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Not by Theory alone...

**The Economics of Gustav von Schmoller
and Its Legacy to America**

Von

Prof. Nicholas W. Balabkins



Duncker & Humblot · Berlin

NICHOLAS W. BALABKINS

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Preface

Anybody who is invited to read a book like this one has a right to know what it is about and what reading it would be good for. While this is true for any book, a word of explanation is imperative in the case of this work. Gustav Schmoller, who was born more than a hundred and fifty years ago, is ignored by professional economists today. The few who know about him generally consider his work irrelevant. Yet it is unclear what this implicit judgement could be based on. When we come across a reference to Schmoller, the information it contains is generally either totally misleading or outright wrong. In his time, Schmoller was one of the most respected professional economists in the world, working in one of the leading research universities in a country blessed with innovative and prospering industries and a political system that, despite its obvious anachronisms, had produced the most advanced welfare legislation. Schmoller's ambition was to make economics interesting and relevant, useful for practical purposes in politics and business, and he was therefore critical of the received university doctrines in economics. As Marshall, in Cambridge, who shared his concerns, he tried to reorient the economics profession from within with new approaches to research and instruction. Today, economics has lost most of its appeal to those Schmoller was able to attract. Future public administrators will rather turn to law, management or computer science than economics. Future business leaders will study management, marketing and finance, but not economics. A thorough understanding of the economy is widely considered irrelevant for success as a professional economist. Schmoller's ambitions and concerns are shared by many today. Few know about his program, how he launched it and how it fared. This book gives an introduction to Schmoller and his work and its significance to American economics. The book is designed as the road-map for those who want to travel in the vast and unknown territory of Schmoller's detailed studies of the development of economic institutions and their effect upon economic activity.

Schmoller's program was aptly described by Joseph Alois Schumpeter in his 1926 article.¹ Since that article is not available in English, let me quote and translate:

"If you want to understand the specific situation in which a particular economy happens to be at a certain time, and if you want to suggest something relevant about its current problems, then everything that in theoretical economics is taken as given, assumed to be invariant and ignored in the course of analysis becomes the main subject of investigation

¹ Joseph A. Schumpeter, "Gustav von Schmoller und die Probleme von heute", *Schmollers Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft* 50, 1926, pp. 373-388 (1-52).

and focal point of interest. These data include the particulars of a nation's economic environment, the endowment with natural resources, capital and machinery, the position in international trade, the social structure, size, composition and distribution of the social product, and the economic and political constitution. In this case, the collection of facts and figures becomes the paramount task, completion of which is a precondition for further research. The second task is to put all this information together in a definite order, in order to make it accessible. Once these two steps have been made, a number of important questions are ready to be answered. The first and the second task can never be quite completed, work on them progresses as the available material is being used and as new methods are developed for data collection and use. Soon, there arises a need to analyse the technical relationships, the real behaviour of social groups and individuals, the constitution and functioning of social institutions such as the state, property, commercial law, etc. The sum of these analyses forms the sociological and economic knowledge of a period, and one can try to forge this knowledge together into a provisional synthesis. It is important to note that Schmoller has actually worked his way through all the stages of this program, and therein lies his greatness." (pp. 17-18)

Later in the same essay, Schumpeter offers a different characterization. The Schmoller program consisted in "approaching the material with a minimum burden of a priori, thereby capturing interdependencies which enter as additional a priori; this yields the (provisional) framework for investigation, a framework that is further refined in a continuing interplay of subject matter and mental process. That this program could once be regarded as specific to a particular school is evidence for the importance of the task Schmoller confronted; that the program is commonplace today underscores Schmoller's success." (pp. 45-46)

It is well known, and Professor Balabkins stresses the point on several occasions, that Schmoller tended to address not only questions of "is" but also of "ought". He was not content with an analysis that did not point the way towards the successful solution of a practical problem. The approach has puzzled many critics, who used to a strict distinction between positive and normative economics, tend to think that a combination of both is methodologically inadmissible. As a matter of fact, Schmoller's "oughts" are not the "oughts" of welfare economics. He arrives at policy prescriptions by enriching the analysis sufficiently with historical, institutional, political, fiscal, and cultural data such as to impose constraints on the set of available solutions. In the end, the choice range for economic policy has been effectively narrowed down, not by means of normative judgement but rather through a process of institutionally rich analysis. As the following discussion by Schumpeter shows, Schmoller's political economy not only differs from contemporary economics by method, but more importantly by subject matter.

