he discussed the topic of a just price and morality of interest. This is best explained by Koehn and Willbratte when they said that the just person for Thomists is a person who engages in an interpersonal [relationship] and “seeks to be sensitive to these justified individual claims on the part of both buyer and seller to a host of goods.”<sup>95</sup> In other words, there is an implication that every individual who exchanges goods (not just the transaction but the whole social interaction) must observe moral laws governing the activity in line with being a virtuous person.

Meanwhile, philosopher Adam Smith may arguably be the first one who did a great deal of writing about Capital. Unlike his predecessors,<sup>96</sup> who also did some work about capital, Smith discussed it by answering how we must use it.

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<sup>94</sup> *Ibid.*, 60.

<sup>95</sup> Daryl Koehn and Barry Willbratte, “A Defense of a Thomistic Concept of the Just Price,” *Business Ethics Quarterly* 22, no. 3 (2012): 501–26, <http://www.jstor.org/stable/23223711>.

<sup>96</sup> John Locke and Francois Quesnay have also contributed writings about the concept of capital. They did not entirely focus on the subject per se and only discussed the matter in relation to other subjects. John Locke talked about capital in connection to the value of labor, while Francois Quesnay talked about it in conjunction with the value of Land.

Furthermore, Smith contended that we must employ capital in four different ways: first, it should be used to obtain raw unprocessed goods for the use and consumption of the society or, secondly, for the employment of producing raw goods for the immediate use and consumption. Third, for transporting the raw or produced goods, or lastly, for the use of distribution.<sup>97</sup> Smith believed that manufacturing generates greater value from the use of capital compared to procuring, transporting, and distributing goods. On the other hand, Smith argued that the consumption of goods produces less value from the use of capital. For John Stuart Mill, capital is the product of saving. Abstaining from consuming the goods<sup>98</sup> or opting not to use one's stock of goods in exchange for another increases possession of the stock of goods to use for future exchange.<sup>99</sup> Mill's definition still does not seem to be satisfying because it was just the same definition as Adam Smith's, only there is an added layer of temporal element. So still what is really capital? According to Schumpeter, French economist Francois Quesnay may be going somewhere in answering the question since he said that capital consists of "concrete goods—all kinds of land bought, as well as of tools bought" and so in general, capital is all around, and they are tangible things that

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<sup>97</sup> Adam Smith, *The Wealth of Nations Book I-III*, ed. with an introduction and notes by Andrew Skinner (London: Penguin Books, 1999), 330.

<sup>98</sup> Consumption is the term used assuming that money is not the only currency used for exchange.

<sup>99</sup> John Stuart Mill, *The Collected Works of John Stuart Mill, Volume II - The Principles of Political Economy with Some of Their Applications to Social Philosophy (Books I-II)* [1848], ed. J.M. Robson, intro. V.W. Bladen (University of Toronto Press; Routledge & Kegan Paul, 2006), 181, <http://oll.libertyfund.org/title/102>.

can be used for the acquisition and exchange of goods.<sup>100</sup> For Schumpeter, capital is more than just goods bought; it can also be from the services brought about by labor, it can even be from the rent of the use of the land, or it can also even be from the consumed goods. He further argued that capital is beyond more than that. In the classical sense, capital is usually gone once an exchange takes place. This is what most neo-classical economists thought in a traditional sense, but for Schumpeter, once the capital is dissolved due to the exchange of goods and services, it takes another form.<sup>101</sup> What most of Schumpeter's predecessors failed to highlight is that capital has its function and purpose. Capital is one of the levers for the entrepreneur to carry out its function. It is for the purpose of (1) diverting the factors of production to new uses and (2) dictating a new direction for producing goods and services.<sup>102</sup> In short, capital is inherently teleological, where its existence depends on how the entrepreneur controls its function. So, when we talk about capital, it is not just about money, cash, gold, or any other currency. We have to think beyond its physical nature, and once we do that, the "services of natural agents, of labor, of machinery, of raw material, all of them [equal] and nothing distinguishes [one] from the others."<sup>103</sup> Schumpeter may also be thinking

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<sup>100</sup> Schumpeter used the French phrase describing capital: *Parcourez les fermes et les ateliers, et ... vous trouverez des bâtiments, des bestiaux, des semences, des matières premières, des meubles et des instruments de toute espèce* which means "Browse the farms and workshops, and ... you will find buildings, livestock, seeds, raw materials, furniture, and tools of all kinds." In other words, everything we see related to an enterprise can be capital.

<sup>101</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 105.

<sup>102</sup> *Ibid.*, 103.

<sup>103</sup> *Ibid.*, 103-104.

ahead of his time because fast forward to the present time, capital now can be described into four or even more different types.<sup>104</sup>

## II. On Credit

As we have established that capital is one of the levers the entrepreneur controls to carry out its function successfully, and so is credit. Before we discuss it further, I would like to delve first into the circular flow of the ‘economic life’ for us to understand credit better. The circular flow of ‘economic life’ is based on the assumption that there is an economic equilibrium. It is important to note that Schumpeter appears to have synthesized both Vilfredo Pareto’s<sup>105</sup> and Adam Smith’s<sup>106</sup> definitions of general equilibrium. Adam Smith’s description of general equilibrium is that there is always a ‘zero-sum’ game whereby there are no winners and losers in every exchange of goods and services. This synthesis of both individuals’ supposition of economic equilibrium is also an enhanced adaptation of Böhm-Bawerk’s definition of general equilibrium. His equilibrium concept assumes that there is an economic harmony where all agents of an economic life are undisturbed. However, there are two instances in which this

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<sup>104</sup> At present, we have Intellectual Capital which is a company’s stock of knowledge, including human capital, structural capital, and relationship capital. We also have financial capital, Technology capital, and Reputation Capital to name a few. See Steven L. McShane and Mary Ann Von Glinow, *Organizational Behavior: Emerging Knowledge, Global Reality*, 8th ed. (New York: McGraw Hill Education, 2018), 19.

<sup>105</sup> “Vilfredo Pareto perceived it [the general equilibrium] as a state of maximum satisfaction, in the sense that no economic agent should be made better off without another being made worse off.” See Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), xvi.

<sup>106</sup> Adam Smith, *The Wealth of Nations Book IV-V*, ed. with an introduction and notes by Andrew Skinner (London: Penguin Books, 1999), 58.

economic harmony becomes unbalanced, according to Bawerk. First are the disturbances that affect the equilibrium, and he highlighted two disturbances: (1) ‘Frictions’ such as errors, mishaps, and economic shortcomings resulting in economic losses and (2) Unplanned changes that affect the whole economic life system and this is arguably the most influential element in the upheavals of the general equilibrium.<sup>107</sup> The second instance has something to do with time in relation to the production of goods and services. Some goods or services may take time to produce, and as a result, the consumption of goods and services will only take place in the future. Schumpeter raised two questions on this second scenario: (1) Is the value of goods or services deemed less or more if consumed in the future? and (2) Does the time gap until it is consumed in the future make a difference in terms of the goods or services’ value? <sup>108</sup> Schumpeter confronts these questions by presenting two conditions. If the value of the goods or services, when obtained now, will certainly generate more of its value in the future, then the value of the goods obtained in the present is higher; and if the value of the goods or services guarantees good supply in the future whether you obtain them in the present or the future, then the difference in the value of the goods when obtained in the present or the future fades.<sup>109</sup> Bawerk raised another point that

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<sup>107</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 29-30.

<sup>108</sup> *Ibid.*, 31.

<sup>109</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 33.

may be deemed to affect the general equilibrium: What about abstinence from consumption of goods or services? Does saving one's stock of goods affect the whole circular flow of economic life? He answered this question on the affirmative side. Bawerk mentioned that since there is a "sacrifice" made by the individual who abstained from consuming goods for the reason of investing it, this gives the individual a right to be rewarded in the form of interest.<sup>110</sup> Meanwhile, Schumpeter's answer to the question critiqued Bawerk's point and stood on the opposing side. Although Schumpeter has maintained an element of association with Bawerk's perspective by recognizing the presence of abstinence from the consumption of goods or services, he presented the context of its circular flow. In a circular flow of economic life, there is an assumption that the movement of all agents in an economic process is steady. Hence, for the investment made resulting from the abstinence of consumption of goods or services presupposes yields expected return in the future.<sup>111</sup> Schumpeter then presented a different angle of perspective about the general equilibrium. He argued that the general equilibrium of economic life thought by the classic thinkers during his time was viewed as a singular instance of equilibrium. Moreover, all goods or services are interdependent with others and, therefore, affect the equilibrium constantly whenever a small change in the goods or services takes place. The only way to understand the general equilibrium is to

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<sup>110</sup> *Ibid.*, 34.

<sup>111</sup> *Ibid.*

understand it in a bigger picture of how one equilibrium interplays with another market. The best way to understand it is to identify its common denominator, which, in the present time, we now call it currency.<sup>112</sup> Therefore, Schumpeter agrees that the circular flow of economic life must always be in a steady state to maintain the general equilibrium, but he presents a different perspective. What makes the circular flow steady is change, and this is the core of Schumpeter's dynamic and evolutionary framework in postulating his concept of the rest of economic agents.<sup>113</sup> How can this "austerity of circular flow model...on [the] suggestive ground of its corollary implication...of real-world economic life"<sup>114</sup> can the concept of credit be justified? Credit is the second most important agent for the entrepreneur to carry out its function, but it becomes a crucial agent in the spirit of innovation. Schumpeter raised three points on why credit is important in an economic life. (1) In a normal circular flow, borrowing funds is not necessary since the very characteristic of the economic life is static. This means there is a normal circular flow; therefore, there is no surplus because the demand for consumption always equals the number of production. However, if there is an introduction of new markets, new products, new processes, or new methods, the proclivity of financing is inevitable. (2) On a historical note, lending money was given practically as a personal loan instead of loaning it for business reasons.

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<sup>112</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 41.

<sup>113</sup> *Ibid.*, xli.

<sup>114</sup> *Ibid.*, xvi.



Eventually, there was a shift in money lending to support entrepreneur's ventures. (3) There was a prevalent misunderstanding of credit as a means to acquire money or other alternative currencies. Schumpeter argued that the real reason for credit is to have the means to acquire actual resources such as raw materials, tools, land, or labor. Therefore, by way of abstraction of this economic agent, credit is just a method of procuring capital.<sup>115</sup> How does an entrepreneur then obtain credit from a lender? There are two cases of how to acquire credit, according to Schumpeter. First, the entrepreneur uses a collateral good they already possess in exchange for credit. Secondly, the entrepreneur obtains credit first to procure goods as collateral. So, the entrepreneur borrows money first and then acquires goods that will support them in carrying out their entrepreneurial function and mortgages the same acquired goods as a form of security to the lender.<sup>116</sup> If obtaining credit from a lender allows the entrepreneur to increase their capacity to pay for acquiring goods and thereby increases their purchasing power; Hence, it also increases its access to capital for the entrepreneur to carry out its function.

### **III. On Entrepreneurial Profit**

To fully explain the necessity of an entrepreneurial profit in an economic process, we must first explore the dichotomy between the static and dynamic characteristics of an economic flow. We have established earlier that a static

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<sup>115</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 63.

<sup>116</sup> *Ibid.*, 90-91.

equilibrium is at a steady state "...[with] the quantity of available resources, consumer tastes, the techniques of production, and the social structure, the behavior of homo oeconomicus will uniquely bring about an equilibrium of resource allocation."<sup>117</sup> This is under the assumption that every economic agent involved in the whole economic process is undisturbed. Meanwhile, The dynamic state constantly has elements influencing the static state of equilibrium endogenously. For Schumpeter, in every social activity, the forces from within the structure "...destroy[s] the framework of those activities, which are merely adaptive to the existing data." and this results in economic development.<sup>118</sup> In an ideal normal state which is in this case, a society having a static equilibrium, the one who produced the goods or services receives the exact value of the means of production and the cost of the raw materials. In contrast, the one who consumed the products or services by paying it for the same value of the means of production and the cost of the raw materials thereby having the same exchange value. This kind of trade appears to agree with Adam Smith's definition of general equilibrium that there are no winners and losers in an exchange between two parties. John Stuart Mill also discussed the concept, but it was not clear how an individual "...will look for some equivalent for this forbearance: [and] expect his advance of food to come back to him with an increase, called in the language of

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<sup>117</sup> Yuichi Shionoya, "The Origin of the Schumpeterian Research Program: A Chapter Omitted from Schumpeter's Theory of Economic Development," *Journal of Institutional and Theoretical Economics (JITE) / Zeitschrift für die gesamte Staatswissenschaft* 146, no. 2 (Jun. 1990): 319, <http://www.jstor.org/stable/40751279>.

<sup>118</sup> *Ibid.*, 320.

business, a profit”<sup>119</sup> For the sake of appropriation, let us agree with Mill’s definition of profit and reinforce it with Shumpeter’s definition. It is also essential to point out that Schumpeter focuses only on the concept of entrepreneurial profit and not on the subject of interest on capital. For Schumpeter, entrepreneurial profit is the difference between the value of the return and the cost of the output in a business, and in his simple definition, it is a surplus over costs.<sup>120</sup> It is the excess amount of value that the entrepreneur gets back after the trade is completed. Suppose a business neither makes a profit nor takes losses. In that case, the return of the cost spent for producing and acquiring the raw materials for production is adequate to cover the whole expenditures for the cost of the enterprise’s activity. Additionally, we have also maintained that economic development is necessary because of the forces within the scheme of economic life trying to expunge the old combinations and, at the same time, introduce new combinations (new products, new methods, new processes, and new market), the total return, therefore, must be greater than the total cost of production and acquisition of goods or services.<sup>121</sup> Schumpeter outlined three conditions to which entrepreneurial profit is necessary: First, the cost of the current technology to

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<sup>119</sup> John Stuart Mill, *The Collected Works of John Stuart Mill, Volume II - The Principles of Political Economy with Some of Their Applications to Social Philosophy* (Books I-II) [1848], ed. J.M. Robson, intro. V.W. Bladen (University of Toronto Press; Routledge & Kegan Paul, 2006), 95, <http://oll.libertyfund.org/title/102>.

<sup>120</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 99.

<sup>121</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 117.

produce the goods or services must have enough margin to compensate for the loss brought about by the introduction of new technology to produce goods or services. Secondly, the cost to produce goods or services brought about by labor must not be lower than the cost of the new method of production. Lastly, the cost of the current technology and the wages must not be lower than the cost of the new technology and new method of production.<sup>122</sup> Based on the conditions highlighted, it is necessary that a profit must be implemented for the sake of economic development, and when this happens, new combinations take place whereby

A complete reorganization of the industry occurs, with its increases in production, its competitive struggle, its supersession of obsolete businesses, its possible dismissal of workers, and so forth [and] the final result must be a new equilibrium position, in which, with new data, the law of cost again rules, so that now the prices of the products are again equal to the wages and rents of the services of labor and land which are embodied in the looms, plus the wages and rents of the services of labor and land which must still cooperate with the looms [goods or services] in order that the product may come into existence<sup>123</sup> and let's call this whole phenomenon as innovation.<sup>124</sup>

#### **IV. On Interest on Capital**

The topic of the concept of Interest is a delicate one because somehow it entails an ethical consequence when approached without prudence. Many theories have been raised about this topic to justify its necessity to the economic process.

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<sup>122</sup> *Ibid.*, 117-118.

<sup>123</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 119.

<sup>124</sup> For now, we will call this 'innovation,' but in Chapter 4, we will be using Schumpeter's term: 'creative destruction'.

Schumpeter posited that an interest must be zero in a static state of equilibrium. This is one of the concepts that made him famous to his peers because many of them, including his predecessors, do not agree with his supposition. Schumpeter maintained that only then an interest must be applied when in a dynamic state of economic life. Lionel Robbins, his fellow Austrian economist, did not agree with his theory. He confronted his thesis by arguing that even in a stationary state of the economy, an interest must be implemented because of the 'Use Theory.' It means that the lender must be rewarded for abstaining from using the fund for consumption or for other purposes.<sup>125</sup> A British economist, Doreen Warriner, came to Schumpeter's defense and expressed that Robbins did not fully understand Schumpeter's static equilibrium theory. If Robbins had fully understood Schumpeter's concept of stationary economy, he would have arrived at the same conclusion that "there is no yield to the use of capital, there is no reason to refrain from consuming it, [and does not] affect the argument."<sup>126</sup> Böhm-Bawerk, a former professor of Schumpeter, also contributed his thoughts to the same topic and started defining interest in connection to Loan. For him, a loan is "nothing else than a real and true exchange of present goods for future goods."<sup>127</sup> He is also one of the economists who criticize the 'Use Theory' to

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<sup>125</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), xl.

<sup>126</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), xl-xli.

<sup>127</sup> Eugen Böhm-Bawerk, *The Positive Theory of Capital*, trans. William Smart, M.A. (New York: G.E. Stechert & Co., 1930), 285.

define interest. He disagrees that a loan should be viewed as a function of hiring in exchange for transferring the “temporary use of fungible goods.”<sup>128</sup> Another theory that Bawerk scrutinized is the ‘Agio Theory’ whereby a borrower purchases the money, “which he receives now by a larger sum of money which he gives later. He must thus pay an ‘agio’ or premium (Aufgeld), and this ‘agio’ is the interest.”<sup>129</sup> He contended that this argument is using semantics to justify interest on loans. “Lending” money is far different from “selling” money to use it, and for him, the theory is “full of mistakes, internal contradictions, and impossibilities.”<sup>130</sup> For Bawerk, the only justification for using interest on loan is the approximation of acquiring goods in the present as having more value than procuring the value in the future. In contradiction to this view, Schumpeter thought that Bawerk’s ‘Time Preference Theory undermines the significance of natural human propensity that there are some instances that an individual prefers to put a premium on acquiring the goods in the future rather than having it in the present.’<sup>131</sup> This argument was previously discussed in Part Two of this chapter regarding credit. The same position will be applied in opposing Bawerk’s theory. Another theory that Joseph Schumpeter criticized about Bawerk on the subject of Interest is his Roundabout Method Theory, whereby he puts more value on the

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<sup>128</sup> *Ibid.*, 286.

<sup>129</sup> *Ibid.*

<sup>130</sup> *Ibid.*, 287.

