The Political Economy of Social Credit and Guild Socialism

Review of a book by Frances Hutchinson and Brian Burkitt, Routledge, London, 1997

This remarkable book on the history of social credit was given to me by Michael Rowbotham some years ago. I must have read it carefully at the time for my margin pencillings are much in evidence. But clearly it required the disturbing developments in the intervening years for me to make a greater effort to appreciate fully some of the conclusions that Major C.H. Douglas had arrived at. The problem was that he was using an approach that varied from that of less unconventional reformers – to the point that they did not even grasp what it was that he was seeking and to an extent actually found. Reflecting that, his solutions and even his language seemed clumsily at odds with the accepted vocabulary and grammar of economic thinking, right or left. Even his A and B Theorem which seemed to us an unschooled blunder of an engineer lost in the labyrinth of accountancy and economic thought.

But the misadventures of the world are forcing us to penetrate the obscurities of his language that barred access to many potential allies.

But a bit of background. "The writings of Major Douglas gave rise to the social credit movement, popular throughout the inter-war years. Douglas's earliest books, *Economic Democracy* and *Credit-Power and Democracy*, first appeared in serial form in the socialist journal the *New Age* in the period immediately following World War I. Close examination of the early Douglas/*New Age* texts alongside the literature of guild socialism reveals that the editor of the *New Age,* A.R. Orage, provided Douglas with a great deal more than editorial support in the formulation of the original texts. Without Orage's guild socialist contribution [the Douglas doctrine] would have provided unpromising material for a popular debate which was to be sustained over two decades throughout the English-speaking world.

"Guild socialism and Douglas had this in common: In their different ways they both questioned the deep faith that Marxist and most brands of socialism shared with the prophets of capitalism – that economic growth was in itself beneficent and necessary, and ultimately liberating. The guild socialists questioned this on esthetic, philosophic and social grounds under the influence of William Morris, John Ruskin, and even of Robert Owen.

The guild socialists saw in excessive industrialization an undermining of the elements of pluralism and local autonomies in earlier societies. Current Globalization and Deregulation with its destructive effects on the environment, the family, the multiplicity of life styles, is only an explosive manifestation of this trend. As important as the effort to safeguard the jobs of workers may be, it is an uphill struggle, given the concentration of power in the financial sector. The incorporation into current price of the rate of growth already achieved brings with it the need to continue that growth, and its rate of its growth into the distant future. The slightest shortfall of this commitment triggers the collapse of the price structure. And since share values serve as collateral for further financing, it becomes unsustainable. The mathematics of the model in fact are those of the atom bomb.

An Unequalled Thoroughness

Douglas-Orage review the nature of money from the ground up with a thoroughness that has few if any equals. "Douglas stressed that production does not create money. It is possible to imagine a producer in a system of single-stage production [i.e., without the purchase of intermediate goods and hence not incurring costs that have need of money]. Having access to land (which has not been bought) and a discarded spade, and having saved seed potato and horse manure (discarded A), it is possible for a producer to plant, tend and harvest a potato crop at no financial cost. The crop can be put in a discarded sack and sold to a neighbour for £5. Has the producer created £5? Or any money at all? That is the sort of maddeningly basic question Douglas was given to asking.

"Nevertheless, at the point of exchange no value is created. However sophisticated the system, production of all commodities follows the same pattern as the potato example. All production requires inputs from the natural world which the economy cannot create. All production requires human inputs. First, an inherited body of knowledge, as in the ability to save seed, cope with pests and drought and so on. Second, a 'producer' who may be employed or self-employed, but who comes to the task physically developed from infancy to maturity and still requires social care. Neither form of 'human input' is produced through exchange on the market. Wealth creation can take place outside the exchange economy.

"Money is a commodity itself. In a single-stage production a large proportion of subsistence requirements can be seen to be produced outside the formal economy. Hence in newly monetized economies 'cheap' labour occurs because subsistence requirements continue to be provided from outside the cash economy.

"Money has no intrinsic properties, only those which people choose to give it. Hence a comment such as 'There is no money in the country with which to do such and so' is meaningless, unless it is an indication that the goods and services required to perform the task in question do not exist and cannot be produced. In that event it would be useless to create the money-equivalent of the non-existent resources. On the other hand, it is misleading to argue that the country 'has no money' for social betterment or for any other purpose, when it possesses the skill, the labour and the material and plant to create that betterment. The financial system in the form of the banks or the Treasury can, if they so wish, create the necessary money in five minutes. Indeed, they are creating money for 'necessary' tasks every day, and have done so for centuries.

