

## Schmoller and Modern Economic Sociology

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### Abstract

Gustav von Schmoller, the leader of the younger German Historical School of Economics, criticized a theoretical approach of classical and neoclassical economics and advocated a historical approach. Schumpeter critically interpreted Schmoller's research program as the prototype of economic sociology. Along the line suggested by Schumpeter, this paper formulates Schmoller's attempt of economic sociology as a historical, ethical, and realistic approach to economics, with a focus on his conception of the economy and his specific topics, i.e., the *Methodenstreit*, the stage theory of development and social policy. Finally, this paper compares Schmoller's economic sociology with the classical and the modern economic sociology and suggests his relevance to the present-day social theory.

*JEL Classification: A12, B15, B31, B41*

Received: February 8, 2006

Accepted: March 22, 2006

### 1. Introduction

When past authors, famous or neglected, are discussed in a context of contemporary disciplines, there are two possible approaches: first, the authors in question are treated by a method of rational reconstruction in light of a present theory and valued as the precursors of a certain aspect of today's knowledge; and second, they are referred to as critics of a present theory, evoking a kind of renaissance of their thought. The two approaches attempt to draw a line in the development of an idea, either from the present to the past or from the past to the present. In actual research in the history of a discipline, however, they are often not clearly separated but intermingled with one another; they are better conceived as two complementary viewpoints in the history of ideas, facilitating a dialogue between past and present.

This paper combines these two approaches and discusses the relevance of Gustav von Schmoller to modern economic sociology in order to suggest what can be learned from Schmoller through an interpretation of his work. Economic sociology is the study of economic phenomena from a sociological perspective.

tive, and is distinct from mainstream economics. Its research agenda concentrates on (1) the sociological analysis of economic process, (2) the analysis of the connections and interactions between the economy and the rest of society, and (3) the study of changes in the institutional and cultural parameters that constitute the economy's social context (Smelser/Swedberg, 1994, 7).

Although Schmoller was opposed to both classical and neoclassical economics he did not retire from economics to sociology, but instead developed a new type of economics, i.e., historical economics. With regard to the content of historical economics, he not only defined sociology or social theory as the goal of economics, but also stressed the need for inquiry into the social forms of economic life – the core of the sociological perspective – in his methodology and economic research. Therefore, it is not inappropriate to call his research program an attempt of economic sociology insofar as it was not admittedly accommodated to the corpus of economics. This line of interpretation was suggested, among others, by Heinrich Herkner (1922) and Joseph Schumpeter (1926).

Herkner characterized the unique feature of German economics at the time by a close association with sociology and regarded Schmoller as the founder of the sociological school of German economics because he could not be identified with any other single titles (Herkner, 1922, 3). While he called Schmoller “one of the greatest sociologists of today,” he neither clarified nor criticized the structure and method of Schmoller's sociology. The influence of Schumpeter's interpretation has been far greater in positively appraising Schmoller's work and setting a new agenda for economic sociology. Schumpeter interpreted Schmoller's research program as the prototype of economic sociology and specified its goal to be a “unified sociology or social science as the mentally (“theoretically”) worked out universal history” (Schumpeter, 1926, 382, my translation, hereafter MT). But he did not accept Schmoller's research program as it stood. He critically reconstructed it from the viewpoint of integrating historical and theoretical approaches, the conflicting issue in the *Methodenstreit*. According to Schumpeter, the result of the integration was the notion of economic sociology.

It is generally undisputed that Schmoller was the leader of the younger Historical School of Economics and that he developed an approach countering mainstream economics, both classical and neoclassical. Identifying the nature of Schmoller's economics, Schumpeter pointed out that it was not merely historical but also ethical; he referred to Schmoller's own labeling of a “historico-ethical” approach (Schumpeter, 1954, 812). Arthur Spiethoff, in his preface to the *Festschrift* on the centenary of Schmoller's birth, added the adjective “realistic” beside “historical and ethical” to describe German historical economics led by Schmoller (Spiethoff, 1938, v). For Spiethoff, a realistic approach meant a phenomenological grasp of reality and its complexities instead of the construction of abstract categories based on arbitrary assumptions and

their logical consequences. It is exactly for this reason that Max Weber, who described himself as a disciple of the German Historical School and used economic sociology or *Sozialökonomik* as his favorite term, observed the essence of this discipline as a “science of reality” or the *Wirklichkeitswissenschaft* (Weber [1904]; 1922, 170). But, more importantly, Schmoller’s realistic approach also aimed at social reform, assisting the discussion and solution of contemporary economic and social issues. Thus, Schmoller’s historical and ethical economics remained neither a description of history nor a prescription of morality, but became an applied science addressing a practical solution for social reform in Germany.

