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BANKING AND INDUSTRY

by

A. W. JOSEPH, M.A., B.Sc., A.I.A.

BIRMINGHAM, ENGLAND

Just as tariffs affect every business, helping some, harming others, so does a faulty monetary system affect every business but with this important difference, it harms *all* business and *every* individual, helping none; even the business of the chartered banks suffers, though to a lesser extent than others.

It is doubtful if our bankers are aware—and certainly our business and political leaders are not—of the particular flaws in the monetary system so lucidly set forth in this article, but, unless the system is corrected, the destructive deflationary period from which we are slowly emerging will in a few years inevitably recur.

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FOREWORD

The famous division of Gaul into three parts has its reflection in the aspects of monetary reform. There is the political aspect, the ethical aspect, and the technical aspect.

The two first of these offer in many ways more emotional attractions than does the third, and for this reason as well as for its conciseness and mathematical soundness I feel that Mr. Joseph's little pamphlet fills a want in the Social Credit Movement. I am confident that it will receive both the circulation and attention which it so fully deserves.

C. H. DOUGLAS.

TEMPLE,
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BANKING AND INDUSTRY.

A paper delivered before the Birmingham Actuarial Society 16th October, 1934.

I will deal in this paper with two questions (1) The basis and working of the Banking system, and (2) The relation between the costs of articles produced and the amount of money distributed by industry.

The easiest way to get a clear picture of the Banks' operations is to study a simplified Bank Balance Sheet. For this purpose and throughout the paper, the Joint Stock Banks will be considered as one institution (which is not far from the truth) and will be referred to as The Banks. On the assets side stand cash in hand, cash deposited with the Bank of England, bills, loans to customers, and securities. On the liability side stand customers' current accounts and deposits, shareholders' capital, and bank reserves. If the Banks make a loan or buy securities they increase their customers' current accounts and deposits, *i.e.*, their customers' money. For consider a simple operation. The Banks lend to a manufacturer in order that he may build a factory. The money passes via the manufacturer to Contractors' current or deposit accounts. These accounts are new money because the balances of no other depositors have been reduced by the transaction. Considering the Banks' balance sheet, on the assets side loans have gone up and on the liabilities side customers' accounts have been increased by the same amount. It is true that this new money may not be used and to the extent that it is just left on deposit it will not serve in effecting the interchange of goods and services. But it will be agreed that the more money there is potentially available for use the more money there is likely to be which actually is used. The money will for the most part consist not of actual cash but of book entries in the Banks' ledgers and will be drawn by cheques.

The extent to which the Banks economise in the use of actual cash is given by the ratio of customers' current and deposit accounts to The Banks' cash in hand plus cash at the Bank of England. This ratio is nowadays about ten to one, which means that there is ten times the amount of money available for use in the Country than there is actual cash or Bank Notes. All this money is a potential claim on The Banks for actual cash; and it would not have been safe within the present framework of banking for these claims to have been created by The Banks had it not been for the statistical fact that under normal conditions customers as a whole do not desire to draw out more than a fraction of their balances. The spread of the cheque system has contributed most to this state of affairs, for with the aid of cheques transactions, which would otherwise necessitate a withdrawal of cash from The Banks and its payment by one customer to another who would in turn have to bank it, are effected without any cash passing at all.

Much confusion concerning Banking has been caused by the refusal of Bankers (though not all of them) to admit the full

implication of banking practice. They have denied that Banks create money. Statements are made such as that "the only real creators of money are the authorities who have the right to print notes." (I am quoting here from a speech by Mr. Beaumont Pease, chairman of Lloyds Bank, to the British Engineers' Association on the 10th May, 1934.) If doubt is felt concerning the previous explanation of how The Banks create money perhaps the following argument will help to clear the matter up. If Mr. Pease's statement were true it would lead to the conclusion that if a large number of notes are printed the Nation is threatened by inflation whereas if The Banks find it possible to increase their ratio between customers' money and their own cash in hand or at the Bank of England no inflation is caused. Now suppose the present cheque system were abolished and every transaction which takes place to-day were effected by physical exchange of money. Thus if X wished to pay a debt of £100 to Y he would demand £100 in notes from his Bank, pass them to Y who would deposit them in his own Bank. The final effect of this transaction would be exactly the same as if X had given a cheque of £100 to Y. Yet the £100 would have had to have been available in notes. The amount of notes in existence to cover present transactions would have to be many times greater than the present issue. According to Mr. Pease this would be an extreme form of inflation and yet in reality nothing would have occurred beyond what is actually happening at the present time by means of the cheque system. On the other hand suppose that by reason of increased popularity of payment by cheque The Banks found it possible to work with a twenty to one ratio. They would be able to increase their loans to industry enormously and the money distributed in the course of capital expansion would circulate and cause a heavy demand for existing consumable goods. Prices would rise and there would be a large real inflation. But according to Mr. Pease there would be no inflation at all because more notes were not printed.

