

# The Veil of Finance

BY

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The first statesman to adopt a scheme whereby wages, salaries and dividends can be increased simultaneously and immediately, without raising the general retail price-level, will have solved the economic problem of the world. Such a scheme exists in Major C. H. Douglas's Credit Proposals. This book describes in non-technical terms the principles and methods of credit-accountancy now in operation, and contrasts them with those which Major Douglas has formulated. The reader is shown exactly what the fundamental issue is. His common sense will pronounce judgment.

Revisionist Press

4/5 Eustace Street Dublin 2 Ireland

Reprint 1974

Sixth Edition.  
First Published in 1926.  
Reprint 1974.

Printed by Blackrock Printers, Co. Dublin.

## PREFACE

THE average man is not interested in Utopia. For two reasons. One is that he has never been able to identify his own face in any photograph of its inhabitants. The other is that while the place itself is eminently desirable, as the estate agents would say, the way to it is too awful for words. So his invariable attitude to social reformers is expressed in the familiar Bairnsfather formula: "If you know of a better 'ole you go to it." He is not going to risk the welfare of himself and his dependants here in order to promote the welfare of "all" on the horizon. The horizon!—Where is it? All!—Who are they? He is logically right.

Yet the reformers have always been intuitively right. The only thing wrong with them is that they have been ninety-nine-per-cent. seers, and one-per-cent. scientists. They have been so busy painting a picture of the economic freedom which certainly is destined to be, that they have had no time to draw an intelligible chart of the economic repression which now is. To look out of prison stimulates the desire to escape, but it does not get the prisoner out. To realise his desire he must at least possess a plan of

the prison. If not, he may tunnel laboriously for months, only to emerge into another cell.

That is why this book has been written. It presents a clear and comprehensive plan of the existing economic prison. In it are marked the cells of the wage-earner, the unemployed, the business proprietor, the investor, and other "interests." The cell doors have no locks. Everybody can walk out when he likes. And when they all assemble in the corridor they will find nobody in the prison but themselves. The main gates, too, will be wide open. All are free to depart. But, being free to go, they will, with a touch of human obstinacy, decide to stay and explore the prison. And behold, it will not be a prison but a stupendous power house and luxurious mansion. A Communist will climb on to a transformer and submit the following motion: "Resolved that we, having been silly fools, do now kick ourselves," which having been seconded by a substantial Capitalist, will be carried by acclamation.

**Who sets out for Utopia leaves it behind.**

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"You are talking like a seer yourself, sir," the reader will probably retort. Let him read on.

## THE VEIL OF FINANCE

### I.

#### The Financiers' Policy

To teach economics to the non-economic mind in terms of economics is futile; it is like teaching French in French to the mind that knows no French. In the latter instance the only possible way of making any advance would be for the teacher to point to a *thing* and recite the French name of it. This does not take the pupil far, but it does at least take him somewhere, for it enables him to conceive that there is some intelligibility about the French language. So let this reflection be our excuse for what follows:—

If ten men on an island are able to produce 100 bushels of corn, and they suddenly choose to produce half the quantity and use the rest of their labour to produce agricultural implements, it is clear that they are *buying* the implements, for they are going short of corn all the time they are constructing the implements. When the work is done, therefore, they are the *owners* of the implements. No question of any debt arises, unless one may fancifully regard the implements themselves as owing 50 bushels of corn to the islanders. In current phraseology the islanders' *abstinence* is an *investment* which brings a *dividend* in corn.

But this illustration pre-supposes equal partnership. What will happen if the island belongs to one of the islanders who hires the other nine? Ignoring considerations of psychological friction about the sharing of the spoils, the main difference will be that the imple-

ments will be the property of No. 1, who will have the power to impose *terms* on the other nine for the use of "his" implements. What will the terms be? Supposing that the islanders can now produce 120 bushels by using these implements; No. 1 sizes up the situation as follows:—He notes that the other nine have been able to keep alive on a total consumption of five bushels each while the implements were being made, and argues that since "what man has done, man can do," they can still continue on the same standard of living. So there is a prospective surplus of 75 bushels; that is to say, there is a margin for a charge or a rent amounting to that quantity, which he can call upon the other nine to pay. Supposing he does so. If the surplus is produced continuously, period by period, No. 1 will in time disappear under a mountain of corn which he cannot consume, while the other nine will live on the 45 bushels.