With regard to these three aspects – historical, ethical, and realistic – Schmoller’s economics evidently differed from the creed of mainstream neo-classical economics that was characterized by a purely theoretical, positive, and abstract approach. The *Methodenstreit* between Schmoller and Carl Menger was a remarkable example of conflict between these two approaches. Schumpeter’s conception of economic sociology, based on the methodology of instrumentalism, was an attempt at a reconciling the conflict by proposing a synthesis of the two (see Shionoya, 1997, Chapter 8).

In the following I first examine Schmoller’s conception of the economy and the method that could legitimate his approach as economic sociology (Section 2), and then analyze his major contributions to economic sociology in terms of the basic characteristics of his approach, i.e. historical, ethical, and realistic (Section 3). This tripartite analysis includes reformulation of the *Methodenstreit*, the stage theory of economic development, and social policy for labor, small business, and social class respectively. Finally, I conclude the paper with a remark on what can be learned from Schmoller in the light of the perspectives of classical and modern economic sociology (Section 4).

## 2. Schmoller’s Conception of the Economy and His Method

Let me summarize Schmoller’s view of the subject matter and method of economics from the Introduction of his *Grundriss der allgemeinen Volkswirtschaftslehre* (1900, vol. 1, 1–124). His concept of the national economy (*Volkswirtschaft*) comprises two basic concepts, individual economic action and community (*Gemeinschaft*). Economic action refers to the acquisition and disposal of goods and services in order to satisfy a variety of physical wants as a condition of our existence. Economic action, Schmoller argues, is “purposeful action that is directed by technical knowledge, rational deliberation, and ethical ideas; it is driven by value feelings and value judgments, i.e., by rational considerations of economic aims and means, their relationship for human beings with respect to utility and cost, and pleasure and pain.” (vol. 1, 2, MT). In an economic sphere, however, individuals do not behave in isola-

tion but are instead tied together by psychological, ethical, and legal bonds. In this sense, economic action takes place within various economic organizations, social relations, and institutions. These organs represent not only technically appropriate forms but also ethical, legal, and social orders, and organize social life in general for the purposes of human beings. Economic activity is part of social life.

In discussing economic organizations and institutions, Schmoller refers to sociological categories such as social organizations (family, clan, tribe, regional community, firms, and the state, etc.) and social relationships (division of labor, ownership, classes, etc.), because the nature of economic phenomena as a whole is different in societies with different organizations and relations. He pays special attention to the separation and independence of firms from the household. Based on division of labor and private ownership, firms produce goods for markets in pursuit of profits, resulting in the formation of social classes, on the one hand, and the establishment of the national economy, on the other. The national economy integrates all organizations within the national boundary by a central organ of the state. For Schmoller, the national economy is not a collection of individual economic actions, but a real holistic existence or “*ein reales Ganzes*” with the same race, the same language, and unified feelings, ideals, morals, laws, and institutions. As we shall see below, the linked concepts of firms and the state provide a key to Schmoller’s historicist vision of social policy.

Schmoller’s basic thesis is the view that “the national economy is partly a natural-technical and partly a spiritual-social system of power.” (vol. 1, 6, MT). The national economy is a part of social life, whose proper function is to socially organize economic processes and phenomena through the interactions between the natural and technical factors, and the psychological, moral, and legal factors. It follows that in order to understand the national economy, one must study its relationship with other social phenomena as well as its internal mechanisms, thus, implying the need to study the psychological, moral, and legal foundations of social life.

To discuss the interaction between individuals and society Schmoller stipulates the integrating role of common feelings and interests shared by individuals in a community. Unless feelings, ideas, impulse, and will are common to a great enough extent so as to serve as the cause of action among a group of people, social institutions will not be established. In other words, economic behavior is impossible without moral communities. He describes this process as a play of spiritual collective powers (*Kollektivkräfte*) leading to the formation of a unified sphere of consciousness (*Bewusstseinskreis*), in which a range of shared economic, social, and political value judgments should prevail and provide the foundations for institutions and organizations. Under the similar social institutions and systems of ideas in all advanced nations, it is found in turn that remarkable agreement has been reached on the feelings, morals, and

values among people. Thus, there exists reciprocity between individual action and social institutions. The most extensive sphere of agreement is the nation with the national spirit (*Volksgeist*), an aspect of which constitutes the national economy (vol. 1, 15–20).