<sup>131</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), xxxix-xl..

production of indirect and future goods than the production of direct and present goods that makes having interest warranting. Schumpeter used his own theory to oppose Bawerk's by putting value on the entrepreneurial activity. The carrying out of new combinations by the entrepreneur in the spirit of innovation or economic development gives a rational explanation for making interest a necessity in an economic life.<sup>132</sup> Schumpeter deemed interest very important when the loaned fund is used for production to foster entrepreneurial function, resulting in innovation. This interest on productive loans (Produktivzins) is seen everywhere in a capitalist setting, especially in new enterprises.<sup>133</sup> Hence, interest is more warranted on capital when used for economic development, and it is the entrepreneur's responsibility to make use of the capital to profit from making new combinations successful. Additional questions can be raised then if interest is warranted on productive loans, when is interest not justifiable? Schumpeter makes a case of two scenarios. First, it is not reasonable to have an interest for the purpose of consumption<sup>134</sup> which, in my opinion, is very idealistic when applied at present. Secondly, if there is no development taking place in a society and it is assumed that the economy is in a static state of equilibrium, then productive interest must not be applied.<sup>135</sup>

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<sup>132</sup> *Ibid.*, xl.

<sup>133</sup> *Ibid.*, 142-143.

<sup>134</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 46.

<sup>135</sup> *Ibid.*, 143.

Another topic of exploration that we must embark on in connection with the subject of interest is when Schumpeter raised the questions about where does interest comes from and why it exists. A perennial problem has been going on for economists concerning the concept of interest. It has been a proclivity that all excess from the returns must be computed and imputed to the same value of the production. In other words, whatever profit the enterprise makes, it should be assigned back to the wages of the labor and cost of rent of the land. To explain the existence of Interest is to just accept it as a matter of fact. This is one way of addressing the conundrum that goes within the economic framework. Interest is a reality and it comes in different forms. One form is best explained through the ‘Theory of Exploitation.’ In this theory, the interest is a portion taken from the wages from the labor. Eugen von Böhm-Bawerk describes this theory as an assumption that laborers are entitled to the original distribution of wages and also the right to claim for a reward for being a productive member of a society that contributes to the productivity of the nation. The manual workers have the right and just claim at least “according to the idea of pure justice to acquire the title of their entire product.”<sup>136</sup> Interest is also expressed in another form through Literal Labor Theory. Adam Smith described this as sharing the whole produce of labor to the owner of the stock “which employs him or her.”<sup>137</sup> It does not always

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<sup>136</sup> Eugen von Böhm-Bawerk, *The Exploitation Theory of Socialism-Communism: The Idea that All Unearned Income (Rent, Interest and Profit) Involves Economic Injustice: An Extract*, 3rd ed. (South Holland, Illinois: Libertarian Press, 1975), 16.

<sup>137</sup> Adam Smith, *The Wealth of Nations Book I-III*, ed. with an introduction and notes by Andrew Skinner (London: Penguin Books, 1999), 44.



follow that the “whole produce of labour belongs to the labourer.”<sup>138</sup> Another theory is ‘Embodied Labor in Capital Goods Theory’ whereby the interest is in the form of embodiment through the machinery of production and raw materials as introduced by James Mill and McCulloch.<sup>139</sup>

Another approach to solving the problem is to deny the existence of theories about interest according to Schumpeter. One way to deny their existence is to consider that there might be other means of production other than labor and land and it turns out that the cost of interest becomes supplemental. Another way of denying their existence is to assume that there might be an invisible mechanism that limits the full imputation and computation of the value of wage and rent resulting in an excess which is eventually considered as interest.<sup>140</sup> Here, we find ourselves in a dilemma between accepting the existence of theories about interest and denying them. Schumpeter then suggests that since there is a gap between understanding the value of the product and the value of the means to production, we can arrive at an assumption that the interest that we deem to be a surplus comes in the form of ‘interest on capital’; because the entrepreneur borrows a fund in the form of credit (a fictionary claim on the borrowed fund)<sup>141</sup> in order to

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<sup>138</sup> *Ibid.*

<sup>139</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 144.

<sup>140</sup> *Ibid.*, 145.

<sup>141</sup> *Ibid.*, 96.

make a profit.<sup>142</sup> So, it may look like there is a mysterious excess moving in a circular flow in the whole state of economic life.

## **V. On Business Cycle**

Joseph Schumpeter raised a profound and unique postulation about this concept, which is one of the elements that affect the economic life. It is vital to grasp the importance of how each factors or each economic agents mutually interacts with each other. The broader understanding of the economic life presupposes a corollary implication brought about the austerity of the circular flow model as raised by Schumpeter. It depicts having a self-regulated and self-functioning system, to say the least. That may be the reason why, and even this writer wondered, many thinkers in the past until the present times are facing challenges in figuring out the core mechanism of an economic life. Schumpeter's account of the business cycle provides a viable theory that satisfies both the domain of economics and philosophy. To have an all-encompassing understanding of the concept, Schumpeter begins by outlining its structure. In the previous sections, we have already established the presence of an equilibrium in an economic life. We also further argued that there is not only one unit of equilibrium that exists within an economic life. It comprises many units of equilibrium and each equilibrium goes through a stationary state (a state

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<sup>142</sup> *Ibid.*, 147.

undisturbed endogenously)<sup>143</sup> and a dynamic state which is a disturbance brought about by innovation. To picture it in a wider sense, the process that consists of a series of units of fluctuations moving from a point of stationary state to a dynamic state are what Schumpeter calls 'business cycles'.<sup>144</sup> There are two phases in each business cycle: (1) The breaking away from the equilibrium which is brought about by entrepreneurial activities resulting in economic development and (2) Moving toward the equilibrium. Schumpeter associated the first phase as 'prosperity' while the second phase as 'depression.'<sup>145</sup> If we speak of prosperity, it is aligned with the concept of progress and is an endogenous element that affects the stability of an economic life. For Schumpeter, progress, by virtue of the mechanism of a cyclical process, is a force that "unstabilizes the economic world" and these disturbances breed an assumption that there will be no economic growth.<sup>146</sup> Based on his assumptions about his theory on the business cycle, it seems that innovation is the '*sui generis*' of his theory. It is the main driving force behind every prosperity and every depression. Schumpeter laid down his proofs that innovation indeed is the main influence of the change going on in a business cycle. First, based on history, it seems that whenever prosperity or depression

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<sup>143</sup> External disturbances such as natural disasters, war, pandemics, etc. will be irrelevant for Schumpeter in understanding the matter of the subject since he assumed that exogenous factors are not the primary drivers of economic life.

<sup>144</sup> Joseph A. Schumpeter, *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*, vol. I (New York and London: McGraw Hill Book Company, Inc., 1923), 138.

<sup>145</sup> *Ibid.*

<sup>146</sup> Joseph A. Schumpeter, *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*, vol. I (New York and London: McGraw Hill Book Company, Inc., 1923), 138.

occurs, innovation is always present. Thinking of innovation's non-existence would prove otherwise. The pattern of economic life will just be a straight line, and fluctuations in a phenomenon cease to exist.<sup>147</sup> Secondly, One can critique that innovation can not be the main reason for the existence of the business cycle, and other factors may cause such phenomena. Let's just say that the point brought up to criticize Schumpeter's theory makes sense. It is still self-evident that innovation is the more dominant factor driving the change based on statistical facts.<sup>148</sup> This makes all the more reason to conclude that innovation is the primary driver of change. Lastly, based on statistics and history, both showed symptoms of prosperity and depression, which is coherent with Schumpeter's conclusion that innovation affects both phases.<sup>149</sup> Let us use a couple of examples of past events to see if Schumpeter's argument is conclusive. The 'Railway' Mania in the UK brought about symptoms of prosperity when it started during the 1830s. This was the time when they introduced the first modern passenger railway in the UK during the mid-1830s, and eventually railway business became dormant until 1843.<sup>150</sup> The symptom of innovation (the first modern passenger railway) during the event of prosperity in the mid-1830s was conspicuous. From then on, from 1844-46, a recession happened, and the "substantial reversal of stock prices" was

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<sup>147</sup> *Ibid.*

<sup>148</sup> *Ibid.*

<sup>149</sup> *Ibid.*, 139.

<sup>150</sup> Gareth Campbell and John D. Turner, "Dispelling the Myth of the Naive Investor during the British Railway Mania, 1845—1846," *The Business History Review* 86, no. 1 (2012): 6, <http://www.jstor.org/stable/23239459>.

imminent.<sup>151</sup> Campbell and Turner described the ‘Railway Mania’ going to a “boom in promotional activity [and] was accompanied by a substantial run-up and [a sudden] collapse of railway stock.”<sup>152</sup> Another hint of prosperity happened during the 1920s in the U.S. and it was a famously known historical occurrence as the “Roaring Twenties”. The surge of innovation happened for several industries such as consumer appliances, radio, automotive, and aviation, leading to economic development and a bullish stock market.<sup>153</sup> Afterward, a recession happened in 1929 and hinted at the start of a ‘Great Depression’ resulting in bankruptcies, a decrease in consumption through spending, and a spike in unemployment.<sup>154</sup> If we based it on inference, this kind of event seemed to support Schumpeter's argument. It is important to note that his method of proving innovation as the salient feature of the business cycle is *a posteriori*. I am not convinced of his theory in order for us to conclude that innovation can be categorized as the primary element resulting in economic change. His explanation is not logical enough to prove the movement of the two phases (from prosperity to depression). Schumpeter is also aware of the shortcoming of his argument about this subject but by way of deduction, the “difficulty [of solving the problem] vanishes and the crucial question of what causes the turn from prosperity into recession finds a very natural answer if we accept [this] schema” because “the

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<sup>151</sup> *Ibid.*, 4.

<sup>152</sup> *Ibid.*, 7.

<sup>153</sup> Christina D. Romer, “The Nation in Depression,” *The Journal of Economic Perspectives* 7, no. 2 (1993): 29, <http://www.jstor.org/stable/2138198>.

<sup>154</sup> *Ibid.*, 27.

process...lacks motive power” and has a corollary implication of what he calls it as “*Perpetuum mobile*” — suggesting that the whole series of events is set to ‘perpetual motion’.<sup>155</sup> One interesting premise that Schumpeter raised about the concept of depression is that it “leads to a new equilibrium” and it somehow gives us a different perspective in dealing with the situation “to convince ourselves” that this one phase of the business cycle happens.<sup>156</sup> He described having this kind of point of view as the cheerful side of depression. So, depression is the resorption of the introduced new combinations carried on by the entrepreneur resulting in innovation. This way of reacting to the event (depression) shows a different perspective about it as a “normal and healthy process of adaptation” to the emergence of “innovations...preceding to prosperity” and it is safe to draw a conclusion that fundamentally, the “cause of depression is prosperity itself.”<sup>157</sup> Another critique brought up to Schumpeter about the ‘business cycle’ is that an individual’s “errors in judgment, excesses (overdoing), and misconduct” are what causes depression, and therefore, innovation can not be the cause of it.<sup>158</sup> This critique appears to prove Schumpeter’s argument even more convincing. Schumpeter agrees with the occurrence of economic errors but they should not be

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<sup>155</sup> Joseph A. Schumpeter, *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process, vol. I* (New York and London: McGraw Hill Book Company, Inc., 1923), 139.

<sup>156</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 214.

<sup>157</sup> *Ibid.*, xxiii.

<sup>158</sup> Joseph A. Schumpeter, *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process, vol. I* (New York and London: McGraw Hill Book Company, Inc., 1923), 140.

viewed as individual errors. He contended that errors come in clusters and they pervade to the whole market and this is due to the people adopting and adapting to the new combinations introduced by the entrepreneur. People will have to get themselves acquainted with these new combinations brought by the entrepreneur and mistakes happen because they are unable to improve and adjust with the introduction of a new phenomenon. Hence, it was the innovation that influenced the depression, and the collection of mistakes and errors was just a symptom. As Robert J. Shiller put it in his book when he described the signs of prosperity during the 1990s due to the emergence of the “dot-com bubble” and eventually the burst of the bubble kicked during the 2000s resulting to recession: “Rome [was not] built in a day, nor was it destroyed by one sudden bolt of bad fortune.”<sup>159</sup>

### **Schumpeterian School of Thought**

Schumpeter raised valid philosophical questions that not many philosophers have realized during his time, especially on each of the economic factors causing economic change. I have observed and even argued that even in the field of academic philosophy, the attention to these subjects is limited. In the previous discussion of this chapter, there should be ample of evidence for us to conclude that Schumpeter must be considered as a Philosopher but how come

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<sup>159</sup> Robert J. Shiller, *Irrational Exuberance*, Revised and Expanded Third Edition (Princeton and Oxford: Princeton University Press, 2015), 69.

Schumpeter is rarely been categorized as such a label? I further argue that even some of the thinkers in the same field as during Schumpeter's time up until the present do not categorize him as an economist. Gottfried Haberler who wrote a biography about him raised a similar question when he asked why is there no "Schumpeterian school?"<sup>160</sup> One main reason that Schumpeter is rarely categorized as such labels is because he was "much more than an economist" because of his achievements in the economic fields and in other schools of discipline.<sup>161</sup> He was just reaching his twenty-fifth birthday when he wrote his first book *Wesen and Hauptinhalt der theoretischen Nationalökonomie* - The Nature and Essence of Economic Theory in 1908. Four years later, he published one of his greatest books: *Theorie der wirtschaftlichen Entwicklung* - The Theory of Economic Development in 1912. At thirty years old, he published *Epochen der Dogmen- und Methodengeschichte* - Epochs in the History of Economic Doctrine and Methodology. All of these early writings by Schumpeter "deals with economics and sociology in their relation to philosophy and history, but also contains interesting remarks on technical economic questions which foreshadow later developments."<sup>162</sup>

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<sup>160</sup> Gottfried Haberler, "Joseph Alois Schumpeter 1883–1950," *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 370, <https://doi.org/10.2307/1884555>.

<sup>161</sup> *Ibid.*, 333.

<sup>162</sup> Gottfried Haberler, "Joseph Alois Schumpeter 1883–1950," *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 340, <https://doi.org/10.2307/1884555>.



He has doctorate degrees both in Roman Law and Canon Law when he registered as a student of the Faculty of Law at the University of Vienna in 1901 and finished as Doctor *utriusque juris* in 1906.<sup>163</sup> In 1919, Otto Bauer, an Austrian Marxist economist appointed him as Minister of Finance of the Austrian Republic<sup>164</sup> wherein I believe brought him closer to reaching one of his ambitions: to one day become the greatest economist in the world. He enjoys talking to his peers about his ambition to become “the greatest economist, horseman, and lover in the world.”<sup>165</sup> Was he a successful Finance Minister back then? Unlikely, because the situation he was in at that time when he assumed that position was at turbulent times according to Haberler, and therefore may have been disappointing to Schumpeter because that part of his life seemed to make his ambitions of becoming a great economist difficult.<sup>166</sup> Schumpeter even said that he would not have carried out his plans as Finance Minister because “only a strong and united government could have done that” but “the government was neither strong nor united.”<sup>167</sup> In 1924, he became the president of the Biedermann Bank and his stint as president of that bank did not last because the bank itself could not last. Even the rest of the banks in Austria were doomed to failure because of the economic

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<sup>163</sup> *Ibid.*, 335.

<sup>164</sup> *Ibid.*, 337.

<sup>165</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 4.

<sup>166</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 346, <https://doi.org/10.2307/1884555>.

<sup>167</sup> *Ibid.*, 349

crisis back then.<sup>168</sup> So, it was obvious that he wore different hats, and it was difficult for him to be categorized as a sociologist, or economist, let alone as a philosopher.

Another reason for the difficulty of labeling him was how his works were described and studied. Schumpeter was not professionally trained in mathematics and he was not considered an expert in algebraic equations but he “acquired a great mathematical knowledge and could follow and effectively expound what even among mathematical economists is regarded as complicated mathematical analysis.”<sup>169</sup> He was considered a savant in the history of economic doctrines and he also specializes in general politics and social history. When Schumpeter tried to study other fields outside of economics, he would use an analogy to compare or highlight similarities between “economic and non-economic areas.”<sup>170</sup> He believed that all his works were analytical and theoretical and thought that all his theories evolved in the dimension of economics. However, he was also aware of the limitations of scientific studies. For example, in his explanation of the concept of equilibrium, the scientific explanation would be incomplete without the method of abstraction to explain the whole phenomena of transitioning from static equilibrium to a dynamic state. In other words, the dilemma he had on his theory

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<sup>168</sup> *Ibid.*, 353.

<sup>169</sup> *Ibid.*, 333.

<sup>170</sup> Yuichi Shionoya, "The Origin of the Schumpeterian Research Program: A Chapter Omitted from Schumpeter's Theory of Economic Development," *Journal of Institutional and Theoretical Economics (JITE) / Zeitschrift für die gesamte Staatswissenschaft* 146, no. 2 (Jun. 1990): 315, <http://www.jstor.org/stable/40751279>.

of stationary equilibrium and dynamic state theory was epistemological.<sup>171</sup> Although he was deemed an expert in history, he was not deemed a “historicist” in the same sense as Hegel and Marx were. Although Schumpeter employed the same method as Hegel and Marx in understanding history, “his rigid scientific discipline did not permit him to go far in the direction of historico-philosophical speculations” because he thought that “materialistic interpretation” of history was more plausible compared to Hegel’s and Marx’s approach.<sup>172</sup>

Another hypothesis we can raise on why he is difficult to categorize is Schumpeter is full of paradoxical theories. At one point, he posits elements of association, and at the same time, he would show elements of critique on the same subject. I think we can not blame him for this because, in his entire life, he constantly battles internally with himself about different subjects. According to Thomas K. McCraw, “he often [holds] not just two opposing ideas at the same time but half a dozen [ideas].”<sup>173</sup> For example, in his theory about ‘creative destruction,’<sup>174</sup> he knew that it is essential in economic development, but at the same time, ethical questions are imminent because, after prosperity, it results in

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<sup>171</sup> Yuichi Shionoya, “The Origin of the Schumpeterian Research Program: A Chapter Omitted from Schumpeter’s Theory of Economic Development,” *Journal of Institutional and Theoretical Economics (JITE) / Zeitschrift für die gesamte Staatswissenschaft* 146, no. 2 (Jun. 1990): 321, <http://www.jstor.org/stable/40751279>.

