

Schumpeter's View of Market Distribution and Redirection of Income and Wealth

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In 1908, Joseph A. Schumpeter set out his original view of how the entrepreneur would increase the material wealth of a nation and in the process benefit the economically less advantaged members of society. The process of creating economic income and wealth would be brought about by the entrepreneur through what Schumpeter called entrepreneurial profit and entrepreneurial wage. Although these two processes could not be captured in neoclassical theory, they none the less provided for a method of income and wealth distribution and redirection without government involvement.

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INTRODUCTION TO SCHUMPETER'S ORIGINAL ANALYSIS

In 1908, Joseph A. Schumpeter published his first book in German, Wesen und der Hauptinhalt der theoretischen Nationalökonomie (The Nature and Essence of Theoretical Economics). This book is not widely recognized because until recently it was never translated into English. In this book, Schumpeter attempted to explain how market capitalism would benefit all economic sectors of society. Schumpeter attempted to utilize a dynamic framework to explain the process of economic growth and the resulting process of income and wealth distribution and redirection. Schumpeter's original view was to explain how the entrepreneurs attempted to increase their material welfare and, in doing so, would redirect income and wealth to the economically less advantaged in society. Schumpeter argues in this original book that the wealthy and elite in society had no interest in entrepreneurship since that brought about unwanted economic change. It was the economically less advantaged in the economy who would seek additional income and wealth and, in their attempts, would bring about this change through entrepreneurship.

In 1908, Schumpeter used the terms distribution and redistribution. However, he indicated that this was not a condition of taking income or wealth from one group and awarding these funds to another group. Instead, Schumpeter assumed that entrepreneurship would redirect and allow future income streams to flow to individuals through their work efforts. Also, incomes would flow to the general public as more materials, more efficiency and more employment became available. The resulting wealth would be spread to the whole society. This concept is quite different than redistribution which in today's terms assumes the federal government takes funds from one group and awards these funds to a different group. Therefore, this paper will follow Schumpeter's intent but not his choice of words and instead use the phrase, “redirection of income and wealth.”

Schumpeter explained how the entrepreneur will create work opportunities for the economically less advantaged and the economically less advantaged and therefore redirect income and wealth toward those groups. Schumpeter viewed individual and economic freedom as the component which created the opportunity and potential for income and wealth development.

SCHUMPETER'S ANALYSIS OF THE ENTREPRENEUR

Joseph Schumpeter defined the entrepreneur as one who innovates. For Schumpeter, that was the only official task of the entrepreneur. The entrepreneurial effort was not to own, manage or finance but rather to create new products and production processes, (i.e. new goods and new methods) which would increase the material welfare of society. However, Schumpeter viewed the entrepreneur as less a person than a function that some persons sometimes performed. Schumpeter's early works suggested that no one was just an entrepreneur in the sense that all the person ever did was to innovate (introduce new products and production processes into the market). Many individuals do not innovate and many individuals innovate only once or twice in a lifetime. Many individuals may have been an owner, manager, financier or a capitalist but at some point innovated (at that point created an original entrepreneur action). In today's literature the entrepreneur is a person who is often fully engaged in innovating but in Schumpeter's original writings, the entrepreneur was a process that many individuals infrequently accomplished.

Schumpeter made a sharp distinction between the inventor and the innovator. While an invention (a new idea or new device) may lie idle and never be used, Schumpeter's innovation was a new product or production process that was offered for sale and/or use in the market. That is, an invention became an innovation only at the point when it appeared in the market place as a new product or new production process.

By innovating and offering new products in the market the entrepreneur creates temporary monopoly control in the market place. This idea developed in his original text would later be used by Schumpeter to develop the concept of creative destruction. However, this monopoly control would not be long lived since new entrepreneurs would develop yet new products and new production processes and replace the previous products and processes from previous entrepreneurs. The entrepreneur would take advantage of the components of his social and cultural environment such as money and individual freedom to enhance the material welfare of society. The entrepreneurial innovation was a creative act which deviated from the established economically powerful by changing the status of the economically and socially disadvantaged in society. Using this dynamic process Schumpeter deviated from both the classical and neoclassical economists such as Marshal, Pareto and others. (p. 54)

SCHUMPETER'S ANALYSIS OF ENTREPRENEURIAL PROFIT

Schumpeter viewed the economically advantaged as a social class that obviously did not want change. This included innovations that brought new products as new production processes. On the other hand, it was the economically less advantaged who were always eager to innovate. Schumpeter viewed innovations as one of only a very limited number of avenues for economic advancement of this class in market capitalism. In addition, Schumpeter saw market capitalism as that economic structure that allowed financial advancement through increased income and wealth. Unlike the aristocratic or cast structures that socially and economically bound the economically less advantage, Schumpeter viewed market capitalism as an economic structure that offered both social and economic advancement. According to Schumpeter, in a market economy the wage earner was always looking for an opportunity to change his economic lot and therefore was constantly on the lookout for an opportunity to attain some of the profit of the established employer or economically powerful.

Schumpeter viewed the negligence and complacency of the economically powerful that was the opportunity that allowed the entrepreneur to profit and redirect that income. (p.231). By seizing that opportunity to redirect whole income streams from the economically advantaged members of society the entrepreneurs could gain income and wealth and increase both their social and economic status in society.