The Banks' practice of creating money (possessing the right to be exchanged on demand into cash) by making loans and buying securities is fundamentally unsound, for The Banks have made themselves liable to pay more cash than there is in existence. They are thus always in a position of potential danger. However safe the ratio between deposits and cash may appear to be in normal times, the structure always breaks down in a crisis. For example, in 1914, at the outbreak of war the Treasury had to come to their assistance by printing and legalising the use of Treasury Notes in order that they should not have to default to their depositors. Banks endeavour to minimise this danger (which be it noted is a danger to the general public just as much as it is to The Banks themselves) by adopting a sound financial policy. Logically the only sound policy would be to cease creation of credit—but such drastic deflation would destroy not only depositors but the banking system as well. The Banks therefore pursue a policy which will keep their liabilities to the public (*i.e.* depositors' money) as much as possible below the public's liabilities to them. In other words there is always a tendency for The Banks to follow a deflationary policy. This they do by not distributing

their profits to the full (by their methods of book-keeping they refuse even to disclose the full amount of their profits) i.e. they keep huge reserves hidden or revealed. As their principal assets are loans and securities, the latter really being loans to the public at one remove, these form balancing items against reserves. Hence the real meaning of large reserves is an equally large public indebtedness to The Banks. And as this so-called sound financial policy is adopted just as much for the supposed protection of the customers of The Banks as for The Banks themselves, the conclusion seems inevitable that there is some flaw in banking policy preventing it from working in the public interest.

It may be pointed out that when The Banks create money by making loans and buying securities, not only do they make themselves liable to pay more cash than there is in existence but simultaneously the public becomes liable to pay them more cash than there is in existence—another unsound consequence of banking policy. In times of bad trade this may bring certain sections of the public completely under their control. Taking the public as a whole it is possible to balance The Banks' liabilities to the public against the public's liabilities to The Banks. The distinguishing feature of a Bank reserve is that there is no corresponding liability of The Banks to set off against the indebtedness of the public to The Banks.

It will be noted also when considering whether banking policy is in accord with the public interest that there is an upper limit to the amount of money that can be allowed to be in existence, dependent on the technical ingenuity of The Banks in economising in the use of actual cash and not related at all to the legitimate needs of industry.

Let us now consider how money is distributed in industry and the resulting costs which are set up. The orthodox standpoint has been put by Mr. J. A. Hobson in *Rationalisation and Unemployment*, page 17, from which I quote as follows:—

"Let me make these statements clearer. As the processes of converting raw materials into finished goods, whether for human consumption or for utilisation in production, are carried on in the business world, money is concurrently distributed (at various intervals, from daily wages to half-yearly dividends) to the persons who apply their labour, ability, land, capital, in the different productive processes, or as profit. These payments proceed *pari passu* with the productive processes, and, as wages, interest, salaries, rents or profits, constitute the costs or expenses of production, on the one hand, and the 'income' of the recipients on the other. If, as I urge, it is convenient to include profit among these expenses, the whole set of payments amounts to the selling price.

"So regarding it, we may say that this selling price has been paid away in the various expenses of production. Those who have received these payments in their money incomes possess the wherewithal to buy all the product, alike the consumable part of it and the capital goods that constitute the other part."

The argument is very plausible, but, as I shall show, it is much too superficial and ignores certain considerations whose omission completely upsets the conclusions which have been drawn. The questions with which we are concerned may be looked at from two different points of view both of which lead to the same result when all the factors are taken into account. There is the usual method of examining payments

made and costs accumulated in the price of each separate article and hence by addition for all the articles produced; and there is the flow method set out by Major C. H. Douglas (author of *Social Credit* and other works) which involves examining the flow of purchasing power distributed and costs accumulated in each period of time for each separate business and hence by addition for all the businesses in the Country. Regarding matters from the usual standpoint, *i.e.* examining payments made and costs accumulated for each separate article the main factors which have been ignored in Mr. Hobson's arguments may be considered under the three headings:—Saving not involving the creation of fresh capital equipment, saving involving the creation of fresh capital equipment, and the time factor.

Saving not involving the creation of fresh capital equipment.