<sup>172</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 367, <https://doi.org/10.2307/1884555>.

<sup>173</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 4-5.

<sup>174</sup> This will be further discussed in Chapter 4.

misery and human tragedy that “cannot assure peace of mind.”<sup>175</sup> On the subject of capitalism, he postulated that it plays a vital role in the economic development, but at the same time, he was convinced that it would eventually fail because of its own success due to its bureaucratic structure.<sup>176</sup> Understanding Schumpeter’s works proves to be complicated and the same time encapsulating his contribution to economics and other fields of discipline make him more interesting to study. Haberler describes his works as “not easy to describe” and “not easy to define.”<sup>177</sup>

One last theory about why Schumpeter not being categorized as a philosopher is that he does not want to be categorized at all by any title we prefer to put him. Schumpeter is a person who does not want to identify himself publicly with any community, group, class, nationality, school, or club. As the famous Austrian economist Carl Menger described him, “He was nobody’s pupil.”<sup>178</sup> Schumpeter was described as a very discreet person. He was never fond nor interested in being in the spotlight, and he never behaved like a “prima donna,” even if most of his peers and people who did not know him thought of him as sort of a celebrity.<sup>179</sup> He was never a great proponent of philosophy as one famous Schumpeter seminar and was one of the speakers on the subject of epistemology

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<sup>175</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 6.

<sup>176</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 366, <https://doi.org/10.2307/1884555>.

<sup>177</sup> *Ibid.*, 360.

<sup>178</sup> *Ibid.*, 343.

<sup>179</sup> *Ibid.*, 359.

suggested that he was not in favor of the German academic trend of incorporating philosophy into the economic dimension.<sup>180</sup> When Haberler asked when he wrote Schumpeter's biography why there is no Schumpeterian school, one of his theories was Schumpeter never wanted to be involved in any political or social clashes. He appeared to be contented to be known as a "scholar and an intellectual" rather than be identified with a "reformer, partisan of capitalism, socialist" or any other "-ism."<sup>181</sup> Another one of Haberler's theories is he was constantly discouraging his followers, including his loyal students, from forming a Schumpeterian "school of thought." This discouragement was more emphasized in Schumpeter's farewell address to his students in Germany, telling them "...there is none and it ought not to exist...Economics is not a philosophy but a science. Hence, there should be no 'school' in our field."<sup>182</sup> Whether Schumpeter must be considered a Philosopher or not leaves an open dialogue to the readers of this paper, and I believe that a debate about this subject will continue until there is an inter-disciplinary school of thought between economics, sociology, politics, and, philosophy.

### **Methodological Individualism**

Another point that I believe to be a compelling argument to consider Joseph Schumpeter as a philosopher is the influence of the works of great

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<sup>180</sup> *Ibid.*, 355.

<sup>181</sup> *Ibid.*, 371.

<sup>182</sup> *Ibid.*, xxxv.

philosophers such as Adam Smith, Montesquieu, John Stuart Mill, St. Thomas Aquinas, and arguably the two most preeminent figures would be Karl Marx and Max Weber. In Richard Swedberg's introduction and depiction of Schumpeter's work and life in the book *Capitalism, Socialism and Democracy*, while studying at the University of Vienna, there were a significant number of Marxist apologists "who forced the other students—including Schumpeter—to take Marxism and sociologist economics seriously."<sup>183</sup> The academic milieu that Schumpeter was in during his stay at the university was a manifestation of how pervasive the works of Marx and Marxism were. In spite of this, he was "happy to debate them," but it was conspicuous that he was "skeptical of Marxism."<sup>184</sup> Even after getting his doctorate, he made connections with Marxist students who eventually became significant members of "the socialist movement, among them Otto Bauer and Rudolf Hilferding."<sup>185</sup> Schumpeter's strong orientation with the school of thought of Marx and Marxism hinted strong evidence of his philosophical framework. His *Theory of Economic Development* book was not just the exposition of his pure economic theories on development, but it was also an application of his method of inquiry, which Schumpeter coined the term 'methodological individualism.' He raised a new approach to solving epistemological issues in order to solve economic problems. He offers a different mode of historical materialism, and he

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<sup>183</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), x.

<sup>184</sup> *Ibid.*

<sup>185</sup> *Ibid.*

discussed a great deal about it in his Doctoral dissertation entitled *The Nature and Essence of Economic Theory* in 1908. He formulated a new understanding of economic and social life, highlighted an interesting principle of association, and critiqued Marx's concept of Superstructure. As described by Lavine, Marx believed that

All human thought in the realms of religion, philosophy, politics, law, and ethics—are conditioned by the economic foundation of society, and specifically by the class division within it. The dominant views in morals, politics, religion, law, philosophy, and art of any society are the ideas of the dominant economic class.<sup>186</sup>

Schumpeter agrees with Marx that economic constructs can significantly influence society. However, he rejects the collectivist nature of understanding the historical materialism of economic and social life. He put a premium on the viability of understanding society through methodological individualism because he believed his method was more effective than Marx and Engel's. Aside from having a collectivist nature of understanding, Marx and Engel's historical materialism presents proclivities of a metaphysical framework of understanding as Haberler defines Schumpeter's methodological individualism as follows:

He had no sympathy whatever for the vague, almost metaphysical "collectivism" of which there is so much in Marxist writings. By this, I mean "the special and exclusive outlook upon the whole of social life" claimed by the Marxists—an outlook which postulates social forces that operate on and influence individual behavior and are somehow independent of the totality of individual actions. [He] always adhered to what he called "methodological individualism," i.e., the principle that social phenomena and forces must be defined and interpreted in

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<sup>186</sup> T. Z. Lavine, *From Socrates to Sartre: The Philosophic Quest* (New York, NY: Bantam Books, 1984), 315, eISBN 978-0-307-79357-7.

terms of interrelations and interactions, often of great complexity, between individuals and their subjective motivations.<sup>187</sup>

To elaborate his method further, Schumpeter suggested that one should only stress the examination of individual economic or social facts when solving an epistemological problem.<sup>188</sup> According to Schumpeter, we will realize two things when we use this method: “it is impossible” and “it is not necessary to have all facts” because the data needed to understand a phenomenon will always be insufficient.<sup>189</sup> In understanding economic or social phenomena, we will also realize certain differences between economic or social facts. However, behind the disparity or heterogeneity of the “phenomena class,” ultimately, the similarities overshadow the number of differences.<sup>190</sup> He maintains that one should only focus on the similarities of each individual facts. Furthermore, he also highlighted the phenomena of the ‘Law of diminishing return in knowing.’ The characterization of this theory means that having additional new facts will be irrelevant in understanding and will not lead to “more knowledge of the field.”<sup>191</sup> It appears that Schumpeter was trying to synthesize two epistemological methods of understanding, knowing by theory and abstract analysis and pure economic theory of understanding. The more new facts we gain, the less we view their

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<sup>187</sup> Gottfried Haberler, “Joseph Alois Schumpeter 1883–1950,” *The Quarterly Journal of Economics* 64, no. 3 (August 1950): 363, <https://doi.org/10.2307/1884555>.

<sup>188</sup> Joseph A. Schumpeter, *The Nature and Essence of Economic Theory*, with a new introduction by Bruce A. McDaniel (New Brunswick, U.S.A. and London, U.K.: Transaction Publishers, 2010), 24, ISBN 978-1-4-4128-1150-7.

<sup>189</sup> *Ibid.*

<sup>190</sup> *Ibid.*

<sup>191</sup> *Ibid.*



relevance, the less we value each new information, and the less we consider the new additional information revolutionary. When we experience new facts about certain phenomena, it is not so much that they are new. It is not so much that we are surprised by the fact that we know something new, but it is much that we have not fully realized the additional information that we have understood. For Schumpeter, the fact is that humans know little, and it is given that we are surprised by any introduction of a new phenomenon. He believes that human behaviors are predictable and rational by default. Arriving at outcomes that we deem unexpected is a given fact because we can not totally grasp all the knowledge there is.<sup>192</sup> Therefore, having new additional information should not come to us by surprise because the unpredictability of human behavior should be in itself predictable and thus must be considered *ipso facto*. Another characterization of methodological individualism is the corrigible nature of understanding a phenomenon. Schumpeter stresses the fact that there will be instances when we will consider certain phenomenon conveys truth as we see it and there will be instances that we will be proven wrong. This method of knowing is the most acceptable method. For Schumpeter, this is the “healthiest method” of understanding social and economic facts because our view of our own existence “comes from wrong conclusions” in the first place, and the “correct conclusions outweigh the wrong ones.”<sup>193</sup>

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<sup>192</sup> *Ibid.*

<sup>193</sup> *Ibid.*, 26.

Now that we have established several characterizations of methodological individualism, Schumpeter believes it is important to identify certain facts that are related to the problem in the first place. In this case, as far as this thesis paper is concerned, we understand the economic facts, and thus, we need to identify the elements related to economic problems first to give respect to methodological individualism. In an economic system, Schumpeter argues that barter is the purest form of understanding economic activities.<sup>194</sup> When dealing with economic problems, the initial action must be dealing with the problem in its pure economic theories. Methodological individualism suggests solving economic problems by treating them at their purest principles and identifying the elements related to the same field. One reason for this, especially in those outside the field of economics, is they exclude the economic aspect of the problem and treat the problem in its purest form, too. This becomes a “one-sided interpretation” of the problem.<sup>195</sup> Say for example, of those who are in the field of sociology, when they treat the problem of their own field, they either exclude the economic aspect of it or they treat it by solving the problem at its purest sociological framework. Methodological Individualism allows us to treat certain problems in their purest sense depending on which field we are in but Schumpeter does not claim to treat problems to its ‘exact’ discipline. Schumpeter was not throwing shade against other fields of study, but what he meant by understanding a phenomenon in its

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<sup>194</sup> *Ibid.*, 32.

<sup>195</sup> *Ibid.*

purest sense is to identify individual or key elements that are related to the fields of study alone and deal with it by understanding how it translates in relation to other fields of study. There is no such thing as an ‘exact’ field of study. Schumpeter explains more about it as shown below:

We do not define it as the "exact philosophy" does; when we describe our method as "exact," we do not denigrate other directions of thought; and we do not sidle up to physics in an improper manner, although we also do not see any reason why one would want to construe a different term of exactness for our science than for theirs. As we already discussed in the context of the law term, not everything in nature is "exact" either. If one pretends it is, it is nothing more than functional fiction.<sup>196</sup>

The objective of methodological individualism is to find the most predictable explanation of a certain phenomenon. In parallel with philosophy, we call this: abstraction.<sup>197</sup> It is the method of identifying the immutable, unchanging, and underlying principle of a phenomenon. Schumpeter highlighted that there are three paths to understanding economic principles, and he believes all three of them as the correct paths: (1) The path of ‘Homo Oeconomicus’ where we understand the individual as a rational hedonistic individual—this is understanding the ethical behavior of the individual, (2) The path of “ordinary businessman” —the method of understanding the individual in its realistic sense or empirical sense, and lastly (3) His ‘methodological individualism’—the examination of an individual’s behavior or other economic element’s dynamics with other elements.<sup>198</sup>

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<sup>196</sup> *Ibid.*, 49.

<sup>197</sup> *Ibid.*, 55.

<sup>198</sup> *Ibid.*

Schumpeter argues that this methodological individualism inquiry makes more sense because when an individual faces an economic problem, the individual is being judged based on his or her economic conduct as an individual and not on his or her collective affiliations or preferences.<sup>199</sup> However, the only perturbing characterization of his methodological individualism is he again left a caveat in using his approach. This method of inquiry must not be treated as a philosophical inquiry as in his words: “We do not want to have anything to do with philosophies...we do not condemn other opinions, but we want to stray away from them.”<sup>200</sup> Nevertheless, I believe that his epistemology in treating economic problems is already in itself philosophical. The irony of his formulation of his methodological individualism is the moment he started an inquiry of which approach must be used in understanding economic problems it is already an act of philosophizing—hence, it is called epistemology. Schumpeter invokes the concept of methodological individualism as an alternative way of understanding the ontology of economic life, just as Engel’s and Marx’s ontology. The way he postulated this principle already makes it dialectic as well. Although he did not explicitly admit that somehow his formulation of a new epistemological approach to economic and social constructs was an introduction of new principles, it still does not count his work as Hegelian dialectic materialism. Not only did he implicitly depart from Marx and Engel’s Historical materialism, but he also

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<sup>199</sup> *Ibid.*, 58.

<sup>200</sup> *Ibid.*, 53.

departed from economic Austrian school of thought. As Hayek describes in his preface for Schumpeter's first manuscript, *Methodological Individualism*,

He had adopted the positivist approach to science expounded by Austrian Physicist Ernst Mach. In the course of time he moved further away from the characteristic tenets of the Austrian school so that it became increasingly doubtful later whether he could still be counted as a member of that group.<sup>201</sup>

This only goes to show that his rendition of methodological individualism was an innovative one. On the other hand, he was not the first person to apply this method. Although he coined this term, Max Weber first used this method to solve sociology's epistemological problems. In Weber's first chapter of his book *Economy and Society*, he discussed basic sociological concepts and also made a caveat, much like Schumpeter made a caveat in his book *Theory of Economic Development* about the same matter,

that an 'individualistic' method involves an individualistic evaluation of any kind,...that the inevitably rational character of concept formation involves a belief in the primacy of rational motives, or even a positive evaluation of 'rationalism.'<sup>202</sup>

Weber also puts emphasis on understanding individual agents' behavior as he calls it "functionaries"<sup>203</sup> which is similar to Schumpeter's understanding of the Law of diminishing return in knowing. It is from actions and interactions of individual elements or agents that a social construct or economic construct is best

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<sup>201</sup> Joseph Schumpeter, *Methodological Individualism*, preface by F.A. Hayek (Bruxelles: Institutum Europaeum, 1908), 1.

<sup>202</sup> Max Weber, *Economy and Society: A New Translation*, ed. and trans. Keith Tribe (Cambridge, Massachusetts: Harvard University Press, 2019), 95.

<sup>203</sup> *Ibid.*

comprehensible. In the introduction of Weber's book, Keith Tribe quoted a letter from Weber to Liefmann evoking a straightforward method in understanding Sociology,

[It] can only be based on the action of one, several, or many individuals; it can only be pursued with a strictly 'individualistic' method. . . . In sociological terms, the state is no more than the chance that particular kinds of specific action occur.<sup>204</sup>

Hence, Weber used methodological individualism in understanding Sociology, and Schumpeter used it in understanding Economics. In his book *The Protestant Ethic and the Spirit of Capitalism*, the whole theme of his manuscript speaks about how Christian Protestants' religious beliefs (a social construct) influenced the individual's orientation toward capitalism at his time. Weber's methodological individualism focuses on the economic disparity between Catholics and Protestants, and he believes that the "spirit of capitalism" is a distinct driver of social behavior resulting in economic disparity. Weber's description of the 'spirit of capitalism' in the context of a "provisional illustration" of Benjamin Franklin's belief about money. As Franklin put it,

Remember, that time is money...Remember, that credit is money...Remember, that money is of the prolific, generating nature...Remember this saying: The good paymaster is lord of another man's purse. He that is known to pay punctually and exactly to the time he promises may at any time, and on any occasion, raise all the money his friends can spare.<sup>205</sup>

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<sup>204</sup> *Ibid.*, 57.

<sup>205</sup> Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, trans. and introd. Stephen Kalberg (New York: Routledge, 2012), 14.

It is, therefore, necessary to identify the spirit of this illustration, which is: an individual must consistently remain productive in the spirit of “organization of [one’s] life.”<sup>206</sup> One can only speculate if Schumpeter curated the method from Weber since he lived ahead of Schumpeter. Both thinkers, though, have thematic similarities with their corresponding economic theories. It is important to note, however, that in the later years of his life, mature Schumpeter did not follow strictly methodological individualism anymore, and he was more focused on using historical, theoretical, and abstract analysis of economic historical evolution as his method. That must also be the reason why back then, in his first manuscript, *Methodological Individualism*, Hayek, in his preface, believed that he was “[reluctant] to see a work distributed which...expounded his views in which he no longer believed.”<sup>207</sup> Although his ‘methodological individualism’ may not be widely received by both fields of study (Economics and Philosophy), it is still worth discussing and “certainly essential enough to the understanding of the development of economic theory.”<sup>208</sup>

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<sup>206</sup> *Ibid.* 16.

<sup>207</sup> Joseph Schumpeter, *Methodological Individualism*, preface by F.A. Hayek (Bruxelles: Institutum Europaeum, 1908), 1.

<sup>208</sup> *Ibid.*

### **Chapter Three: Joseph Schumpeter's Theory of the Entrepreneur**

Aside from the concepts highlighted in the previous chapter, one particular economic agent that Schumpeter deemed equally important as one of the drivers of change and innovation in economic life is his concept of the 'Entrepreneur.' An individual's perception of an entrepreneur is divided: some regard them as a significant part of the community, especially in a capitalist society. In contrast, others question their sincerity because they think of them as having opportunistic tendencies. Despite the fact that Schumpeter offered a suitable ontology about the 'entrepreneur' more than eighty years ago, all the more reason to accentuate the growing importance of discussing this concept at present times. Schumpeter's postulation on the concept of 'entrepreneur' is consistently coherent with the abstraction of a social fact resulting in an economic fact and followed by the austerity of economic conduct.<sup>209</sup> To construct a well-defined representation of Schumpeter's concept of the 'entrepreneur,' this chapter will be divided into three parts. Firstly, we will explore extensively Schumpeter's concept of the 'Entrepreneurial Function.' In this part, we will discuss the concept of teleology, which leads to economic life's *sui generis*, which is innovation or, in a grand depiction, towards economic development. Furthermore, we will also discuss how the 'entrepreneurial function' fundamentally interplays with the concepts (Capital, credit, profit, interest, and business cycles) previously discussed in the second chapter of this thesis. The second part navigates into the more familiar scope of

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<sup>209</sup> See Chapter Two of this Thesis about abstraction of social facts and economic facts.



philosophers, which is on the subject of ethics. Schumpeter's supposition on the 'entrepreneur's' motive definitely falls in understanding the moral grounds of the concept. However, a caveat must be in place in this part since I, although having spent eight years in seminary, admit to having shortcomings and a lack of specialty on the subject. This part is more of an invitation to a philosophical discourse as we highlight similar discussions raised by other thinkers and what Schumpeter believes to be the real motive of an 'entrepreneur' or at least how they should be. Lastly, we will probe another function of the entrepreneur: the function of 'leadership.' Looking into this area of entrepreneurs' function will give us a better understanding of Schumpeter's position on why profit and interest are justifiable in economic life. After discussing all this, I hope to elevate the understanding of the concept of 'entrepreneur' as one of the intrinsic essential elements of economic development.

