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The Contemporary Relevance of Clifford Hugh Douglas

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In times of economic recession conventional economists often turn to the work of unorthodox amateurs in their search for solutions. It is their practice to abstract from heterodox works those aspects which most closely accord with mainstream thought, while dismissing the less familiar elements as irrelevant. The work of one such amateur, Major Clifford Hugh Douglas, attracted the attention of Keynes and Hawtrey in their search for solutions to the twin problems of *eco*-nomic decline and unemployment during the interwar years. Although providing valuable insights into contemporary problems, Douglas' writings lack coherence when read as an attempt to solve these problems in any conventional sense. Indeed, *Economic Democracy,* which introduces all Douglas' basic concepts, was first published in 1919 when the trade cycle problems of the interwar years were yet to manifest themselves. Douglas was motivated by other concerns. He questioned the necessity for economic growth, while seeking reasons for the failure of industrial technology to deliver a comfortable lifestyle for all, free from long hours of labour and perpetual insecurity. As an explanation of the financial mechanisms which require an escalating increase in material output as an essential prerequisite for distributing effective demand to consumers, Douglas' work deserves critical re-examination.

This article originates in a systematic appraisal of Douglas' writings in the years immediately after the First World War.[1] Douglas was familiar with the work of the American economist Thorstein Veblen,[2] founding father of institutionalism, and his critique of capitalist finance is in accord with the tenets of that school.

Douglas' original observations

As consulting electrical engineer to Westinghouse in India and to the Post Office in London before the First World War I (he designed the fully automated unmanned Post Office Tube), Douglas noted that financial restrictions inhibited the introduction of new technologies. However, such constraints on government activities were overcome with the outbreak of war in 1914. His observations, when working on the accounts at Farnborough in 1916, of an imbalance between wages paid out and costs generated within a given period, gave rise to his widely-debated 'A+B theorem'. While Assistant Superintendent of Farnborough aircraft factory Douglas acquired the rank of major. Subsequently, between 1918 and 1922, he consolidated his theories with the assistance of A. R. Orage, the guild socialist editor of *The New Age.*

By developing the implications of his observations, Douglas became convinced that economic decisions were made by default. Although money was essential to the maintenance of a modern economy, decisions concerning its creation and circulation occurred within banking circles. These were not democratically accountable to the community. Naively, Douglas the practical engineer believed that the mere publication of his findings would enable the community at large to exercise conscious control over the monetary mechanisms which ultimately determine the nature and quantity of production and the distribution of commodities to consumers. In his view, money could become a 'ticket system' for the allocation of the community's goods and services rather than a system of speculation operated by and for the financial benefit of a small section of society. His writings were the subject of extensive public debate throughout the UK in the 1920s and 1930s. Douglas was engaged in verbal or written discussion by Frank P. Ramsey (1922), John A. Hobson (1922), Maurice Dobb (1922, 1933 and 1936), G. D. H. Cole (1932 and 1933), Hugh Gaitskell (1933), Evan Durbin (1933), H. R. Hiskett (1935 and 1939) and Geoffrey Crowther (1934). His work was noted by Keynes in the 1920s and 1930s and circulated in many other countries.

Douglas in context

The extent of this debate indicates that Douglas was read by the leading political economists of the interwar years. However, during the 1930s and subsequently, the very vigour of debate over 'Douglas Social Credit' has coloured later perceptions of Douglas as an economist. Douglas appears as a maverick figure, an eccentric ploughing a lonely furrow well off the beaten track. There is no biography of Douglas, and an early study presents him as cold and aloof, unable to 'get off his pedestal and examine the oilers and greasers who are lubricating his wheels and shafts'. His books reveal a 'benevolent condescension', a contempt for humanity in general, be they financiers, socialists or citizens. Therefore the vehemence of the debate during the interwar period requires some explanation.