But no one can imagine that sort of thing happening for long. The "system" would reveal its absurdity to all of them, the owner included. The latter would give orders to reduce corn production, and would direct the energy of the islanders to the production of something other than corn. But (assuming that the islanders lived on nothing but corn—*i.e.*, that corn be taken to represent the means of life in general) this policy would not remove the difficulty, for if an accumulation of corn was found to be redundant, an accumulation of implements and other means of *promoting corn-production* would be a "white elephant." The owner, in the end, instead of being buried in corn which he could not consume, would be loaded up with tools and machines for which no use could be found.

Now this illustration represents what is going on every day in the industrial systems of the modern world. The result everyone can see for himself—a terrific accumulation of factories, machines, tools, and transport facilities on the one hand, and a languid dribble of consumable goods and services on the other. Yet the

whole object of making the former has always been the intention of increasing the latter. We behold the surprising spectacle of whole populations voicing their dissatisfaction with this result in more or less violent terms, but still retaining their belief that the system under which it has appeared is fundamentally right and proper. It is as though some veil obscured their vision and prevented their seeing (as the islanders would have seen in a very short time) the absurdity of the position. There is such a veil. It is the Financial System. That is the essential difference between our case and the case of the islanders. They had the advantage of being able to analyse the *physical nature* of their economic development, and were therefore able to see its defects. We, on the other hand, have come to trust exclusively in the *financial presentment* of ours. Trust in figures need not necessarily mislead us; but they must answer to facts. And that is precisely *what they do not do* in our existing system of national accountancy. Actually they invert them.

Let us go back to the island. Under the conditions sketched out, can anyone imagine the owner—even if he acted only from a self-interested point of view—continuing to force the islanders to make him more corn than he could eat, or more implements than they could use? Would he not—unless he were a stark lunatic—decide that either everybody should eat more corn, or that, if not, everybody should work fewer hours a day? Would he not be just as well off if, having collected a surplus of corn (as in the first stage), or a surplus of implements (as in the second), he *made a present* of them to anybody who wanted them? Further, if he were a man of ordinary humanity, would he not be *happier* if he did so? And if he were a ruler, would he not find the *preservation of law and order* an easier task in consequence? Then why, in our own case, are such correctives not applied—not even thought of? The answer lies in the Financial System. What we

mean is that whereas the owner on the island was free to adopt whatever means he thought fit to correct manifest errors, modern owners of industrial plant are not free to do so. On the island the owner *controlled* economic policy. In Britain to-day, the industrial capitalist does not. He can only *administer a financiers' policy*. Economic policy is subservient to financial policy.

The next question is: What is the financiers' policy? It can be expressed in three clauses.

1. Everybody must work hard.
2. Everybody must consume little.
3. Everybody must save much.

Now this is not a temporary policy. It does not hold out the promise—"Do these three things for a time, and then you can stop doing them"; it says, "Do these three things *all the time*, or else you can never prosper." How you can prosper *until you stop doing them* (especially and obviously Clause 2) is not explained. No matter that in 1815 everybody was obeying the policy, and that in 1925—after over a century of unremitting work, abstinence, and saving—the necessity for continuing to obey is preached more vehemently than ever; no voice questions the policy—not even Labour asks "What about it?" in the sense of a fundamental challenge.

## II.

### The Purpose of an Economic System

THERE is no inherent necessity for a money system to obscure the truth about the physical processes of production and consumption which take place under it. For instance, it would not occasion any sensible person the least trouble to devise such a system for application to the conditions we have imagined to exist upon the

island, and to show that it could operate for, and not against, the interests of the islanders as consumers; in fact, the difficulty would be the other way round—namely, that one can hardly conceive of a money system which defeated their objective deceiving the islanders into believing that it was assisting it.

Take the case where the ten men were producing 100 bushels of corn. They could borrow £100, use it for production purposes, pay themselves £10 each, spend the money on the corn, consume it all, and finally repay the £100.