It will be agreed that the orthodox argument cited above does not make provision for the distribution of more money than is sufficient to balance the costs of goods coming on the market. If therefore some of the money distributed is saved whether by a private person or by a company there must be a deficiency of purchasing power. This fact will not be denied if saving takes the form of hoarding money or leaving money unused on deposit at the bank. But it applies equally well if we "invest" our savings by buying securities. If we purchase the securities from The Banks (not necessarily direct) the money paid to The Banks is immediately cancelled and is no longer available for buying goods. (On the liability side of The Bank's accounts, deposit and current accounts are reduced by the sum paid and on the assets side investments are reduced.) If the investment is effected by buying securities from another member of the public and if the second member uses the money he has obtained for purchasing goods, then of course this transaction has not decreased purchasing power. The second member of the public has, however, spent past savings and it is undeniable that the spending of past savings will neutralise the effects of present saving. But in normal times the amount of present saving largely exceeds the amount of spent past savings. For the effects of a lack of money are so serious both to an individual or to a corporation that there is a continual urge by the Government, Insurance Companies, and other parties to impress on the public the traditional virtues of hard work and thrift. In times of deep depression when money is scarce the tendency to save may be overcome, although what usually happens is not that past savings get spent, but that they are destroyed by the depreciation in value of the security in which the saving has been invested. Taken as a whole the net increase in saving particularly in the form of Company reserves and the losses due to writing off or writing down of share values are big factors in causing a deficiency of purchasing power.

The above argument is not intended to give the impression that it is wrong to save. Indeed in a world where money is scarce, the provident man or company has a huge advantage over the one who has not saved. All it is intended to prove is that under present conditions saving causes a deficiency of purchasing power.

Saving involving the creation of fresh capital equipment. (The double circuit.)

The simplest way to study what occurs in the process of using savings for fresh capital expansion is to examine a sequence of operations in detail. Suppose a manufacturer whose existing resources are otherwise employed starts a business by borrowing say £10,000 from The Banks. He builds a factory and in so doing distributes £10,000 to contractors. He must repay The Banks the £10,000 and therefore must include it as an overhead cost in the prices of the articles which he produces. Now ignoring the fact that the original £10,000 was distributed at one time and must be collected from the public in the prices of articles at another time (which point will be dealt with later) we may say that the public has possession of the money wherewith to meet the overhead costs. Suppose the manufacturer's business prospers and not only is he able to collect his necessary overheads, but he is able to accumulate a reserve of say £5,000. By so doing he has collected from the public £5,000 more than he has distributed. So far this is an example by a business of saving not involving the creation of fresh capital equipment. But suppose the manufacturer decides to use his £5,000 for expansion. He builds an extension to his factory costing £5,000 and in so doing distributes this amount to contractors. Now he is all square as regards money distributed to the public. But having built a factory at a cost of £5,000 he will according to normal accounting methods charge in the price of the goods manufactured by the second factory overheads sufficient to bring him in £5,000. These costs have never been distributed and therefore sooner or later the costs of his articles will exceed the money in purchasers' hands. The £5,000 has run a double circuit. It was included in the price of the original articles in order that the £5,000 reserve should be formed and it is also included in the second batch of articles. But it was only distributed once when the second factory was built. Or alternatively the matter may be looked at from the following point of view. The extension to the factory is a new physical increase of wealth but the amount of the money available has not increased. Had the manufacturer approached The Banks when he wanted to build his extension and borrowed £5,000 he would have distributed £5,000 new money to the public. But instead he accumulated a reserve and tried to make an existing £5,000 suffice to meet the costs he set up by building the extension.

It might be objected that the manufacturer is under no necessity to include the cost of the extension in the price of the goods manufactured by this new factory. This is perfectly true and the manufacturer could have written down the value of his factory extension to nil as soon as it was erected, in which case he need not collect the cost of the extension in the prices of his goods. Such a procedure, however, is contrary to accepted accountancy practice, is opposed to commonsense and is in essence extremely deflationary. It is also contrary to the accounting methods which the manufacturer would be forced to use if he had built the factory by borrowing from The Banks. The full import of this latter statement will be appreciated

if the factor of competition is considered. Suppose a competing manufacturer Y without private resources builds a factory in the same way that X did when building his original factory, *i.e.* by borrowing from The Banks. He borrows, let us say, £5,000 which he distributes to contractors and therefore he is bound to collect the £5,000 in the prices of goods. X is not bound to collect his £5,000 but in practice will try to do so. X and Y between them are trying to collect £10,000 from a public which has only received Y's £5,000. X could, of course, undersell Y, but the more likely thing to occur would be for X to collect £2,500 from the public and Y a further £2,500. X would thus have been forced to write down the value of his factory extension to £2,500 and Y would be £2,500 in debt to The Banks, *i.e.* would still be trying to obtain £2,500 from the public in order to get himself out of debt. Thus the double circuit has formed an excess of costs over purchasing power which excess might have originally been rendered harmless if the original manufacturer had adopted the spartan procedure of writing down his extension of capital to zero. But in the hurly-burly of competitive trade some of the deficiency is made absolute because some manufacturers are forced into debt to The Banks, while other manufacturers are compelled to write down their capital and so subsidise the public.