Crowther, the leading authority on money for a generation of economists, included an appendix on Douglas in each edition of his *An Outline of Money* between 1940 and 1947, originally written as an article for the *News Chronicle* in May 1934. Crowther does not attack Douglas; rather, he lambasts the general public for attempting to understand social credit, which 'deals with the extremely difficult and technical subject of monetary theory, which one would not expect to have a wide popular appeal'. Ten pages later he decides that although 'the final conclusion at which I arrive is not that Major Douglas is wrong', there is nothing of value in his work which is not already to be found in the writing of 'scores of other economists'. With patronising 're-luctance', he concludes that Douglas' proposals would 'do more harm than good.... It is always distasteful to disagree with enthusiastic idealism, especially when the objectives of the movement are so admirable.'

Douglas' extraordinary success in raising popular awareness of his analysis of the role of money in the economy has served to obscure his contribution as an economist. Even E. F. Schumacher, whose work is far less substantial than that of Douglas, is "widely regarded as an economist, while the American Henry George, with similar credentials to Douglas, has appeared in *The Penguin Dictionary of Economics.* Today Douglas has become virtually unknown. Politicians, social reformers, environmentalists, campaigners for ethical investment and those seeking to rescind Third World debt are more inclined to latch on to the work of Gesell and Soddy,[3] despite their lack of analytical rigour, in preference to embarking upon a systematic study of the extensive works of Douglas.

Douglas' economic analysis has never been presented within the context of past and contemporary schools of economic thought. The value of his work lies in its contribution to the institutional/evolutionary school, now experiencing a revival. Although Douglas' theoretical framework is in accord with that of Veblen, to this day economists fail to address the crucial issues of debt, in its many forms, environmental degradation and international (especially offshore) finance, because they lack the tools to do so. Douglas' theories, developed from within the emerging guild socialist and institutionalist framework, offer the basis for a more structured approach to political economy which has lain dormant for the greater part of the twentieth century.

The fundamental flaw in neo-classical theory lies in its failure to come to terms with the fact that in reality the market is a social institution, underpinned by legal and contractual frameworks which have been negotiated and which can be renegotiated. Douglas called for a gradual and considered adjustment to the institutional framework underpinning economic activity. His call failed to impress orthodox economists because their traditional theoretical starting point was that no such institutional framework exists. However, over the last decade theoretical orthodoxy has broadened its own analysis to incorporate institutions on the basis of methodological individualism (i.e. they are perceived to be the product of individual optimisation while, once established, their actions can be analysed as rent-seeking behaviour). While preferable to a neglect of institutions, such a perspective is an extraordinarily narrow foundation from which to analyse their operations.

Consequently, economic theory has become detached from everyday reality, sanctifying fictions while diverting the attention of political leaders from creating a meaningful analysis of real world phenomena. However, the alternative institutionalist economics requires reworking by refining its theories relating to the role of financial institutions in the processes of production, distribution and exchange over time.[4] Douglas' writing provides the basis for development of this crucial area of theory.

Analysis of growth economics via the A + B theorem

Douglas' A+B theorem demonstrates the two-dimensional nature of investment, i.e. its demand-increasing and its capacity-creating aspects. In *Credit-Power and Democracy* the theorem is explained as follows:

> A factory or other productive organisation has, besides its economic function as a producer of goods, a financial aspect—it may be regarded on the one hand as a device for the distribution of purchasing power to individuals through the medium of wages, salaries and dividends; and on the other as a manufactory of prices—financial values. From this standpoint its payments may be divided into two groups:
>
> Group A - All payments made to individuals (wages, salaries and dividends).
>
> Group B - All payments made to other organisations (raw materials, bank charges and other external costs).[5]

Purchasing power flows to consumers through the A payments. However, all past payments together determine price. Hence 'the rate of flow of prices cannot be less than A+B'. Under a system of multiple-stage production, *at any point in time* commodities on the market will bear the prices of accumulated costs over past periods. If consumer incomes (A payments) are to be sufficient to buy the commodities presently available (created over a series of past periods), *more money must be invested in future production,* so that it can be paid out through the 'factory or productive organisation' in the form of wages and salaries. Current incomes are dependent upon *present* production, whether of consumer, intermediate or capital goods.

