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The New and the Old Economics

by C. H. DOUGLAS

In view of the progressive situation in Australasia, the present appears to be a suitable moment to make available the text, for some time out of print, of Douglas's reply to Messrs. Copland and Robbins, the last major contribution to the discussion of Social Credit economics from his pen. The text of which the first instalment appeared in The Social Crediter for July 10 will be published in pamphlet form later:—

(*Conclusion*).

Categorically, there are at least the following five causes of a deficiency of purchasing power as compared with collective prices of goods for sale:—

1. Money profits collected from the public (interest is profit on an intangible).
2. Savings, *i.e.*, mere abstention from buying.
3. Investment of savings in new works, which create a new cost without fresh purchasing power.
4. Difference of circuit velocity between cost liquidation and price creation which results in charges being carried over into prices from a previous cost accountancy cycle. Practically all plant charges are of this nature, and all payments for material brought in from a previous wage cycle are of the same nature.
5. Deflation, *i.e.*, sale of securities by banks and recall of loans.

There are other causes of, at the moment, less importance.

Excluding taxation, which is a separate although allied subject, all distributed purchasing power is recovered from the public through the agency of prices. This is just as true in connection with the recall of trade loans as in any other form of expense. It seems obvious, therefore, that, with the exception of savings, the whole of the above causes of the difference between purchasing power and prices can be found in B payments, which are money ultimately on its way back to the bank, and none of them, with the exception of savings, are found in A payments, and if we subtract the A payments distributed in a given week minus savings from the total prices claimed in a given week, we shall get B payments as a measure of the net debt claims against the public for the week in question.

As bearing upon this, the Association of American Engineers at Columbia University, previously referred to, remarks that "the total debt claim against the physical equipment of all American industry has risen to the fantastic figure of 218,000,000,000 dollars—a debt claim on posterity." They correctly remark that a temporary revival to "prosperity levels" is possible by increasing the debt claim through a policy of inflation, but that a downward oscillation will result from this that is likely to end in the utter collapse of the price system under which industry has operated.

The foregoing is sufficient answer to the quotation from Mr. J. M. Keynes, which begins: "Let X be equal to the cost of production of all producers. Then X will also be equal to the incomes of the public." This is the well-known logical fallacy known as the *petitio principii,* which consists in assuming the truth of the fact which you have set out to prove and then proving the assumption from the logical conclusion. The cost of production is *not* equal to the incomes of the public, and therefore the rest of the argument merely indicates what would happen if it *were* equal.

Professor Copland then goes on to argue that the whole system of production would have broken down had my analysis been correct, and mentions the interesting fact that A payments in Australian industry are about one-fourth of the total value of output of goods in factories. It is well understood how it has been possible for industry to carry on up to the present time under the faulty financial system we have examined, and the two more important causes are: firstly, the excess of exports over imports, resulting in taking goods out of the country and receiving purchasing power in return for them, thus at one and the same time decreasing the amount of goods in the country and increasing the amount of purchasing power in respect of the remaining goods; and secondly, by a progressively excessive production of capital goods, the A payments of which become available to buy the consumable goods, the method to which reference is made by the American authorities quoted previously. Both of these latter processes have now become, in practice, impossible to any considerable extent, and the present crisis is the result.

It may now be convenient to deal with Professor Robbins's views on the matter.

(R) "Not only is there no reason to attribute a depression to a deficiency of consumption," said Professor Robbins, "but there is, on the contrary, considerable reason to believe that the coming of depression is due to the fact that there is too much consumption." I cannot help feeling that we are indebted to Professor Robbins for putting the logical inference from the financial position into plain words, and it appears to me to be such a *reductio ad absurdum* as should convince anyone that its premises are unsound.

Professor Robbins, however, does not agree with Professor Copland, but remarks: "It was perfectly true, as Major Douglas urged, that the sums distributed as ultimate incomes—wages, salaries, rents etc. were insufficient to purchase the total product of industry. But so far from that being the cause of industrial crisis, it was in fact an essential condition of the smooh functioning of the industrial system. If a system were considered which was in stationary equilibrium—*a system in which no saving was taking place*

(*continued on page 2, col. 1*)

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From Week to Week

(To avoid interrupting Major Douglas's text unsuitably is has been necessary to curtail the available space on this page to such a degree as again to suspend for one issue the notes under the above heading which are almost a constant feature of *The Social Crediter*.)

THE FIG TREE

In order that the printers may be instructed in good time concerning the number of copies required to be printed, will intending subscribers to *The Fig Tree* who have not done so kindly fill in and return to the publishers at 11, Garfield Street, Belfast, the order-form enclosed with this issue of *The Social Crediter*?