However, over time this “entrepreneurial profit would disappear and further entrepreneurial activities would spring forth to change income distribution yet again through someone seeking new entrepreneurial profits. (p.232). Schumpeter saw this effort as a continuous, dynamic process. This continuous dynamic process according to Schumpeter would accomplish two economic positives. First, there would be a continuous improvement in the material provisioning for the members of society. And, second, there would be a continuous redirection of profits from the established economically privileged members of society to the economically less advantaged members of society. This again set Schumpeter apart from both the classical and neoclassical economists because he felt that a complete theory of economics could not be studied from a static representation as expressed by both classical and neoclassical economics but rather must be dynamic in nature. (p. 219).

SCHUMPETER’S ANALYSIS OF ENTREPRENEURIAL WAGE AND ENTREPRENEURIAL INCOME

Schumpeter viewed society as largely comprised of wage earners. Obviously, these wage levels varied and economic scarcity issues separated the levels between the technical and the general laborer. Once complacent with the wage level, especially at a higher level, the wage earner would perform daily tasks and accept the social income level that was provided. However, at the lower end of the wage scale were persons that in Schumpeter’s terms were the economically disadvantaged wage earners. This group of wage earners was often (maybe always) looking for an opportunity to expand wages. This effort to do the task differently, more efficiently or in some way better was an attempt to increase that wage. The reward for this extra effort which Schumpeter termed “Individual enterprise” (p. 230) was one of Schumpeter’s ideas to redirect income from the wealthier part of society to the economically less advantaged. This different or extra effort by the wage earner leading to entrepreneurial wages was what Schumpeter viewed as a very strong advantage of market capitalism and individual freedom.

Schumpeter argued that this entrepreneurial wage was a result of entrepreneurial performances and was “not enumerated under the influence of supply and demand” (p. 230). Rather, Schumpeter argued that this redirection from the more economically privileged to the economically less advantaged could be seen “morally as a reward – but not a ‘wage’ economically speaking” (p.230). Schumpeter states that entrepreneurial wage theory would have social justification and not be a scientific theory. Schumpeter explained that there was no interdependence between effort and reward or hours worked and pay. Schumpeter went to great lengths to differentiate entrepreneurial wage, income and profit from ordinary income and rent. Ordinary income and rent according to Schumpeter could be included in a static framework but entrepreneurial wage, income or profit would not (p. 229). According to Schumpeter ordinary income and rent was simply a payment for use whereas entrepreneurial return was the result of a creative process bringing new additional value into the market. Therefore, income was redirected not redistributed.

“These ‘entrepreneurial performances’ are not enumerated under the influence of supply and demand, in the sense as other types of labor. What the entrepreneur receives is by no means distinctly determined and may be greater or lesser than the ‘value’ of his performances for someone. In addition, this cannot be a price because no value functions are available for this commodity at most, for the entrepreneur HIMSELF, but who stands across from him as the new opponent? Every answer other than “no one” is based on fiction. MORALLY, one could speak of a ‘reward’ which this profit represents, but not of a ‘wage’ economically speaking. But in this sense, this theory would be a ‘social justification’, therefore no scientific theory altogether” (p.230).

SUMMARY

In the area of politics and economics, the concept of income and wealth distribution as well as redistribution has always been an integral part of the discussions. Presently, that topic seems even more relevant as it has received the attention of academics, and the public in general. It seems rather amazing that it was a part of Schumpeter's first book published over one hundred years ago. To understand Schumpeter's entrepreneur, and this process of redistribution (redirection) one must view the social, political and institutional framework of economics from which the entrepreneur exists and functions. Schumpeter viewed this redirection of income and wealth as accumulation, growth and change and not a static redistribution of a fixed level of income and wealth.

The entrepreneur is an innovator who combines and transforms the factors of production (including capital) in an effort which results in adding material value to the economy. This change in value brings about the possibility of income and wealth redirection. At the end of Schumpeter's first book, he explained through many examples how dynamic interactions between society, institutions, government taxation, etc. income and wealth are created in a dynamic interaction bringing about material well being for its citizens. (p. 253ff). At the heart of this dynamic process was what Schumpeter called entrepreneurship. This life blood of the economic system was not a person but rather a process performed by many individuals but infrequently by each. This process was an integral part of Schumpeter's economic prosperity, income and wealth creation, as well as income and wealth distribution and redirection in a continuous dynamic process.

In 1908 Schumpeter did not deal with the complexity of welfare, entitlements, bailouts, social security, etc. that are a part of today's government. However, he did address a clear path to income and wealth for a vast majority of society. This, in turn, according to Schumpeter would lead to economic growth and prosperity for all who would choose to participate in entrepreneurial efforts and as buyers, sellers and innovators of products therefore, benefit the nation as a whole.

Over one hundred years ago, in his first book, Joseph Schumpeter drew an economic map to material prosperity for every nation to follow. It did not include massive government redistribution policies or bulging bureaucracy but instead relied on the simple formula of entrepreneurship leading to a continuous redirection of income and wealth to all who endeavored to better themselves and in the process create economic growth and prosperity for the nation. If we want a set of guidelines for government involvement in income and wealth redistribution, then the government must be encouraged to promote entrepreneurship in the United States. Without individual and economic freedom to create innovations, society will not have the economic growth need to continue economic prosperity.

REFERENCES

Joseph A. Schumpeter, *The Nature and Essence of Economic Theory*, English edition and New Introduction by Bruce A. McDaniel, Transaction Publishers, Rutgers – The State University, Piscataway, NJ 2010