In making this observation, Douglas recognised the drive to economic growth inherent in capitalist economies. He was unique in observing that investment does not arise from the saving of a proportion of a finite sum of money. On the contrary money, in the form of financial credit, is constantly created and re-created as debt for the purpose of profitable investment.

Money creation and money circulation

Douglas questioned the assumption that a bank only lends its own and its customers' money, asserting that in fact a bank lends new money. Bank loans create bank deposits. Since bank loans/deposits constitute money, the quantity of money varies according to such transactions. Banking is not 'simply a pawnbroking transaction between borrower and lender ... The question of collateral security is ... quite immaterial; every credit transaction definitely affects the interests of every person in the credit area concerned, either through the agency of prices, or by the diversion of the energies available for productive purposes.' These observations constitute a case for 'socialised credit creation'.

In a barter economy with low division of labour, single-stage production, and exchange based on a double coincidence of wants, demand and supply, are readily matched so that general overproduction is impossible. In an industrialised money economy, however, a mismatch is likely unless remedial action is taken. In his debate with J. A. Hobson, Douglas said:

> The wages, salaries and dividends distributed during a given period do not, and cannot, buy the production of that period. That production can only be bought and distributed under present conditions by a draft, and an increasing draft, on purchasing power in respect of future production. This latter is mainly and increasingly derived from financial credit created by the banks ... An increase in the money paid this week does not depend at all on the goods which can be, and are, supplied this week, and is not part of the cost of the goods which can be supplied this week.[6]

As production expands over a period, the money supply is increased, resulting in a higher price level which can be sustained only if the volume of money rises at an accelerating rate. Prices cannot fall below costs plus a minimum of profit in a capitalist economy since profit forms the inducement to produce. Investment increases the capacity to produce over the long run; it expands the community's 'real credit'. Consequently, Douglas noted that technological innovation must lead to rising prices (instead of falling prices as might logically be anticipated), or unemployment and a failure of distribution.

The manufacturing base

The production of manufactured goods at an ever-increasing rate, regardless of their usefulness so long as they are profitable, is the basis of a capitalist economy. Neither the distribution of income nor the exchange of goods and services can occur without the accelerating expansion of profitable capitalist accumulation. This process, as Douglas foresaw, carries three fundamental implications.

First, advances in technology do not achieve a stable level of output consistent with sufficiency of material needs, an increase of leisure and ecological sustainability. On the contrary, the production of commodities needs to increase at an accelerating rate, regardless of any notions of sufficiency and irrespective of the resulting distributional inequalities. It follows that planned obsolescence linked to the generation of new 'wants' through advertising is essential to maintain demand and profitability. As the experience of subsequent decades shows, armaments achieve this end, being immediately disposable once used and frequently rendered obsolete before the point of sale by counter-systems already in the pipeline.

Secondly, as outlined in an article entitled 'Pyramid of Power', published in 1919, extension of the economies of scale inherent in the application of new technologies and the financial mechanisms required by profit constraints inevitably generate a concentration of power at the top of a diminishing number of large scale, closely linked industrial and financial enterprises whose management becomes increasingly bureaucratic, whether they are owned privately or by the state. Finally, exports become essential not only to acquire imports but also to offload surplus produce in order to facilitate production and exchange on the home market.

Four premises

Four premises underlie the Douglas texts. First, the objective of industrial activity should be the delivery of a sufficiency of goods and services to the consumer, regardless of the profitability of their production to a small section of society. Employment merely for the sake of earning an income, no matter what was being produced, should cease to be an essential feature of the economy. Hence it should not be up to 'High Finance or members of the Labour Party Executive (however great their moral or intellectual qualifications might be)' to appropriate to themselves the right 'to arbitrate on what is or is not "useful work" or withhold a share in economic prosperity from "non-workers" as thus arbitrarily defined.'[7] The policy conclusion is the payment of a basic income to all citizens, as an inalienable right of their citizenship (the so--called 'national' or 'social' dividend).

