

Douglas Social Credit

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Source: *The Australian Quarterly*, Vol. 3, No. 12 (Dec., 1931), pp. 61-74

Published by: Australian Institute of Policy and Science

Stable URL: <https://www.jstor.org/stable/20628963>

Accessed: 18-01-2022 06:36 UTC

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DOUGLAS SOCIAL CREDIT

By W. C. WENTWORTH

**“Frederick: To me you seem beautiful: but then
I have never seen any other woman.”**

—The Pirates of Penzance.

The Douglas Social Credit enthusiasts, apart from their common faith, exhibit one other almost unvarying characteristic—they know nothing whatever about economics. Indeed this is one of their traditional boasts. One finds, for example, Mr. W. H. Rhys—who in Australia can claim, if not a pontifical at least a hierophantic authority in the sect—thanking God that Major Douglas is not as other men. “Douglas, not an ‘economist’—thanks be!—but a practical engineer trained in the applied sciences.” One of the easiest ways of gaining the confidence of the inexpert is to deride expert knowledge and assert that it is useless: to pose as the plain man who sees through the subtlety and sophistry of the learned. The advocates of the Douglas Scheme have found this device ready to their hands. Most of the adherents of this faith have never read a book on economics in their lives outside Douglas Social Credit literature; to such any treatment of economic subjects appears profound, and any proposals seem plausible provided only they hold out the acceptable hope of something for nothing.

The Douglas Social Credit system (if indeed one may concede the title of system to such a heterogeneous collection of incompatibles) is, of course, not new, though it has contrived to dress itself up in modern garb. Reference to the pseudo-Aristotelian *Oeconomica* (B.C. 300) will show instances of ancient application of “Douglas” principles in

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debasement of the currency: and indeed the abortive Gracchan Corn Act in Rome may be said to exhibit certain of the same characteristics—the essence of this legislation being a state sale of corn under cost price in order to keep Italian agriculture working at its fullest capacity. We may say, then, of the Douglas theory, that it is old—but none the better for that: that its antecedents can indeed be traced, but are never found to be respectable.

The fallacy which inspires the Douglas System is dignified by the name of the “Douglas Social Theorem”. It is vital to the system, and when the error upon which it is founded is exposed, the whole crazy edifice crashes to the ground. I intend, therefore, to examine this “Theorem” at some length. It must be emphasised that there is nothing serious about the system except the seriousness with which it is believed. I then intend to show the exact way in which economic and social disaster would fall upon a country foolish enough to put the Douglas principles into practice. Throughout I shall take Mr. Rhys’ pamphlet, “Real Wealth and Financial Poverty”, and H.M.M.’s pamphlet, “An Outline of Social Credit” as giving a true—though condensed—account of the Douglas doctrine. Both these publications are prefaced by eulogistic letters from Major Douglas himself, and may therefore be taken as fairly representing the received version.

The Douglas Theorem states that “The Wages, Salaries, and Dividends distributed (as embracing practically all money incomes and therefore the sum of consumers’ purchasing power) over any given period of time, do not, and cannot, buy the product of that period.” Mr. Rhys thus explains this:

“Now in all business undertakings there are other payments of money made, besides the payments as wages, salaries, and dividends. The payments of industry are really divided into two groups. Let us distinguish them by calling one group A, the other B. Group A includes all

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payments made to individuals, i.e., wages, salaries and dividends. Group B includes all payments made to other organisations for raw material, power, light, bank charges, etc.—‘overheads.’ We may express these two groups of payments in another way, by saying that the A group are inside payments, as being payments made to the individuals connected with or ‘inside’ any particular industry, either as employees, officials, or shareholders; and the B group are outside payments, as being made to other firms or organisations ‘outside’ of and apart from the particular industry which may be under consideration.

“With these facts firmly in our minds it will at once be seen that the amount of money being paid to individuals, the group A payments is the only money consumers receive in respect of that particular production, and represents what is termed the rate of flow of purchasing power. But since all payments made by industry, including Group B, go into price, the sum of costs and prices or, in other words, the rate of flow of prices, cannot be less than $A + B$; with the result, since A will not purchase A & B, that a portion of the product must be distributed by means of a fresh creation of money or credit by the banks, and which is not included in the wages, salaries and dividends that come under group A.”