As a result of the interactions between individuals and institutions resulting from spiritual and ethical factors, the moral orders of social life take root and are embodied in institutions and organizations as the average standards of individual judgments and action. Schmoller identifies the moral orders of social life as consisting of three kinds of norms, i.e., customs, laws, and morals. He maintains that economic life as an aspect of social life cannot be understood without understanding the historical development of these norms. Economic institutions and organizations are not only natural and technical, but also psychological and ethical in the sense that the social framework does not work without a consensus of ethical values even if the social framework is technically feasible. “Social institutions and organizations become the most important products of moral life. They are the crystallization of moral life.” (vol. 1, 61, MT). “The national economic system is a branch and a tributary of the moral systems.” (ibid, 69, MT). “The historical development of economic life, in the first place, certainly consists of better production and provision of economic goods for human beings, but it will succeed only with better institutions and more and more complex organizations. . . . It is the great ideas of progress and ethical ideals that are fixed in institutions.” (ibid, 64, MT).

From this setting of problems three points are derived with regard to the research agenda of economics. First, the motive of economic activity embedded in social institutions should not be regarded as limited to self-interest and earning impulse alone; people are also endowed with public interest and economic ethics for work, saving, and entrepreneurship. Second, the national economy should not only be viewed as a natural-technical process with respect to population, capital, and technology, but also as a spiritual-ethical system. Third, since morality is historically crystallized in institutions, the formation of institutions and the relationship between institutions and individuals, rather than the individual behavior perceived in isolation, should be the subject matters of economics. Institutions should be viewed as a means to achieve various social and individual efforts rather than as mere givens. If these requirements are not fulfilled, economics is reduced to what might be called a natural science of utility calculus or equilibrium price economics.

Following Book I: Land, People and Technology (vol. 1, 125–228), the main body of the *Grundriss* consists of Book II: The Social Constitution of the Economy (vol. 1, 229–457) and Book III: The Social Process of Commodity Circulation and Income Distribution (vol. 2, 1–678). These two parts compare to the anatomy and physiology of the national economy: the former develops the sociological categories and in fact amounts to a basic economic sociology,

while the latter is concerned with price economics of the neoclassical school clothed by the massive description of historical and institutional conditions.

How, then, is Schmoller's economics formulated as a research program? Since I have discussed Schmoller's research program and its methodology in detail elsewhere (Shionoya, 1995), a brief account will suffice here. He presented a systematic statement of research methods and methodology in a long article in the *Handwörterbuch der Staatswissenschaften* (1911) as well as in chapter 3 of the Introduction to the *Grundriss*.

Both materials are products of his later life, in which his earlier radical criticism of a theoretical approach is toned down; in fact, the former article is a revised and expanded version of the 1893 article appearing in the first edition of the *Handwörterbuch*.

The formal aspect of his research program consists of three steps: (i) the observation and description of economic phenomena according to time and space, (ii) the definition and classification of these phenomena within a coordinated system, and (iii) the causal explanation of the phenomena and recognition of their interrelatedness (Schmoller, 1900, vol. 1, 100; 1911, 455). Although this set of procedures articulates the historical method of the German Historical School, it should not be judged in opposition to a theoretical method but in light of the subject matter that it addresses. Schmoller does not deny the significance of the deductive method, general concepts, and regularity in economic phenomena, and admits that the completed science is generally deductive (1911, 478). However, in view of the fact that economics must deal with the complicated relationship between economic activity, social institutions and historical evolution, he emphasizes the importance of accumulating monographs of historical studies for present use because economics has not yet sufficiently advanced to allow the use of deductive methods and the formulation of universal laws. Therefore, the most economists can do is summarize and coordinate the collected historical data and conjecture ad hoc causal explanations – that is, steps (i) – (iii).

As far as Schmoller's framing of the subject matter is concerned, his approach appears to stem from a perspective of economic sociology. But his method does not indicate the extent to which data collection should be pursued. Referring to the history of economics, he held that the development of human knowledge took place by the alternation of empiricism and rationalism and that, in view of the present stage of economic development, one must now engage in empirical research (Schmoller, 1888, 147–50). When Schumpeter found a prototype of economic sociology in Schmoller's approach, he envisaged economic sociology as a way of integrating theory and history, and in his case also imposing a theoretical method on historiography. Schumpeter characterized economic sociology as "a special field which, owing to the nature of its object, is not only a detailed and material-collecting discipline, but

also a theoretical discipline.” He furthermore regarded such economic sociology as dealing with a “given” of theoretical economics (Schumpeter, 1926, 369–70, MT). In order that economic sociology may be established with such qualifications, Schmoller’s methodological basis should be criticized and reconstructed.