When one is forced to write off capital in this way one is said, in banking parlance, to be putting one's house in order, and this method is one of The Banks' traditional means of overcoming a slump. The method it must be admitted is of some success in its primary object of reducing the disparity between costs and purchasing power, but it is questionable whether the resulting dislocation and stagnation of trade followed by the crop of bankruptcies caused by such drastic deflation are not worse than the disease it is intended to cure. That such a method should be put forward as the only sound way of overcoming an admitted disparity between costs and purchasing power is a result of the view that it is unsound if not impossible to distribute new purchasing power in any other way than through the banking system as loans to producers.

The Time Factor

In the preceding arguments costs and purchasing power have been considered without relation to the time at which the costs come on the market as prices and purchasing power is distributed as wages, salaries and dividends. But this question of time is all-important.

The disparity in time between costs and purchasing power as regards separate articles may be divided up into three stages. First stage:—Before the goods come on the market money distributed is in excess of prices. The proportion of money and the period of time over which it is distributed in advance depend on the article produced and on the conditions of industry. Thus if human labour is being displaced by machines the amount of money distributed when the machines are made may be larger than that distributed at the time when the goods themselves are being made. Second stage: — When

the goods come on the market costs exceed money distributed. Third stage:—Later on (according to the orthodox theory, *i.e.* excluding the considerations of saving and the double circuit referred to earlier) the difference between costs and purchasing power is made up by dividends. This distribution may not be completed until many years after the goods have been sold, and usually at least a year will elapse before dividends are declared. Thus even granting the orthodox assumption that "some time or other" money distributed may be sufficient to meet the costs of articles produced it could only be pure chance if at any given moment the amount of purchasing power in the hands of the public were exactly equal to the costs of the articles on the market.

It is sometimes asked how is it that if there is a continually increasing difference between costs and purchasing power the economic system has not broken down completely long ago. The first reason is that The Banks apply the cure of deflation, *i.e.* they force companies to write down perfectly good assets to book values much below their reasonable real values. The second reason is that by purchasing securities The Banks give the sellers additional purchasing power (a point that will be dealt with later in more detail). The third reason is the discovery of foreign markets. Goods and their associated price values are exported so that the total of price values in the home market is reduced. The fourth, and a very important reason, is the time factor. For the money created by The Banks and distributed in advance on those final goods which have not yet come on the market may be, and in boom periods always is, sufficient to cover with perhaps a handsome margin the fundamental disparity between costs and purchasing power. But those retailers who are fortunate enough to have goods available for sale at such a time immediately take advantage of the boom conditions reigning to raise their prices to absorb the superabundance of money, thus causing inflation. Such boom conditions can only be temporary because later on when the goods in respect of which money has been distributed in advance come on the market purchasing power will be deficient unless a new crop of capital goods is put into course of production and additional money is put into circulation. In fact even under the orthodox view of costs and purchasing power it is necessary for the continued working of the economic system that there should be enough goods in the First and Third Stages to balance those in the Second Stage. When the factors of saving and the double circuit are taken into account it is clear that fresh capital goods must be produced in geometrical ratio to keep the economic system working.

It will be seen from the above exhaustive analysis that the usual argument is by no means straightforward. Major Douglas has, however, discovered a shorter analysis which cuts through many of the difficulties and this analysis is known as the A + B theorem. The essential difference between Major Douglas' treatment and the usual arguments is that costs and purchasing power are considered as a flow through the productive system.

We can divide factories into those making consumable goods and those producing either capital equipment or goods which are incomplete. Let $A_1 + B_1$ be the costs in a period to time of articles produced by factories making consumable goods divided up into A_1 costs which refer to money paid to individuals by means of salaries, wages, dividends, etc., and B_1 costs which refer to money paid to other institutions. Let A_2, B_2 be the corresponding costs of factories producing capital equipment. The money distributed to individuals is $A_1 + A_2$ and the cost of the final consumable goods is $A_1 + B_1$. If money in the hands of the public is to be equal to the costs of consumable articles produced then $A_1 + A_2 = A_1 + B_1$ and therefore $A_2 = B_1$. Now modern science has brought us to the stage where machines are more and more taking the place of human labour in producing goods, *i.e.* A_1 is becoming less important relatively to B_1 and A_2 less important relatively to B_2 .

In symbols if $\frac{B_1}{A_1} = k_1$ and $\frac{B_2}{A_2} = k_2$ both k_1 and k_2 are increasing.