THE NEW AND THE OLD ECONOMICS—

(continued from page 1).

(my italics)—it was clear that, of the total volume of payments being made at any moment, only a comparatively small proportion were made for the final product. The remainder went to facilitate the movement of goods between the different earlier stages of production.... These payments did not go at the moment to the recipients of ultimate income. They were costs, but not net income. In any computation of the net value produced during the unit period they would set off one against the other, and at the end of such a process there would be available the value of the consumers' goods. To this, and to this only, corresponded the incomes of the ultimate factors of production. In many-stage production the net income did not equal gross income, and it was highly undesirable that it should do so. Only in a system of hand-to-mouth or single-stage production was it compatible that the requirements of equilibrium that the net income and the gross income should be identical".

(R) I am not quite sure whether Professor Copland would regard the foregoing explanation by Professor Robbins as being an outstanding example of clarity, but, apart from that and with a slight modification which I will indicate at once, I should be inclined to say that, if I understand it correctly, Professor Robbins has obtained a more accurate conception of the truth than has Professor Copland. The exception to which I refer is in respect of the words which I have italicised—"a system in which no saving was taking place," and I should substitute for these words—"a system in which no saving *had taken or was taking place*." The real meaning of Professor Robbins's statement amounts to this —that if we can imagine the modern industrial system doing only so much work upon capital goods as to maintain them indefinitely in exactly the same state of efficiency, then, quite obviously, consumption would be exactly equal to production. Under these conditions, the amount of wages distributed on maintenance would obviously be added into the cost of the end products, and collectively with the wages paid to the final producers of end products would be sufficient to buy the end products *always providing that no charges in respect of the original plant, buildings, and other capital goods which were merely being maintained, were charged in the prices of either intermediate or ultimate goods,* and that no one made a money profit. The most casual examination of Professor Robbins's example will be sufficient to make it clear that it is not one which has any relation to either the modern costing system or to the actual physical facts of production. In passing, it may be noted that, not only in the case of Professor Copland and Professor Robbins, but in the discussions which took place before the Macmillan Committee in 1930 and at Ottawa in 1923, it seemed to me and to others that the professional bankers and economists were quite ignorant of rudimentary cost accounting, and it is possible that this ignorance may have some bearing on the remarkable divergence of opinion which seems to exist on matters of fact. Not only is real saving in the physical sense, by which I mean a constant surplus of production in a form tangible or intangible, inevitable, apart from being a desirable feature, of the present production system, but there is no possible case in which the present system is worked, as it is supposed to be worked, in which charges do not appear in respect of the use of real, *i.e.,* physical capital. It is a perfectly proper thing, from a cost accounting point of view, for a workman to charge for the use of a hammer, and the moment he does this he is making charges in respect of capital. When the banking system endeavours to drive down prices by deflation, so as to make it impossible to collect these charges, it is merely transferring the injustice which it normally inflicts on the general public, to the manufacturers and the investor, who have been induced to undertake the business of providing goods and services on the tacit understanding that, not only shall they be paid for their present work, but that they shall be paid for their past work, which in their case is represented by savings which they have invested in the new business. The banking system can at any moment, and normally does, make this payment impossible eventually forcing the liquidation of the assets without compensation to the persons on whom it is continually urging the necessity and virtue of saving.

SECTION V.

THE JUST PRICE AND THE PRICE FACTOR.

Professor Copland quite correctly states that this part of the Douglas theory follows naturally from the A plus B theorem, and it follows equally naturally that, as Professor Copland's criticism of the A plus B theorem is invalid, that his criticism of the price factor is also invalid. There is a method, however, of looking at the matter which arises from the more fundamental proposition that, while in the modern world consumption is less than production, under the existing financial system it is necessary for the producer to recover costs and prices from the public at a greater rate than he makes disbursements. This means that the consumption rate represented by prices is greater than the production rate represented by direct costs, and is the direct reversal of the physical facts. Nevertheless, it is an essential to the producer who is bound by the conventions of the financial system, otherwise he would make a loss on a year's work, having issued more money than he recovered.

The greater part of the surplus production is capital production, and we have to find a method of restoring his money to the producer of capital goods as soon as they are produced, while only charging the consumer for them at the rate that they are used up. The justification for this, of course is that real credit is a measure of the rate of production. So that, if total production = (B) capital goods + (A) consumption goods, production costs are A+B, but true consumption costs are (A) + $\frac{B}{X}$ where X is the average life of real assets, and if we are only going to charge the consumer true costs, we have to pay the producer B—$\frac{B}{X}$ representing the value of the capital goods, to enable him to carry on his business. But if, in addition, he recovered the whole of his costs eventually from the public in prices, he would have recovered his costs twice over, therefore is is necessary to reduce the price to the public by the same amount B—$\frac{B}{X}$ that we repaid to the producer of capital goods, that is to say, retail prices must bear the same ratio to total costs that consumption does to production.