### **Entrepreneurial Function**

As discussed earlier, the 'entrepreneur' is one essential element (human element) that drives changes in economic life and, more importantly, in the aspect of the production of goods and services. It is noteworthy first to discuss the essence of economic production of goods before we delve into the nature of 'entrepreneurial function.' The main objective of the production of goods and

services is to satisfy the consumers' wants.<sup>210</sup> However, Schumpeter clarifies that in the order of fulfillment of wants, production is not driven towards aiming to satisfy the consumers' wants first, and then all forces resulting in innovation come in second. Innovation takes precedence over satisfying consumers' wants.<sup>211</sup> It is the innovation that creates or re-creates the market, therefore, a new demand emerges. Although the primary goal of production is to satisfy the wants of the consumers, this is just the essence of production in a static state of equilibrium. Meanwhile, in a dynamic state of the economy where there is a constant flux of change, the essence of production is innovation.<sup>212</sup> To explain further, innovation covers five cases: (1) *Innovation on products* —this happens when a new unfamiliar quality of good is introduced to the consumer; (2) *Innovation on method* —this happens when a new way of producing is introduced. This method is normally not yet tested system of production, but it can also be a result of scientific discovery, and this method can also pertain to how products are handled. (3) *Expansion, Creation, or Re-creation of Market* —this is where a new market opens on a certain location<sup>213</sup> it has never entered before. (4) *Innovation on Supply Chain* —This is the acquisition of a new source. It can also be an alternative

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<sup>210</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 58-59.

<sup>211</sup> *Ibid.*, 59.

<sup>212</sup> *Ibid.*

<sup>213</sup> Schumpeter mentioned 'country' as the location whereby the market enters to. However, applying this concept at present times it can also pertain to demographic market, psychographic, behavioral, and sometimes firmographic markets. See Chernev, Alexander. *Strategic Marketing Management*. 8th ed. USA: Cerebellum Press, 2014. eBook. ISBN: 978-1-936572-21-2.

source or raw materials. (5) *Innovation on the Organizational Structure*—this can be the creation of a monopoly, cessation of a monopoly, making way for a new one, and resorption of a monopoly.<sup>214</sup> These forms of innovation involve manufacturing or implementing a combination of new ways of production or as has been repeatedly mentioned in previous parts of this thesis: ‘new ways of combinations’. Hence, the essence of production, as Schumpeter put it, is to “combine materials and forces within our reach,” and any activity that is not coherent with it is just a continuous adjustment. There may be changes going on in an enterprise or industry, but it does not count as development nor are aligned to the nature of ‘innovation.’<sup>215</sup>

Now that we have clarified this matter, a question on the problem of discontinuity must be raised. When new ways of combinations are being introduced, normally the new enterprise does not replace the existing ones. Rather, the new enterprise exists alongside the old ones. Schumpeter used the example of the introduction of stage-coach railways instead of the use of horse-driven public transportation to prove his point. For better understanding, let us use Elon Musk’s introduction of the use of Starlink’s satellite for accessing internet connection to the market as an alternative option compared to the usual cable or Digital Subscriber Line (DSL) internet connection. Starlink is one of the

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<sup>214</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 59.

<sup>215</sup> *Ibid.*

divisions of SpaceX and a company that provides broadband internet using satellite (This is a good example of Innovation on product). Starlink provides internet connectivity to sparsely populated regions where internet company providers using fiber optic cables can not be connected (This is a good example of the second form which introduces of new method, and the third form which is creating a new market opening in places that has never entered before). One of the strengths of Starlink is that they have 15,000 satellites launched in outer space as of June 2021, which is more compared to other competitors like OneWeb and Amazon.<sup>216</sup> To avoid low latency, meaning to avoid slow transmission of data from one point to the next, Starlink's satellites have to orbit Earth closer to Earth. Starlink currently has a Low Earth Orbit (LEO) of approximately 550km above Earth, according to the study done by McDowell,<sup>217</sup> which presupposes the need for an increased number of satellites and faster satellite movement for better and faster coverage. To have faster internet satellite coverage, there is a need for more satellites having Low Earth Orbit (LEO) and faster movement of satellites. To have faster movement of satellites, Elon Musk presented a solution, which is the use of Krypton Hall thruster propellants.<sup>218</sup> Two noble gases are being used for Hall Thrusters to increase movement of satellites in outer space: Krypton and

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<sup>216</sup> Two companies following suit of the 'new combinations' carried out by Elon Musk's Starlink.

<sup>217</sup> Jonathan C. McDowell, "The Low Earth Orbit Satellite Population and Impacts of the SpaceX Starlink Constellation," *ApJ* 892, no. L36 (2020): 13, <https://arxiv.org/pdf/2003.07446.pdf>.

<sup>218</sup> CNET Highlights, "WATCH: Elon Musk discusses Starlink Internet at MWC 2021 – Livestream," YouTube video, June 29, 2021, 13:10, <https://www.youtube.com/watch?v=RcnVTgrgT>

Xenon. Two noble gases are being used for Hall Thrusters to increase movement of satellites in outer space: Krypton and Xenon. In a report and a study by Nakles et al., they suggested that Krypton gas is less expensive, implying it is far more abundant than Xenon. This is an interesting fact because, from a pricing standpoint, this is one of the factors that influenced the subsidy of the production of network terminals of Starlinks. On their website, connecting to the network will cost approximately \$499, excluding the shipping fee of the terminal, taxes, and import duties.<sup>219</sup> On top of that, there's a monthly service fee of \$99. Elon Musk revealed that the terminal cost is around a thousand dollars <sup>220</sup> which literally means Starlink is providing the cost of products and services more than they should get back out of it. It will be more expensive to subscribe to a satellite internet service if the thrusters' gas used by their satellite is Xenon; ergo, choosing Krypton is more feasible (This is an example of Innovation on the supply chain or raw materials). This is an example of a phenomenon of innovation that ticks all five cases or forms of innovation presented by Schumpeter. To answer the question of discontinuity, although Starlink's satellite internet is now in the market as an indicator of new combinations carried out through innovation, the other enterprises that offer the old ways of connecting internet are still present

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<sup>219</sup> Matthew R. Nakles, William A. Hargus, Jr., Joseph J. Delgado, and Ryan L. Corey, "A Performance Comparison of Xenon and Krypton Propellant on an SPT-100 Hall Thruster," *OMB NO. 0704-0188*, August 10, 2011, 1, <https://apps.dtic.mil/dtic/tr/fulltext/u2/a549666.pdf>

<sup>220</sup> CNET Highlights, "WATCH: *Elon Musk discuss Starlink Internet at MWC 2021* – Livestream," YouTube video, June 29, 2021, 18:20, <https://www.youtube.com/watch?v=RcnVTgrgT>

alongside.<sup>221</sup> The only time that the old enterprise will last is to adapt and try to reinvent itself, following the same essence of production in a dynamic state of economy. New entrants constantly challenge the old enterprises as outsiders without any pressure from old production methods. Another question, whenever innovation occurs in the market, is: Does innovation only focus on unused raw materials or sources? Schumpeter clarified that resources or raw materials do not have to be new ones, but they sometimes reuse, repurpose, or re-organize old resources, and they are just being used in a different way or method.<sup>222</sup> Furthermore, questions about discontinuity brought about by innovation are about unemployment. It is true that when innovation takes place, there are huge signs of unemployment, but this does not mean that innovation is always happening. For Schumpeter, sometimes, a surge in employment happens during innovation. Nevertheless, during the cessation of the old ways or methods, unemployment is inherent in capitalist settings, and they are necessary for economic development.<sup>223</sup> Having clarity of the essence of production will also give us clarity in finding the distinct characteristics and nature of the ‘entrepreneur.’ Why is this important? Yuichi Shionoya, a famous Japanese economist who has spent most of his life studying Joseph Schumpeter and has written many articles and books about his works and connecting them to different disciplines such as

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<sup>221</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 60.

<sup>222</sup> *Ibid.*

<sup>223</sup> *Ibid.*

sociology and philosophy, said that the main concept of economic development is comprised of innovation, a carrier, and its means.<sup>224</sup> We have already covered from the previous discussion about the concept of innovation, and it is obvious that Schumpeter's hero as the carrier is the 'entrepreneur.' On the subject of means, it will be discussed later in the succeeding chapters. The term 'entrepreneur' was widely known as "risk taker" in French. The earliest citing of the term 'entrepreneur' was used in 1725 by Richard Cantillon, an Irish-French economist.<sup>225</sup> Over time the term has evolved and has been described and defined by many thinkers. Richard Cantillon thought that entrepreneurs have different activities compared to capitalists; the entrepreneur must not be perceived as synonymous with a capitalist. Ironically, Adam Smith posited that an entrepreneur's activities must be synonymous with the capitalist's; Jean-Baptiste Say, a French economist, thought about entrepreneurs' function as making the state better by means of using materials for production; John Stuart Mill returned to the same definition as it was thought during the 1700s that entrepreneur and capitalist are associated through risk.<sup>226</sup> As we've seen from the mentioned thinkers how they defined and described the 'entrepreneur', it is therefore crucial for Schumpeter, to identify entrepreneur conspicuously systematic with the

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<sup>224</sup> Yuichi Shionoya, "The Origin of the Schumpeterian Research Program: A Chapter Omitted from Schumpeter's Theory of Economic Development," *Journal of Institutional and Theoretical Economics (JITE) / Zeitschrift für die gesamte Staatswissenschaft* 146, no. 2 (Jun. 1990): 320, <http://www.jstor.org/stable/40751279>.

<sup>225</sup> Bruce A. McDaniel, *Entrepreneurship and Innovation: An Economic Approach* (Armonk, New York: M.E. Sharpe, 2002), 31.

<sup>226</sup> *Ibid.*, 31.

concept of economic development. We need to identify the salient features of an ‘entrepreneur’ so that it can be distinguished from the ‘capitalist’. One of the foregrounding definition of the ‘entrepreneur’ when Schumpeter was studying the concept was J.B. Clark’s ‘entrepreneur’s function’ which “[combines] productive factors, to bring them together.”<sup>227</sup> Leon Walras, one of Joseph Schumpeter’s favorite economists, defined entrepreneur as *faisant ni bénéfice ni perte*, which means an entrepreneur who is making “neither profit nor loss” in French.<sup>228</sup> Another economist influential to Schumpeter is Alfred Marshall, who defined the concept of the ‘entrepreneur’ as “management.”<sup>229</sup>

Since an ‘entrepreneur’ is a carrier of economic development, that means the ‘entrepreneur is the one responsible for carrying out ‘new combinations.’ Along with Schumpeter’s definition of the ‘entrepreneur’ is its ‘entrepreneurial function. He highlighted three types of entrepreneurial functions. First, as a “promoter”. Secondly, as a possible “entrepreneur by profession”. And lastly, a “captain of industry.”<sup>230</sup> The entrepreneur as a ‘promoter’ can be best described as an enterprise marketer nowadays. A distinct characteristic of an ‘entrepreneur as promoter’ is someone who is only associated with only pervading innovation in the new market. Social and moral status does not fundamentally concern the

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<sup>227</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 67.

<sup>228</sup> *Ibid.*, 67-68.

<sup>229</sup> *Ibid.*, 68-69.

<sup>230</sup> *Ibid.*, 69.



promoter. For the second stype of entrepreneurial function, the entrepreneur can neither be the enterprise's creator nor the driving power in the process; therefore, the necessity of a face of an enterprise is imminent. The third type of entrepreneurial function assumes the full function of an entrepreneur in carrying out new combinations. This is what Schumpeter called the modern type of entrepreneurial function. It is safe to say that this is the same entrepreneur that can be associated with a CEO like Steve Jobs or Bill Gates. However, Schumpeter further explained that the salient feature of an entrepreneurial function is to "carry out new combinations," and the moment they cease to assume that function is the moment they lose it.<sup>231</sup>

An interesting question raised by Schumpeter: "Why then is the carrying out of new combinations a special process and the object of a special kind of 'function'?"<sup>232</sup> Schumpeter presented three answers to this question. First, entrepreneurs' functions are designed for a dynamic state of the economy. They face the challenges head-on because of the volatility of the market. They are the ones who possess the skills, knowledge, and capability to confront changes. Secondly, if it were easy, many would have been entrepreneurs. If no changes were happening or the economy was in a static state of equilibrium, there would not be a need for entrepreneurs. Lastly, it highlights the difference between a

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<sup>231</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 69.

<sup>232</sup> *Ibid.*, 70.

manager and an entrepreneur. Managers effectively function in a stable system, while Entrepreneurs are influential in an evolutionary and revolutionary economy.<sup>233</sup> This question is still being asked nowadays and considered very relevant: “Why do very few individuals dare to venture into entrepreneurship compared to being employed? The same answer presented by Schumpeter more than eighty years ago can be applied to answer this current one.

Having said all these dichotomies, Schumpeter further asked, how do we know which method is best for production? Schumpeter argued that we have to continue using the same method that has already been tested to work until the entrepreneur introduces a better one.<sup>234</sup>

Another point worth mentioning is the question of the entrepreneur's class. Since the entrepreneur's function is ephemeral, they do not belong to any class compared to landlords, capitalists, or the working class.<sup>235</sup> The question of why the entrepreneur's function is expected to be shortlived will be answered in Chapter Four. It may seem like a simple function for an entrepreneur to assume, but in reality, there are so many factors to consider with respect to carrying out ‘new combinations.’ Its function plays a vital role in economic development, and this function requires a great sense of “initiative,” “authority,” and “foresight”<sup>236</sup>

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<sup>233</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 71.

<sup>234</sup> *Ibid.*

<sup>235</sup> *Ibid.*, 69.

<sup>236</sup> *Ibid.*, 67.

[pointing] entirely in one which is the inundation of innovation to the marketplace.

### **Entrepreneur's Motive**

Economist Thorstein Veblen, a contemporary of Joseph Schumpeter, also presented a definition of an 'entrepreneur' and argued that his definition should not be contested. He maintained that the entrepreneur, or he calls it, as "undertaker," and his function is held to be "coordinating of industrial processes with a view to the economics of production and heightened serviceability."<sup>237</sup> The main function of Veblen's entrepreneur is to facilitate the production of better products or services and, therefore, must be the main motive in assuming its function. The main ethical norm of Veblen's entrepreneur must be driven by altruism because, ideally, the entrepreneur must strive to streamline productivity to make the lives of others easier. Meanwhile, if the entrepreneur classifies with this conduct, the entrepreneur may not be able to fulfill its other function, which is to make a profit. Veblen further argued that the business man or the entrepreneur is expected to behave based on economic conduct, and those who have succeeded in running a business, ergo making a profit, presuppose that they somehow compromise their expectations of moral behavior.<sup>238</sup> Veblen suggested that to

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<sup>237</sup> Thorstein Veblen, *The Theory of Business Enterprise* (New York: Charles Scribner's Son, 1904; repr., New York: Barnes & Noble Digital Library, 2011), 19-20, ISBN: 978-1-4114-6468-1

<sup>238</sup> *Ibid.*, 20.

solve this dilemma, the entrepreneur must have a strong sense of justice to deal with people, and their actions must be guided by moral principles, and the same should be applied to the consumers. Hence, consumers must also be warned to be more cautious when engaging in a trade transaction.<sup>239</sup> Based on Veblen's definition of entrepreneur and based on what has been discussed regarding Schumpeter's, it seems that Schumpeter's entrepreneur is driven by objectivism while Veblen's focus is on representing the whole community, which is an altruistic view of morality.<sup>240</sup> Schumpeter navigates this matter by positing several premises to determine the entrepreneur's moral orientation. Schumpeter raised a point saying that to understand the moral compass of an entrepreneur; one must associate them in relation to understanding the concept of a circular flow of an economy. In a circular flow, we see the production and consumption of goods and services. We've already established earlier that in a static state of equilibrium, the objective is to satisfy the wants of the consumers. We've also found earlier that the dynamic state of the economy exists. In a dynamic state of economy, the needs and wants of consumers change in constant flux. By default, the satisfaction of consumer's wants is a usual motive for economic action, which can be concluded that the entrepreneur is a hedonist. However, Schumpeter clarified that

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<sup>239</sup> Thorstein Veblen, *The Theory of Business Enterprise* (New York: Charles Scribner's Son, 1904; repr., New York: Barnes & Noble Digital Library, 2011), 20-21, ISBN: 978-1-4114-6468-1

<sup>240</sup> Theofanis Papageorgiou & Panayotis G. Michaelides, "Joseph Schumpeter and Thorstein Veblen on technological determinism, individualism and institutions," *The European Journal of the History of Economic Thought* 23, no. 1 (2016): 8, <https://doi.org/10.1080/09672567.2013.792378>.

it is not a proper way to identify the entrepreneur's ethical norm this way. Schumpeter tried to offer non-hedonistic characteristics to justify the entrepreneur's ethics. The first motive of an entrepreneur is the "dream and the will to find a private kingdom," —which means the entrepreneur is driven by the motive to create something he can own and, at the same time, bring people along with them into this "kingdom."<sup>241</sup> This seems to be a combination of altruism and objectivism. It is associated with altruism because it seeks to include the act in the hope of increasing the welfare of others. Secondly, the entrepreneur has the "will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself."<sup>242</sup> The entrepreneur's motive seemed coherent with Immanuel Kant's ethical concept of duty<sup>243</sup> where the entrepreneur aims to 'succeed for the sake of success itself.' However, there are certain aspects of the motive that Schumpeter added in his description, which is "the impulse to fight and to prove oneself superior to others." He also added that the motive was associated with playing a sport, which he metaphorically described as a 'financial race' or a 'boxing match' that the entrepreneur must end up the victor brought about by the entrepreneur's actions.<sup>244</sup> So, for a second, it

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<sup>241</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 79.