Second, 'financial credit', the supply of money, is a 'mere device which can have no significance apart from "real credit" '. The latter is defined as 'the correct estimate of the *ability* to deliver goods and services when required'.

Third, banks and financiers can and do create financial credit. By successful manipulation they appropriate the power resident in the real credit of the community for purposes which are largely antisocial and self-interested.

And fourth, price should be linked to the ratio of production to consumption in such a way as to ensure that neither overproduction nor underproduction occurs. Douglas' A + B theorem demonstrates the finance-driven pressures to economic growth which force expansion of production (and export) of material goods beyond a consumer-defined sufficiency.

In line with these four premises, Douglas and Orage developed the Credit Scheme, first publicised as the Draft Mining Scheme, in the appendix to *Credit-Power and Democracy.* The scheme, which drew from guild socialism, syndicalism and associated traditions, attracted widespread interest, leading to the recommendation that it be adopted as policy by the Labour party. Its detailed proposals for localised control of industrial finance are beyond the scope of this article. However, its repudiation by the Labour party in favour of adherence to capitalist 'business-as-usual' principles had far-reaching implications.

Labour and the Douglas scheme

The rejection of Douglas' proposals by the Labour party in 1922 proved decisive for the subsequent history of guild socialist economic analysis. To Douglas and Orage, as for many socialists at the time, the alternative economic framework presented in the Douglas texts was in close accord with a socialist critique of capitalism. 'Labourism', as promoted by the Labour party, challenged 'not a single proposition of the capitalist system'. Rather, 'every strike has been a fight for position in the system'.[8] Individuals aspire to positions of status and power *within* the system which they might as socialists be expected to challenge. According to Douglas and Orage, by opting for short-termist class-based politics the Labour party failed to build on the lessons of the 1914-18 war, which indicated how to create a socialist political economy offering the potential for a united society and for international peace based upon the principles of sound finance and local banking.

The abolition of capitalism and its (peaceful) replacement by a guild socialist political economy, as advocated in the Douglas texts, could have proved appealing to the rank and file of the Labour party. As Orage explained in *The Labour Party and Social Credit,* co-authored with Douglas in 1922, such a programme would present 'immediate social relief' with a 'minimum disturbance of existing social arrangements. No attack is made upon property as such ... No confiscation is implied, nor any violent supersession of existing industrial control ... Nor are men expected, as a condition of the practicality of the scheme, to be better than they are.' However, the Fabians were already committed to endorsing, and merely reinterpreting, neo-classical orthodoxy through three decades of intellectual development, crystallised in their sponsorship of the London School of Economics. Pressures from within the Labour party to consider alternative ideas were therefore ignored, so that the 'scheme' was perfunctorily dismissed in a brief report entitled *Labour and Social Credit* (1922).

The report concluded that the Douglas-*New Age* Scheme was 'out of harmony with the trend of Labour thought, and ... indeed fundamentally opposed to the principles for which the Labour Party stands'. The proposals were dismissed in eleven pages, in which the A+B theorem was discounted on the same misunderstanding contained in Ramsey's 1922 analysis. This subsequently became the 'standard misinterpretation'. The concept of producers' banks was declared to be unworkable on the grounds that it did not accord with current banking practice. Part II of the report conceded that the Labour party would not have 'effectively' refuted the Douglas proposals unless it could be shown that the party possessed 'a policy for dealing with the admitted dangers of the control of credit by profit-making interests'. Therefore nationalisation of the banking system and the development of municipal banks was proposed, although how they would effectively alter the relationship between production and distribution was not examined.

According to Douglas and Orage, the effect of the report was to reinforce the capitalist status quo. The operation of orthodox finance in arbitration between costs and price was endorsed, occasional malfunctions in the system being attributed to excessive profits. The report 'goes out of its way to state that, whether sound or not, a scheme which would give the worker higher wages, cheaper living, real control of both policy and conditions, and an incomparably wider outlook on life, and these both at once and progressively, "is fundamentally opposed to the principles for which the Labour Party stands" '.