"Money can be described as a 'ticket system' whereby money 'tickets' or grants the right to participate in the economy. The ticket office [of a railway] is not the place where the measurement of productive capacity should take place. To orthodox economists steeped in general competitive equilibrium theory the dynamic relationship between money creation and policy formation in production and distribution was incomprehensible.

"'In popular belief, banking is understood to be no more than a private pawnbroking transaction between borrower and lender: lenders place their savings in a bank, and borrowers take that same money to invest in new machinery, labour and materials. In reality the banker is in a unique position of lending something without parting with anything, and making a profit on the transaction' (Douglas, 1923). 'The bank lends new money; bank loans create money and the uses to which it can be put are dependent upon these transactions' (Douglas, 1922c). 'Every credit transaction affects the interests of every person in the credit area concerned, either through its effect on prices or through the diversion of the energies available for production purposes' (Douglas, 1922c). 'An overdraft, arranged perhaps on the basis of the title deeds of a factory, facilitates production. However, the overdraft is new money exactly as if the banker had coined goods for sale' (Douglas, 1920). Hence the granting of credit by a financial institution is more realistically viewed as the creation of a mortgage on future production than as the allocation of the past savings of industry. The term 'deposits' is highly misleading, implying something deposited for safe keeping, like jewels in a safe deposit. Bank deposits are not like that. The deposits of commercial banks are to them liabilities, although they are assets to their holders."

Our Censored Textbooks

"As later explained (by *Encyclopedia Britannica*, 1979) – a bank that received, say, $100 in gold might add $25 to its reserves and lend out $75. But the recipient of that $75 would himself spend it. Some of those who received gold in this way would hold it as gold but others would deposit it in this bank or in other banks. If, for example, two-third were deposited, some banks would find $50 added to deposits and to reserves and would repeat the process. When this multiple expansion process worked itself out fully, total deposits would have increased by $200, bank reserves by $50 and $50 of the initial $100 would have been retained as 'currency outside banks.'"

You will find that process explained in even greater detail in just about any textbook on economics published in Canada prior to 1991 when the bill was passed abolishing statutory reserves that banks had to redeposit as security against the deposits received in chequing accounts. By that the key mechanism of banking had been suppressed. That, of course, and the speculative banking orgies that have taken over since banks were deregulated to empower them to acquire brokerages, underwriting, merchant banking, derivative boutiques, are what have made the ideas of Douglas-Orage more important than ever before.

"'Problems occur when the banking system operates according to its own agenda, with the requirements of the consumer a secondary consideration. Unlike the social reform business, the banking business is immensely powerful, talks very little, acts quickly, knows what it wants' (Douglas, 1922b). 'The quantity of money is dependent upon the power of the banker's pen. Banks create new money which ranks equally with legal tender as a means of exchange. Although credit is more properly regarded as common property, it is administered by the banker primarily for the purpose of private profit' (Douglas, 1923, 1919b). According to orthodox theory, money, equivalent to the price of every article produced, exists in the pocket, or in the bank, of somebody somewhere in the world. It is assumed that the collective sum of wages, salaries and dividends distributed in respect of the articles for sale at any given moment is available as purchasing power at the same moment. Some persons may have more money in their pocket or bank than they wish to spend on consumable goods. By abstaining from consuming, they form a fund which enables capital goods such as tools, plant and factories, to be paid for, and therefore to be produced. Crucially, the money which they 'use to spend or invest is constantly created and destroyed by the banking system for its own financial advantage' (Douglas, 1924a).

"Real credit is the 'effective reserve of energy belonging to the community.' Its administration has fallen to the banking system and financial institutions generally. Consequently the 'creative energy of mankind' becomes subject to artificial restrictions which bear no relationship to the realities of everyday existence' (Douglas, 1919b). The potential real wealth of society is communal in origin and should therefore be subject to the control of the entire community. Financial credit is administered by the banking system 'primarily for the purpose of private profit' (Douglas, 1919b).

"The Douglas/*New Age* texts note that banking originated as a private venture, observing that at the time the Bank of England remained a private institution. Nevertheless, the guild socialists did not consider that a politically controlled central bank would be truly independent of private banking interests. Just as state capitalism, i.e., a socialist government under the existing economic conditions would produce wage slavery as effectively as private capitalism, so too would state banking continue the *status quo* in terms of financial control over industrial policy. Hence Orage's derision of the Labour Party, on its rejection of the Douglas/*New Age* scheme." History has confirmed his judgment, but it is, however, important to remember the international campaign of the Bank for International Settlements in the 1980s to declare the independence from their governments of all central banks. Given what it had in the works, the world banking community clearly needs all the safeguards and secrecy it could get."