<sup>242</sup> *Ibid.*

<sup>243</sup> Immanuel Kant, *The Metaphysics of Morals*, trans. and ed. Mary Gregor, intro. Roger J. Sullivan (Cambridge; New York: Cambridge University Press, 1996), 201, ISBN 978-0-521-56673-5.

<sup>244</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 79.

may seem like the entrepreneur's motive is the same as Kant's principle, the concept of what is a categorical imperative, but how Schumpeter described it makes one convinced to be objectivist. Lastly, I believe this motive to be more Kantian in principle because the entrepreneur's motive is to act in the duty of joy in creation.<sup>245</sup> Therefore, this last motive, as described by Schumpeter, is the most anti-hedonist motive of an entrepreneur. Although one of the indicators of success based on the economic conduct of an entrepreneur is to have a pecuniary gain, which is not the primary objective of the entrepreneur.<sup>246</sup> When we say pecuniary gain, we mean having a monetary return for the entrepreneur's productivity. If this is the case, the entrepreneur's motive of joy in creation is essential to the pervasion of economic development in the market. Otherwise, there would not be any innovation if the main goal is just to make a profit, and there would not be any need for entrepreneurs in the first place in the absence of innovation, as we have already concurred from previous discussions.

Meanwhile, it is noteworthy to discuss the thematic alignment of the methodological individualism approach of Max Weber and Schumpeter in formulating the concept of the entrepreneur. Schumpeter's theory of entrepreneur draws its foundational principles from Weberian origins. According to Langlois, Schumpeter's framework of the concept of the entrepreneur is "an application of

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<sup>245</sup> *Ibid.*

<sup>246</sup> *Ibid.*, 80.

Weber's social theory to the problem of economic growth."<sup>247</sup> For Schumpeter, the greatest characterization of the entrepreneur's motive is the joy of creation. The 'joy of creation' is the motive to carry on the entrepreneur's function in fulfilling one of the essences of economic development, which is innovation. In other words, if we put it in Max Weber's context, Schumpeter's theory of entrepreneurship is a fulfillment of a duty in the spirit of a certain essence of a phenomenon, which, in this case, innovation—making this framework a Weberian provenance.<sup>248</sup> Max Weber's theory of entrepreneurship is a fulfillment of a duty in the spirit of capitalism—making this framework a Benjamin Franklin's provenance.<sup>249</sup> The difference, however, between Weber's and Schumpeter's entrepreneur is in how they arrive at the theory. Schumpeter's framework of inquiry is within the realm of economics, while Weber's is within the spectrum of sociology.

### **Leadership as an Entrepreneurial Function**

In the Islamic culture, there has been a continuous debate about ethical concerns in pursuing entrepreneurship because of the "idea that religion can be connected positively with entrepreneurial leadership is not novel and continues to

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<sup>247</sup> Richard N. Langlois, "Schumpeter and Personal Capitalism," *Economics Working Papers*, no. 199605 (March 1996), University of Connecticut, [https://opencommons.uconn.edu/econ\\_wpapers/199605](https://opencommons.uconn.edu/econ_wpapers/199605), 2.

<sup>248</sup> *Ibid.*

<sup>249</sup> Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, trans. and introd. Stephen Kalberg (New York: Routledge, 2012), 14.

attract scholarly attention.”<sup>250</sup> Following Davide Ravazzoni’s article, he posited that pursuing entrepreneurship could be viewed as a novel act in line with Ibn Qayyim Al-Jawziyya’s concept of *Himma*. Ravazzoni argued that the concept of *himma*, postulated by the Damascene Hanbali scholar Ibn al-Qayyim, is an Islamic expression of entrepreneurial leadership. Furthermore, *himma* is a way of “thinking with intensity about an issue or opportunity, intending to do something about and fulfilling intentions.”<sup>251</sup> Ravazonni associated this concept to reinforce his argument that this is in line with Schumpeter’s concept of entrepreneurial leadership. There are fundamentally two features of Joseph Schumpeter’s concept of leadership: (1) The energy of action and (2) the particular type of motivation.<sup>252</sup> Leadership of an entrepreneur for Schumpeter is based on the function of authority and not on how intelligent they are. They basically do not have to be the smartest in the room to assume their function as leaders. Their main function as leaders is to inspire and to facilitate the act of creating something new.<sup>253</sup> That is why our definition of an entrepreneur is one who carries out new ways of combinations. Entrepreneurs then are not the ones who “[come] up with a new

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<sup>250</sup> Davide Ravazzoni, “Ibn Qayyim Al-Jawziyya’s Himma: Entrepreneurial Leadership As an Expression of the Islamic Tradition,” *Australian Journal of Islamic Studies* 8, no. 2 (2023): 77, <https://doi.org/10.55831/ajis.v8i2.531>.

<sup>251</sup> *Ibid.*, 88.

<sup>252</sup> *Ibid.*, 89.

<sup>253</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 76.



idea: the essence of what they do is to carry it out and fulfill it.”<sup>254</sup> This is also where Schumpeter clarifies the difference between an inventor and an entrepreneur. The inventor is the one who creates a new idea or product, while the entrepreneur is the one who takes action and brings the idea or product to the market in the spirit of innovation.<sup>255</sup> Using Joseph Schumpeter’s concept of entrepreneurial leadership, Ravazzoni was able to connect Ibn al-Qayyim’s *himma* as a “powerful conceptualization of entrepreneurial leadership in Islamic tradition.”<sup>256</sup> By this reason, having been able to have leadership as one of the entrepreneur’s function, we can now have a better distinction between an economic leader entrepreneur and a capitalistic entrepreneur. The type of leadership that the entrepreneur does is to “lead” in the creation of new combinations. Unlike politicians who need to persuade the public to buy into their idea, the entrepreneur simply introduces the newly produced channels to the marketplace and somehow imposes the new demand of the consumers.<sup>257</sup> Moreover, the entrepreneur's leadership resonates not only within the enterprise's organization but also with the industry. As soon as the entrepreneur introduces

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<sup>254</sup> Davide Ravazzoni, “Ibn Qayyim Al-Jawziyya’s Himma: Entrepreneurial Leadership As an Expression of the Islamic Tradition,” *Australian Journal of Islamic Studies* 8, no. 2 (2023): 89, <https://doi.org/10.55831/ajis.v8i2.531>.

<sup>255</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 76.

<sup>256</sup> Davide Ravazzoni, “Ibn Qayyim Al-Jawziyya’s Himma: Entrepreneurial Leadership As an Expression of the Islamic Tradition,” *Australian Journal of Islamic Studies* 8, no. 2 (2023): 90, <https://doi.org/10.55831/ajis.v8i2.531>.

<sup>257</sup> Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*, intro. John E. Elliott, ed. J.M. Robson (New Brunswick, USA; London, UK: Transaction Publishers, 1983), 77.

new combinations, the rest of the industry adjusts and somehow tries to adopt and adapt to the implemented changes brought about by the innovation borne by the entrepreneur.<sup>258</sup> Ironically, the only one the entrepreneur needs to convince is the bank or the 'financier' to loan a fund for economic development. On the other hand, the capitalist entrepreneur exploits the whole new phenomenon brought about by the entrepreneur in the hope of getting a monetary gain.<sup>259</sup>

Schumpeter made a caveat about highlighting the entrepreneur's importance in the whole process of economic development. He never intends to 'glorify' the entire character of the entrepreneur, as most of his readers misconceived. For Schumpeter, the 'entrepreneur' as a function operates as an essential element in economic development because it is the carrier of innovation. One important note to be considered in understanding its nature is that the entrepreneur's function of carrying out new ways of combination does not fully guarantee success. It is also one good reason to point out why very few embark on the path of entrepreneurship. Its journey is not guaranteed because the entrepreneur deals with many unknown terrains. The upside is that entrepreneurship does not have exclusivity. It can be from different walks of life. That is why entrepreneurs can be deemed not to have any social class. Even though entrepreneurs can not be associated with any social class, in the event they become successful in their function, their social status becomes elevated,

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<sup>258</sup> *Ibid.*, 77.

<sup>259</sup> *Ibid.*

according to Schumpeter. More often than not, Schumpeter further noted that they usually come from the lower class and are deemed a newcomer of a bourgeois status. If this is the case, they are expected to conduct themselves coherently to the elite's social norms. The entrepreneurs usually become the center of mockery, alienation, and the tendency to be laughed at.<sup>260</sup> The characteristic of the entrepreneur being disruptive of the status quo and the challenges they experience are one reason they are undervalued in society.

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<sup>260</sup> *Ibid.*

## **Chapter Four: Social Ontology of Money and The Creative Destruction**

### **Social Ontology of Money**

Joseph Schumpeter wrote a great deal of theories about the concept of money in his book *Theory of Economic Development* and his unfinished manuscript *Treatise on Money*. Although it was not readily apparent when he wrote the *Treatise on Money*, he probably began writing his incomplete manuscript around the 1920s. There were many speculations as to why he was not able to complete it, and one of those reasons was

Perhaps [he] hesitated with the publication for similar reason as with another equally unfinished life's work, his *History of Economic Analysis*, the possible conclusion of which he discussed with me [Fritz Karl Mann] only a few days before his death: the scientific resistance that awaited him appeared too great to make one last effort worthwhile.<sup>261</sup>

The “scientific resistance” that Mann was referring to could be the peers of Joseph Schumpeter who were skeptics of his theories during his time; especially during the period before 1950 (the year before his death) when he had already accomplished a lot of successful publication that may have raised provocations to other thinkers in his time. One person in particular who can be associated with the “scientific resistance” was British philosopher and economist John Maynard Keynes, who was a contemporary of Joseph Schumpeter. Apparently, during that period, Keynes’ work *General Theory of Employment*,

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<sup>261</sup> Joseph Schumpeter, *Treatise on Money*, orientation by Fritz Karl Mann, trans. Ruben Alvarado (Aalten, the Netherlands: Wordbridge Publishing, 2014), xxxi, ISBN 978-90-76660-36-3.

*Interest and Money* gained widespread acclamation and validation in the context of economic ideology and policy governance primarily because Keynes' theory presented a practical solution to the "Great Depression" during their period. Mann described Keynes' approach as "...tailor-made to a policy prescription that resonated in countries going through the throes of economic depression."<sup>262</sup> His theory in solving the problems of the Great Depression involved the participation of the government in achieving a static state of economic equilibrium. Schumpeter called this approach "one evil that needed to be avoided" because it was divergent from his advocacy of addressing issues using pure science and "must never be muddled" by other fields of study outside the realm of economics.<sup>263</sup> As has already been established from this paper's second chapter, he called this approach methodological individualism. What Schumpeter was suggesting in solving the problem of depression during his time was to implore the bank to issue loans in the form of credit to entrepreneurs in order to pursue their function in the essence of economic development. He called this proposition as "credit theory of money," while Keynes' proposition, which allows the intervention of the government to solve economic problems, was called the "monetary theory of credit."<sup>264</sup> Although Schumpeter's theory was not widely accepted in his era, his theory was used by many economists as a scapegoat in explaining the problem of the Great Depression during the 1920s. The dynamics

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<sup>262</sup> *Ibid.*, xxxiv.

<sup>263</sup> *Ibid.*

<sup>264</sup> *Ibid.*, xxxv.

of the contrasting theories of Schumpeter and Keynes were very influential in 1948 when academics across other disciplines started discussing the concept of money and monetary policy. It is in this regard that having a solid foundation of understanding the nature of money or, in a philosophical sense, having a better ontology of money is essential to having an acceptable social ontology of economic life. Money is the primary element in driving economic development, and it can be argued that it is one of the important agents that bridges economic life and social life. The importance of understanding the social ontology of money can be best put in Schumpeter's reason that money "is an element of the overall social process and as such a matter for economic theory, for sociology, and finally for historical, ethnological, and statistical fact research"<sup>265</sup> and also philosophical. Hence, Schumpeter's objective in his theory about money was "to understand the 'essence,' the 'meaning,' or the 'function' of money in the economic life process."<sup>266</sup> Laying a substantial groundwork about the ontology of money allows society to implement better monetary policy. This is to say that the influence of better economic activity breeds a better outcome in a social structure. This is mainly the reason why Schumpeter characterizes the economic situation of society as a symptom:

The condition of a people's monetary system is a symptom of all its conditions: a government budget deficit, the manner and spirit of financial policy even without a deficit, every measure of trade and commercial policy at all that promotes or discourages economic

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<sup>265</sup> *Ibid.*, xiv.

<sup>266</sup> *Ibid.*, xvii.

activity, finally the revival or decay of economic life, must exercise a fundamental influence on currency even when they are not immediately visible in every case.<sup>267</sup>

How society handles economic activities and, eventually, economic problems are directly proportional to how society understands the social ontology of the concept of money and its relation to a monetary policy. This becomes a revelation of the real nature of a social structure. This is an invitation of Schumpeter to study economic life from a much broader perspective. Schumpeter used an analogy about the collapse of German currency, and many (during that period) concluded that the main cause of the fall was due to the invasion of Ruhr, and no one posited a theory that the cause of the economic downfall at that time was primarily a monetary policy problem in the first place.<sup>268</sup>

### **I. The Physical Nature of Money**

The proclivity to understand a concept of phenomenon is to understand its intrinsic and extrinsic components. In the context of money, the extrinsic component is its material composition. In the primitive era, the purpose of an exchange of goods was not for the purpose of consumption and use. It was for the sake of further exchange until one gets the desired goods in the household. The currency of money was not present during the primitive times. One can only imagine how difficult it would be to eventually and finally obtain a certain good from numerous exchanges or transactions with numerous individuals. Schumpeter

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<sup>267</sup> *Ibid.*, 2.

<sup>268</sup> *Ibid.*

described this primitive barter transaction as “very time-consuming, inconvenient, and often impossible to find an exchange partner who has just what you need.”<sup>269</sup> These barter systems just kind of evolved by themselves, and there was no rationality behind them. Its evolution was not a product of the rigorous decision-making of the early humans done collectively, nor was there an influence of methodological influence of society. It was just practically necessary to have a material good as a means for an exchange, and this transaction was not thoughtfully designed by society. This nature of money can be traced back to Aristotle’s supposition that money is used as a ‘medium of exchange.’<sup>270</sup> This is the first intrinsic nature of money, according to Schumpeter.

Another important note Schumpeter highlighted in a barter transaction was that people usually use non-valuable goods from their household as a medium of exchange. <sup>271</sup> This makes sense because it would be counterproductive to exchange something valuable possession in order to obtain goods for your household. German sociologist, economist, and political theorist Max Weber, in his book *General Economic History*, attested to the same theory and described that at one point in the old times of Russia, fur money “consisting of bits of fur with no use value” was used for barter transaction and he even appended that in Southern regions of Russia, the form of strips of cotton which has no real value

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<sup>269</sup> *Ibid.*, 19.

<sup>270</sup> Joseph A. Schumpeter, *History of Economic Analysis*, ed. Elizabeth Boody Schumpeter, intro. Mark Perlman (Taylor & Francis e-Library: Routledge, 2006), 59.

<sup>271</sup> *Ibid.*, 21.



was used and was eventually adapted for service as token money.<sup>272</sup> In addition to the historical evolution of the material construct of money, Schumpeter highlighted the works of Montesquieu, and John Stuart Mill, both attested to the same phenomenon of the use of goods that are of no value in every household for the purpose of barter. According to Mill, the Portuguese used ‘macute,’ a garment that was gradually “reduced to an unusable piece of cotton material or mat,” as a means of exchange.<sup>273</sup> This phenomenon then has evolved into a different form of exchange. Barter is an exchange of goods, but when an individual finds it necessary to “accept in exchange what one does not want in order to get what one does want by means of a further act of barter,” Schumpeter calls it an ‘indirect exchange.’<sup>274</sup> For many years, thinkers accepted this traditional view of the nature of money as a medium of exchange, but Schumpeter offers a different historical context about the nature of money, which brings us to the second nature of money: money as a stored value. He explains this concept of indirect exchange as a “subsidiary means of commerce,” making it another:

...viewpoint that the original medium of exchange would have been the most marketable commodity would seem to take a back seat to the viewpoint that the original medium of exchange would have been a material that one does not gladly part with and only does so out of necessity. And this latter viewpoint indicates **hoarding and not exchange** mediation as the 'most original' function from which the

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<sup>272</sup> Max Weber, *General Economic History*, trans. Frank H. Knight (Mineola, NY: Dover Publications, Inc., 2003; originally published 1927 by Greenberg, Publisher, Inc., New York), 178, ISBN 9780486147765.

<sup>273</sup> Joseph Schumpeter, *Treatise on Money*, orientation by Fritz Karl Mann, trans. Ruben Alvarado (Aalten, the Netherlands: Wordbridge Publishing, 2014), 21-22, ISBN 978-90-76660-36-3.

<sup>274</sup> Joseph A. Schumpeter, *History of Economic Analysis*, ed. Elizabeth Boody Schumpeter, intro. Mark Perlman (Taylor & Francis e-Library: Routledge, 2006), 59.

remaining ones may have evolved, although they became more important, with exchange mediation in particular doubtlessly growing up into the fundamental aspect.<sup>275</sup>

Money as a stored value was goods that were hoarded items in the household. This viewpoint provides a distinct nature of money, especially in the context fast forward to the present times; this is broadly called as a deferred payment. This viewpoint is not something new, as Schumpeter credits this to Aristotle.<sup>276</sup> Schumpeter further agreed with the supposition of Aristotle that if money is a means for exchange and naturally has value as a hoarded item, therefore, it must also be a means to measure a unit.<sup>277</sup> This means that money's feature is intrinsically the quantity and quality of the commodity contained in a coin, a bill, a fur, a macute, or any other material composition used for exchange. To fulfill the purpose of money (Schumpeter used the term for "convenience"), people decided to put a stamp on it "in order to save the trouble of [weighing] it all the time."<sup>278</sup>

## **II. The Nominal Nature of Money**

Although Plato highlighted that money is a symbol provides an evolved ontology of money. Schumpeter did not want Plato to get credit for the theory of the evolving nature of money because, for him, Plato remarked money as a

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<sup>275</sup> Joseph Schumpeter, *Treatise on Money*, orientation by Fritz Karl Mann, trans. Ruben Alvarado (Aalten, the Netherlands: Wordbridge Publishing, 2014), 23-24, ISBN 978-90-76660-36-3.