In Orage's view, the Fabians translated the word 'socialism' to mean 'the Supreme State (to which every man must bow, and by whose officials all human activities from the cradle to the grave, and after, shall be regulated)'. The Fabian faith in the power of central planning, coupled with their close association with the LSE, that 'unimpeachably orthodox institution', may have constituted an obstacle to the abolition of economic conflict. The rejection of the *Douglas-New Age* Scheme by the Labour party in 1922 brought to an end the close collaboration between Douglas and Orage. Orage moved abroad, returning to the UK only briefly before his death in 1934. Although Douglas continued to promote social credit until his death in 1952, the guild socialist context of its origin was neither remembered nor further developed as a body of political economy.

Guild socialist economics

In 'An Editor's Progress', published in 1926, Orage refers to Douglas' extension of the guild socialist approach to economics in three key aspects: the spectre of limited production; the relationship between work (employment) and income; and the relationship between ownership and control.

Orage observed that social reformers laboured under the misapprehension that the main problem of civilisation was how to maintain an increase in production in order to meet increasing demands for goods and services. Diminishing production would, it was thought, reduce the opportunity for a more equitable distribution of the products of civilisation. The facts dispel the spectre. Although millions of workers were sent to war in 1914, while vast quantities of armaments and supplies were produced and consumed, 'the net output of England at war exceeded its peace output by several times'. However, normally the world produces only a fraction of its total capacity. Fields, factories and workshops lie idle, while the labour and inventions necessary to use them are also unemployed. The abundance of nature and human invention are well capable of providing enough for all. The problem is not so much how to increase production as how to limit it to a diminishing demand without having devastating effects upon the viability of the economy. The existing price system was incapable of handling inventions designed to increase supply and reduce prices. Indeed, at the end of the First World War surplus stocks presented an obstacle to 'the restoration of the pre-war industrial system'.

The *New Age* created a ‘rumpus in the Socialist and Labour camps' when it first suggested that individual work is not a just prior condition of individual income. By virtue of the common inheritance of past invention and labour, combined with current labour, the community as a whole is 'the ultimate legitimate owner' of the whole productive mechanism. Every individual should be ready to work if called upon from necessity to do so. However, it was logically absurd to require that in order to obtain an income every individual should work, whether or not there was a demand for their services, and whatever their state of health or capacity for employment might be. 'Our simple little proposal to put everybody upon an "unearned income" ' was attacked from all quarters in the labour movement. It did not accord with the programme of 'Labour officials and class-Socialists' who were building their careers on attacks on unearned incomes. Still less did it appeal to the 'puritanic' Webbs to give every citizen their birthright of an annual share of communal production, making further social reform unnecessary. Nor was it attractive to Shaw, with his 'workhouse scheme of a universal dividend in return for a universal industrial service'.

Orage's most significant discovery arising from his discussions with Douglas was the need to distinguish, in an economic sense, between ownership and control. An individual or firm may own a field, a factory, or even their own labour. However, ownership gives economic control only to the extent that the factor of production in question is in demand. Effective demand is determined by price. Price in its turn is determined by financial mechanisms which control the supply and availability of money. Control of the market does not lie with the legal owners of the physical means of production; rather, it lies with the creators of financial credit. The presence (or absence) of finance determines the relationship of supply to demand through price.

The social control of money

A minority of mainstream economists, including Keynes, Hawtrey and Meade,[9] used theoretical apparatuses resembling that of Douglas in formulating proposals for the efficient operation of the economy. Douglas argued that the substitution of state planning for the large-scale planning of private oligopolistic enterprises provided no remedies in itself. He viewed money as a useful 'ticket system', one which should become dependent upon, rather than be the determinant of, society's priorities. This objective could be approached by the provision of a national dividend to all citizens, linked to the control of material resources and financial credit through geographical location and decentralisation of industry. These proposals relied upon the future development of computing to assess past costs, prices and material levels of consumption. Furthermore, technological developments would facilitate the ability to forecast future requirements at increasing levels of accuracy and sophistication without dispensing with the price mechanism.