Since $A_2 = B_1$ this means that

$$\frac{A_2 + B_2}{A_1 + B_1} = \frac{(1 + k_2) A_2}{1} = \frac{1 + k_2}{1} \frac{A_2}{(1 + \frac{1}{k_1}) B_1} \text{ which is increasing.}$$

Thus in order that the economic system should keep working it is essential that capital goods should be produced in ever increasing quantity relatively to consumable goods. As soon as the ratio of capital goods to consumable goods slackens, costs exceed money distributed, *i.e.* the consumer is unable to purchase the consumable goods coming on the market.

The Trade cycle and The, Bank's sources of profits

Let us now collate the information we have gleaned concerning the monetary system and follow out a normal trade cycle from slump to boom and back to slump again. We start from a state of slump, *i.e.* a state where there is unquestionably a disparity between costs of goods and purchasing power. Traders are unable to sell their goods and they are forced to reduce prices and cut into reserves or capital. A number of them become bankrupt which causes further loss of the public's capital and in some cases a loss to The Banks. As a loss to The Banks is a lightening of the public's indebtedness, this all helps in reducing the difference between the public's effective purchasing power and the costs of goods. By itself, however, this forced deflation would not be sufficient to turn the tide. But the course of the slump has resulted in a reduction of bank loans to industry and of the corresponding deposits, as The Banks have been unwilling to lend to new borrowers or even to continue old loans in the prevailing uncertainty. Hence the Banks' ratio of deposits to cash is reduced. They are able to increase deposits by other means and this they can do by purchasing securities. The inducement is an increase in profits. The rate of interest on the securities they buy exceeds the rate they pay on depositors' accounts formed by their very action in purchasing

securities. The Banks generally prefer loans to securities because the rate of interest is higher but if they cannot grant loans with safety they are glad to turn to securities. The purchasing of securities increases the amount of money in the hands or accounts of the public. It is true that only a particular class of the public gains by this extra money, namely the investing public, but in time some of this money percolates through to ordinary trade channels. The extent by which money is created by The Banks in this way can be gauged by the fact to which Mr. Reginald McKenna attested in his speech on the 26th January, this year, to the shareholders of the Midland Bank that since February, 1932, when the Country was in almost the lowest depths of depression, deposits had risen by nearly £300 millions, almost solely on account of purchases of securities initiated by the Bank of England and followed by The Banks. There is, of course, a secondary effect of these purchases of securities by The Banks, the value of securities rises.

After some time the increase of money in circulation combined with the previous deflation and reduced prices is sufficient to make purchasing power approximate to the costs of goods on the market. Trade is restored and confidence is engendered. Manufacturers are prepared to enter on fresh commitments and The Banks to finance them. The very action of the Bank of England in purchasing securities is an all clear signal to the Trading Banks that it is safe to advance loans to industry. After a time the amount of deposits in comparison with The Banks' cash approaches the ten to one limit and they are forced to sell securities in order that they may continue making loans to industry. They will do this readily because the price of securities has been forced up by the previous purchases initiated by them and followed by the public and the yield obtained on securities is well below that obtainable on loans. The sale of securities by The Banks will not cause an immediate fall in their price because the public (which includes trading companies) is making large profits, putting them to reserves and investing these reserves by purchasing securities from The Banks. The extent of the boom will depend on the ratio between capital goods in course of construction and consumable goods which are finding their way on to the market. So long as capital goods are produced at an ever expanding rate the boom will continue and may even become hectic. But all the time the A+B theorem is at work making for a potential increasing disparity between costs and purchasing power. Sooner or later the crop of consumable goods emerging on the market exceeds the fresh capital goods in course of construction and the underlying deficiency of purchasing power and hidden load of debt become revealed. Manufacturers and traders are forced to sell goods at cut prices and to sell securities in order to payoff loans. Conditions are not improved by the action of The Banks in attempting to call in loans whose backing which seemed sound enough in the good times is now perilously near the amount of the loan granted. In this period of the trade cycle the amount of deposits will decrease because The Banks while calling in loans to industry will be prevented by the prevailing insecurity from making the deficit good by purchasing securities. There is a snowball effect

—prices of goods and securities fall—loans are called in—purchasing power is further diminished—more goods and securities are sold at cut prices—values fall further, and so on. The slump carries on until as indicated above the Bank of England turns the tide by purchasing securities.