Now this is utter nonsense. Mr. Rhys has confused “Particular production” with “Particular industry.” He says, “The group A payments is the only money consumers receive in respect of that particular production.” But what group A payments? Mr. Rhys evidently means the group A payments of the particular industry which manufactured the product. Then what of the “A” payments in subsidiary industries? It will be seen that “B” payments for this particular industry comprised “Raw materials, power, light, bank charges, etc.—overheads.” (Incidentally, is raw material an “overhead”?) The man who grew or otherwise produced the Raw Material received wages for his work: the mechanics in the power-house

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were paid: the clerks in the bank received a salary: and the proprietors of each of these undertakings may have drawn a dividend. In each of these cases purchasing power is placed in the hands of the consumer, and no article goes into consumption to correspond with it until the final product issues from the industry which sells it to the public. Thus by the time this is ready for sale the public has in its hands purchasing power derived not only from the A payments of the final industry, but also from the A payments of other industries. It must be emphasised again that until the final product issued from the final industry no article went into consumption to correspond with the A payments in subsidiary industries. Or did Mr. Rhys, when he referred to "the group A payments" mean to include all group A payments, and not only those in the final industry? In that case it is by no means evident that their sum will not buy the final product. Altogether Mr. Rhys has used a great many words, and said nothing. It is as if someone were to propose a number—say 21—and point out that it was the sum of 3, 4, 2 and 5. On adding those figures up he finds they total 14, and announces that he has discovered a great principle. He then propounds an elaborate theorem to show how to divide numbers so that the sum of their parts is not equal to the whole. If anybody suggests that his arithmetic is incorrect he denounces them as enemies of progress, pig-headed bigots, fighters against truth. And that is all Mr. Rhys has done. He has taken a total cost, split it up into parts, and then tried to show that the parts do not total to the whole.

Now let us turn to H.M.M. His explication of Major Douglas' "discovery" "that the aggregate of prices is always greater than the aggregate of incomes" is as follows:

"Take any business you like, and analyse its costs, and you will find that they can be divided into two groups—inside and outside payments. Inside payments are the wages, salaries, commissions, dividends, and directors' fees, etc., paid to, or received by all the individuals associated

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with the business, employers and employed, and constitute their income. Outside payments are payments made to other firms for plant and machinery, raw materials, etc., and these payments are obviously not income as far as the paying firm is concerned, yet the selling price of its products is the sum of the inside and outside payments. It follows, therefore, that the people in that business cannot buy all they produce—assuming that they wanted to do so. Receiving an income representing the inside payments alone, they clearly cannot pay prices made up of both inside and outside payments. That is true of any single business, therefore it is true of all businesses collectively. It follows then, that the income of the community is insufficient to buy all the goods it produces. This statement remains true, even if all profits and interest are eliminated. Prices would still be the sum of inside and outside payments, while incomes would be the inside payments alone.”

H.M.M. is a victim of that same lamentable confusion of ideas which one noticed in Mr. Rhys. “The people in that business,” he says, “cannot buy all they produce—assuming that they wanted to do so.” But this is exactly what they don’t want to do. The recipient of “inside” payments in a smelting works does not wish to buy the metal ingots produced, he only wants to buy the car which is the ultimate form in which they go into consumption. He is not a “consumer” of his own products at all except mediately. Consider, for example, an economy which is comprised of three factors—a mine, which produces ore and sells it to a smelting works, a smelting works which produces metal and sells it to a motor-car factory, and a motor car factory which produces cars for consumption. Douglas would try to persuade us that the total of consumable goods is ore + metal + cars: he not only eats his cake, but digests it too, and then asserts that he still has it.