Or take the case where they produced both corn and implements. They could go through the same process of finance with a similar satisfactory result, the difference being that they would produce and consume (say) 50 bushels of corn each, and would produce and acquire (say) one plough each. In this case one can imagine their repeating the operation indefinitely, bringing into use at every successive stage the ploughs accumulated during preceding stages—and all without necessarily increasing the amount of money (£100) used for the purpose. Of course, it is a little difficult to imagine their using money at all in these primitive circumstances, but the point is that supposing they did use money, the fact of their doing so need not put them in any worse position than if they had done without it. Nevertheless, it would be possible for them to get in a worse position (or relatively so), and that would be if they continued to make ploughs beyond the point at which they could usefully employ them all. But if they so continued, let it be noted that the error would lie in their *economic policy* and *not in their financial mechanism*; that is to say, once assume that they *willed* to make more ploughs than they could use to increase the corn supply, the question of whether their financial mechanism was perfect or imperfect, or whether they employed a financial mechanism at all, would not affect the result—waste of time and energy. The moral of

this is vital; it is that if any people misconceive the true *purpose* of their economic system, *not even an absolutely perfect financial system* will save them from the consequences of their error of judgment.

The true purpose of an economic system is to achieve the highest rate of consumption by the least expenditure of personal energy, compatibly with the assurance of the continuity of the process. To illustrate: if the total possible production of corn on the island under any conditions were (say) 100 bushels, and the number of ploughs necessary to maintain that quantity were (say) twenty, a well-conceived economic policy would aim at maintaining the number of ploughs at twenty; it would not encourage the making and accumulation of ploughs beyond that number (except, perhaps, for a small margin against accidents). The general principle involved here can be stated thus: *that an expansion of capital equipment is not good economics while the existing equipment is not fully used.* The time for such expansion is when factories cannot overtake their orders, not when they are unable to get orders.

But here a difficulty arises. Let us imagine our islanders have brought the number of ploughs up to the adequate number of twenty, and that (let us say) two of the islanders have been hitherto devoting their time to the making of ploughs. As soon as the limit is reached the work of these two men is no longer required. Also (by hypothesis) they are not wanted for corn growing, because the maximum quantity is already being produced by the work of the other eight. The island is suddenly confronted by the entirely new phenomenon of *two unemployed!!* Does not this blow sky high our concept of the true economic system? Well, it depends upon whether these men are still going to be permitted to eat corn or not. Suppose that they have hitherto eaten 10 bushels each, and now they are to eat no more. Happy thought! let them commit suicide. Now there is an output of 100 bushels, and only eight men to eat

them. Assuming that the eight men *can* eat the extra 20 bushels bequeathed by their departed neighbours, then things proceed smoothly. But one must look a little more deeply into the question than this. One must ask oneself first what *policy* would underlie the rule that those two men should cease eating as soon as they ceased working. In the first place, it would not be a purely economic policy; for to the pure economist the only essentials would be that the maximum output of corn was produced and consumed. The question of how many people participated in the consumption he would leave to sociologists and moralists. (It is true that *numbers* of consumers have a direct bearing upon total consumption, because individual capacity for consumption has a definite limit; but let us leave that on one side for our immediate purpose.) The point we wish to make is that the policy which forbade those two men to eat would be based on the concept that *eating was a handicap to production*, that it was a form of *waste* which was only tolerable up to the point at which it kept men in a condition of efficiency for work. So, as the efficiency of these men could not be put to any use, they must forgo their share of corn. *Corn may only be supplied as a reward for work.* But now observe; there is a corollary to this outlook. If consumption is a handicap to production, any policy based on that idea would not only deprive *unemployed* men of their corn, but would see that *employed* men did not have more than was "necessary." This involves a revision of our hasty supposition just now that the 20 bushels of corn would be distributed among the other eight men. On the contrary, the very concept which forbade the two to eat at all would equally forbid the other eight to eat more. What then? This, that the total consumption of corn on the island would be reduced thenceforth to 80 bushels. Two consequences would follow. One would be that 20 ploughs would now be too many, and the other would be that fewer

than eight men's work would be required. More unemployment! More suicides! Less production and consumption.