It will be noticed that in addition to The Banks' normal interest profit, *i.e.* the balance of interest received on loans or securities above that paid to depositors they have two other large sources of profits. The normal cycle of operations involves purchases of securities by The Banks at lowest prices and sales at their highest. Secondly during the onslaught of the slump the security upon which loans have been granted is in many cases reduced in value below the loan itself and this means that the security, it may be a farm or a factory or shares in a company, becomes the property of the Bank itself either directly or through a controlled operating company. At this stage The Banks will very likely make some book losses. This is reflected in lower profits so that in times of depression The Banks suffer in monetary profits as do other trading concerns and they are forced to draw upon their reserves hidden or revealed in order to maintain dividends. But although they are losing in monetary profits they are all the time gaining in physical assets, *i.e.* they become actual possessors of farms, factories, *etc.*, at the price of the original loan instead of at the value of the asset as a going concern in times of prosperity and this price may be as little as 50 per cent. of its real value. For the most part they do not sell these assets in the slump but they nurse them until better times come along. When conditions have improved and there is plenty of money about (created by The Banks and issued on loan to producers of fresh capital equipment) the value of these physical assets increases and The Banks are able to sell some of these farms, *etc.*, to the public. The Banks are business concerns and they do not sell for the amount of the original loan which acquired the property. They get the best price they can and it usually shows a substantial profit. To express the matter shortly The Banks are always able to get in on the ground floor and get out before the bottom falls out. Normal accounting methods and the arbitrary conventions in which The Banks work make it possible for them to initiate periods of inflation and deflation in such a manner as to make them appear to be the result of natural law. In periods of deflation they become possessed of the assets of the Nation. In periods of inflation they are able to realise these assets at a profit and also to make profits on their holdings of securities. To the extent to which these profits are not distributed either as salaries to their employees or as dividends to their shareholders the public is mortgaged to The Banks without having the means to payoff the mortgage.

It has been stated earlier that purchases of securities by The Banks help to prevent the breakdown of the economic system. As the public becomes more and more indebted to the Banks there ensues an increasing deficiency of purchasing power. Now if The Banks purchase securities they create deposits which will help to counteract the deficiency. Hence in order to keep things going there is a tendency

to encourage any scheme for creating securities for The Banks to buy. The Banks themselves will sometimes take up the whole or a large portion of a government issue but they also advance money to their customers to subscribe for a portion of it. The customer gains since the rate of interest on the issue is greater than that on the loan. The Banks gain because the rate of interest on the loan is greater than that payable on the deposits resulting from the government's spending the money raised by the issue. It may be that The Banks do not take up the whole of an issue and thus obtain the full interest difference between that borne by the new issue and that granted by The Banks to their depositors because in this way the fiction is maintained that the issue is subscribed out of public savings instead of out of a new creation of money by The Banks themselves. Now all the securities which come into possession of The Banks either at first hand, or at second hand via a loan to the nominal owner of the security, are a funding of the public's indebtedness to The Banks. Thirty per cent. of the budget expenditure of the Country last year was in respect of interest on the Nation's loans and a large proportion of this amount was payable directly or indirectly to The Banks. Hence the popular idea that high taxation is a potent cause of bad trade is quite correct, for the portion of the taxes which represents interest to The Banks is potential purchasing power of the public which will be cancelled when it reaches The Banks unless redistributed in the form of salaries to Bank officials or dividends to Bank shareholders. The taxation of the public in order to pay interest on past indebtedness to The Banks has now reached very large dimensions and its seriousness is due to the fact that no member of the public is able to escape the burden. That the true nature of this evil is not known is apparent by the support which is given to the principle of high taxation by many well meaning persons, particularly Socialists on the grounds that taxation is merely a passage of money from the hands of one set of persons, usually the rich, into those of another set of persons, usually the poor. The fact that so large a proportion of taxation simply raises costs without being redistributed is not grasped. Furthermore a completely inadequate picture of the Nation's resources is presented and many projects which are crying out to be done and which on physical grounds the Country is well able to afford are put aside in the belief that the Nation cannot bear the cost.

Distortion between money and reality

The flaws in the financial system have had the effect of divorcing monetary policy from physical reality. In some instances the peculiar position has been reached that if a course of action is looked at from the financial point of view one result appears to hold whereas if it is looked at from the physical point of view exactly the opposite appears to hold. Four important examples of this distortion of the truth are worth examining here.

(1) **Imports and Exports.** There can be no question that from the standpoint of physical wealth a country is richer by its imports and poorer by its exports. Yet we have the anomaly that

when a country exports more goods than it imports it is looked upon as having a "favourable" balance of trade and when it does the reverse it is said to have an "unfavourable" balance of trade. That this is no mere question of words is indicated by the fact that every country in the world, rich or poor, is actively engaged in trying to foist its goods on to other markets and to keep out of its own markets the goods of other countries. The reason why countries adopt a policy so stupid when real wealth is considered and so impossible to fulfil when the world is taken as a whole is that in the course of making goods for export money is distributed to workpeople which helps to make up the existing and growing deficiency of purchasing power in the exporting country, and the total prices in the home market are reduced by the export of the goods made with this money. Hence companies which manufacture goods for the export market are looked upon with favour even when they are doing such a criminally stupid action as to manufacture munitions, armaments and aeroplanes to sell to a country which may use them against the country from which they were bought.