SECTION VI.

THE SUPPLY OF CREDIT.

As Professor Copland specifically states on page 22: "Major Douglas denies that there will be any increase in prices with an increase in the credit issued resulting from his application of the price factor. His denial would be valid if his A plus B theorem were correct, but this theorem is itself invalid." It will be seen, therefore, that the criticism of this section is really answered by the rebuttal of Professor Copland's criticism of the A plus B theorem, and is, in fact, answered by Professor Robbins. It is a curious fact, to which I do not take exception, that although Professor Copland presumably has the Minutes of Evidence of the Macmillan Committee, he prefers to quote my evidence on this matter given before the Canadian House of Commons ten years ago. I am, however, satisfied to rely upon the answer given by me, as quoted by Professor Copland, and repeated here (Q) "What is to prevent this?" *(rise of prices)*. (A) "Because the rise of prices which occurs in connection with the printing of what is referred to as fiat money takes place in accordance with the *assumption* that the price of an article is what it will fetch, and (that) if there is more money in the market in relation to the same amount of goods, and people want the goods, then it is clear that the articles will fetch more money, and that is what causes the rise of prices in connection with what is called fiat money. That takes as an axiom that you have a rise of prices in connection with the increased supply of money; but if you apply the increased supply of money, if you like to put it that way, to the reduction of prices, that is a condition of affairs which cannot possibly take place, because the application of money does not take place unless you get a fall of prices. It is impossible. If I say I will let you have 5 dollars towards an article which costs 20 dollars if you charge 15 dollars for it, then you do not get the 5 dollars unless you charge 15 instead of 20 dollars; and the provisions which can be made to ensure that that takes place are perfectly obvious by means of such a thing as a discount voucher or something of that sort; so that the rise of prices cannot possibly take place." Professor Copland's only comment on this is an unsupported statement that the increased money would raise prices.

Perhaps, however, the answer to Professor Copland's contention is contained in the fact that the payment for an article from two sources is in operation all over the world at the present time. If I, having a capital of £1,000,000, manufacture an article, of which the cost of manufacture is £5, and owing to economic depression I am forced to sell the article for £4, I am applying my private store of credit which I call my capital of £1,000,000 as a subsidy in aid of a reduction of prices to the extent of 20 per cent. I can go on doing this until I have sold one million articles at £1 below cost. Furthermore, I can go on doing it indifinitely if my bank will give me an indefinite overdraft. If Professor Copland will explain to me exactly where and how at the present time this unquestionable selling below cost by a draft upon credit is raising prices, I shall be infinitely obliged to him.

Nothing is more curious than the terror which seems to possess the conventional economist at the suggestion of anyone having more money.*

I am confident that Professor Copland is quite sincere in his views, but I think they arise from the unconscious effects of a training moulded in accordance with banking interest. The essential point, of course, is that the limitations placed upon the distribution of goods shall be either the physical limitations of the productive system, which limitations have in fact, practically disappeared, or the limitations imposed by psychological and physical satiety. In common both with bankers and most orthodox economists, Professor Copland evidently desires that all controls shall be in the hands of the banking system, in which aspiration I do not agree with him.

Professor Copland in this case also provides a diagram to show how the system suggested would work. This diagram begins by stating that producer's costs are £200, specifically described as A plus B payments. The producer is then shown as paying out £200 to the consumer, whose income is consequently shown as £200. I am sorry to have to repeat myself so often, but the consumer's income and the producer's cost are not one and the same thing. Once again, Professor Copland seems quite oblivious to the existence of anything called time. In his diagram he shows the consumer's income increased by £50 owing to the operation of the price factor, at the same moment that the article to which the price factor will subsequently be applied, is still in the production stage, and, I think quite gratuitously, labels this £50, "inflation."

*Cf. American Bankers' Association circular, 1877. "It is advisable to do all in your power to sustain such newspapers, especially in the agricultural and religious Press, as will oppose the issue of greenback paper money, and that *you also withhold patronage or favours from all applicants who are not willing to oppose the Government issue of money.* Let the Government issue the coin and the banks issue the paper money of the country, for then we can better protect each other."

"To repeal the law enacting national bank notes, or *to restore to circulation the Government issue of money, will be to provide the people with money* and therefore seriously affect your individual profits as bankers and lenders."