According to Schmoller, theory is nothing more than a summary or generalization of empirical facts; it is so difficult to grasp the complexity and diversity of all the historical developments of economic life that a pursuit of realistic assumptions for deduction would require many efforts of historiography. In Schumpeter’s view, in contrast, economic sociology as the discipline of cooperation between theory and history followed an instrumentalist methodology. By instrumentalism I don’t mean the currently accepted narrow view that theories are instruments of prediction. The original version of instrumentalism developed by Ernst Mach, Henri Poincaré, and Pierre Duhem, and supported by Schumpeter, held that theories are instruments for clarifying, organizing, explaining, and predicting observable phenomena (Shionoya, 1997, Chapter 5). From this standpoint, assumptions are arbitrary creations of the human mind and need not be justified by facts, and theories deduced from assumptions are not descriptive statements of reality, but instruments for understanding and explaining reality. Hence, a theory is neither true nor false; it proves useful if it can cover an increasing amount of facts to which its instrumentality applies. Instrumentalism facilitates deductive attempts even when a sufficient amount of empirical data has not been collected according to the Schmollerian standard. One should have a feedback process between theory construction and fact-finding in order to practice research in economic sociology. For this purpose, Schumpeter redefined Schmoller’s program as follows:

“Approaching the materials with a minimum load of the a priori in order to grasp relationships, and then increasing the a priori for the future and working on the new conceptions that serve as (provisionally) existing tools for dealing with more materials; thus proceeding with the constant interaction between materials and theoretical work.” (Schumpeter, 1926, 381–2, MT).

Although Schmoller did not deny theory in principle, he did not have a coherent methodology. When he considered the nature of concept formation, while admitting nominalism instead of realism, he argued that concepts are means for constructing thought; they are not perfect copies of reality, but are hypothetical and provisional and can, therefore, be constantly improved (Schmoller, 1911, 466–468). Since abstraction meant to him a deviation from reality, it was natural that he could not give a realist status to concepts and conceptual frameworks. There was only a step from this position to instrumentalism. But he was so concerned with data collection that he loaded concepts with rich empirical content; the result was that he could not understand the instrumental role of concept formation. We find here Schmoller’s metho-

dological contradiction: in spite of his nominalist position, his ultimate goal was scientific realism.

From the instrumentalist interpretation of theory it follows that the definition and classification of the phenomena by a coordinated system – the second step (ii) in Schmoller’s research procedure – should play an important role of theorizing. This prescientific act may be called vision. Instrumentalism allows the prescientific elements to play a role in the construction of theories by first positing a vision of what we want to know. In this regard, it is noteworthy that Schmoller describes what could be regarded as a plausible approach to economic sociology: “About the total development of economic conditions we possess no more than tentative attempts, hypothetical propositions, and teleological considerations.” (Schmoller, 1900, vol. 1, 109, MT). This sort of knowledge, however inadequate, is indispensable as a step in the feedback process between theoretical formulation and historical research under the instrumentalist methodology.

Having succeeded Schmoller’s sociological perspective, Schumpeter and Weber elaborated the methodological position of economic sociology and made substantial progress in the field of economic sociology. Despite the apparent differences between Schumpeter’s background of Ernst Mach and Weber’s background of Heinrich Rickert, Schumpeter’s instrumentalist methodology and Weber’s ideal-type methodology proved quite similar as theorizing principles for the sociological perspective. They are counted as the major figures of classical economic sociology (Swedberg, 2003, Chapter 1).

### 3. Schmoller’s Contributions to Economic Sociology: An Interpretation

Although the historical, ethical, and realistic aspects in Schmoller’s economics are correlated with each other, I will analyze his substantive contributions by interpreting each of these characteristic aspects in terms of three topics, (a) the *Methodenstreit*, (b) the stage theory of economic development, and (c) social policy.

#### 3.1. The *Methodenstreit*

The *Methodenstreit* was a confrontation between Carl Menger and Schmoller, or between the Austrian School of Economics and the German Historical School of Economics; it was alleged to be a controversy about the relative superiority of a theoretical-deductive-individualistic approach versus historical-inductive-holistic approach. But it is agreed among the historians of economics that the controversy was not about the historical and theoretical methods, but instead about intellectual interests in different subject matters. Theor-



ists were concerned about small-scale problems relating to the static economic order in the process of resource allocation within a market system, including production, distribution, and consumption, that is, an order rhetorically described as established by an invisible hand. Historians, in contrast, were interested in large-scale problems of the development of communities and the evolution of socio-economic institutions in the historical context, that is, the development and evolution led by a visible hand from the moral viewpoint of social justice.

The lesson of the *Methodenstreit* is that since the effectiveness of different methods is judged by their applicability to different subject matters, it is not useful to speak of the superiority of one method over another in a general way. It is instead more enlightening to construct a wider synthetic framework of thought from the *Methodenstreit* rather than to dissolve the confrontation as a pseudo one. This is what I try to do here by introducing another controversy between contractarians and communitarians in contemporary moral philosophy (Shionoya, 2004). The two controversies deal with the problems and methods of social science and are, therefore, identical in form as well as in substance although they arose out of different disciplines. A juxtaposition of the two controversies reveals the underlying structure of Schmoller's historical and ethical approach.