This point is so fundamental that it is well to emphasise it. The Douglas argument proceeds on the as-

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sumption that every time goods change hands, there is consumption in the proper sense of the word. Carried to its logical conclusion this argument should mean that there is "consumption" proper in every process and at every stage of it, and it is only necessary to subdivide the process of manufacture in our minds to make the value of the product anything we choose. The money which is needed to finance the suspense account of production is not necessarily drawn from the amount which is called for to purchase for consumption the current products of the factories, since bank credits on capital account are generally used to finance goods in process, and are in fact demonstrably large enough to do so. Now let us turn our attention to yet another of H.M.M.'s fallacies.

He states his argument as follows: "If all the costs of production were traced back to their original source, it would be found that they consist of payments made to somebody or other for services, real or imaginary; so at first glance it might seem obvious that, no matter what the cost of production may be, there is always bound to be sufficient money in the communities' hands to buy the whole of the product. That is far from being the case. What is overlooked is that the various items appearing in costs to-day represent payments made over a long period of time. Some were made last week, some last month, some many years ago; but to be effective as purchasing power now—as they would have to be in order to buy to-day's products—every penny of those payments would have had to be saved. We know, however, that most of the money was spent as it was received—had to be spent by the recipients in order to live—and no longer exists as purchasing power; for, as we shall see later, money, or purchasing power, is extinguished in buying goods for final use or consumption."

This argument disregards one very vital point—the continuous nature of the flow of payments. It is true that the recipients of purchasing power had to spend in order

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to live, and that therefore they no longer possess the particular purchasing power which was issued against the particular goods coming into consumption. They have, however, purchasing power in respect of other goods which have not yet come into consumption. Take an illustration: A ship is built, the construction taking two years. During this time wages will be paid to the workmen, and they will, of course, spend them for subsistence. When the ship is complete, "depreciation" will have to be added to the freights: but purchasing power will be put into the hands of the workmen in respect of some other ship or undertaking. In other words we are concerned not with the amount of "capital" expenditure, but with the net increment or decrement of capital expenditure in succeeding periods. It is perfectly true that if capital expenditure suddenly ceases, purchasing power will not be sufficient to buy the goods produced, with the consequence that losses are inflicted on producers; but sudden cessation of capital expenditure is evidence that previous capital expenditure has been misdirected and wasteful, and the remedy lies not in continuing the capital extravagance (which would simply mean that everybody would have to work harder to produce less), but in controlling the boom before it assumes dangerous proportions. It may be in place to mention that it is perfectly possible to get an accurate measurement of the effects which changes in the rate of capital expenditure will have on the ratio between purchasing power and the cost of goods. An application of the formula:

$$P = \frac{E}{O} + \frac{I^1 - S}{R}$$

—where P is the price-level of consumption goods, E the earnings of the community, O the volume of the total output of all goods, R the volume of the total output of consumption goods, S the amount of savings, and I^1 the cost of new investment—will give the required result. But the

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theory of the relationship between savings and investment seems to be a closed book to these writers on Douglas topics, who continue to apply the vaguest and most misleading of generalisations to subjects which are perfectly susceptible of mathematically exact treatment.

H.M.M. seems to imagine that a depreciation reserve is necessarily sterile. This is far from being the case. Take the following instance: A man spends £10,000 in equipping a factory. He commences production and pays in his first year wages, etc., to the amount of £5000. The goods he produces he prices at £8000, made up as follows:—

Wages, etc., £5000; Depreciation, £1000; Profit, £2000. In respect of these goods, purchasing power has been issued to the extent of £7000. But what of the odd £1000? This the business possesses in cash and, with regard to it, may adopt one of two courses. It may either invest the £1000 in the purchase of goods or shares, or it may leave it in the bank. In the first case the business will exercise purchasing power and (though of course it will not buy its own products) thus tend to even up the disparity between price of goods produced and power to purchase them. In the second case the same result will be achieved by a more circuitous route, the bank will find itself with an extra £1000 in liquid funds. On this sum it will be paying interest, and will therefore be forced to look round for an investment in which to place it. Purchasing power will thus be exercised mediately through the banks. It is true that the suspense account which arises through the time lag between the time the goods are bought and the initiation of the cycle whereby the purchasing power of the business is put into operation will need financing: but this is bound to be trivial, consisting as it does merely of a fraction of the depreciation over one cycle of production, and the Douglas advocates have yet to show that the banks grant no credit at all.

