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Schumpeter's Review of Frank A. Fetter's Principles of Economics

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Translator's Note:

This review of Frank Fetter's textbook by Joseph A. Schumpeter was brought to my attention by Dr. Matthew McCaffrey of the University of Manchester, who suggested a translation. It was originally published in German in volume 17 of the leading Austrian journal in economics in the early 20th century: *Zeitschrift für Volkswirtschaft, Sozialpolitik und Verwaltung* (Journal of Economics, Social Policy and Administration). The journal was edited by some of the most eminent economists of Austria at that time, namely, Eugen von Böhm-Bawerk (1851–1914), Theodor von Inama-Sternegg (1843–1908), who had passed away shortly before the publication of volume 17, as well as Eugen von Philippovich (1858–1917), Ernst von Plener (1841–1923) and Friedrich Freiherr von Wieser (1851–1926). The discussion of Fetter's text is part of a series of nine book reviews by Schumpeter contained in this volume. In them, he discussed new publications in the English, French and German literatures, including E. R. A. Seligman's

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Principles of Economics, William Stanley Jevons's unfinished, posthumously published *Principles of Economics, A Fragment of a Treatise on the industrial mechanism of Society and other Papers*, Léon Polier's *L'idée du juste salaire* (The Idea of the Just Wage), and H. von Leesen's German language biography of Frédéric Bastiat.

The review of Fetter's *Principles* is the last one of this series, and is also the most laudatory. Schumpeter emphasizes that the book is more than merely a textbook, and he highlights the close connection between Fetter's theory and the economics of the Austrian school. The review is therefore of interest from the vantage point of the history of economic thought. In particular, Schumpeter recognizes the importance of Fetter's classification of entrepreneurial activity—the "enterpriser's function" in Fetter's words—as just another form of labor. Without going into any detail, Schumpeter hints at the extremely important social implications suggested by this view, but then proceeds to provide a brief rejection of this position from the perspective of pure economic theory.

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Review 9:
Frank A. Fetter, *The Principles of Economics, with Applications to Practical Problems*
New York: The Century Co. (1905)
Joseph A. Schumpeter[1]

This book surely deserves special attention, not only as a textbook that is rich in content, but also as a scientific achievement. Once again, the focus lies on theory, which is entirely based on the phenomenon of value. This is clearly brought to the reader's attention already by the structure of the book, which is oriented towards value. As such the endeavor is to be appreciated, since, if one is to base it on only one principle, it means a step towards the unification of the edifice of our science. However, by analyzing still other things besides pure theory within the same system—if one tries to fit everything into the same scheme—one is expecting too much of this value foundation. The first part [of the book] is entitled "The Value of

[1] *Zeitschrift für Volkswirtschaft, Sozialpolitik und Verwaltung*, Band 17, pp. 415-420 (1908).

Material Things" and provides a doctrine of needs, an introduction to the law of marginal utility, and other basic aspects in much the same way as most "psychological" economists would present them. These outlines, which are very attractive and clear, strike a chord with those of the proponents of the Austrian school. Indeed, Fetter is much closer to the latter than the other American theorists.

The law of diminishing returns takes a back seat and appears almost solely as a formal concession to American practice when it is given a special chapter in the section on fundamental concepts. Similarly, it is merely a terminological measure without any substantive significance when the author expands the term rent to every physical and value gain. In connection to the latter we should point to the elegant term "psychic income," which surely deserves further use. Here, we would like to complain about just one point. The term is defined as a form of total utility, given by the product of the quantity of a good that an economic agent owns and its marginal utility. This notion of total utility can be found quite frequently in the works of notably non-mathematical theorists. It is based on the assumption that, in any given moment, all units of the good are valued equally according to their marginal utility, and hence that the total value of all available units is given by the sum of the equal values of each unit, just like the total quantity is given by the sum of the units. But this is certainly an erroneous belief. From the fact that all of the single units available at the same time are valued equally, it does not follow that the value of several of these units is equal to the sum of their single values. Instead, when it comes to the value of several units, needs of higher intensity become important that do not influence marginal utility as such, which is only determined by the least urgent need, and each time presupposes the satisfaction of the more urgent ones. This, however, is contested when we deal with larger quantities, and when evaluating the latter this needs to be taken into account. Only one unit is valued at the margin. All the others are given higher value, namely, that marginal value that would prevail without the units already given a lower value. Each unit must be given a different marginal value from which we can calculate the sum. But this means nothing else than that the total value is an integral.