In Table 1 the two axes denote problem and method, as perceived from a global perspective of social science. Two research problems are distinguished: order within a given social system, and the basic structure of that social system. As for methods, individualism and holism are differentiated. In both economics and ethics an inquiry into the internal order of a system entails a theory of the good, while an inquiry into the basic framework of a system gives a theory of the right. Economics as a theory of the good has developed the micro theory of market equilibrium (A), based on the concept of individual good (utility). Ethics as a theory of good offers a communitarian theory (C), based on the concept of the common good in community. The former depends on the individualistic method and the latter on the holistic method. Then, with regard to a theory of the right addressing the basic structure of society, contractarianism of John Rawls (B) derives a theory of justice on the basis of methodological individualism; historical economics led by Schmoller attempted to explain the evolution of communities that embody the idea of justice (D) based on the holistic method.

While the current controversy in ethics is the conflict between (B) and (C), as represented by one of the diagonal arrows in the table, the *Methodenstreit* in economics was the conflict between (A) and (D), as indicated by the second arrow in the table. Each standpoint in the controversies, based on a distinctive combination of problem and method, produces a unique system of thought (A)–(D), and constitutes a complementary, not competing, part of knowledge for the whole social universe. Ferdinand Tönnies's conceptual scheme of the

*Gemeinschaft und Gesellschaft* (1887), an eminent work of economic sociology, is interpreted as an identification of the four standpoints in Table 1 with four approaches to social organizations: (A) and (B) are the individual and social approaches to the *Gesellschaft* (association), i.e., calculation and contract; (C) and (D) are the individual and social approaches to the *Gemeinschaft* (community), i.e., understanding and custom. Tönnies’s work is regarded as the typification of the psychological-ethical foundations of economic institutions, which Schmoller was concerned with.

Table 1  
Two Controversies in Economics and Ethics

Problem / Method	Order within system (theory of good)	Basic structure of system (theory of right)
Individualism	(A) Theory of market equilibrium (theoretical economics)	(B) Theory of justice (contractarianism)
Holism	(C) Theory of common good (communitarianism)	(D) Theory of system evolution (historical economics)

As a brief digression, it is interesting to read Schmoller’s critical review of Tönnies’s book. As we shall see below, Schmoller’s contrast between regional communities and business firms is nothing but an application of Tönnies’s pair concept of *Gemeinschaft* and *Gesellschaft*, which have become key terms in sociology insofar as the terms are used as an ideal type. But Schmoller rejected them on the grounds that they were not founded on a secure basis with regard to the historical relations and realistic economic and social life but instead worked out within a kind of “illusory ideas” (*Phantasievorstellungen*). Schmoller blamed Tönnies for retreating to the age of Fichte and Hegel (Schmoller, 1888a). As far as economic sociology is a science, however, it must be based on conceptual formulations combined with empirical fact-finding.

Schmoller’s economics (D), if adequately formulated, uncovers the evolution of ethical, social, and political principles by using prevailing norms in order to explain factors constituting the basic structure of economic institutions. By morals Schmoller does not mean his own subjective judgments, but

objective moral judgments as historical facts. His ethical approach does not mix values with facts, as his opponents claimed, but aims at analyzing the factual values underlying economic and social institutions. Furthermore, his ethical approach was not only intended to recognize moral facts, but was also formulated in a teleological form. He regarded teleology as a heuristic device that supplements an empirical science when empirical knowledge is not sufficient to causally clarify the behavior of a social whole (Schmoller, 1911, 437). His methodological holism is teleological.

For Schmoller, the major content of teleology was the principle of justice. He believed that all social progress depends on further victories of justice. As mentioned above concerning the role of the common feelings in the interaction between individuals and society, the theory of common good (C) is closely linked with the theory of system evolution characterized by the concept of the right or justice in the national economy (D). The common good as an order within social organizations is compatible with the conception of justice that constitutes the basic structure of the system as a whole. Rather, for Schmoller, values in ethical communities are the evolving basis of the conception of justice. It is worthwhile to note a similar relationship between (A) and (B). While Menger and Hayek had suggested the idea of spontaneous order to explain (B) on the basis of (A), the New Institutional Economics growing in the recent decades makes a similar effort to provide an individualistic approach as an account of the basic structure of the system as a whole.

In Schmoller's view, the distribution of income and wealth is governed by institutions for the rights of property, inheritance, and contract, and these institutions are a product of feelings, thought, actions, customs, and laws (Schmoller [1881]; 1894, 21–2). Therefore, his viewpoint focuses on the formation of ethical communities, their common aims, and the relevant human qualities. His attempt at integrating historical and ethical inquiries resulted in the stage theory of economic development, our next topic.