(2) **Wealth and Debt.** Nature and science have united to produce the potentiality of an increasing real wealth and leisure for every individual. The amount of metallic money mined each year does not keep pace with the expansion of real wealth. Extra money can only be formed, by means of bank loans, *i.e.* by increasing debt. Hence on the one hand we have a surplus of riches and leisure and on the other hand an increase of world debt. As has often been pointed out the richest country is the country which has the biggest National Debt.

(3) **Distribution of Leisure.** Attempts are being made to limit hours of work in order to end the anomalous position which now exists of a proportion of the population working continuously and even working overtime while a large body of unemployed cannot find any work at all. No more sensible remedy than limitation of hours could possibly be found to distribute the amount of work there is to do amongst all the working population, and yet under present conditions the scheme is bound to fail. For suppose the working week is 40 hours and it is proposed to limit hours to 30 hours per week. Either the wage bill must go up 33% per cent. so that the price of the manufactured articles, difficult enough to sell already, must be increased; or the wage of each individual worker, little enough already, must be decreased by 25 per cent. Thus we have the position that a straightforward commonsense remedy is bound to fail under present financial methods. The difficulty can, however, easily be overcome if the remedies which will be suggested later are put into effect. We must agree first that if less personal work is done then it is only just that wages should be decreased unless there is increased efficiency. Thus the price of the manufactured article would not increase. It will be suggested later that all members of the public should receive a direct consumer income. In this way the total income of the workman will be adequate to satisfy his needs although the portion derived from wages is reduced.

(4) **Public Works by means of Borrowing.** Under present conditions when a municipality or a country wishes to create a public asset whether productive as, say, a waterworks, or unproductive as, say, a public park, it has to borrow. This is because incomes are insufficient to stand the strain of further taxation or increase of rates. It has been explained how this borrowing is a temporary palliative to overcome the chronic deficiency of purchasing power, but it merely shifts the burden from the present to the future, and consolidates the Country's enslavement to The Banks. But what should be noticed particularly about such a transaction is that although the Country has distrained on future purchasing power financially, it has built the Public Work out of current income physically. For if the Public Work were not done the workmen engaged on it would be unemployed, the food and clothing which these workmen would consume would either not be produced at all or would be thrown away, the materials to build the Public Work would be left unused. If building a Public Work meant that men who would be otherwise engaged on production of consumable goods, on maintenance of capital equipment or on creation of new and useful capital equipment were diverted from these occupations, there would be a physical borrowing because the work they left undone now would have to be done in the future. In such circumstances there would be some justification for financial borrowing. Under present conditions, however, when there are over two million unemployed and a surplus of materials the financial operation of borrowing does not correspond in the least to the physical aspect of the matter.

Remedies.

The remedies for our present serious economic state need not be revolutionary nor drastic. In particular there is no need to alter the organization which is working well, namely, the system of production. All that is necessary is to make a straightforward onslaught on the organizations which are not working properly. The first essential is to give the bankers confidence in the system they are operating and the second to give the public confidence in the trading system. This confidence must, however, be engendered by attacking the sources of the trouble not merely by preaching optimism.

Thus at present the Banks by granting credit make themselves liable to pay in cash more money than there is in existence. At the back of their minds there is always the fear of a run, and they limit their advances to the arbitrary working ratio of ten times their cash. Since 1928 the fear of a run has been quite illusory because the Bank of England then took powers to increase the fiduciary issue to any amount on demanding permission from Parliament. Nevertheless The Banks seem unaware of this fact—or they are afraid the Bank of England will not grant them the necessary facilities. It should be a fundamental of banking practice to grant credit to any amount to meet the legitimate needs of industry. Credit should not be restricted by any artificial Bank ratio. There is a certain amount of danger in allowing private institutions to have unfettered powers of increasing

credit and as it would be the Nation's credit which would in reality be backing the money created there are grounds for requiring that some public body, say a statistical department of the Board of Trade, should be set up to control the total amount of credit issued.