"Almost generally accepted is the fact that there are moments of social and political crisis in which the political interests of classes and parties largely coincide — we think of the analogy of a sinking ship.

More important, but not quite as generally accepted is the other fact that political parties of differing programs, once in power, in normal times cannot engage in radically

different policies. Not only will they discharge their routine duties in more or less the same way, even the far-reaching political decisions which mark an entire period are taken quite irrespective of the color of the party currently in power. (pp. 8-9)

Once we have acknowledged these premises, one of the reasons for the supposed impossibility of a nation's common policy objective at a particular time is no longer valid.

The policy measure that needs to be taken now is determined by the necessities of the moment. It corresponds to a situation inherited from the immediate past. The basic facts are given and cannot be readily changed. What is generally considered a policy issue needs a political response, what is widely considered as critical or dangerous needs to be avoided, what is widely considered desirable needs to be attained. What has been begun needs to be continued or brought to an orderly completion. Questions that have been raised cannot be ignored. Therefore both the elected politician as an individual as well as the elected group or party are embedded in a system of given circumstances, necessities and responsibilities that do not leave them a choice between an infinite number of options, nor allow them the luxury to pursue those policies which directly follow from their ideological predispositions. Where this is ignored, failure and defeat loom immediately." (pp. 9-10)

Schmoller's "oughts" can be interpreted as the results of an approach to political economy that proceeds by enriching the analysis with qualitative and quantitative data until the set of solutions has been narrowly constrained.

When Schmoller emphasizes the need for a normative or policy-oriented approach to economics, his intention is not to make economic analysis subservient to his own private political opinions. He did not disagree with Max Weber and his followers on the need to separate personal convictions from scholarly analysis. He did, however, teach that values are important in economic activity, and in particular in political economy. Hence, the kind of economic knowledge we can produce in political economy, in his own words, is composed of intellectual understanding and practical purpose, where ultimately the purpose has to guide the intellectual endeavour. From there it follows that economic theories are important tools, not ends in themselves. Although Schmoller was by no means uninterested in theory and kept up with theoretical developments in economics in both the German language and international academic journals until his death, he was consistently critical of theorizing that could not conceivably serve a practical purpose. This theme is developed in the sixth chapter of the present book.

Many have found Schmoller's work inaccessible, found the material presented overwhelming and deplored a lack of structure and sharp contours. Zimmermann², a student of Schmollers, describes how this feeling was shared among many young economists who came to his lectures, himself included. Schmoller's

² Waldemar Zimmermann, "Gustav von Schmoller und der akademische Nachwuchs", in Arthur Spiethof (ed.) *Gustav von Schmoller und die deutsche geschichtliche Volkswirtschaftslehre*, Festgabe zur hundertsten Wiederkehr seines Geburtstages 24. 6. 1938, Berlin: Duncker & Humblot, 1938, pp. 349-364 (360).

theories were not built on the principles of elegance and parsimony, as contemporary economic theories are. Schmoller was interested in developing theoretical constructions which were fit to capture an economic phenomenon in its historical dimension, theoretical structures that at the same time, apart from the economic essence, could also accommodate the relevant historical, sociological and political theories and facts bearing upon the economic phenomenon. Why did he not confine himself to a simple underlying structure around which to build his principles of historical economics and thus make it easier for economists to learn from him and perhaps subscribe to his views? The reason is readily explained. Schmoller did not primarily want to succeed with his students or his fellow economists. He wanted to train able civil servants who, on the basis of a thorough education in all the relevant areas of public administration, would be reluctant to superimpose predetermined views on complex situations. Numerous offers to write the authoritative principles of economics he declined. Rather, in almost fifty years of writing, rewriting, researching and re-researching he developed what he modestly called the basic outline (Grundriss) of comprehensive, institutionally rich, and practically relevant political economy. Schmoller attached great importance to this work. After retiring from active teaching duties (at the age of 75), he devoted the last five years of his life to prepare a second thoroughly revised edition and saw to its completion.

Unfortunate labels can deter serious study just as much as complex theoretical concepts. The attribute "historical" suggests that the approach is a thing of the past in more than one sense. Yet an institutionally rich political economy can forego the prodigious use of historical research just as little as theoretical physics the use of mathematical analysis. This reliance does not reduce theoretical physics to bad mathematics nor Schmoller's economics to bad history. An institutionally rich and practically realistic political economy can hardly be expected to thrive if it is reduced to the use of one methodology at the expense of the other. A balance of different methods, not the exclusive use of one over the other was what Schmoller stood for.