### 3.2. The Stage Theory of Development

Before dealing with Schmoller's stage theory as the synthesis of his work in economic sociology, it is useful to distinguish three economic perspectives in light of different approaches in the history of economic thought: natural-technical, psychological-ethical, and institutional-historical. The most inclusive perspective was advocated by Schmoller: as we have mentioned, he maintained that the economy consists not only of natural-technical factors but also of psychological-ethical factors, and focused on the institutional-historical process in which the two former categories of factors interacted. His perspective was much wider than that of classical and neoclassical economics which were concerned with the equilibrium of the market economy attained by a play

of natural-technical factors. In economic theory the profit and utility motives are assumed merely as a device for the mechanical maximization calculus.

Schmoller's perspective was also wider than that of the older German Historical School. Wilhelm Roscher, one of the founders of the German Historical School, had asserted a stage theory of economic development based on the assumption of the "historical and physiological" approach to economics, and held that the life of nations develops through four stages: childhood, youth, adulthood, and old age. In each of the three former stages, land, labor, and capital are regarded as predominant in the working of the economy. Roscher's stage theory, though based on the historical observation of institutional schemes for each industry, is mainly oriented to changes in the working of natural-technical factors including factor input and industrial composition (Roscher, 1843). It does not deal with the role of psychological-ethical factors, leading to the distinction with Schmoller's stage theory.

Schmoller distinguished three types of social organizations in a national economy: the family and kindred, local community (village, city, and state), and firms (Schmoller, 1900, vol. 1, 230). He believed that by referring to the role of social organizations in economic life, one could discuss the interactions between the natural-technical factors and the psychological-ethical factors, which was Schmoller's basic vision on the working of an economy, since the ethical factors are crystallized in institutions and organizations. The three types of organizations are based on different organizational principles. In the family and kindred, the principles are sympathy, kinship, and love; in the local community, they are neighborhood, nationalism, law and coercion; and in the firms, it is a contract based on private law (vol. 1, 453–4). According to Schmoller, it is wrong to argue that economic life is always an individual process simply because it is concerned with a technical process of satisfying individual wants. The focus on the social organizations was the crux of his stage theory of economic development. In his famous article on Mercantilism, he wrote:

"In every phase of economic development, a guiding and controlling part belongs to some one or other political organ of the life of the race or nation. At one time it is the association of the kindred or tribe; at another the village or mark; now it is the district, and then the state or even a federation of states, which plays this part. . . .

In association with the tribe, the mark, the village, the town (or city), the territory, the state, and the confederation, certain definite organisms have successively evolved with ever wider scope: herein we have a continuous process of development, which, though it has never accounted for all the facts of economic life, has, at every stage, determined and dominated it." (Schmoller [1884]; 1896, 2–3; translation revised).

In contrast with the firm, the family and community are not established primarily for economic purposes. From the autarchic family or tribal economy developed two types of organizations. Organizations of a local community such as a village economy, a city economy, a territorial economy, and a na-

tional economy were formed for the purpose of controlling economic life and serving the public interest at different levels of the regional economy. The second type of organization includes firms developed to pursue private profits, which entail various institutional arrangements such as the division of labor, markets, social classes, property ownership, and so on. With the growth of transportation, commerce, markets, and competition, the old organizations based on the protection of narrow interests were threatened so that efforts and tendencies toward larger groupings of economic forces became inevitable. Schmoller reveals that his argument rests on two propositions: first that,

“in spite of the fact that it is the individual and the family that labour, produce, trade, and consume, it is the larger social bodies which, by their common attitude and action, intellectual as well as practical, create all those economic arrangements of society, . . . upon which depend the economic policy of every age in general and its commercial policy in particular.”

and second that:

“historical progress has consisted mainly of the establishment of ever larger and larger communities as the controllers of economic policy in place of small.” ([1884]; 1896, 77; translation revised).

Shifts from one stage to another depended on the struggles between the challenges of natural-technical forces and the responses of social-ethical forces, the latter being carried out by the far-sighted town administrators, territorial lords, and state bureaucrats. Specifically, controls by guilds in a city economy, rules by lords in a territorial economy, and social policy by the state in a national economy were attempts at the moral binding of an economy. Particularly, he emphasized that Mercantilism was a political effort of nation-building in terms of the national economy as the unified organ.