Now there have been presented above two diametrically opposed concepts. The first regarded consumption on the highest scale as the true objective of production. The other regarded consumption as a handicap on production. Combine the two, and you arrive at the theory that *an economic objective is at the same time an economic handicap*. Now is it possible to conceive of a people accepting such a theory? Quite certainly. The British people, the French people; in fact, all peoples. Yet they are not fools. What is conceived and what is planned is debated and decreed over their heads. They are quite unconscious of the conflict in which they are involved, the conflict between Finance and Scientific Industry. This unconsciousness extends up into the highest reaches of the industrial system itself: not simply wage-earners, but the most celebrated business administrators, are unaware of the issue. It is hidden behind the veil of deceptive financial figures.

### III.

#### The Banker's Issue of Credit—and its Consequences

WE have previously remarked, in discussing the activities of the ten islanders, that in the primitive conditions contained in our hypothesis it was difficult to imagine their troubling to use a money system at all; for obviously they could get on without it. Much more difficult, then, is it to imagine their misusing one; for obviously they would see through it. For instance, the mere sight of, say, seven or eight ploughs laid by in idleness would have a *meaning* for them—they would instantly draw the conclusion that they were wasting time by adding to their number. And especially so if,

at the same time, the people who were making ploughs could be usefully employed in driving those already made and helping to increase the yield of corn.

Now to-day this kind of thing is happening all round us: we have idle machinery, idle men, and, at the same time, short supplies of the things those machines and men are able to produce. Yet, marvellous to relate, when the New Economist points to these facts, and awaits the answering flash of instant realisation of their *meaning*, he is faced with drab gapes in every direction. Why is it? Well, the answer is not hard to seek. The industrial system has grown so complex that ordinary people cannot *see it working* as those islanders could theirs. Whereas the latter could, as it were, *inspect their economic activities as a whole*, and therefore reason about them as a whole, people living under modern conditions can only *look round within* their economic system, and can therefore only reason about such problems as fall in their limited survey. With the sub-division of labour has come the sub-division of reasoning. It is not that people to-day are less intelligent than the islanders; it is that scientific discovery and organisation have produced problems within problems to a degree demanding almost a super-intelligence to comprehend. Little wonder that in the whirl and roar of the machine age bewildered human beings accept the machine, and the multiplication of the machine, as the appointed end of economic activity. And less wonder still when the financial controllers of policy deliberately engender such a belief.

We may imagine how an exponent of "Sound Finance" would present its case to the islanders:—

"Now you good people, you must remember that although you are getting along very comfortably at present, there are likely to be bad times to come, and you must prepare for them by working a little harder and eating a little less. This will produce 'savings,' which will be your shelter when the storms break. You are at present reap-

ing and eating 100 bushels of corn by your personal labour, supplemented by 20 ploughs. If you will grow only 75 bushels in future and divert your spare labour to making more ploughs, you will be pursuing the wisest method of saving. It is true, as some of you will be thinking, that growing extra corn and saving that, instead of ploughs, appears a better method, but it is not, it is a worse method. For corn is more perishable than ploughs; and, apart from that, if you accumulate corn, you must also build barns to store it. How much better than storing up *things* is it not to store up the *means* of quickening their production? Do this—and every day you live on 25 bushels less corn you will be accumulating your *power of consumption*; and as you watch the growing number of ploughs you will realise that in them you have an iron guarantee against want, and they will become for you a symbol, like the rainbow in the heavens, that nevermore will the flood of penury, which overtakes the improvident, destroy your civilisation. Now, if you agree, we will together work out a scheme based on *saving*. In order that it shall be properly organised it must be controlled—of course, in your interests—from some centre. I will be that centre. Activities must be co-ordinated, and I will co-ordinate them for the agreed end. I shall do so by issuing to you *licences* to work. They will go by the name of Money. They will be loaned to persons who will engage in *approved* kinds of work. These persons will pass them on in certain quantities to others who co-operate in carrying out that work. And as and when the licences are thus distributed in payment for work accomplished, they will become, in your hands, *licences to eat*. The essence of the scheme is that all production and consumption must come under this licensing method. In this way shall I be able to give effect to our common policy. For instance, if there appears a tendency to grow corn to excess, I can stop it by loaning fewer licences to corn-growers. Or if certain plough-makers exhibit a tendency to exuberant prodigality in the distribution of licences to their workers, I shall be able to correct their mistaken humanity by the same means. In this instance you will see the danger: if workers get hold of too many licences, they will all rush to change them into corn, and will thereby tempt the plough-makers to go into the corn-growing business to share in the sudden artificial prosperity which will be temporarily manifested there. This, as you will realise, would be contrary to our agreed policy. So much for the penal side of the scheme. But there is another

