Joseph A. Schumpeter (1883-1950) was one of the most influential economists of the 20th Century. He was born in Trest in the former Austrian-Hungarian Empire and studied law and economics at Vienna University 1901-06. He was first affiliated with the University of Graz. After short periods as Austrian Minister of Finance (1919-20) and chief manager of an Austrian bank (1920-24), he became Professor at the University of Bonn in Germany in 1925. From 1932 up until his death in 1950, he was professor at Harvard University.

In most of his research publications, Schumpeter preferred to exceed the traditional limits of economic theory and to analyze economic phenomena in a broad historical, political, institutional and sociological framework. This broad research approach is exemplified by his by far most famous book “Capitalism, Socialism and Democracy”, which was first published in 1942 during the Second World War but reappeared in revised editions in 1946 and 1949.

The manuscript of the present book “Treatise on Money” was discovered among the papers left by Schumpeter on his death in 1950. The text revealed that he had worked on the book project “Geld und Währung” during many years. Some notes were written as early as in the late 1920s, while teaching economics at the University of Bonn.

The text was originally meant to be published as volume 36 of the huge “Enzyklopädie der Rechts- und Staatswissenschaft”, but Schumpeter later changed his mind. He revised the manuscript several times, but he never finished it. There has been a great deal of speculation as to why Schumpeter did not publish the book. Some observers have referred to the success of the contemporary outstanding British economist John Maynard Keynes, who in the 1930s published two very influential books: “Treatise on Money” (1930) and “General Theory of Employment, Interest and Money” (1936). The world-wide economic depression in the early 1930s changed the focus in economic research away from account settling and clearing functionality of financial markets and towards means to fight unemployment. Keynes saw the implications of this earlier than Schumpeter and provided a strong theoretical basis for activity stimulating policy instruments, in particular in various forms of fiscal policy.

Fritz Karl Mann (University of Cologne) took the initiative in the 1970s to publish the unfinished manuscript under the title “Das Wesen des Geldes”, with Vandenhock & Ruprecht, Göttingen in veneration for the old master and in accordance with the wishes of Schumpeter’s widow. A new German edition was published in 2008. The 2014 English edition based on the 2008 version is translated by permission of Vandenhoeck & Ruprecht. In the English translation, the title has been changed from “The Essence of Money” to “Treatise on Money”. This last title was used by Schumpeter himself in a reference to the unfinished manuscript in his own published work “Business Cycles”, (1939).

Schumpeter’s broad analytical approach is already visible in some of the words used in the chapter headlines. He writes about the history of money, the sociology of money, the doctrine of money, the capitalist economic process, the economic account in the Socialist Commonwealth, the theory of the price level and the money market as heart of the capitalist economy.

The book is extraordinary rich in terms of references to classical philosophers and economists. Schumpeter has studied and quotes extensively the works of Charles de Secondat Montesquieu, Adam Smith, Thomas Robert Malthus, David Ricardo, David Hume, John Locke, John Stuart Mill, Karl Marx, Léon Walras, Alfred Marshall, Gustav Cassel, Knut Wicksell, Vilfredo Pareto, Eugen von Böhm-Bawerk, Étienne Laspeyres, Hermann Paasche, A.C.Pigou, Carl Menger, John Maynard Keynes and many many others. So, in addition to monetary theory the book provides a very well written survey of the history of economic ideas.
Schumpeter wants the reader to understand that money is an important subject. Already on page 1 he writes: “a people's monetary system exercises a fundamental influence on its economic activity and its destiny in general”. On page 2 follows the impressive sentence: “Nothing demonstrates so clearly what a people is made of than how it conducts its monetary policy”. After having referred to the German inflation in the 1920s, he describes the disorganizing effect of a currency breakdown on national character, morality, and all branches of cultural life. Some of Schumpeter’s sentences are very long. From time to time, the reader is reminded of the fact that the author originally formulated them in German. Nevertheless, the text is clear. His discussion of the goal of monetary policy (p. 7-11) – price stability or inflation below a certain level – sounds surprisingly modern.

In chapter 2 regarding the sociology of money, Schumpeter explains that it is impossible to write a satisfactory history of the monetary system independently of theory. He explains the four functions of money: medium of exchange, measure of value, standard of deferred payments and store of value.

Chapter 3 contains an outline of the development of the doctrine of money. The author describes monetary theory in the Ancient World, in the Medieval Period, in the Early Modern Period and in the Modern Age. Schumpeter was a great admirer of David Ricardo. “The nature of money was very clear to him, and it was this which kept him from explicitly saying that material value does not essentially appertain to money” (p.74). Ricardo knew (!) that the stability of purchasing power is the decisive factor in assessing a monetary system (p.75). Another economist held in high regard by Schumpeter was Léon Walras. In the 1886 edition of “Théorie de la Monnaie”, Walras brings the principle of cash-holding in as the cornerstone of the theory of money (p.83). Gustav Cassel is credited for the development of the theory of purchasing power parity (p.84).

The economic account in the Socialist Commonwealth is the subject of chapter 4. In a centralized socialist economy, the central office has to consider the amount of demand satisfaction of the comrades (!), and the need to choose between different production possibilities in terms of that amount, i.e. the actual economic element in the economic plan, which through numeric specification makes up the economic account (p.94). Schumpeter explains that resource allocation in such an economy presupposes a unit of account as well as of entitlement and that the institution of money can fulfill this need.