Schmoller’s scheme of development in stages from a village economy, to a city economy, to a territorial economy, to a national economy was designed in terms of the concept of the regional community as the carrier of social policy in a broad sense that worked to regulate and modify the free play of firms in markets. It can be labeled as a public economy model of institutional changes. The stage scheme is an outcome of a series of articles on the historical development of the firm from the household economy (Schmoller, 1890–93). According to Schmoller, the modern business firm has double aspects – technical-personal organization and moral-spiritual organization – and has gradually adapted to the public need of social responsibility and social justice (Schmoller, 1900, vol.1, 413). The transformation of firms in his public economy model illustrates the falsity of the self-interest assumption in economic theory.

### 3.3. Social Policy

Schmoller was one of the founding members of the *Verein für Socialpolitik*, which was intended as a public forum on social policy. In face of a variety of social issues caused by rapid industrialization, most of the members of the younger German Historical School including Schmoller supported the intervention of the government in the economy, in opposition to the claims of the *laissez-faire* by the German Manchester School on the one hand, and of revolution by socialists on the other. While he admitted that advances in the psychological-ethical conditions of all classes is a basis of social reform, he held that the role of the bureaucracy is to work for the public interest rather than the particular interests of political parties and interest groups. This is not his ad hoc argument but is derived from the defense of Mercantilism based on his stage theory. He insisted on the need to approach policy issues on an empirical and historical basis, not merely on an ideological one.

The whole period of Schmoller's academic career covers the period "from 1870 to 1914," which specifies an important period in the history of economics. Although the main topic for this period is no doubt the establishment and development of neoclassical economics by the Marginal Revolution, Schumpeter characterizes an aspect of economics during this period as the "*Sozialpolitik* and the Historical Method" (the title of Chapter 4 of Part IV, *History of Economic Analysis*). The relationship between the *Sozialpolitik* and historicism was a distinctively German doctrine.

I cannot discuss Schmoller's work on social issue and social policy in detail here (see Backhaus, (ed.) 1997; Grimmer-Solem, 2003), only its general significance. His idea of social policy was based on a synthesis of several propositions: first, Germany was a latecomer to the process of industrialization inaugurated by Great Britain; second, the industrialization process is quite diverse across countries; third, a latecomer depends on institutional factors rather than on *laissez-faire* to catch up advanced countries; fourth, institutional development is explained not so much by the free choice of autonomous individuals in markets as by the sense of community and coordinated actions based on shared values. These propositions are derived from Schmoller's historicist view, stage theory, and public economy model, and are integrated in Gerschenkron's thesis of economic backwardness that latecomers to economic development do not follow the same time sequence as their precursors and that they can design new patterns of development through institutional devices (Gerschenkron, 1962).

Schmoller's deep concern for institutions was ultimately based on the practical need of nation-building through the appropriate design of an institutional framework for the latecomer Germany, which incorporated social policy into the strategy of industrial growth to ameliorate the conditions of the working classes. The German invention of social policy including social insurance and

its philosophical foundations of communities were later exported to Great Britain through the intermediary of British idealism.

#### 4. Conclusion: A Comparative Appraisal

Methodological concern for economic sociology centers on the relationship between the economic area and the non-economic areas. While neoclassical economics is concerned with the workings of markets that constitute the economic sphere, the non-economic areas are often conceived of as consisting of sociological elements that form the institutional preconditions for markets. This idea was a perennial source of the attempts of institutional economics. If the research object of economics is identified within the economic area and that of sociology within the non-economic areas, and a link between them is not analyzed, there are only two separate disciplines of economics and sociology without room for economic sociology. In fact, for most of the twentieth century the indifference to economic sociology prevailed both in economics and sociology.

If economic sociology is to hold at all, one of two types of approaches with respect to the relationship between the economic area and the rest of society (sometimes conceptualized as institutions) must exist. First, although the economic and the non-economic areas are distinguished as the proper objects of economics and sociology respectively, economic sociology investigates the links between the two areas, that is, the links between everyday economic action and social institutions. Examples include Marx's study of ideology through the relationship between the superstructure and the substructure of society, Weber's study of the relationship of the Protestant ethics to the workings of modern capitalism, and Schumpeter's study of the influences of successful economic development on the moral basis of capitalist system. In these examples an analysis of the links is conducted by the application of sociological concepts. Under the influences of German sociology of knowledge, historicism, and romanticism, an orientation toward social wholeness among social scientists brought about the golden period of classical economic sociology including the works of Marx, Durkheim, Simmel, Weber, and Schumpeter.

A second type of economic sociology is based on another conception of the economy. In this conception, economic action is conceptualized as embedded in society without distinguishing the economic and the non-economic spheres, an emphasis being on the social nature of economic life. All economic actions are embedded within social networks rather than carried out by atomized individuals who are motivated by self-interest.

Advocates of contemporary sociology, known as the "new economic sociology" since the mid-1980s, assert the importance of networks of social relation-

ships in economic actions and try to explain the core economic subjects by sociological approach (Granovetter, 1985).