As long as 'real credit', the means to maintain life, was controlled by financial credit, the community could be coerced into patterns of production and consumption which failed to preserve the social and ecological fabric upon which all economic activity remains dependent. Douglas advocated a sophisticated form of social planning based upon the manipulation of monetary mechanisms designed to reflect the common claim upon the cultural inheritance.

These mechanisms would replace financial speculation for individual profit, offering the potential to achieve social and ecological sustainability.

Conclusion: beyond the growth shibboleth

'I do not regard it as a sane system that before you can buy a cabbage it is absolutely necessary to make a machine gun.' Douglas' comment of the 1930s remains starkly relevant to present concerns. As sea levels rise, weather patterns change and statesmen deliberate about the impact of production, consumption and long-distance transportation upon the planet's fragile ecosystems, the quest for economic growth nevertheless remains sacrosanct. Fear of unemployment fuels demands for government subsidies to BMW for the purpose of retaining production at Longbridge. Sites in Germany, Hungary and North America compete for investment despite the existence of 30 per cent overcapacity in car production in Europe. Governments have to deal with astute, powerful companies, able and willing to move globally according to their own financial interests, while creating more jobs for machines and fewer for humans.

> It is very often said that the present crisis is a crisis of overproduction; I have never heard it called a crisis of underproduction (I have heard it called a crisis of underconsumption, but that is a different thing), and yet the financiers, or rather the Bank of England, are saying that the crying need of this country is reorganisation of the productive system. Can there by anything more ridiculous than to suggest that a crisis which is on the one hand described as a crisis of overproduction, should be cured, or could be cured by making industry more efficient, assuming that were to be done?[10]

Over the intervening decades, Douglas' analysis of the role of democratically unaccountable financial institutions in the processes of production and income distribution retains its accuracy. Until or unless financial mechanisms are adapted to provide local control over local production, technological progress will continue to produce jobless growth, bringing escalating environmental destruction coupled with failure of income distribution. Douglas' twin proposals for a national dividend (a form of guaranteed basic income for all) coupled with local producers' banks as outlined in the. 'Draft Mining Scheme', offer the potential for a new power dimension within the economy. Furthermore, measures of this type contain the capacity to provide income security, not only for the unemployed but also for women and ethnic and other socially excluded minorities. A thorough reappraisal of Douglas' political economy is overdue; not least it could provide a platform, when reworked in the light of contemporary circumstances, for a genuine 'third way' between market allocation of resources and centralised planning.

Notes

1 For detailed historical references throughout this article see Frances Hutchinson and Brian Burkitt, *The Political Economy of Social Credit and Guild Socialism,* London, Routledge, 1997.

2 Thorstein B. Veblen, *The Theory of the Leisure Class,* New York, Macmillan, 1899, and *The Theory of Business Enterprise,* New York, Scribner, 1904.

3 Silvio Gesell, *The Natural Economic Order,* London, Peter Owen, 1958 (first publ. 1934); Frederick Soddy, *Wealth, Virtual Wealth and Debt: The Solution of the Economic Paradox,* London, Allen & Unwin, 1933.

4 See e.g. Geoffrey Hodgson, *Economics and Institutions,* Cambridge, Polity, 1988, p. 5.

5 Clifford H. Douglas, *Credit-Power and Democracy,* London, Cecil Palmer, 1920, pp. 21-2.

6 Clifford H. Douglas, 'The Douglas Theory: A Reply to Mr. J. A. Hobson', *Socialist Review,* March 1922, pp.139-45.

7 Clifford H. Douglas, *These Present Discontents and the Labour Party and Social Credit,* London, Cecil Palmer, 1922, pp. 31-2.

8 Clifford H. Douglas, *The Control and* Dis*tribution of Production,* London, Stanley Nott, 1922, p. 152.

9 See James E. Meade, *Liberty, Equality and Efficiency: Apologia pro Agathotopia Meam,* London, Macmillan, 1993.

10 Clifford H. Douglas, 'Major Douglas at Aberdeen', *The New Age,* 11 October 1934, pp.271-2.