In chapter 5 and 6, Schumpeter discusses the capitalist economic process and the roles of households and firms in this process. In a market economy, the production process does not proceed with a conscious plan, nevertheless a certain order prevails and not anarchy. Entrepreneurs and merchants play a decisive role. Households earn income in many forms: wages, rents, quasi rents, monopoly profits, speculative and windfall profits, entrepreneurial profits, interest and dividends. Households expenses consist of consumer spending, investments, debt repayment and interest payments. If incomes and expenditures are not in balance, bank deposits and bank loans are used to accommodate imbalances. Firms earn income by selling their products, and the fundamental expenditure items of firms are payments for purchased means of production including wages and cost of maintenance and operation and cost of expansion or modification of installations. Entrepreneurial profits are the premiums that in the capitalist economy are set for the successful implementation of an innovation in the economic process (p.139).

Banks and the central bank are discussed in more detail in chapter 7. Schumpeter describes the role of banks in the financial system and the most important items in banks’ income statements and balance sheets. From time to time, Schumpeter applies dramatic language: “Cash on hand – can be a real reserve with respect to borrowed funds in the sense of being kept ready to form a first line of defense against an onslaught of “depositors” when they make withdrawals, not as part of ongoing activity but with the intention temporarily or permanently to retire from bank transactions, as it wont to happen in panics” (p.161). Schumpeter stresses the role of the central bank as a bank for the private banks (p.166). Central bank independence is important (p.169). The list of monetary policy instruments comprise open-market operations, discount rate policy and moral suasions. An interesting point concerns the “profit interests of the central bank” (p.178). In Schumpeter’s view, there are no serious conflicts in the longer term between the profit interests of the central bank and the broader public interest. Depending on the legal framework, the central bank can prevent functionless panic-inspired damage to the economic process. It can iron out short-term fluctuations in the discount rate that otherwise might cause serious disturbance to such a sensitive money organism –. Especially in connection with exchange-rate policy –” (p.180).
Chapter 8 deals with bank-mediated money creation. Provision of checking and giro balances to households and firms are essential parts of banking business. These credit items are “cash” for the households and companies concerned, available quite as easily and for the same purposes as when furnished with an equal amount of physically held coins (p.190). When banks acquire assets, they create bank liabilities that for other people are cash. Bank credits create bank deposits. For individual banks, the derived deposits partly goes to other banks, but for the banking system as a whole the principle holds. Through the interbank market liquidity deficits and surpluses can be accommodated. This is essential to the understanding of the bank-mediated settlement process. The banking system can create purchasing power (p.202).

The headline of chapter 9 is the essence of money. Schumpeter applies the idea of social central bookkeeping, which registers all economic activities and makes it possible to explain how payment processes are related to economic life. Money is used as a means of payment for the provisional adjustment of credit relations deriving from the non-simultaneity of the services and counter-services entering into the economic clearing process (p.218). With reference to Léon Walras, Schumpeter discusses how to determine the value of money. It can be done arbitrarily or it can be based on a commodity, for instance gold (p.232). Schumpeter has harsh remarks about gold coverage provisions in central bank legislation. “What is at play here is primarily a deliberate defense on the part of public opinion that has learned from abuse and disasters, and legislation following in its wake. The memorial to this mentality, that pays homage to a naïve but in practice often very healthy metallism and that views bank-mediated money creation as a shameful thing to be opposed” (p.239).

In chapter 10, Schumpeter draws some conclusions. Money is nothing more than a technical tool of social clearing (p.241). Money is not a good and not a commodity. Coins can in principle continue to circulate endlessly and facilitate economic transactions. The velocity of circulation reflects the change of hands that coins undergo. It is not strictly correct but practically allowable to speak by analogy with the velocity of the circulation of coins, of the velocity of the circulation of deposits (p.247).

Chapter 11 is a very long and detailed discussion of price index problems. Schumpeter explains the implications of changes in goods combinations and quality of goods. Weightings should have economic meaning (p.286).

In chapter 12, which is the final and incomplete chapter of the book, Schumpeter starts with the equation of exchange:

\[ M \times V = P \times T \]

where \( M \) is money supply, \( V \) velocity of circulation, \( P \) an index of the price level and \( T \) a measure of the quantity of goods transacted. Even though the equation seems to have tautological features, it can help us to understand the payment processes and the essence and materialization of the national accounts (p.296). Only with an understanding of the money and credit side of the economic development can we begin to understand the capitalist money process. The economy tends to show self-motion with a wave-like character. Entrepreneurs play a key role both in up-turns, where they borrow in order to introduce better methods of production and innovations, and in down-turns. The money market is, according to Schumpeter, the heart of the capitalist economy. Monetary theory has to take the multiplicity of interest rates into consideration. Science was and often still is inhibited in the task of unbiased recognition of the contours of reality in this area (p.325).

A reviewer has an obligation to decide if he wants to recommend a book to a wider readership. Schumpeter’s book will be of interest to readers who are also interested in monetary and economic history and in an overview of the contributions of classical philosophers and economists to monetary theory. Such readers will enjoy the exciting text written by an intelligent and hardworking economist with a deep understanding of the interplay between money, finance and politics. Readers, who are more interested in implications for monetary policy in the 21st century, may prefer other sources in light of the far-reaching changes over the 60+ years that have passed since Schumpeter’s death.