The next "Division," entitled "Capitalization and Time-Value," starts with a theory of money. Little by little, as the result of a long discussion, a robust theory of money smoothly breaks fresh ground. Fetter's theory points in the right direction, as this sentence shows: "money in all its money uses is an indirect agent to be judged just as other indirect agents are."[2] This is indeed a very useful starting point. It just goes a bit too far to use the notion of money as a tool not merely as an analogy, but to take it completely seriously and speak in the same way about income earned from the ownership of money as income earned from the ownership of a tool.

We now turn to the notion of capital and the theory of capitalization. The former is characterized by its clarity. Fetter rejects Clark's separation of capital and capital goods. What is said about capitalization is entirely up to date. The derivation of the value of capital from the value of the return is nicely illustrated with the example of the purchase of rent-charges.[3] This may be the most attractive presentation of the topic, and to have clarified it, one of the largest advances in modern theory is.[4] Only one thing is not quite in order. Prof. Fetter seems to regard the discounting of future revenues as a matter of course, and only tries to determine the magnitude of the discount factor. This is not proper. Moreover, the way in which the "Time-Discount" is determined is not quite satisfactory. Following this, more practical explanations follow which are suited to facilitate the beginner's understanding of the processes involved in financial reality.

Next, the author addresses the subject of interest on money loans and treats it in the Böhm-Bawerkian spirit, in order to provide an elaborated and sound "Theory of Time-Value." The following chapter is also very useful: "Relatively Fixed and Relatively Increasable Forms of Capital." Less satisfactory is the treatment of the relationship between the interest rate and savings activity. Apart from the fact that only detailed statistical investigations

[2] Added by translator: (Fetter 2003, p. 63).

[3] Added by translator: (Fetter 2003, ch. 15).

[4] Added by translator: Schumpeter's original syntax truly resembles the style of Master Yoda here. It is as unusual in the original German as it would be in English today, although it might have been a stylistic device in Austria at the time. The original reads: "Es ist das vielleicht die anziehendste Darstellung dieses Themas, das klargestellt zu haben, einer der größten Fortschritte der modernen Theorie ist" (Schumpeter 1908, p. 417). Then again, it may simply be a mistake. In that case, the translation does justice to it. If not, it was worth a reference to Yoda.

could definitely solve this problem, it is already shown by everyday experience—and besides also the new theory—that savings cannot be considered a simple function of the interest rate and that deviations are merely due to secondary causes, as Fetter seems to suggest.

The second part is entitled "The Value of Human Services" and contains first of all a theory of wages and then a theory of enterprises and entrepreneurial profit. Most of what is presented here has little to do with the principle of value. Strictly speaking, this classification only fits to the few words on the pure theory of wages. The latter assumes that labor is an economic good, a starting point which is ever more generally considered to be useful, but does not lead very far.

The author covers the topic of "The Supply of Labour," by which is meant the theory of population. He truly attempts to overcome the hidden complexity, which makes this area one of the darkest of political economy. But this attempt only shows how little can be said about the problem from our point of view, and to what extent the answers must lie with other sciences.

Fetter begins with biological facts, but of course, what he offers is neither complete nor does it guarantee scientific reliability. Besides that, already the first lines [of this discussion] contain a number of unproven assertions, some of which surely must surprise us, such as that humans have overcome the stage in which natural forces blindly determined their reproduction, and that in "earlier stages" one had merely sought to keep the population at a certain level, that war used to be the normal condition of the peoples, and many more, points about which the appointed expert in the field would surely shake his head in disbelief. We use this occasion to express our conviction that the omission of such territory would be one of the most urgently needed reforms in the system of economics.