It can now readily be seen that the famous $A + B$

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theorem is so much nonsense, though it is not pleasant to be forced to extricate the truth from the morass of misology in which the Douglas advocates insist on immersing it. Let me quote an illustration of how Mr. Rhys applies this theorem:

“Let us now take a somewhat complex example of what is called chain or series production. A farmer sells a fat beast in the auction yard to the meat works. To the farmer the bullock has no ‘cost’, much less its hide; he must take what he can get for it, and what he does get we might call his ‘wages’. But to the meat works the hide becomes a cost, an overhead charge, and we may put it down at, say, £1. The hide is sold to the tanner for that sum, and so the meat works recovers its cost. We may set the illustration out thus:—

“The meat works sells the hide to the tanner for	£1 0 0
The tanner’s factory costs are, say, 10/-, profit 3/-, and he sells the hide to the currier for	£1 13 0
The currier’s factory costs are, say, 7/6, profit 4/-, which he recovers by selling it to the leather merchant for	£2 4 6
The leather merchant’s costs are, say, 10/-, profit 5/6, which in turn he recovers by selling the hide to a trunk maker for ..	£3 0 0
The trunk-maker’s costs are, say, £6, of which £4 are wages and salaries and to which he adds £1 as profit, and now we have a lea- ther trunk costing	£10 0 0

“Now, without adding selling charges and profits of the retailer, it must be obvious that a charge of £10 on the world’s purchasing power has been created; and it is just as clear that £5 is the only sum of money consumers can have as purchasing power to meet that charge in respect of that particular product.”

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This egregious nonsense calls for no comment. But for stupidity the following is hard to beat:

“Let us recall to our minds the houses built as a result of overdrafts. . . . Even had the overdrafts never been repaid the banker would not have lost anything. How could he, since the loan involved nothing but a book-entry, and its repayment nothing but another book-entry. Really the banker ‘lost’ the money by ‘destroying’ it the moment he received the cheque in repayment. Stern necessity compels the trader to demand repayments of debts, because he has to pay the money to his creditors; but no such necessity exists for bankers, other than that of balancing the account—a mere matter of figures.”

And yet there are people who can take Mr. Rhys seriously!

Now let us turn from the Douglas Theorem to the Douglas Scheme. It is, briefly, this: That goods should be sold at the “Just Price”, which is different from the Cost Price. It is obtained by means of the following formula:

$$\text{Just Price} = \text{Cost} \times \frac{\text{Financial Cost of Total Consumption}}{\text{Financial Cost of Total Production}}$$

The suggestion is that at the end of any selected period the government statistician should total up the income of the people (the “Financial Cost of Total Consumption”) and divide it by the Total Cost of Goods produced. Members of the community would then receive corresponding discounts over all their purchases during the selected period. Let us disregard for a moment the impracticability of the proposal, and endeavour to examine its theoretical implications. Briefly it is a method of dissipating in a short period the savings of generations, and accentuating the violence of fluctuations in national prosperity.

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The true cost of production includes depreciation; so does the true financial cost. Plant is actually consumed in the production of goods; but the Douglas advocates advise us to make no provision for this. The consequence is that those who follow this advice enjoy a brief period of transcendent prosperity (living on the labour of the men who constructed the machines) and finally find themselves destitute alike of provision for the present and facilities for the future. We have seen that the amount of purchasing power put into the hands of the community is either more or less than the amount required to buy the goods going into consumption as the rate of investment in capital goods has increased or decreased. The "national dividend" may thus quite easily be a negative quantity—in fact, very often must be so. Let us see how the Douglas system, assuming it were put into practice, would affect a national economy.

Manufacturers in a country make payments of, say, £60,000 for wages, etc. They cost their production at £100,000, made up as follows:—Wages, etc., £60,00; Depreciation, £30,000; Profit, £10,000.

