Review of Treatise on Money by Joseph A. Schumpeter

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The appearance in English translation of Schumpeter's *Treatise on Money* should be of considerable interest for scholars of monetary theory. The newly published volume may be viewed as the missing link between two of Schumpeter's other key works: *Theory of Economic Development* ([1938] 2008) and *Business Cycles* ([1939] 1964).[1] The latter volume, published three years after Keynes' *General Theory*, was dismissed by Schumpeter's student Hyman Minsky: "The crisis of capitalism produced a magnificent theoretical response from Keynes; Schumpeter's was banal." (Minsky, 1983, p. 1). Minsky's dissatisfaction sprung from Schumpeter's increasing devotion to the Walrasian general equilibrium system—a system Minsky viewed as incompatible with the central role played by money in Schumpeter's earlier work: "... Schumpeter got enmeshed in a Walrasian trap that assumed only real things matter, whereas in his original vision, money mattered." (Minsky, 1983, p. 15) The current volume is of interest then for the light it sheds on Schumpeter's attempts to reconcile a positive role for money with the Walrasian system.

In *History of Economic Analysis*, Schumpeter (1954) contrasts his "credit theory of money" with the dominant—then, as now—"monetary theory of credit". It is this credit theory of money that Schumpeter attempts to lay out in his *Treatise*. Schumpeter argues that the "essence" of money is not located in any of the specific forms in which it is found—whether that be a commodity, a banknote or something else—but in the constantly shifting complex of credit and debit positions which underpin all economic transactions. The role of money is to provide a clearing system for this network of creditors and debtors, allowing claims and counter-claims to cancel each other out: "the economic meaning of the handover of little pieces of metal

[1] Schumpeter began work on the *Treatise* in between writing *Theory of Economic Development* and *Business Cycles* yet the book remained unfinished even by the time of his death. Some commentators have suggested that the publication of Keynes *Treatise on Money* ([1930] 1971) led Schumpeter to abandon the project. Messori (1997) argues that this view has been overstated.

fashioned in a certain manner . . . is that it reduces someone's credit and increases someone else's by the same amount" (p. 218). It is argued that anything that can be used to perform this clearing process performs the role of money: "what performs the service of money is money" (p. 244).[2].

Money in its most essential form is thus a pure unit of account, as in Wicksell's (1936) "pure credit" economy. This leads Schumpeter to reject the concept of the supply of money: "to speak of a quantity of existing units of account would make as much sense as to say that a certain number of units of length exist with which everything that has that length must be measured" (p. 244). Without a meaningful measure of the supply of money, the quantity theory of money and all of the associated apparatus surrounding must also be abandoned.

Schumpeter's theory is laid out in a sequence of steps, starting with the analysis of a socialist economy in which all production is performed by labour and the clearing of value credits (labour) and debits (consumption) is done by the central planner. The model is gradually expanded to include non-labour inputs and unexpected shifts in consumption demand. The analysis is then shifted to the more complex case of a capitalist system in which economic activity takes place ". . . by the interlocking of individual or 'sub-group' motives and initiatives" (p. 133).

Schumpeter then goes on to outline a system of accounts based on a division of the economy into household, firms, banks and the central bank. Although not formalised to the same degree, Schumpeter here essentially describes what are now known as flow-of-funds accounts (see, e.g. Michell, 2012). On the basis of these accounts, Schumpeter demonstrates the role of the banking system as the locus of account settlement, and the central bank as "the final distillate of all transactions passing through the banking system" (p. 132). It is this settlement role that confers on the banking system the power to create new purchasing power: in issuing new credit, new deposits are created simultaneously.[3]

At this point, however, the text begins to dwindle. Further discussion is provided of the determination of the price level and of the concept of the velocity of circulation, but at the end of Chapter XII the text simply stops mid-sentence. The reason for this is that the draft was never completed, and the version published now is an English translation of the manuscript compiled by Fritz Karl Mann and published as Schumpeter (1970). It is

[2]Schumpeter is highly critical of the chartalist approach of Knapp ([1905] 1924) as well as dismissing "monetary reformers": "A sharply-defined type of social reform monomaniac sees money, it's reform or abolition, as a social panacea . . . " (p. 4)

[3]Of the incorrect doctrine that "*borrowing by banks* is the actual and logical precondition for their lending", Schumpeter notes, "even today it is still advocated by distinguished men of science and practice" (p. 192). The correct doctrine—that loans create deposits—is traced by Schumpeter back beyond even Hartley Withers (1909) to Henry Dunning Mcleod (1855–56).

thus intriguing that the introductory notes provide so little discussion of the process by which the manuscript was compiled—particularly in light of the claim by Messori (1997) that drafts exist of an additional three chapters.

We can therefore still only speculate as to whether Schumpeter succeeded in synthesising Wicksellian monetary theory with Walrasian framework—and what his opinion would have been of Woodford's (2003) more recent attempt at exactly the same synthesis.

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