side. There will be a system of rewards. Roughly I may put it like this—the man who makes the most ploughs relatively to the quantity of licences he distributes for consumption purposes will be the first served when I hand out further licences, and I shall see that, since he has got ahead of the others so far, he is put in a position to get still further ahead of them in future. This will create a spirit of healthy *competition* throughout the island, for those who lag behind will be unable to continue in business at all, and will have to become the employees of their more enterprising rivals.

If one can imagine the islanders\* swallowing this reasoning, it is easy to see how they would be overtaken by the same problems as face us to-day. The agreed policy being to produce the most ploughs with the least “expenditure” of corn, it would follow that the corn-growers would not only be allowed, but positively encouraged, so to fix the “price” of their corn as to recover from the consumers all the licences-to-eat which the latter would earn as wages through the plough-making industry (as well, of course, as the wages paid out by the corn-growers themselves). In short, *all* the banker’s (as we will now call him) licences—no matter how large a volume he issued—would (assuming that they all went into the pockets of the islanders as wages) be withdrawn through the price of corn, and become the revenue of the corn-growers. These growers would then discover that after they had repaid their original borrowings to the banker, they had a substantial surplus of licences. The first manifestation of *inflation* would have appeared, and with it the *sense of property in money*, also the concept of the corn-growing business as a *money-collecting mechanism* instead of a means to

\* One cannot imagine a small community of islanders who know the maximum yield of their land to be 100 bushels, even with the aid of ploughs, being convinced by this argument; but a large population not having definite information as to the possibility of developing their production by means of machinery, could easily be deceived.



corn-consumption. The banker\* would directly encourage this kind of thinking by his subsequent address in his parlour to the "successful" corn-growers. It might run something like this :—

"Gentlemen,—My books show that my first issue of money under the new policy was £2,000. Of this sum £1,500 was borrowed by the plough-making industry, and the other £500 by yourselves. Now, what has happened? Disregarding your personal expenditure on corn for your own consumption, so as to keep the main question clear, you have laid out £500 on corn production and have collected £2,000 for the corn. You have made a profit of £1,500. You will want to know what you can do with it. Now, legally, as I originally explained, the whole of this money, having been earned by you in return for your social service to the community, is a licence to consume corn. But no matter how you indulged yourselves, you could never hope to use more than a tiny fraction of the money in that way. That, however, is a mere side issue. The real consideration is the fact that we have all agreed, as a principle, to keep down corn consumption to the lowest point. Then to what end, you ask, shall you devote this money? My answer is: to the same end as I originally issued it. Your £1,500 is an *investment surplus*, which means that you, in your turn, are free to *lend* this money for business enterprise. There are two directions in which you can lend it. First, there is your own business. You will require £500 to prepare the next harvest. In this connection alone you can see an advantage to yourselves, for hitherto I have been obliged to require of you a little more money back than I originally lent you. But now you have enough money of your own, and will escape this charge, which goes by the name of *interest*. To that small extent you will be adding to your future profits. There remains, then, the question of the other £1,000. You will not want it for your own business, since you are already producing as much corn as is necessary under our scheme. But there is the plough-making industry. You might, it is true, start such an industry yourselves as an adjunct to your own business, but perhaps, all things considered, you will find it suit

\* It is important to bear in mind our hypothesis that the banker is sponsoring the principles of "Sound Finance," as generally understood to-day.