The following chapters, like the one called "The Law of Wages" or the one on "The Relation of Labour to Value," are of economic nature. The latter is very close to Böhm-Bawerk's thought and goes to show that this theory is increasingly gaining recognition.

A correct and calm outline of the rather accepted modern views on the iron law of wages and the wages fund doctrine closes the theoretical part of this "Division," the rest of which deals with aspects that are usually explained in reference to the theory of wages, albeit there actually is no deeper connection, for example, wage systems, the progress of the working classes, trade-unionism etc.

The second "Division" of this part is entitled "Enterprise and Profit," where the latter term refers to entrepreneurial profit in the narrower sense. Again, we wish to direct the reader's attention to the original systematization of the book, which it would possibly be worthwhile to imitate. The theory of distribution would accordingly not form a separate topic, the claim to which it has lost as soon as one realizes that incomes are merely instances of price and value phenomena, at least in so far as their sheer economic nature is under consideration. We see such as approach here: interest and rent fall under "The Value of Material Things," so that in this section there only remains to be explained the value of human efforts, which for several reasons the author wishes not to conflate with material goods. For this classification to be complete, all the incomes, except the two mentioned, must thus be explained as the results of human labor. Therein lies not only an economic but also a very important social theory, which we cannot further explain here. The most important purely economic implication of this view is that entrepreneurial profit is based on labor, that is, more precisely the entrepreneurial profit in the narrower sense, which, as is well-known, has to be separated from the entrepreneur's salary.[5] Fetter mentions a number of qualifications that are necessary to perform this particular kind of labor and seems to explain the extent of entrepreneurial profit exclusively from their scarcity.

This implies that entrepreneurial profit must be as much a regular phenomenon as wages, interest and rent, and that its tendency to disappear, ascribed to it by pure theory, does not exist.

It seems to us that this theory, which has already often been advocated, is not tenable for the following reason: if one is to explain an income from the value and the price of an effort, it is necessary that supply and demand enter into a price battle on the market with mutual over- and underbidding to set a price to which the theoretical exchange scheme fits. The latter becomes

[5] Added by translator: Schumpeter uses the term "Unternehmerlohn" (Schumpeter 1908, p. 419), which seems to be translated best as "entrepreneur's salary" or "employer's salary."

useless, however, as soon as the process is different, which is the case here. One must not confuse a general ethical judgment of the entrepreneurial function in the social production process with those individual valuations that determine price formation. The entrepreneur does not appear on the market in order to sell at a fixed rate his entrepreneurial effort to the workers, capitalists, landowners or the consumers, or to society as such.

The lack of the latter is precisely the characteristic element. The imagined buyer of entrepreneurial effort, whoever it may be, is not even capable of forming an opinion about the price that he pays, and so he is incapable of comparing it with the utility he expects from the entrepreneurial effort. The entrepreneur appears on the market not to sell his effort, but to sell goods. Moreover, he buys production goods and pays their owners, so that he stands on the opposite side of the workers, capitalists, and landowners. The principle of value thus breaks down when it comes to the income of the entrepreneur. In addition, the latter is not nearly as steady a phenomenon as the other sources of income. One tends to express this fact quite often in contrasting entrepreneurial profit as a "dynamic" source of income with the three "static" ones.

In fact, the distinction between static and dynamic is meanwhile generally accepted and represents in my eyes one of the major advances in new economic theories. We have sorely missed this distinction in Professor Fetter's system.

Thereafter, the author discusses the phenomenon of monopoly. In doing so, the whole exact monopoly theory, one of the best in pure economics and surely not without some practical relevance for that matter, is omitted. After some brief remarks of very general nature, Professor Fetter proceeds directly to the discussion of organization and especially the problem of trusts. What he says about this is certainly very useful. The data provided are also very instructive for the beginner. Short remarks on speculation and crises close this part.

The third part is very rich in content and very well suited as an introduction to economic policy, especially for the American student.

Another aspect has to be mentioned, namely, the appendix of questions and critical notes, which seems to be a very practical didactic device. Indeed, the American method of education is very different, and one can hardly compare American or English classes with our seminars. Nonetheless, such a collection of questions seems to be very appropriate for our study programs too.

REFERENCES

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