Finance Rules the Rulers of Kingdoms

"The creation of 'financial credit' ensures that 'industry becomes mortgaged to the banking system' (Douglas, 1924a). 'Appreciation of the role of finance in initiating economic activity was noted in *The National Guilds'* edited by Orage (1914) and originally printed as a series of articles by S.G. Hobson in the *New Age* in 1912-13. 'A great financial network covers the world, operating on an informal but highly centralized basis. It rules the rulers of kingdoms.'

"At this point, Hobson and Orage went no further than suggesting that the (industry-based) guilds would have to become their own bankers, working through a national clearing house."

At this point Douglas formulated his "A+B theorem," which focused on an aspect of financing production quite different from what economists and accountants had even considered.

"In 1908 he had been in India in charge of Westinghouse's interests in the East. One of those concerned the survey of a large district with a view to installing hydro-electric equipment. The prospects were good. On his return to Calcutta, however, it became clear that there was no money to proceed with the project. At the time labour was plentiful in India and the manufacturers in Great Britain were short of orders. Furthermore, prices for machinery at the time were very low indeed. Douglas recalled having been taken into the confidence of the Comptroller-General of India in Calcutta on the matter of 'credit.' He was told of the trouble he experienced with the Treasury officials at home in England, and with their departments in India, in regard to the extraordinary operations they undertook melting down rupees to deal with the exchange. This was done with regard to 'what they called the quantity theory of money.' The Comptroller-General concluded that 'money and currency and the silver rupees, etc., have almost nothing to do with this situation. It almost entirely depends on credit. Silver and currency form only a very small part of financial operations. Douglas noted this for future reference.'

"Some years later, before the outbreak of World War I, Douglas states he was employed by the British Government at home to design and ultimately construct a railway which runs underneath London from Paddington to Whitechapel. Despite the absence of physical or engineering problems and a plentiful supply of labour, the project could not be completed. Finance lay at the root of the problem. However, as soon as the war commenced, money was available for practically anything.

"After 'an interval' Douglas 'was sent down to Farnborough, to the Royal Aircraft Factory, in connection with a muddle into which the institution had got.' Douglas concluded that the only way to ascertain how work was being allocated 'was to go very carefully into the costing which took place.' The existing costing system produced 'admirable information about what happened three years and two months before, but that was not of any use to me.' According to Douglas, he introduced very early computers – 'tabulating machines' used on the London and North Western Railway. Information was punched on to cards and the cards were put into the machine that processed them. One day it occurred to him that by the end of the week total wages and salaries were not equal to the value of the goods produced during the week. The fact of this happening in every factory across the land *at the same period of time* meant that the purchasing power distributed in the form of wages and salaries will not be sufficient during any week to buy the product unless extra money is being injected into the system each week."

That was the origin and significance of the notorious A+B theorem. It was not enough to point out, as did many including myself, that the discrepancy was because many items produced both as intermediate goods as manufacturing parts, buildings, engineering projects would be useful over many years and would be financed until they were fully depreciated years later. That is exactly what he wished to free society from – dependence on the financial institutions. Hence he brought in the concept of a social dividend representing the contribution of society over generations in creating the institutions, the inventions, the scientific and technical discoveries that made the productive potential of our world possible. It would include, too, the unrewarded labour of slaves, the contribution of martyrs and prophets that made possible the social and legal framework for modern society and its productivity. That could be allotted to all citizens and it would fill the gap and free society from servitude to financial capital.

Instead of patenting scientific discoveries, even genes, for speculative investors to collect a rent on them, the social dividend would contribute to gear down the drive to maximization of the financial sector. It would encourage alternative life styles that would cultivate other goals than the consumption of highly promoted items of little or negative usefulness.

The contribution of Douglas-Orage to the incorporation of the non-market sectors of the economy – health, education, social security, the environment – is crucial. The power-grab of the banking system that Douglas and his associates identified almost a century ago, have come into a lethal flowering. In the long-overdue reassessment for what passes as economic science, their ideas will require careful attention. The Hutchinson-Burkitt book is mandatory for preparing ourselves for the task.

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