you better to lend your £1,000 to the existing plough-making concerns. The term applied to such a proceeding is known as *financing*. But why should you lend to other people? you will be wondering. The answer is that they will pay you a small regular sum for that service, such as you have previously paid to me. So, gradually your invested money will grow in quantity: it will be what is known as a *revenue-producing* expenditure. Again, there are two ways in which you can lend your money. You can lend it for a fixed annual interest or for a proportionate share of the total profit of the plough-makers, however much or little it may prove to be. In the first case, they would sign a paper known as a *Debenture*, on which they would state exactly how much interest they would pay you year by year: it would be a fixed proportion of the sum you lent. If they were ever unable to pay, you, as *debenture shareholders*, would have the right to seize their ploughs and sell them, or a sufficient number of them to repay your loan and interest; or you could force them to sell the whole business as a means to the same end. In the second case, they would hand you a paper called an *Ordinary* share, but this would entitle you only to participate in profits actually made by them. If they were very successful, you might get several times as much per annum as you would from a debenture investment: but if they made no profit you would get nothing, and perhaps none of your loan back. Therefore you have to choose between the lesser and the greater risk attaching to your investment. Which will you do?

#### IV.

#### The Banker's Withdrawal of Credit— and its Consequences

LEAVING the corn-growers to make their decision, let us turn to the plough makers. At this point they have put up a factory, for which they have paid out (say) £1,000 in wages, and have collected and assembled materials and made ploughs, for which they have paid £500 in wages. This totals the £1,500 that they originally borrowed. The whole of that sum, as we have just seen, has gone into the possession of the corn-

growers. The plough-makers have, on the one hand, *assets* (factory, material and ploughs) which (valued at cost) amount to £1,500, and *liabilities* (the debt to the banker) which amount to the same sum. But they have no money.

Now the banker has reserved to himself the right (as all bankers do) to call in his loan at any time he thinks fit, and we will suppose he decides to do so just at this particular time. There is another meeting in his parlour, and he addresses the plough-makers in some such terms as these :—

“Gentlemen,—You owe me £1,500. I have allowed you sufficient time to get your factory and materials together, but now I must request you to repay the loan, or at least reduce it by a substantial amount. A debt owing to a banker is called a *floating debt*. Now, floating debts mean sinking communities. I will explain the reason some other time, as it wants a great deal of explaining to people like yourselves who have not grown up under a sound financial system. Anyhow, the debt must not float any longer. That does not mean that the debt must disappear; it means that you must turn it into a *fixed debt*. A fixed debt is a debt owing to your own kith and kin. Therefore you will see that the process of changing the nature of the debt is simply one of changing the identity of the person or persons to whom you owe it: in short you “fix” your debt by borrowing from your neighbours and paying me, the banker, out. Happily for you, there is a way open for you to do it to the extent of £1,000. The corn-growers have got a surplus of money to that amount, and I have suggested their lending it to you. I have good grounds for knowing that they view the suggestion favourably, so the next step is with you. You must *form a company*. You must *raise capital from the public* to the amount of £1,000. To do this in proper form you must *issue shares*. I will now instruct you in the details of the operation if you will listen attentively.”

In due time the company is floated. Let us suppose that it issues 1,000 ordinary shares of £1, and that the corn-growers take them up and pay for them. This enables the plough-makers to pay £1,000 to the banker in reduction of their debt to him. But it leaves them still

owing him £500. We can deal with this by supposing that the banker agrees to let the money remain on the condition that they issue 500 £1 *mortgage debentures* at 5 per cent. interest, and hand them over to him. (The interest question does not affect the main issue we are dealing with, so this 5 per cent. need not be borne in mind by the reader.) These mortgage debenture shares are so called because, as we heard the banker explain to the corn-growers, they give the holder the right to step in and take the factory and plant directly the borrowers default in paying their interest; that is to say, the borrowers mortgage their land, factory and plant—in just the same way as a private house-owner might do. On the other hand, the holders of the ordinary shares have not this right, and if anything goes wrong they have to stand aside and see the property into which they have put their money disposed of—probably at “scrap prices” — for the benefit of the holders of the superior *debenture* shares. So in the case we are imagining, the banker has become what is spoken of in these days as a *secured creditor* of the plough-making industry in contradistinction to the corn-growers, who are termed *unsecured*.

It will be convenient to sum up the position at this juncture. We have seen the banker create and issue £2,000. We have watched him encourage the corn-growers to “profiteer,” because in that way the consumption of corn has been kept down. We have watched him get the plough-makers into a mess, and then get them out of it by inviting the corn-growers to invest their super-profits with them. Lastly, we have seen him get back into his possession £1,500 out of the £2,000 he originally lent.