<sup>276</sup> Joseph A. Schumpeter, *History of Economic Analysis*, ed. Elizabeth Boody Schumpeter, intro. Mark Perlman (Taylor & Francis e-Library: Routledge, 2006), 59-60.

<sup>277</sup> *Ibid.*, 60.

<sup>278</sup> *Ibid.*

symbol just to facilitate the exchange of goods in relation to the “facts of the division of labor and market commerce.”<sup>279</sup> For Schumpeter, it was just a comment made by Plato without any systematic reflection on the concept itself. Meanwhile, Schumpeter credits Aristotle for the evolution of the nature of money as a Nominal phenomenon. This is the part when society finally accepts the concept of money by putting a stamp on it. The transition from different means of a commodity in exchange for goods to a stamped coin certifies its quantity as purely “declaratory,”<sup>280</sup> Hence, the derivative term of money is “νόμισμα,” which means ‘currency’ and its root word “νόμος” which means ‘law.’ Money is by the declaration of the law of the society certifying it as a statement policy for its utility. The value of the money now is no longer derived from the physical commodity but based on the agreement of an institution. Money now is based on a legal or social convention rather than based on its physical nature. Schumpeter was leaning towards Aristotle’s understanding of money as a physical commodity (based on its physical nature) rather than the nominal nature of money, mainly because Aristotle also claimed that money is a good. He found himself in a dilemma because of Aristotle’s supposition about money because he refused to believe the Aristotlean or, in the case of medieval times, the Scholastic view of reality. Thomas Aquinas even added the Divine Order in connection with the

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<sup>279</sup> Joseph Schumpeter, *Treatise on Money*, orientation by Fritz Karl Mann, trans. Ruben Alvarado (Aalten, the Netherlands: Wordbridge Publishing, 2014), 38-39, ISBN 978-90-76660-36-3.

<sup>280</sup> *Ibid.*, 39.

concept of money, and Schumpeter believed that this additional divine perspective did not change the nature of economic thought at all. Meanwhile, Schumpeter mentions the evolution of Scholastic Economic thought through late thinkers such as Buridan and Oresme, who developed their own theory considering the physical nature of money.<sup>281</sup>

### **III. Three Currency Ideals**

Schumpeter brought forth another aspect of money in relation to how a healthy economic life should be. This underpins the understanding of the role of money in society. There are three currency ideals that the state of society tries to solve when they are in turmoil. (1) The increase of purchasing power —deflation, (2) The decrease of purchasing power —inflation, and (3) Constant purchasing power —stability. Each of these ideals characterizes indicative assumptions of how robust the welfare of economics and society is.<sup>282</sup>

In a social context, deflation is a phenomenon usually tied up to depression or, in the context of economics —recession. What Schumpeter is imploring in dealing with such a phenomenon is to broaden its understanding. There is no denying that this breeds an unfavorable outcome, but on the other hand, this phenomenon favors different economic elements such as lowering of interest rates of loans and leniency of obtaining credit from the bank. This allows the entrepreneur to have better freedom to carry out its function and fulfill its

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<sup>281</sup> *Ibid.*, 41.

<sup>282</sup> *Ibid.*, 7-8.

objective of materializing economic development.<sup>283</sup> This is not to say that Schumpeter is throwing shades at individuals who are harshly affected by the state of depression, but with respect to having a philosophical inquiry in understanding the phenomenon and staying true to his methodology, highlighting the distinction between problems in economic policy and social policy will help society better solve problems.

When one talks about inflation, usually one that comes into mind is the news headline causing the economic downfall of society. Schumpeter provided clarity on the subject and argued implicitly that this is far from the news headline that we usually hear about inflation. Decreasing the purchasing power means decreasing the value of the money. When the value of money decreases, the propensity is the prices go high because of the supply and demand. Although many economists will say that inflation is a bad thing, deliberately decreasing the value of money means putting a stop to the prolonged aggregation of wealth.<sup>284</sup> Inflation may not just be an economic phenomenon but also hinges on a connection to social and ethical questions on policies. If the value of money decreases, this means the wealthy individuals too will be affected, and inflation pacifies wealth disparities. Moreover, inflation also promotes “production and relief of the most active element of the economy, the entrepreneur.”<sup>285</sup> Inflation somehow brings aid to entrepreneurs because the real value of their decreases. It

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<sup>283</sup> *Ibid.*, 8

<sup>284</sup> *Ibid.*, 9.

<sup>285</sup> *Ibid.*

is also an indicator of an increase in spending for consumers, allowing enterprises to possible growth. Schumpeter mentioned, “Kernel of Truth with factual errors.”<sup>286</sup> What he meant by this was that inflation could be used to spur productivity and help entrepreneurs facilitate economic development, but he warns that the society that wields it may misuse its function, resulting in unfavorable economic and social outcomes.

For Schumpeter, stability means having a steady reference of money. The reference to money must be “reliable,” and the one representing it calls it “sound money man,” meaning having an honest representative making decisions about it.<sup>287</sup> Schumpeter is calling out those in charge of implementing monetary policies to hold the value of money consistently. Ethical governance of money is necessary for having a stable currency in a society. Back then, gold was deemed a steady reference of money; however, due to its volatility and complexities governing monetary policies around it, there seems to be a need for ethical inquiry in an institution to keep an eye on any scandals or errors.

#### **IV. The Unfinished Business of Money**

It was unfortunate that Joseph Schumpeter was not able to finish his manuscript on the *Treatise on Money*. The economic and philosophical narrative of Schumpeter’s work on the concept of money is worth examining because of the speculative possibilities of what could have unfolded. His struggle to reconcile

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<sup>286</sup> *Ibid.*

<sup>287</sup> *Ibid.*, 10-11

the physical and nominal nature of money together was very noticeable on his writing. Although he acknowledges his stance and leans on the side of money as purely having a physical nature, his explanation is somehow vague. A strong probable reason why his commitment to the physical nature of money was perhaps because of his commitment to his methodological individualistic approach in positing theories. Schumpeter's contemporary rival beat him to it in finishing and publishing a manuscript about money having kind of identical title: *Treatise on Money: The Pure Theory of Money*. Keynes rendered a more philosophical and detailed account of money. Signaling a contrast to Schumpeter, he leaned on the nominal nature of money. For him, money is a device controlled by a State policy. In order to solve the dilemma of Schumpeter between leaning on the physical nature of money and the nominal nature of money, his reconciliation of both natures is based on having two distinct concepts: 'Money' and 'Money of account.' 'Money of account', as defined by Keynes, is in which "debts, prices, and general purchasing power are *expressed*."<sup>288</sup> On the other hand, 'Money,' be it in its physical nature or nominal nature, "derives its character from its relationship to the 'money of account.'<sup>289</sup> If this is the case, the existence of 'Money' is dependent on the existence of 'money of account.' What is the distinction between money and money of account? The money of account is the

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<sup>288</sup> John Maynard Keynes, *A Treatise on Money, Volume I: The Pure Theory of Money*, 2nd ed., vol. 5 of The Collected Writings of John Maynard Keynes (Cambridge: Cambridge University Press, 2013), 3, first published 1930.

<sup>289</sup> *Ibid.*

“description or title,” and “the money is the thing which answers to the description.”<sup>290</sup> To explain better, Keynes used a metaphor about the title ‘King of England’, whereby associated with ‘money of account’ while ‘King George’ is associated with the concept of money. As mentioned earlier, money of account are debts and prices. Since they are debts, that means it is a deferred payment, while prices are concepts associated with sales or purchases, and therefore, both concepts offer contracts. If both offer contracts, that means both are enforceable by law.<sup>291</sup> This is when Keynes arrived at the real nature of money, where its evolution becomes as a ‘money’ proper because of the State’s intervention, as he best describes below.

The State, therefore, comes in first of all as the authority of law which enforces the payment of the thing which corresponds to the name or description in the contract...It is when this stage in the evolution of money has been reached that Knapp's chartalism—the doctrine that money is peculiarly a creation of the State—is fully realised.<sup>292</sup>

Keynes derived his argument from Georg Friedrich Knapp, a German economist who posited that “Money is a creature of law”<sup>293</sup> Knapp further argued that money has to be a ‘specie’ possessed by the state for the sake of money gaining its power. In other words, it is by necessity that money must be State-owned; otherwise, money in itself does not have power. Another feature of money by

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<sup>290</sup> *Ibid.*

<sup>291</sup> *Ibid.*

<sup>292</sup> *Ibid.*, 4.

<sup>293</sup> Georg Friedrich Knapp, *The State Theory of Money* (London: Macmillan & Company Limited, 1924), 1.



necessity is that it must be “continuous”<sup>294</sup> Money, as he explained, must be referenced to a certain commodity that has a stable value even if money is replaced by a different ‘money.’ This is for the sake of keeping its consistency to any transaction made using it. If, for example, we replace the bills with cryptocurrency, the value of the cryptocurrency must be referenced to the old value of the bill. As discussed earlier, Keynes has established that money of account is expressed contract as an offer and as an acknowledgment of debt. Under the category of contract as an acknowledgment of debt, money can be recognized as a private debt—he calls it Bank money.<sup>295</sup> Meanwhile, if money may no longer be represented as a private debt but a debt owed to the State, then it becomes a validation that the money owed is as good as real money value by State declaration. He calls this Representative money.<sup>296</sup> This creates a distinction between fake money and real money. No one can just go around spending money or borrowing money just because someone believed it so as real, but it is backed by the government that the money being spent or being borrowed is, in fact, ‘represented’ by the State. Now, under the ‘representative money,’ there are three forms of money, according to Keynes. First is the ‘commodity money’ which is “composed of actual units of a particular freely obtainable, non-monopolised

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<sup>294</sup> John Maynard Keynes, *A Treatise on Money, Volume I: The Pure Theory of Money*, 2nd ed., vol. 5 of The Collected Writings of John Maynard Keynes (Cambridge: Cambridge University Press, 2013), 4, first published 1930.

<sup>295</sup> *Ibid.*, 5.

<sup>296</sup> *Ibid.*, 5-6.

commodity,”<sup>297</sup> which is parallel to Schumpeter’s physical nature of money as a unit of measure. The second form is the ‘fiat money’ which is a “representative (or token) money—now generally made of paper except in the case of small denominations—which is created and issued by the State,”<sup>298</sup> which again in parallel to Schumpeter’s physical nature of money it can be characterized as money as a medium of exchange. The only difference is that it is money as a medium of exchange that is legally tendered by the government. The last form is what Keynes calls ‘managed money,’ which is “similar to fiat money,” but only this time, the State references this money to other currencies to ensure that the value of the money does not diminish.<sup>299</sup> They link this money to something measurable like gold or other currencies.

Keynes’ approach in abstracting the concept of money becomes a bit more complicated from here on, but his reconciliation of the nature of money brings a great contribution to the advancement of the study of money in the field of economics and philosophy. His approach seemed like the Hegelian dialectic method because he just made a synthesis between Schumpeter’s study of the physical nature of money and the nominal nature of money, although he did not mention anything about knowing about his work. Coincidentally, there seemed to be a positive contrast between Keynes’ and Schumpeter’s theory on the ontology

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<sup>297</sup> *Ibid.*, 6.

<sup>298</sup> *Ibid.*, 7.

<sup>299</sup> *Ibid.*

of money. Despite their differences in their studies, both can be assumed that money plays a vital role in economic life and social life. Schumpeter believed that money is essential in the State's fulfillment of one of its functions, which is monetary policy, while Schumpeter believed that money in the form of credit helps boost the entrepreneur's function to carry on new combinations and fulfill the vision of innovation. However, the dialectic on the nature of money does not stop here. Philosophically speaking, both arguments do not satisfy the principle of abstraction. Both thinkers have drawn a social ontology of money subjectively, but there needs to be an underlying principle that must be arrived at objectively. This chapter serves as an exposition of Schumpeter's social ontology of money and this also highlights the potential of a philosophical inquiry about the concept of money. And it appears that the potential is very promising.

### **Creative Destruction**

The concept of Schumpeter's Creative Destruction was already hinted at in his book *Theory of Economic Development*, published in 1911. However, a comprehensive exposition of it came about 31 years after publishing the *Theory of Economic Development*. Schumpeter started writing *Capitalism, Socialism and Democracy* in 1938 and published the book in 1942. This was the period when the Second World War was beginning to start its traction. This book *Capitalism, Socialism and Democracy* was well received after its publication despite Schumpeter's belief that this book was a "potboiler and...it spawned many

thousands of future citations by journalists, political scientists, sociologists, economists, and historians.”<sup>300</sup> Be that as it may, be, this book appeared to be his implicit full admittance that strictly following his methodological individualism will not be enough to understand the ontology of economic life fully. He then realized that he needed to implement theoretical and abstract analysis to understand the phenomenon and find the relationship of the phenomenon to other constructs, especially social constructs. He used his methodological individualism by breaking down how Karl Marx is viewed from different fields of study. He believed that Marx, the sociologist, was wrong because of his “oversimplified view of social class.”<sup>301</sup> This version of Marx only believed that there are two classes of society—(1) the capitalists who own and control the means of production and (2) the proletarians who do not.<sup>302</sup> Schumpeter raised an interesting critique against Marx’s claim, and he highlighted that with capitalism, there were many proletarians who started or founded businesses and eventually became capitalists themselves. In other words, Marx seemed to ignore the possibility of the cyclical nature of an individual’s economic life, and every individual undergoes the two phases of the economic cycle—prosperity and depression. Another version of Marx that Schumpeter did not agree with is Marx the economist. With the maturation of capitalism, Marx believed that the working

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<sup>300</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 347-348.

<sup>301</sup> *Ibid.*, 349.

<sup>302</sup> *Ibid.*

class total income share would decline and eventually lead to depression and revolution against the capitalist.<sup>303</sup> In short, the cause of depression for Marx is capitalism. He believed that the “wealthiest state of society leads to the suffering of the majority—and since the economic system leads to this wealthiest condition, it follows that the goal of the economic system is the unhappiness of this system.”<sup>304</sup> Schumpeter on the other hand, presented his first rebuttal against Marx’s remark about capitalism. Looking at the evidence according to Schumpeter, it appears that the workers’ income not only “grown dramatically” but also their standard of living also had risen.<sup>305</sup> Schumpeter agreed with Marx’s prophetic claim that a revolution will eventually happen against capitalism but Schumpeter had something different kind of revolution in mind. The reason why Marx’s prophetic claim the revolution of the proletarians will take place is because he failed to understand the individualistic nature of society. Formulating an understanding of social structure with a collectivist nature was a mistake because it “strips of all determinateness [of the individual] so as to class him as capitalist or worker.”<sup>306</sup> Karl Marx’s historical materialism navigates the field of political economy, while Schumpeter stressed the understanding of economic life through its evolutionary dynamic nature. Through his methodological

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<sup>303</sup> *Ibid.*

<sup>304</sup> Karl Marx, Dirk J. Struik, and Martin Milligan, eds., *Economic and Philosophic Manuscripts of 1844* (New York: International, 1964), 1st American ed., 69.

<sup>305</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 349.

<sup>306</sup> Karl Marx, Dirk J. Struik, and Martin Milligan, eds., *Economic and Philosophic Manuscripts of 1844* (New York: International, 1964), 1st American ed., 159.

individualism, Schumpeter was able to “distinguish entrepreneur from the capitalist” which Marx failed to do because he had “no adequate theory of enterprise.”<sup>307</sup>

The only version of Marx that Schumpeter agrees with is Marx the Prophet and the Teacher. Due to the Age of Enlightenment, society felt that human thought was liberated through its rationalization. However, the endowment of religious significance needs to be replaced. It is the society’s propensity to resist the introduction of a new way of thinking and find somehow a parallel or similar nature which the people accept and “embrace [Marx’s] message of the terrestrial paradise of socialism.”<sup>308</sup> It appeared, however, that the perceived promise of “socialistic deliverance” from the ills of capitalism was broken and fostered the “rational proof” to be uncertain.<sup>309</sup> Schumpeter’s second rebuttal against Marx, claiming that capitalism has been causing depression in society, is that he somehow agrees with him, but at the same, it is the same capitalism that “disheartened bourgeois and elated intellectuals.”<sup>310</sup> Schumpeter further argued that historically, we’ve seen certain cycles of prosperity and depression over periods of time, and evidently, capitalism has shown positive effects on society. Meanwhile, he has a different theory about what is causing depression, and he

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<sup>307</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 349.

<sup>308</sup> *Ibid.*

<sup>309</sup> *Ibid.*, 350.

<sup>310</sup> *Ibid.*

seems to raise an indictment against Keynes' economic theory, which is pointing the finger at the "difficulties incident to the adaptation to a new fiscal policy, new labor legislation, and a general change in the attitude of the government to private enterprise" had made the depression worse.<sup>311</sup>

What hints me to affirm that Schumpeter's book *Capitalism, Socialism and Democracy* was a full departure from his methodological individualism approach is that he suddenly started inquiring about questions about both social facts and, at the same time, in conjunction with economic facts. Schumpeter asked several questions, such as:

How can one understand these issues? Why, after seven decades of struggle, did capitalism triumph over communism? Are exorbitant executive pay schemes and continual accounting frauds corruptions of capitalism or its natural state? When people ask about terrorists "Why do they hate us so much?" what part does capitalism play in the definition of "us"? How long can China and other countries sustain their economic progress without granting more political liberties to their people?<sup>312</sup>

So, Schumpeter no longer focuses on engaging inquiry on pure economic theories. Still, he is putting an interdisciplinary mix of inquiry on sociology, economics, and philosophy (although he would not admit this aspect). He then asked his famous question on capitalism: "Can Capitalism survive?" His immediate response was: "No. I do not think it can."<sup>313</sup> Schumpeter further discussed that this question is, in fact, irrelevant. His objective in this part of his

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<sup>311</sup> *Ibid.*

<sup>312</sup> *Ibid.*, 5-6.