It may be convenient at this point to define inflation, which is an increase of money tokens accompanied by an exactly equivalent rise of prices, so that the two sides of the account (money and prices) still bear the same ratio to each other, but are both larger. It may also be convenient to explain that the £50, which by his hypothesis the consumer gets, is the £50 which is necessary to pay for the charges which are *allocated* to the direct cost of production, but which are really carried over from a previous cycle. The validity of these consumer credits rests wholly on the assumption that two processes are taking place in the productive world at one and the same time, the creation of real credit, not only by the production of goods for consumption but by the production of goods, processes, and systems, which increase the rate of production. And, on the other hand, the opposite process of consumption, which includes not only goods consumed in the ordinary sense of the word but all forms of deterioration. To say that these are equal is simply the same thing as saying that we could not produce any more goods and services if the whole of our available labour were employed in the whole of our available factories for the whole of the available time. If Professor Copland is not prepared to contend that this is the present situation, then he must admit that capital appreciation is greater than capital depreciation, or we could never have got where we are. If he admits that, the only question at issue is: To whom does the difference between capital appreciation and capital depreciation belong? The Marxian Labour contention is that it belongs to labour. My contention is that, being overwhelmingly the result of that which for short may be called "cultural inheritance," it belongs to the community. The banking organisation on the other hand quite specifically contends whether it says it or not, that it belongs to the banks, and implements this contention by only issuing financial credit against this balance of real credit upon its own terms. I am quite content to leave to the judgment of the general public the decision as to which of these contentions is correct.

SECTION VII.

Professor Copland summarises his conclusion that my theories are unsound under the following headings:—

"(1) It gives a wrong interpretation of the functions and powers of banks to create credit.

(2) It ignores the fundamental relationship between credit and prices.

(3) Its analysis of the disparity between costs of production and spending power is fallacious.

(4) The determination of the Just Price through the application of the Price Factor is consequently misleading.

(5) The issue of credit of the amount required by the theory would undoubtedly raise prices and cause general inflation."

In regard to (1), apart from the short comment upon his criticism which I have made, it may be sufficient to remark that there is no real difference of opinion by any recognised authority upon this point, and certainly not by the Macmillan Committee. Joint Stock Banks quite certainly do create financial credit up to the limitations of their agreed ratio of cash to deposits, and if central banks are included, there is no limitation to the power of banks to create financial credit.

(2) I am afraid the only answer to this is that the fundamental relation between credit and prices is not what Professor Copland thinks that it is, but is the relation between production and consumption.

(3) I trust that the somewhat lengthy discussion of this point has now made the matter clear.

(4) Any criticism of the Just Price through the application of the Price Factor fundamentally must rest on the relationship between production and consumption.

(5) Apart from the fact, which I think is obvious, that Professor Copland does not understand the basis on which it is proposed to issue credit, his argument is that it would cause a rise of prices. Curiously enough, practically all the banks, and practically all the economists who advise banks (although many equally reputable share my views) are now saying that what is required, as the phrase goes, to "restore prosperity" is a rise of prices, and that the present crisis has been produced by a fall of prices. While I do not agree with this, Professor Copland cannot have it both ways, and it seems impossible to avoid the conclusion that what he objects to is not a hypothetical rise of prices, but a rise of prices produced without the creation of a fresh debt to the banks, where again I do not agree with him.

As an argument against the necessity for any measures of this character, he remarks that statistics show that real wages have almost doubled since the Napoleonic Wars, while many social amenities, such as free education, have been provided for the people. The first contention is, if I may say so, completely damning to his argument. If real wages have only doubled in this country in 100 years, while rates of production have increased by at least 50 times, then the population has been defrauded of all but 4 per cent. of the increase. As I previously remarked, the increase is probably much more than 50 times, but I am satisfied to understate the case. In regard to his second contention, the social amenities and free education to which he refers are not free at all—they are paid for by taxation of incomes already, for the most part, too small. Taxation is simply a form of compulsory saving, is essentially deflationary in character, and merely means a decreased demand upon consumable goods.

I feel that it is neither becoming nor desirable that at this distance I should comment on Australian banking policy, to which the last section of the pamphlet is devoted, beyond directing the attention of the Australian public to the exact meaning of a balanced budget, as explained in Chapter V. of "The Monopoly of Credit." Professor Copland concludes by remarking that there is no prospect that the Australian banks will put the Douglas Credit Theory into operation. So far as the decision rests with the banks, Australian or otherwise, I feel sure that he is right. But, while no doubt a good deal of serious trouble may intervene, it is, I think, the opinion of an increasing and by no means impotent body of the public in every country that action, substantially along the lines I have indicated, is essential to the progress of civilisation. If this opinion is correct, then I think I am justified in recalling not merely to Professor Copland, but to the controllers of the institutions who obstruct such progress, the well-known answer given by George Stephenson to an enquirer who asked what would happen if a cow got in front of his locomotive.

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