While Schmoller's program has survived and is well in academia, notably in America, his name is remembered by very few, but his work remains thoroughly inaccessible. In the economics discipline, the institutionalist approach has some of its roots in Schmoller's approach. Economics as a professional discipline, however, has lost its prominence side by side with the law schools. Business schools and schools of public administration continue the emphasis on institutionally rich, theoretically sound and multidisciplinary scholarship that can lead to practical solutions. Perhaps it is time that economics need not be sterile and unrealistic. Perhaps it is time to insist on its usefulness. And perhaps this book can help bring about the reconsideration of a man's work who stood for those practical values.

Maastricht, February 8, 1988

Prof. Dr. Jürgen Backhaus
Rijksuniversiteit Limburg

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Chapter I

Schmoller: Street-Smart Years

Gustav Schmoller was born on June 24, 1838, in Heilbronn, north of the modern city of Stuttgart, in what today is the state of Baden-Württemberg, one of the eleven constituent states of the Federal Republic of Germany. He died on June 27, 1917, in Bad Harzburg.¹ His mother, *nee* Therese Gärtner, came from Calw, a small industrial town in Württemberg, known in the 17th and 18th centuries for its cloth industry. In her ancestry were physicians and well-known scholars in the natural sciences.² His father, Ludwig Friedrich David Schmoller was born in 1795, became a soldier in 1813, and saw combat duty against the armies of Napoleon. He rose to the rank of an officer and was seriously wounded in battle. He was knighted for his services to the royal house of Württemberg, and he died in 1865 in Heilbronn. The ancestral family may have originated in Russia, for, according to Schmoller's own interpretation, the name Schmoller is supposedly a Slavonic word and refers to 'smoller', meaning a charcoal burner.³ Schmoller's friend and supporter in Halle, Heinrich Leo, had forever repeated this tale.⁴

Schmoller's father was a business administrator of the royal estates of Württemberg, so the young Schmoller grew up in a materially comfortable home. His father's house was large and well appointed, with a beautiful garden full of fruit trees and flowers. Located in the center of the town, its spacious courtyard and garden served the children as a playground.⁵ Schmoller lost his mother when he was nine years old, so he was actually brought up by his father. According to Schmoller, his father was an industrious and forceful personality with a sunny disposition.⁶ Even though his father worked long hours in the

¹ Meitzel, C., "Schmoller, Gustav v.," in *Handwörterbuch der Staatswissenschaften*, Jena, Fischer, 1926, vol. 7, pp. 251-253.

² Schmoller, G., "Meine Heilbronner Jugendjahre," in *Von schwäbischer Scholle*, Heilbronn, Verlag Eugen Salzer, 1918, p. 55.

³ *Smoliti* in Russian means to tar or to apply pitch. It could very well be that Schmoller's friend, who told him the supposed origin of the name, could have referred to the Russian word *smoljar* or even more properly *smoliljschchik*, somebody who applies pitch.

⁴ n. a. *Reden und Ansprachen gehalten am 24. Juni 1908 bei der Feier von Gustav Schmollers 70. Geburtstag*, Altenburg, 1908, p. 47.

⁵ Schmoller, G., *op. cit.*, p. 53.

⁶ *Ibid.*, p. 54.

office, he maintained a light touch, so to speak. He strove to educate his children by example and admonition; he stressed the importance of continuous application on their part, for otherwise they would amount to nothing in life.⁷ His accounts of his wartime experiences left a profound impression upon the children.⁸

From early childhood, Schmoller learned to understand and appreciate the needs, wants, and living conditions of ordinary folk. In his father's business office he regularly met people from all walks of life, be they workers or farmers. These daily contacts gave him an early insight into the nature of the prevailing social and economic institutions, the process of legislation, and the administrative practices of the small kingdom. He also spent his summer vacations with his grandparents in Calw, which at that time was one of the most industrial towns in Württemberg. In Calw, he came to know well the prevailing life styles and living conditions of the industrial workers, craftsmen, peasants, businessmen, and government officials. All these early experiences must have left an indelible impression upon the young Schmoller.⁹