<sup>313</sup> *Ibid.*, 61.

book is not to provide a prophetic claim but to raise a theoretical and abstract analysis of a certain phenomenon and use it as enough evidence to arrive at a particular observable pattern and invoke a phenomenon that is “inevitable” or “necessary.”<sup>314</sup> Schumpeter then incorporates philosophical inquiry as his methodological individualism theoretical and abstract analysis, using empirical and positivist approaches to study. His book *Capitalism, Socialism and Democracy* is an exposition of the ontology of capitalism and socialism, and he wishes to provide a theory on how these two sociological concepts interplay with democracy. In his discussion about capitalism, he is “at pains to demonstrate why capitalism has been a very good thing—and then underscore its fragility.”<sup>315</sup> Why the need to inquire about the ontology of capitalism and socialism? Schumpeter saw it necessary because it was at this time that the misconception about capitalism and market competition was prevalent. Many thinkers believed during his time that there was an “imaginary golden age of perfect competition” and that capitalism’s increase in output (productivity) affected the welfare of society.<sup>316</sup> Having a better understanding of the ontology of capitalism will lead us to a better understanding of his concept of ‘creative destruction.’

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<sup>314</sup> *Ibid.*

<sup>315</sup> *Ibid.*, 351.

<sup>316</sup> *Ibid.*, 81.



## **I. On Capitalism**

He maintained in the statement of his thesis about the exposition of the ‘creative destruction’ as a process:

The thesis I shall endeavor to establish is that the actual and prospective performance of the capitalist system is such as to negative the idea of its breaking down under the weight of economic failure, but that its very success undermines the social institutions which protect it, and “inevitably” creates conditions in which it will not be able to live and which strongly point to socialism as the heir apparent.<sup>317</sup>

Capitalism’s demise is a result of its success and its failures, and because of its cyclical nature, it will eventually and by “necessity” transition to socialism. He further argued that he maintains the conclusion, but it does not follow that he advocates socialism. He uses a metaphor as an explanation of his conclusion by saying that just because a “doctor predicts that his patient will die persistently, this does not mean that he desires it.”<sup>318</sup> Schumpeter’s first order of business in supporting his arguments about the concept of ‘creative destruction’ is to debunk first all misconceived ideologies about capitalism and socialism. It is also important to note that ‘creative destruction’ is a phenomenon only present in capitalism.

First, Schumpeter believes that economists and other thinkers are too drawn to the measurement of the production of society as a basis of human flourishing. He does not negate this method, and he believes that this method “is

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<sup>317</sup> *Ibid.*, 61.

<sup>318</sup> *Ibid.*, 63.

sufficiently reliable to give us a general idea” of a good representation of output as a “test of economic performance.”<sup>319</sup> Nevertheless, one must take into account that when innovation takes place, this method of measuring production “would still fail to convey an adequate idea of what it means for the dignity or intensity of pleasantness of human life.”<sup>320</sup> On the other hand, the method of measurement is reliable if our only objective is to measure money. For Schumpeter, an increase in income does not connote the satisfaction of happiness of humanity, but it does not also mean that when capitalism rises to success, it follows that the workers’ wages go down. Schumpeter found that the surge of expenditures of the masses is on “personal services and handmade commodities,” where the prices of such commodities were considered highly expensive.<sup>321</sup> He uses an example where the “modern workman” is finally able to afford to pay for modern dentistry, which Louis XIV could only afford at that time. Another proof that capitalism is the cause of the increase in wages is when “factory girls” who are working for an enterprise that manufactures silk stockings that only Queen Elizabeth would afford and wear are now accessible for purchase by them. This means capitalism’s essence of production is to satisfy the wants and needs of the mass consumers and not just to satisfy the wants and needs of the bourgeoisie. This was an argument against Marx’s claim that capitalism lowers the wages of the workers.<sup>322</sup>

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<sup>319</sup> *Ibid.*

<sup>320</sup> *Ibid.*, 66-67

<sup>321</sup> *Ibid.*, 67.

<sup>322</sup> Karl Marx, Dirk J. Struik, and Martin Milligan, eds., *Economic and Philosophic Manuscripts of 1844* (New York: International, 1964), 1st American ed., 85.

Secondly, the conception that the Industrial Revolution was the cause of the increase of production but not the increase of wages of labor. This is, again, a Marxian conception. Schumpeter and Marx both agree that the advancement of technology is caused by capitalism.<sup>323</sup> The difference between the two thinkers is that Marx believed that advancement is caused by capitalism through human labor, while Schumpeter believed that innovation is brought about by capitalism through the fulfillment of the entrepreneur's function, which is to carry forward new combinations. Hence, as Schumpeter puts it below, the introduction of new combinations caused the Industrial Revolution.

These revolutions periodically reshape the existing structure of industry by introducing new methods of production—the mechanized factory, the electrified factory, chemical synthesis and the like; new commodities, such as railroad service, motorcars, electrical appliances; new forms of organization—the merger movement; new sources of supply—La Plata wool, American cotton, Katanga copper; new trade routes and markets to sell in and so on.<sup>324</sup>

Third and lastly, the belief that the economic state tends to be in a static state of equilibrium. This is where Marx and Schumpeter, fully agree with each other in terms of line of thinking about the nature of the economic state. Marx rejected the key tenet of Adam Smith and other classical economists during their time that there is an 'invisible hand' of God that consistently corrects the economic equilibrium.<sup>325</sup> This claim suggests that all economic elements and

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<sup>323</sup> *Ibid.*, 81.

<sup>324</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 68.

<sup>325</sup> Karl Marx, Dirk J. Struik, and Martin Milligan, eds., *Economic and Philosophic Manuscripts of 1844* (New York: International, 1964), 1st American ed., 71.

agents tend to equalize naturally. For Marx, we do not live in an economy where the equilibrium is static because we see inequalities everywhere. The economy favors the interest of the capitalist and downplays the interest of proletarians. Meanwhile, Schumpeter agrees with Marx that there is economic disparity, but he departs with Marx's line of thinking by positing that the cause of the disparity is a natural phenomenon called the business cycle, putting our economy in a dynamic state. Thus, this is the nature of 'creative destruction'—the circular flow of two phases of the business cycle, which are prosperity and depression.<sup>326</sup> As established from the previous writing of this paper, this business cycle's nature is *ipso facto*, where a phenomenon tends to act as a "recurrent rejuvenation" of the whole process.<sup>327</sup> Therefore, the essence of 'creative destruction' is vicissitudes, and it is directly proportional to how fast the innovation takes place.<sup>328</sup>

Schumpeter further highlighted the positive effects of creative destruction, which he calls prosperity. First, creative destruction allows prosperity through the adaptation of new trends and advancement of policies related to economy, politics, culture, and Social legislation. It was evident that with every introduction of new technology, new market, new product, new organization, and new market, the rest of the society follows suit and must adapt to the new combinations.<sup>329</sup>

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<sup>326</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 68.

<sup>327</sup> *Ibid.*, 68.

<sup>328</sup> *Ibid.*

<sup>329</sup> *Ibid.*, 68-69

Another positive side effect of ‘creative destruction’ is unemployment. This may come as a shock, but for Schumpeter, unemployment, like poverty, is a phenomenon that capitalist evolution itself can not eliminate.<sup>330</sup> However, this phenomenon allows individuals to hone their skills through the period of adaptation brought about by innovation. Schumpeter calls this prosperity effect of creative destruction ‘Supernormal’ unemployment. Of course, Schumpeter did not ignore the phenomenon of unemployment brought about by “war effects, dislocations of foreign trade, wage policies,” and natural calamities such as the recent COVID-19 pandemic.<sup>331</sup> He also believes that the real tragedy in unemployment is the unemployment ‘*per se*’ plus the “impossibility of providing adequate for the unemployed without impairing the conditions of further economic development.”<sup>332</sup> For Schumpeter, this is where the state should be intervening in case this happens.

To verify if this creative destruction phenomenon is favorable to a capitalistic society, Schumpeter pointed out the instance where entrepreneurship overthrows feudalism. The rise of capitalism opened opportunities for entrepreneurs to own their private enterprises to access credit. This phenomenon was beneficial for the bourgeoisie because of the incentives it brought for their success in business and, at the same time, allowed the workers to pursue business

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<sup>330</sup> *Ibid.*, 69.

<sup>331</sup> *Ibid.*

<sup>332</sup> *Ibid.*, 70.

freely and reach the same social status as the bourgeoisie.<sup>333</sup> On the other hand, entrepreneurship brings an equal level of playing because of the element of failure. When a bourgeoisie fails at business, they either maintain their social status from their savings or levels with the working class because of economic inadequacy.

With creative destruction, the transition of the economic school of thought from thinking that enterprises are in a state of perfect competition to monopolistic competition. Every new combination being introduced in the market will take place the old combinations. The new combinations will assume a monopolistic nature since the rest of the market will be unfamiliar with new developments in business. This is contrary to the popular belief of neoclassicist economists who thought that capitalism would reach its apex of technological advancements as he puts it, “technological possibilities are an uncharted sea.”<sup>334</sup> After the rise of businesses having a monopolistic nature comes the rise of oligopoly, in which

Small number of large and powerful firms compete with one another in the same line of business: oil, steel, automobiles, chemicals, and a few others. Most of these companies are engaged in mass production, mass distribution, or both;<sup>335</sup>

Schumpeter believes that an economic state with enterprises having an oligopolistic nature will result in not having a “determinate equilibrium” this

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<sup>333</sup> *Ibid.*, 74.

<sup>334</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 118.

<sup>335</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 354.

fosters a market with “a dog eats dog” economic environment as he characterizes it as enterprises having “endless of moves and countermoves, and indefinite state of warfare between firms.”<sup>336</sup> If this phenomenon continues, a capitalist society will eventually reach its demise, and the root cause of it is that “capitalism has developed the seeds of its own destruction.”<sup>337</sup> The individualistic nature of the people of capitalist society will abuse its freedom, and they are “free to make a mess of their lives,” and their individualistic tendencies will become their tool to “hang themselves.”<sup>338</sup>

## II. On Socialism

Schumpeter raises another epistemological inquiry on Socialism: “Can Socialism work?” He believed it would work but only on a certain condition—it must “replace an economy based on mature big-business capitalism [society].”<sup>339</sup> If that is the only condition for socialism to succeed, then the rest of the society that it will try to replace will not work, for example, a society that was just brought about by a violent revolution.

There are five benefits of Socialism, according to Schumpeter. First, the society will no longer have to worry about having a hostile economic environment. All information in a socialist society will be centrally located because the authority will also be centralized. If the authority is centralized, the

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<sup>336</sup> *Ibid.*

<sup>337</sup> *Ibid.*, 355.

<sup>338</sup> *Ibid.*, 357.

<sup>339</sup> *Ibid.*, 360.

role of the socialist state then will “act as a clearing house of information and as a coordinator of decisions.”<sup>340</sup> Secondly, innovation and advancement of technology will also be centrally located. The innovation will also take place in the market faster because there will not be any “stubborn resistance along the way.”<sup>341</sup> Fourth, when people in a socialist society get downsized, the central planning authority will just redeploy to another project.<sup>342</sup> In a socialist society, unemployment will not be a main social issue, and people will only be unemployed due to the advancement of technology. Lastly, Schumpeter believed this benefit is the most important; the socialist state has a monopoly of the pricing, and they eradicate all the bureaucracies that normally impede progress in capitalism. They may even lower pay levels and remove taxes.<sup>343</sup>

If capitalism overthrew the feudal system, socialism would overthrow the bourgeoisie class. Their class must be obsolete because, according to Schumpeter, their group “is the most symbolic of capitalism.”<sup>344</sup> Where should this group go, then? Schumpeter suggested allowing them to perform and assigning them to managerial functions rather than liquidating them. This assignment will be very critical in the transition from a capitalist state to a socialist order, and the success in dealing with their group will be a turning point in the economic prosperity of socialism.

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<sup>340</sup> *Ibid.*, 361.

<sup>341</sup> *Ibid.*, 362.

<sup>342</sup> *Ibid.*

<sup>343</sup> *Ibid.*

<sup>344</sup> *Ibid.*, 363.



The next group that the socialist regime will have to deal with is the workers. The downside in a socialist state is that the workers will find it difficult to work harder or to be more productive, mainly because they will have this impression that they are being exploited by the government. There is no more incentive to work hard in a socialist order. The upside is that the socialist regime has the authority now to discipline their workers, and they have the authority to “command that moral allegiance which is being increasingly refused to capitalism.”<sup>345</sup> An individual might feel like their work is insignificant anymore since there is no reward for becoming more productive, but when a socialist society implements certain disciplines to make their people work hard, they can foster their society towards working hard with a unified objective. With the authority now centralized in a socialist regime, they have access to a broader range of tools to enforce disciplinary actions.<sup>346</sup> How does a socialist state deal with non-compliance? Their central authority will publicly dishonor the individuals who are insubordinate if needed. This is the difference between a capitalist society and a socialist society in terms of production. Survival is the theme in capitalism when one works hard while in a socialist order; there is a proclivity of stable employment and job security, but productivity may no longer be motivating.<sup>347</sup>

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<sup>345</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 211.

<sup>346</sup> *Ibid.*, 215.

<sup>347</sup> *Ibid.*, 211

### III. The Problem with Democracy

So, how does one rule a society? It is an interesting question raised by Schumpeter. He asserts that true democracy is “feasible only where every adult votes on every issue.”<sup>348</sup> The irony of understanding democracy is that it is really difficult to define it in its real sense. The word democracy was a derivative term from a Greek word meaning “for the people,” and unfortunately, we’ve seen in history that policymakers of a democratic state have “excluded women, slaves, foreigners, and others.”<sup>349</sup> We have also seen some democratic societies that focus on the common good of society, and Schumpeter argued that it is not a “sufficient criterion for democracy.”<sup>350</sup> The common good can be characterized as public interest, the general welfare of the people, and its utility. He posited that there are two main problems of democracy. First, even if we have already established that the interest of the common good of society can be categorized as interest, welfare, and happiness, in the end, the common good still “means different things to different people,” and secondly, the people cannot seem to reach a consensual and rational argument.<sup>351</sup> There are four reasons for these problems, according to Schumpeter: (1) Voters are more interested in the short-term benefits because they are greatly influenced by the promises made by the political candidates, (2) Social

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<sup>348</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 368.

<sup>349</sup> *Ibid.*, 367-368.

<sup>350</sup> *Ibid.*, 369.

<sup>351</sup> *Ibid.*

concerns that do not affect individuals directly are thought of irrational to them, (3) The lesser concerned the individuals are about the social issues and the more irrational they are as voters, the easier they are to get manipulated by groups that use “psycho-technics” <sup>352</sup> to persuade public opinion and eventually influence outcomes in the elections, (4) the culmination of the mentioned three points implies the will of the voters as in-authentic because the vote of the individuals was influenced externally. <sup>353</sup> It can be argued that Schumpeter’s first two assumptions of what is causing the problem in a democracy are ethical problems. On his first assumption, individuals tend to be short-sighted when it comes to weighing the good of a society. Furthermore, on his second assumption, individuals tend to disregard more pressing matters that would affect society. Does the individuals’ predilection toward what is obtaining the good ‘immediately’ and having no regard for more important matters that would affect the social and economic welfare of the society make a democratic society inadvertently foster a society a hedonistic and nihilistic environment? If not, a follow-up question on this: are these then an effect of capitalism that we tend to be short-sighted? It can also be argued that the last two assumptions of Schumpeter pose an epistemological and sociological problem.

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<sup>352</sup> These are commonly known now as advertisements.

<sup>353</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 369.

To solve the problem of democracy, Schumpeter presented an alternative solution in the 22nd chapter of his *Capitalism, Socialism and Democracy*: “Another Theory of Democracy.” For him, democracy’s framework in making policy-related decisions must be rooted in “individuals [acquiring] the power to decide by means of a competitive struggle for the people’s vote.” Schumpeter thought that this alternative theory of democracy was a departure from the classical doctrine of democracy, where the public is completely involved in any political activity. This re-defined structure of democracy is actually now most countries are practicing. The focus is no longer on the common interest of the people but on the competition itself. Groups having common interests will have to choose their own champion, or eligible individuals can represent themselves to compete for a vote. The main objective of the competitive election, according to Schumpeter, was to decide who gets to make decisions for every social issue of the state. The elected leader does not have to be good or expert about social issues, but the objective of voting for the leader must be focused on how good the leader is in making decisions. At present times, however, we still encounter the same four assumptions that Schumpeter presented that are causing the problem of democracy.

Capitalism, then, for Schumpeter, will not succeed in a democratic structure of society because of its endogenous nature of “incessantly [revolutionizing] the economic structure from within, incessantly destroying the

old one, incessantly creating a new one” —ergo ‘creative destruction.’<sup>354</sup> The demise of the entrepreneurial function will speed the demise of capitalism because of the achievements of a capitalist enterprise; the enterprise itself “tends to automatize progress.”<sup>355</sup> If all enterprises’ operations are automated, there will no longer be a need for entrepreneurs, and this will also result in the end of capitalism. The function of the entrepreneur then will be reduced to management as Schumpeter put it, the entrepreneur will “just [be] another office worker.”<sup>356</sup> Of course, if we are to look at Schumpeter’s supposition and compare it to the present time, his prediction of the fading role entrepreneur’s importance has no merit at all “on the grounds of an illegitimate shift of underlying epistemology” according to Richard N. Langlois.<sup>357</sup> Langlois explains his critique on the supposition of the obsolescence of the entrepreneur as an epistemological issue that leads to obfuscation about the significance of the scientific discipline of inquiry, making his conclusion invalid without enough evidence to infer such a claim.

Another reason for its demise is what Schumpeter calls the “Evaporation of the Substance of Property.”<sup>358</sup> The traditional “visible and touchable” property

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<sup>354</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 83.

<sup>355</sup> *Ibid.*, 134.

<sup>356</sup> *Ibid.*, 133.

<sup>357</sup> Richard N. Langlois, "Schumpeter and Personal Capitalism," *Economics Working Papers*, no. 199605 (March 1996), University of Connecticut, [https://opencommons.uconn.edu/econ\\_wpapers/199605](https://opencommons.uconn.edu/econ_wpapers/199605).