In order that the trader should have confidence in the economic system the fundamental deficiency of purchasing power must be corrected. The trader will then be able to produce goods in the certainty that if they are well made and satisfy a real demand they will be bought. This can be done by the creation and distribution of fresh purchasing power to consumers. The needs of producers will already have been met by The Banks. The amount of consumer credit to be distributed will have to be discovered by experience under the guidance of the Board of Trade or some other body. The factors which will affect it will be (1) the total prices of consumable goods coming on the market, (2) the existing amount of money, (3) the amount of producer credit being created, (4) the amount of savings (true savings, not the present large savings inspired by the insecurity of the economic system), (5) the amount of past savings being spent, and a number of other miscellaneous factors. There is no need, however, to estimate each factor separately. The additional purchasing power must be such that the amount of money in the hands of the public shall be sufficient to purchase the goods available. It is important that the money should be distributed to consumers as a dividend. It must not be necessary, as it is under the present system, that before the public can consume present production, a mountain of fresh capital equipment must be created. Most of the world, in particular this country including the empire, has grown sufficiently rich in physical resources to have got beyond that stage. This does not mean to say that the growth of capital equipment will be stopped. Quite the contrary, for the needs of producers will be dealt with first by The Banks. But when their needs are satisfied the remaining deficiency of purchasing power will be made up by issuing credit to consumers. It is not inconceivable that the impetus to trade might be so great that too much money might be distributed to consumers via producers. In these circumstances it would be necessary to take money away from consumers and this could be done by taxation or other means.

There is no reason to expect inflation, *i.e.* a rise in prices so long as the total money in consumers' hands is not in excess of the total costs of consumable goods on the market. The fact that the public would have confidence in the economic system would also operate to prevent inflation. For when there is plenty of money in the public's hands but traders have an inherent lack of confidence, traders collect as much of the money as they can from the public by means of higher prices in order to form reserves and high profits before the good times end. But if there is faith in the economic system this is unnecessary. Consequently the increased purchasing power does not result in increased prices, but on the contrary by inducing increased production of consumable goods cuts down overhead costs and the need for advertising and actually reduces prices. But at the initiation of the scheme and probably for some years after it would be necessary to

take precautions. Probably the simplest plan yet propounded for dealing with this difficulty is that of Major Douglas, known as the just price or price discount plan. Under this scheme some of the money which it has been decided must be created and distributed to consumers is not distributed direct to each consumer in the form of a Dividend, but is only distributed to a consumer when he purchases a final consumable article as a discount off the price of the article he is purchasing. In order to be allowed to operate the price discount the retailer must become registered and the conditions of registering are that his books must be open to inspection, he must make a minimum profit (in order to prevent price cutting) and he must not make more than a fair profit based on turnover which shall be determined by the conditions of his trade and the usual turnover applicable to that trade. Incipient inflation due to retailers making unnecessarily large profits can then be prevented because retailers who did profiteer would not be allowed to register and would lose the benefit of the price discount. Furthermore by this plan the consumer credit would only be issued at the time the goods were placed on the market and not before. The incentive to manufacturers to produce consumable goods would still be there but consumers would not have money burning holes in their pockets beforehand.

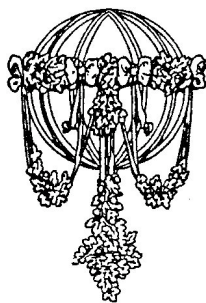
If the methods outlined in this section were put into practice (and detailed plans for getting them into operation are in existence), we should have the result that the monetary system would reflect reality. The principle that there should be an exact correspondence between money and real things should, however, be carried further right into our accounting methods. The maxim which should be adopted has been expressed by Major Douglas in the phrase which only has to be stated for its truth to be apparent, namely, that "The true cost of production is consumption." For example, if a factory is built, the Nation has gained an asset. The cost of the factory should not be embodied in the prices of articles produced by the factory long before the working life of the factory is over and thus the credit corresponding to this asset retired. The only factory costs which should be included are those of maintenance and obsolescence.

In conclusion it might be pointed out how important it is that assurance companies should study the economic effects of saving, because it is their business to offer to the public the most useful form of saving that has yet been discovered. It is indisputable that saving is beneficial to the individuals who are fortunate enough to have a surplus out of current income, but what about those who have not? In this connection it will be remembered that in a recent discussion by the Society relating to the Cohen report it was pointed out that the officers expected to receive a pat on the back for their services in inculcating thrift; instead of which they were told that it was doubtful whether it was a good thing that money should be dragged out of the pockets of the working man for assurance when it could better be employed in feeding and clothing the man and his family while he was alive. Furthermore if, as has been indicated

earlier, every penny saved causes a dislocation of industry, the good rendered to the community by saving is not so apparent. Assurance companies, therefore, if only to safeguard their own position should look with favour on any plan which would have the effect

(a) of allowing the public to have a surplus income available for saving,

(b) of counteracting the evil which results at the present time from saving's reducing effective demand for the products of industry.



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