In both types of economic sociology as well as in neoclassical economics, the crucial point is the conception of individuals. In neoclassical economics individuals are defined as maximizing their own material interests in a rational manner, and a society as an aggregation of such atomized rational agents has as its task merely the efficient use of scarce resources; there seems to be no scope for economic sociology. Therefore it might be odd to see the emergence of the New Institutional Economics from the application of neoclassical economics to a wide range of problems traditionally given little attention in economics (“economic imperialism”). Classical economic sociologists, in contrast, have depended on a wider and plural conception of individuals as the basis of economic action: for example, Weber distinguished four kinds of social action – instrumentally rational, value-rational, affectual, and traditional – which cover economic action (Weber, [1922]; 1978); similarly, Schumpeter distinguished between the static, hedonistic man and the dynamic, energetic man (Schumpeter, 1912). These conceptions of the individual are different from the neoclassical economic man, and can bring economics into contact with institutions. Different types of man are applied to the economic area and the non-economic areas respectively, leaving the rational type of action to economic area and non-rational types to the institutional preconditions for economic action.

On the other hand, advocates of the new economic sociology maintain that (1) the pursuit of economic goals is normally accompanied by that of non-economic ones (the inseparability of economic and non-economic motives), (2) human action is always socially situated and cannot be explained by reference to individual motives alone (social embeddedness, or the inseparability of individual and non-individual motives), and (3) social institutions are constructed not automatically in response to economic needs but through interactions between individuals and social networks (the social construction of economic institutions) (Granovetter, 1992, 4). All these propositions are meant as a critique of New Institutional Economics. Granovetter, one of the proponents of the new economic sociology, describes:

“One of the main differences between the old and the new sociology of economic life is thus exactly that the newer work reverses economic imperialism by offering sociological accounts of core economic subjects such as markets, contracts, money, exchange, and banking. In doing so, it is much less accepting of orthodox economic theory than the older tradition that focused on the institutional preconditions for economic life, and thus never needed to offer an alternative account of everyday economic activity.” (Granovetter, 1990, 95).

Then, where is the place of Schmoller in light of the types of economic sociology if his work is interpreted as economic sociology? Because he has not been treated by sociologists proper as an economic sociologist, his place



has not been designated with reference to the classical and the new economic sociology.

In this paper I have observed the essence of the formal and substantive aspects of Schmoller's work. Based on these observations, I argue, first, that Schmoller's framework of double forces within the economy (i.e., the natural-technical and the psychological-ethical forces) indicates that his conception of economic action was based on the pluralistic view of the self, which constituted the basic vision of the German Historical School in opposition to the rationalist view of the atomistic economic man. This means that he could have accepted the first and second propositions of the new economic sociology based on the relationship between the economic and the non-economic motives, as well as between the individual and non-individual (social) motives, because he did not separate the economic area from the non-economic areas. He held that economic action is always socially situated under the interactions between the two groups of forces and influenced by the nature of the social organizations to which it belongs. After Schmoller, those who are regarded as the classical economic sociologists, i.e., Weber, Schumpeter, and others including even Marx, separated the two areas and discussed the relationship between them perhaps because they respected the autonomous status of price economics more highly than Schmoller. There was no discussion of the relationship between the economy and society in Schmoller's work because the economy and society were conceptually integrated from the beginning.

Second, I argue that Schmoller's historical-ethical approach to economics cannot be absorbed into the new economic sociology as far as his substantive work is concerned, because he developed his work primarily on the institutional-historical perspective in which natural-technical factors and psychological-ethical factors interact. In this respect his economic sociology is closer to the classical economic sociology of Weber and Schumpeter than the new economic sociology; in fact, it proved the prototype of classical economic sociology.

This aspect of Schmoller's approach in comparison with the new economic sociology relates to the latter's third core proposition. Although the new economic sociology emphasizes the social construction of economic institutions, to which Schmoller certainly would have agreed, it has not explored the institutional-historical dimensions of society. If the ambiguous (or flexible) concept of social embeddedness in the new economic sociology is analyzed into more exact and operational terms, it can be observed that action is historically and ethically conditioned by institutions and organizations because the historical continuity and discontinuity of society are explained by institutions, and the ethical content of society is crystallized in institutions. However, the flexibility of the concept of embeddedness (a "conceptual umbrella") might be a source of its attraction for gaining wide consent (Swedberg, 1997, 170–71). Contemporary economic sociology, an American phenomenon, is so absorbed in countering neoclassical economics and New Institutional Economics that it

has failed to succeed an aspect of the European legacy accumulated by Schmoller and the classical economic sociologists.

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