<sup>358</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 156.

ownership has evolved now into a non-tangible and abstract nature. This is evident now in the present time as we are seeing enterprises being owned by shareholders instead of the old way of owning enterprises individually. Enterprises being owned by shareholders fosters a bureaucratic environment, which in this paper has already been discussed as one of the reasons for the demise of both capitalism and socialism. There is also the growing hostility of the public toward capitalism, where the increase of individuals getting more educated results in an increase in intellectual freedom, and the assumption of this phenomenon gives an opportunity for educated individuals to criticize the authority easily. <sup>359</sup> Ironically, capitalism in a democratic state has forged an environment that freely allows questioning the authority and to the point of eventually disliking the benefits of capitalism itself. The civilization of a capitalist democratic state will raise more concerns about job insecurity or inequality, leading to the people's politically aggressive nature under a capitalist state. Capitalism fosters an environment of emotional disconnection, and the pervasive increase of intellectuals implies a rise of standards of life that will eventually bring hostility to capitalism. Schumpeter describes this phenomenon of social unrest as a “secular improvement that is taken for granted..and individual insecurity that is acutely resented. <sup>360</sup>

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<sup>359</sup> *Ibid.*, 152.

<sup>360</sup> *Ibid.*, 145.

Meanwhile, we have also established that for Socialism to succeed in democracy, the state should deal with the management of the workers and the gradual transition of the bourgeoisie to managerial functions. Another condition for Socialism to succeed in democracy is that the potential leader must be “sufficiently [of] high quality.”<sup>361</sup> The leader must be highly capable of making the right decisions for the state; therefore, the choice of mechanism for selecting or voting for a leader is vital. Secondly, the extent of the leader’s capability to make decisions must be constrained. The two conditions Schumpeter brought up remind us of the same conditions that eventually became a dilemma for one of the Founding Fathers of the American Constitution, James Madison. Schumpeter argued that for a democratic state to succeed, both under capitalism and socialism, it must be capacious and, at the same time, must be constrained. Here lies the dilemma, as Madison said during the discussions of the Federal Convention in 1787: “The means of defence agst. foreign danger, have been always the instruments of tyranny at home.”<sup>362</sup> This dilemma was one of the foundations in formulating the American Constitution. The assumption is that any government strong enough to protect its sovereign from foreign predators is implied to be strong enough to be the predator itself. That is why a democratic state must have the capability to assume its function and must be constrained to abuse its power. Lastly, according to Schumpeter, for democracy to succeed, it should have

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<sup>361</sup> *Ibid.*, 290.

<sup>362</sup> James Madison, "Friday June 29th in Convention," in *The Records of the Federal Convention of 1787*, vol. 1, ed. Max Farrand (Indianapolis: Liberty Fund, Inc.), 301.

“democratic self-control.”<sup>363</sup> The legitimacy of a government must be checked internally and must be balanced accordingly in order to sustain its legitimacy.

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<sup>363</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 294.



## **Chapter Five: Summary, Conclusion, and Recommendations**

### **Summary and Conclusions**

At the onset of this manuscript, I have highlighted cases from different countries and different periods indicating consistent state reliance on entrepreneurs during economic turbulent times. This implies how significant the function of the entrepreneur is to society. Additionally, I implore the need to pay attention to the degree of focus within academic philosophy. Philosophical research has been focused more on business ethics, but there seems to be a scarce philosophical discussion around the business itself and the phenomenon of entrepreneurship. This finding highlights a revelation that there seems to be a gap in philosophical discourse on the subject. Therefore, this thesis has argued that there needs to be a broader approach in economics, and with interdisciplinary collaboration with philosophy comes a possibility of enmeshment of perspectives. This interdisciplinary approach allows us to foster broad academic development in both realms. I have explored the social ontology of economic life by attempting to navigate the foundations of social and philosophical elements in alignment with economic facts such as capital, credit, entrepreneurial profit, interest in capital, business cycles, and the concept of money. To fulfill this objective, I have highlighted Joseph Schumpeter's theory of the entrepreneur and the concept of creative destruction. I hope there was justice in this paper in an attempt to explore the social ontology of economic life as conceived by Joseph Schumpeter.

The second chapter presents the philosophical orientation of Joseph Schumpeter's works by answering the question: Is he a philosopher? Further discussion of this chapter took shape around the framework, raising three arguments, each supporting the claim that Schumpeter's academic contribution in the field of economics also constitutes significant philosophical inquiry. The first argument hinges on Jana Mohr Lone's concept of the 'Philosophical Self.' This concept is described as a natural tendency of an individual who questions concepts that many people commonly disregard. This description of an engagement is in the form of doing philosophy. His second book *The Theory of Economic Development*, exemplifies a characterization of his 'Philosophical Self.' His attempt to investigate the nature of the existence of several economic elements and agents such as Capital, Credit, Entrepreneurial Profit, Business Cycle, Prosperity and Depression, and Money is an evident manifestation of his 'Philosophical Self.' At the same time, I took this opportunity to highlight further each of the economic facts in line with staying true to the objective of identifying ontologically the nature of economic life's existence. Schumpeter's examination of economic concepts goes beyond mere economic analysis. Another extra element of my argument is the acknowledgement of Schumpeter from his peers and followers. They regarded him more than an economist and some thought of him and his works to be philosophical. The last argument to support the claim that Schumpeter must be a philosopher is his method of inquiry, which he coined

himself as ‘methodological individualism.’ Schumpeter’s methodological approach is similar to that of Max Weber, who is known for his great works in the field of sociology. Max Weber was also described as a philosopher because of his profound academic contributions to the field of Philosophy. Schumpeter may have coined the term but Weber was ahead of him and appeared to have shared similarities with Weber’s approach to sociology. This parallel further bolsters the view that Schumpeter's work constitutes a form of philosophical inquiry. Schumpeter’s works go beyond the limits of philosophy and economics. His methodological individualism approach was a starting point of his philosophical journey in explaining economic realities.

In the third chapter, I have rendered three important accounts of Schumpeter’s concept of the entrepreneur: the entrepreneurial function, the entrepreneur’s motive, and Leadership as its special function. Using these three findings has helped us arrive at a better answer to the ontological question: What is an entrepreneur? In this research, I came to a realization that there was, for a long period of time, a disparity in defining or describing the concept of entrepreneur and the phenomenon of entrepreneurship, making it more difficult to have a proper ontology of the concept. Much of the challenge in having a proper ontology of entrepreneurship or the concept of entrepreneur is the dichotomy between an entrepreneur ‘per se’ and the concept of a capitalist. Some thinkers believe that both the entrepreneur and capitalist are synonymous concepts. For

Schumpeter, the role of the entrepreneur in a capitalist society is to be the carrier of innovation in the economic life. The entrepreneur is coming from nowhere and “shatters the equilibrium, hits it with a hammer,” as Professor Rae describes.<sup>364</sup> Meanwhile, the motive of the entrepreneur is what drives its function to fulfill the spirit of innovation. It has been asserted in this chapter that the best motive of the entrepreneur is the ‘joy of creation,’ and the pecuniary gain of the entrepreneur just acts as a secondary motive. The last depiction of the entrepreneur is its special function, which is leadership. Since they are characterized as drivers of innovation and change in economic life, their introduction of new combinations in the market automatically makes them leaders in their own industry. The highlight of this chapter is the parallelism of Schumpeter’s and Max Weber’s entrepreneur since both appeared to have collegial relationships and have a similar methodology in their studies of their respective fields. The fulfillment of Schumpeter’s entrepreneurial function is through the spirit of innovation while Max Weber’s concept of entrepreneurial function is fulfilled through the spirit of capitalism. In this third chapter, I underscored the significance of the entrepreneur to society, provided a historical evolution of the concept of the entrepreneur, briefly discussed the ethical dimension of entrepreneurship through its motives, and drew a parallel depiction of Max Weber’s concept of the entrepreneur and Schumpeter’s.

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<sup>364</sup> Douglas Rae, "Karl Marx, Joseph Schumpeter, and an Economic System Incapable of Coming to Rest," in the course "*Political Science: PLSC 270*," (video lecture, Yale University, accessed December November 28, 2023), <https://oyc.yale.edu/political-science/plsc-270/lecture-4>.

In the fourth chapter, I opened up the limitation of Joseph Schumpeter's concept of money. Although Schumpeter's work on the matter was unfinished, it is important to discuss its merit to have a better footing in the exposition of the ontology of economic life. Money is essential in the discussion of economic life because, as Schumpeter put it: "any satisfactory theory of money implies a theory of the economic process in its entirety."<sup>365</sup> In this chapter, it was argued that Schumpeter was leaning toward the physical nature of money (money as a medium of exchange, money as a unit of measurement, and money as a stored value) as opposed to his contemporary rival, John Maynard Keynes's theory that money is inherently nominal (money's essence is based on its legal tender). After the examination of the concept of money, the chapter transitions its depiction of Joseph Schumpeter's concept of 'creative destruction.' This concept describes the process by which old economic structures are dismantled and new ones are created, driving economic innovation and evolution. Schumpeter argued that this phenomenon's success would result in a new economic life, reshaping the economic structure and reforming the social structure of a state. Hence, highlighting the importance of the discussion of social concepts such as capitalism, socialism, and democracy. Our discussion of the ontology of economic life from the second chapter of this paper allowed us to link the relations of the economic elements in depicting a social structure. It was expressed in this chapter

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<sup>365</sup> Joseph A. Schumpeter, *History of Economic Analysis*, ed. Elizabeth Boody Schumpeter, intro. Mark Perlman (Taylor & Francis e-Library: Routledge, 2006), 278.

that capitalism will eventually reach its demise because of the endogenous influential factors such as rationalization of the individual resulting in to increase of intellectual standards, bureaucracies of managing the enterprises, hostility of the public against the authority due to the rise of intellectuals, and its monopolistic and oligopolistic nature of competition. Meanwhile, when capitalism's obsolescence happens, it should transition to a socialist state, but Schumpeter highlighted conditions in order for the state to succeed. First is to make sure to allocate carefully the place of the bourgeoisie in the social structure. Schumpeter suggested making them managers to maintain their morale in order for them to continue being productive. Secondly, Schumpeter also stresses the importance of giving discipline to the working class. The advantage of socialism is the departure of questioning the authority, but it is still essential for the socialist authority to maintain the same environment and at the same time, entice them to be productive. This fourth chapter connects the ontology of economic elements and puts forward the relation of the economic elements to social facts. This chapter offers a compelling argument that having a proper ontology of economic elements or agents will lead us to have a better understanding in the context of overarching social issues. The study of the ontology of economic life is irrelevant unless we find the relationship of the nature of economic elements elevated to a study of social constructs. Thereby calling it, the 'Social Ontology' of Economic Life. The social part is vital to this thesis. As recently discussed in my previous

chapters, what constitutes the social ontology of economic life is, first, innovation, which was primarily discussed in the second chapter, whereby I have enumerated economic elements and presented arguments of the nature of each concept. These economic elements serve as the lever for innovation. Second is the entrepreneur, who is the carrier of innovation. The entrepreneur is the initiator of innovation and navigates each of the levers (the economic elements discussed in the second chapter) to carry on the innovation process. Lastly, are the means that serve as an institutional framework—in this case, Schumpeter highlighted social institutions such as Capitalism and Socialism that implement suitable financial and economic mechanisms to introduce innovation. Moreover, they can also be banking systems that provide credit and financial facilities to aid in establishing legal and economic infrastructures and monetary policies.

The whole discussion of this thesis and completing this paper allowed me to arrive at certain realizations. First, in this attempt to highlight the ontology of economic life, what transpired in the research is, that I went straight breaking down the economic elements that influence change and innovation. I was under the assumption that in the pursuit of ‘doing’ philosophy, one must follow the order in identifying which discipline to embark on or discuss—(1) Metaphysics (or in this case, Ontology), (2) Epistemology (3) Ethics, and (4) Politics.<sup>366</sup> It is the same approach applied to this paper to understand economic life’s social

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<sup>366</sup> John Smithin, *Rethinking the Theory of Money, Credit, and Macroeconomics: A New Statement for the Twenty-First Century* (Lanham: Lexington Books, 2018), 195.

ontology. The whole journey of my research and coming up with this paper allowed me to witness a personal revelation that learning the epistemology of Joseph Schumpeter in knowing the reality of economic life's existence was very helpful. Had I just focused on presenting the ontology of the economic elements of economic life, it would have been challenging to transition the ontological concepts to the social ontology of a certain reality. Meanwhile, this does not necessarily mean that I will put a premium on the discipline of epistemology over metaphysics. I believe it is safe to assume that both the metaphysical approach of study and the epistemological method of understanding reality are codependent on each other.

Another realization, as I read through the book of Joseph's *Capitalism, Socialism and Capitalism*, Schumpeter thought that Capitalism's demise is caused by consistently and repetitively experiencing the process of creative destruction. This phenomenon leads to several instances of social transformation. If a society goes through many instances of creative destruction that eventually transforms a different face of society, then according to Schumpeter, he "would have spoken of transformation" instead of using the term destruction.<sup>367</sup> Therefore, this concept of social transformation is of Marxian provenance, but his vision of revolution is not similar to Schumpeter's. Instead of a revolution coming

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<sup>367</sup> Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, with a new introduction by Richard Swedberg (London and New York: Taylor & Francis, 2003), 162.



from the proletarians, it is a combination of the human element (the entrepreneur) and the economic elements as the lever for innovation.

Another realization is the illusion of believing that there is an economic equilibrium. Economists have been positing theories for a very long time, starting from Adam Smith's assumption about a general equilibrium. Schumpeter's postulation that a society is in a dynamic economic state departs from the longest and oldest paradigm about economic equilibrium. During an email exchange with Mr. Torrey Byles, M.S. of Southern Oregon University of California, he mentioned that most of the economics since Adam Smith up to now "have been pursued by academics who presuppose that the system is stable," but the economic life as we have already established with the discussion about Joseph Schumpeter's business cycles that it is not a stable one.<sup>368</sup>

Joseph Schumpeter is a versatile thinker inclined to interdisciplinary studies. This paper is an exposition of his works in conjunction with the discussion of the social ontology of economic life, allowing this paper to open many paths of academic study. A recommended direction for different topics to be discussed academically should be in order.

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<sup>368</sup> Torrey Byles, an email message from the author, November 21, 2023.

**Recommendations**

In the progression of this paper, several points and considerations for further studies may strengthen the advocacy of interdisciplinary studies between the fields of economics, sociology, and philosophy. Hopefully, this thesis paper will also encourage other scholars of philosophy to consider an academic discourse delving into different topics philosophically about business, economics, money, and other economic elements.

First, I urge that future research be done on the subject of money. Since the discussion about the social ontology of money in the fourth chapter of this paper was a bit of a cliffhanger so to say, I recommend a further study of the social ontology of money. I believe that embarking on a study through the lens of John Searl's philosophy of language will solve the problem of Joseph Schumpeter's dilemma about the real nature of money. For John Searle, money is a statement of declaration institutionalized by society in order to act in a social transaction.

Second, a comparative study of the concept of entrepreneur between Joseph Schumpeter and Max Weber must be inevitable. We have already established in this paper that both thinkers have used the same method of inquiry using methodological individualism in their respective fields to understand the historical evolution of economics and sociology. It would be interesting to

discover whether both are thematically aligned or not with the concept of the entrepreneur.

Third, another interdisciplinary study, both philosophical and economics study, is recommended on the subject of entrepreneurship by synthesizing Schumpeter's philosophy with John Maynard Keynes.' This study should allow researchers to navigate the possibility of putting the entrepreneur's function under the state's umbrella. This further research should focus on the socio-political effect of this proposal, and the ethical topics should also be regarded. A suggested inspiration for the study can be found in the book of well-renowned economist Mariana Mazzucato: *The Entrepreneurial State*, wherein she posited that putting the entrepreneur in a public spotlight makes it more sustainable for any form of state. She argued that the entrepreneur has been operating in a private platform, making the entrepreneur's operation unsupervised and un-monitored. Mazzucato suggested that the government should be the enabler of entrepreneurship to control and manage other important issues affected by industrialization and capitalism like the ecosystem.

Fourth, a comparative study between Karl Marx and Schumpeter is imminent. A concern raised in this paper is that philosophy scholars rarely discuss the philosophical dimension of economics. I believe that a more similar theme, such as this recommendation, will broaden philosophical studies, especially in the Philosophy Department of the University of Santo Tomas. Also, much of the

philosophical discussions of Karl Marx lean towards socio-political concepts, but Engels and Marx wrote *The Economic and Philosophical Manuscripts of 1844*, which I believe is an excellent source for highlighting the comparative study.

Lastly, I believe this recommendation to be provocative, but hopefully, further research will give merit to this proposal. I suggest incorporating a philosophical dimension into economics by broadening the discipline of Filipino Philosophy. I think there is a potential in discussing concepts such as ‘utang na loob’ in the context of the philosophy-economics approach by using the social ontology of money as the starting point. Discussion on the social constructs such as ‘*mukhang pera*’ (Money faced), ‘*pera ay ugat ng kasamahan*’ (Money is the root of evil), ‘*pera-pera lang*’ (It is all about the money), and ‘*mga mayayaman yumayaman, ang mga mahihirap lalong humihirap*’ (The rich gets richer and the poor gets poorer).

During the course of reading this paper, one can notice my certain biases, especially the inclination towards making the entrepreneur the hero of economic development and advocating interdisciplinary studies of philosophy and economics. My biases are what Schumpeter calls ideologies. In this regard, I would like to end this paper by leaving a quote from Joseph Schumpeter’s Presidential address at the American Economic Association held on 30th of December 1948, as a response to the topic of ideologies being hinted at in this paper:

The persistence of ideological vision is not a bad thing but a good thing...Through it we acquire new material for our scientific endeavors and something to formulate, to defend, to attack. Our stock of facts and tools grows and rejuvenates itself in the process. And so—though we proceed slowly because of our ideologies, we might not proceed at all without them.<sup>369</sup>

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<sup>369</sup> Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction* (Cambridge, Massachusetts, and London, England: The Belknap Press of Harvard University Press, 2007), 483.

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