The government statistician would then announce that since purchasing power to the sum of £70,000 had been put into the hands of the public, and goods costing £100,000 had been produced, purchasers would receive a discount of roughly £3 for every £7 spent. Now purchasing power against the goods produced has been issued as follows:—

Public—Wages, etc., £60,000; Profit, £10,000; Discount, £30,000. **Manufacturers**—Cash on hand, Depreciation Reserve, £30,000.

In other words, a total of £130,000 purchasing power has been issued against goods costing £100,000. The natural result is that prices tend to rise, the inflation thus set up counterbalancing any reduction in prices from the Douglas

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bonus. In consequence there is a rush for investment, and great over-production of capital goods. So the effects of the debauch of one period are submerged in a fresh debauch, until the structure of society collapses under the strain.

Or are we to suppose that the manufacturers refrain from exercising the purchasing power or the depreciation reserve. In that case the consequences are even more disastrous. They build up big cash reserves on current account. Either the banks will make an investment against these, or they will not. In the first case prices will rise, and in addition the banks will be financially embarrassed when the manufacturers find it necessary to withdraw their money to replace their plant. In the second case there will be a general financial collapse when those replacements fall due.

For example, suppose the position becomes as follows: The manufacturers hold uninvested reserves against depreciation of £200,000; their plant becomes obsolete and they decide to replace it.

The consequences are simple. There is no longer enough labour to go round on the old terms. Competition for it becomes intense: costs mount: and the depreciation reserve is insufficient to replace existing plant. At the same time wages for goods for current consumption rise in sympathy: production for current consumption falls off as workmen attain economic freedom and forsake their occupations for a life of leisure: the community exists for a while on its liquid stocks, and then is faced with stark famine. The consequences of the application of the Douglas scheme finally turn out to be a depression of a magnitude undreamt of. In essence the scheme contrives, simply by debasing the value of the currency, to put the savings of past generations into current consumption. The end is a shortage not of money (that in itself is a trivial thing) but of factories, roads, houses—all those things which are

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subject to slow but inevitable deterioration, and whose replacement unfortunately demands labour and human energy.

For, when all is said and done, what can the advocates of the Douglas scheme hope to achieve? The making of goods, whether capital or consumption, entails a certain amount of labour. This labour they cannot hope to lessen. Will it be easier to build a house in a Douglas Social Economy? Or would the bricklayer be blind to the benefits of the system and consider the work no lighter? The advocates of the Douglas system see only dimly the two inherent defects in the present system.

1. The lack of fluidity in adjustments between supply and demand brings about unemployment, with a consequent reduction in the total national production.
2. The present system works badly in its apportionment of expenditure between capital and consumption goods. The consequence is that there is too much plant, but none working at its full capacity.

It is unreservedly true that the adoption of Douglas principles would have the effect of multiplying both these difficulties enormously. For both would it make the necessary causal nexus between supply and demand, act in a more circuitous fashion (since the remedy for excessive consumption of capital goods could be delayed out of all reason, so that catastrophe would precede any premonition of disaster), and also by irregularly stimulating and retarding capital investment (whose rate of increase should correspond with technical progress in industry) it would aggravate the very condition for which it professes itself a cure.

The Douglas advocate does not hesitate to advance the

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most fulsome claims. He may be compared to an itinerant herbalist at a country show whose remedy is "guaranteed" to cure consumption, gout, sprained ankles, and ingrowing toe-nails. He has, so he asserts, acquired the prescription from some fabulous Chinese sect. "What of the doctors?" interjects an onlooker. "Ignorant bigots," he replies. "Affiliated to the B.M.A., which is only concerned with keeping people sick." So the Douglas advocate. His remedy is guaranteed to cure unemployment, over-production, under-production, hopeless aspirations—all those ills to which nation or flesh is heir. His doctrine is the true, the exact science. "What of the economists and bankers?" somebody asks. "Ignorant and corrupt," he answers, "blind to the truth and only concerned with keeping the people in economic subjection."

The quack and the Douglas advocate have one other attribute in common: against neither can infuriated purchasers enforce their guarantee.

W. C. WENTWORTH.