Schmoller Sr. wanted Gustav to become a civil servant like himself. Although Gustav's junior academic high school years were boring, as he claimed at the end of his life, his senior high school was more taxing and stimulating. He took his high school diploma in the spring of 1856, third in his class.¹⁰ Upon graduation, on account of his delicate health, Schmoller Sr. urged his son to skip a year and a half and spend it in his office to get even better acquainted with the administrative problems of the royal government and household.¹¹ The young man obliged, and during 1856-57 he learned the financial and administrative practices of his native Württemberg. He also travelled and became familiar with the lay of the land, its roads, rivers, bridges and the numerous customs houses as well. But above all, he observed life at the grassroots and acquainted himself with the prevailing economic and social conditions.¹²

Prior to working with his father, Schmoller took private lessons in higher mathematics for a few months with a certain Mr. Riekher. But, as Schmoller wrote at the very end of his life, it was this early experience with his father that

⁷ *Ibid.*, p. 55.

⁸ n. a., *Reden und Ansprachen gehalten am 24. Juni 1908 bei der Feier von Gustav Schmollers 70. Geburtstag*, Altenburg, 1908, p. 48.

⁹ Francke, E., "Gustav Schmoller und die Sozialreform," in *Soziale Praxis und Archiv für Volkswohlfahrt*, vol. 26, # 44, 1917, p. 862.

¹⁰ Schmoller, G., *Meine Heilbronner Jugendjahre*, p. 54. See also, *Reden und Ansprachen*, p. 48.

¹¹ Hintze, O., "Schmoller, Gustav v.," in *Deutsches Biographisches Jahrbuch. Überleitungsband II: 1917-1920*, Stuttgart, 1928, p. 125.

¹² Hintze, O., Spiethoff, A., Beckerath, E. v., "Gustav von Schmoller, 1838-1917," in *Lebensbilder grosser Nationalökonomien*, edited by Horst C. Recktenwald, Köln and Berlin, Kiepenheuer and Witsch, 1965, p. 334.

laid a foundation for his subsequent development and interests. This early practical knowledge of life, something that today we might call being street-smart, shaped his intellectual development and perceptions of reality.¹³ Throughout his life, Schmoller's thinking, judgement, and inferences were based on real-life experiences and perceptions of social and economic problems — not on neat abstract, logical and simplified constructions of reality. To paraphrase Schmoller, one could probably lay down his maxim as follows:

“Grass-roots experience is a great asset; it enables you to recognize a mistake every time you repeat it!”

In October 1857, Schmoller enrolled at the University of Tübingen to major in *Kameralwissenschaft*,¹⁴ a term which in America has been described as a discipline “which combines public finance, statistics, economics, administrative science, history and even sociology.”¹⁵ From today's mainstream perspective, such a major is nonsensical. Was this *Kameralwissenschaft* a field of inquiry which turned a young man into a jack-of-all-trades and master of none?

What is almost always forgotten today, particularly by English-speaking economists, is that for centuries Germany, like Italy, was but a geographic concept. In reality, Germany consisted of some 300 German-speaking kingdoms, duchies, free cities, and tiny principalities. These political entities were forever threatened by their stronger neighbors. To assure their continued survival, these small states, each headed by an aristocrat, developed strong bureaucracies, run by officials trained in all aspects of statecraft. As a rule they were graduates with a degree in *Kameralwissenschaft*. The object of this science was to teach future government officials “how to preserve and increase the general means” of the state.¹⁶ It taught them how to maintain law and order, how to keep the roads, bridges, and watermains in good repair, how to improve nutrition, and how to cultivate lands properly.¹⁷ In other words, it was a hands-on training for the solution of the pressing social and economic problems, designed to preserve the survival of one of the 300 small, but sovereign German-speaking entities. It was only after the end of the Napoleonic wars when, by 1815, the number had been reduced to 38.

Schmoller pursued his studies with gusto; he was an eager beaver. He strove to obtain as broad an education as possible, but his economics preparation got

¹³ *Reden und Ansprachen*, p. 49; see also, Schmoller's *Meine Heilbronner Jugendjahre*, p. 57.

¹⁴ Schmoller, G., “Meine Heilbronner Jugendjahre,” in *Von schwäbischer Scholle*, Heilbronn, Verlag Eugen Salzer, 1918, p. 54.

¹⁵ Fischer, W., “Schmoller, Gustav,” in *International Encyclopedia of the Social Sciences*, vol. 14, New York, The Macmillan Company and The Free Press, 1968, p. 60.

¹⁶ Small, A. W., *The Camarelists. The Pioneers of German Social Polity*, Chicago, The University of Chicago Press, 1909, p. 441.

¹⁷ *Ibid.*, pp. 442-444.