And now it is necessary to note that if he follows the procedure of the bankers of the present day he will *destroy* the £1,500, *leaving only £500 in existence on the island*. The fact that such actual cancellation of money goes on as an *invariable practice of modern*

*banking* is the crux of the whole economic problem, and no person who does not grasp it and its significance is in a position to contribute any assistance whatever to a solution of our industrial and social troubles. As to the fact being a fact, there is no need for us to do more than refer readers to Mr. McKenna's\* recent speeches to the shareholders of the Midland Bank. In one of them he asserted that "every bank loan creates a deposit," and that "every repayment of a bank loan destroys a deposit" to the same amount. The word "deposit" need be no stumbling-block to the new reader—for our present purpose the word "money" may be substituted. Now, as to the significance of the fact. It comes out clearly in the present illustration. The banker on the island created "deposits" or "money" to the amount of £2,000, and the islanders had the use of it for a time. But subsequently he required and received repayment of his loan to the amount of £1,500. We will now suppose that this £1,500 has been destroyed. That means that there is now only £500 on the island—and it is the amount which the corn-growers reserved for the purpose of financing their preparations for the next harvest. *There is no other money anywhere—not even in the banker's possession.*

Of course, it will be said that the banker has the power to make some more. But the practical point is that the islanders have left him to exercise this power at his own discretion; so everything depends upon whether he *will* make some more, and, if so, how much. In the circumstances which we have set out there are some sound arguments why he should not. We will leave them aside for the moment, and consider the position if he does not. Let us look at the account books of the plough-making industry. They show that it has incurred costs amounting in all to £1,500. In the long run it has to get all this amount back *in money*

\* The Right Hon. Reginald McKenna, Chairman of the Midland Bank.

through sales of its product. But, long run or short run, there is only £500 of money on the island; so that, even supposing the corn-growers got a sudden whim that they would use all their remaining money to buy ploughs, that would still leave the plough-making industry with a balance of £1,000 *irrecoverable costs*. But the corn-growers are going to use the money otherwise, and, seeing that the economic policy of the islanders involves keeping down the production of corn, the number of ploughs that will be ordered will be negligible. So the plough-makers will be left with the bulk of their products on their hands. They will default in the payment of interest on their debentures. The banker, as debenture-holder, will intervene and seize the "security."\* He will then offer it in the "open market." Now, the only possible purchasers are the corn-growers. Supposing them to purchase the property. They cannot bid more than they have got, which is £500. The banker accepts the bid, takes the money, and cancels it. Now, the banker's books are clear; there is no money on the island; the plough-makers have lost their property; the corn-growers have lost their £1,000, and have got a plough-making property which has cost them a further £500. But the worst is not yet. If the banker refuses to lend any more credit the plough-making property will be worth nothing at all, and the corn-growers will have lost the whole of the £1,500 which they originally collected as profit.

The difference between this grotesque sequence of events and the facts of present-day profiteering and investment under the existing financial regime is simply a difference between the numbers of the victims. Essentially, the very same principles are operating. They are not detected because of the complexity of the modern industrial process to which we have previously

\* It was to avoid an act of this sort by debenture holders that Messrs. Vickers had to consent to the writing down of their ordinary shares from £1 to 6s. 8d. (December, 1925).

referred. They are the cause of the alternation of "booms" and "slumps." They explain why it is that while, during the war, the amount of money issued by the banks to the British people was doubled, the amount of their national debt was multiplied ten times. An additional sum of £1,000 millions appeared, but an additional debt of about £7,000 millions also appeared. And this huge disparity of £6,000 millions—this money deficit—was caused, in order, first by the inflation of prices when the bankers were issuing new credits; second, by the draining of the consumer's purse by that inflation; third, by the repayment of the money, *via* investments, to the bankers, and their cancellation of it. And the flood of bankruptcies that has marked the period of the banks' "deflation policy" (*i.e.*, the calling in of loans) proceeds from the above causes, just as did the plough-makers' bankruptcy on the island.

#### V.

#### Do We Live on Our Export Trade?

It will, perhaps, be objected that the process by which the islanders were brought to bankruptcy in our illustration depended upon the banker's premature withdrawal of the loans he had issued. The objector could reasonably point out that such a withdrawal, accompanied by a refusal to advance new loans, does not truly represent the practice of the banking system in modern industry; that to-day there is a continuous stream of loans coming out of the banking system as fast as former loans are being repaid. This is true, but upon examination it does not make any difference. Our only purpose in making the islanders' banker stop financing them at the end of the first cycle was to estimate the consequences arising from that particular cycle—that cycle, of course, being typical of any subsequent ones. We saw that the

issue of £2,000, when first expended by the islanders, was recorded as £2,000 costs, but that by the time it was all repaid to the banker it had only defrayed £500 of costs. Thus three-quarters of the total costs it had created on its way out of the banking system were left still standing when it finally got back into the banking system. £1,500 worth of costs (represented by the plough-makers' factory and stock) had not been recovered by them; and, since all the money was now destroyed, these costs were *irrecoverable*.

Now, no further cycles of bank credit could bridge that disparity—except on one condition, that is, that the banker were to create and *give* (not *lend*) the islanders £1,500. The immediate effect of *lending* the islanders that further sum would be to add it to pre-existing unrecovered costs; so that the total would now be £3,000 instead of £1,500. And ultimately, when the new £1,500 was repaid and destroyed, it would leave behind it *additional* irrecoverable costs. And so with every successive credit cycle. Nothing could stop the cumulative progression of irrecoverable costs (represented by *surplus*—that is *unsellable*—production) so long as the agreed economic *policy* of the islanders was adhered to. Is it not antecedently inevitable that if your economic policy is to "produce more and consume less," as the modern expression of the prophets of sound finance teach it, you must necessarily get a surplus? And is it not equally certain that the financial rules framed for the purpose of carrying out that policy must result in, and *ought* to result in, making that surplus unsellable?—for if the people were made *able* to buy it, they *would* buy it—and there would be no surplus! It is not just an *accident* that the people in any given country are unable to buy more than a fraction of what they produce; it is the very result foreseen and prepared by the controllers of their credit system. And to what end this surplus—this production of goods beyond the community's power to purchase? Why,

that the surplus may be exported. "We live on our export trade" declaim the prophets. Do we? We must go back to our island and see how.

We must make one alteration in the illustration, and first of all suppose that instead of one banker financing the whole island there were two of them doing so—one administering the Eastern half of the island, and one the Western. It will be convenient to keep to our original total figure of credit, namely £2,000, but we will suppose that each banker issued £1,000 to his own clients, and that the two cycles of finance did not intermix—that the Easterners exclusively used the Eastern credit, and the Westerners the Western. Now, assuming the consequences of the use of the credit were as we have previously described, you would have, at the completion of the two contemporary cycles, an Eastern surplus of unsellable goods amounting to £750, and a Western surplus of the same amount; and there would be, *ex hypothesi*, no money in the islanders' possession, either in the East or in the West. It is obvious that this new situation does not differ an iota from the old, so far as the crux of the difficulty is concerned—namely, the impossibility of selling the surpluses.

But now consider. Suppose that while the Easterners and Westerners were asleep one night some subterranean convulsion caused the island to separate into two—an Eastern and a Western island. You may also imagine, if you wish, that some miracle caused the islanders on the Western island to speak another language—to count their money on a different notation—and to call it by a different name. Thereupon you will be able to visualise the opening of an era of *international trade*, as we call it nowadays. The Western island is now an *overseas market* to the Eastern island; and *vice versa*. Hurrah! the difficulty is now overcome—the rationale of the surplus is at last established—for now the two sets of islanders can exchange their respective surpluses, they can trade with each other and

grow rich. And all this magic just because the sea now flows between the two halves of what was once one bankrupt island. Fifteen hundred pounds of costs and no money to meet them—that was an impossible position when the two islands were joined together; but now that they are separated, each with £750 of costs and no money—why, the thing is settled! The Easterners and Westerners are going to recover costs—and "live"—*"on their export trade."*

But can it be true? Can the bisection of a bankruptcy create two solvencies? These questions do not need any answer. Everyone will see at once that the mere exchanging of the Eastern and Western surpluses by the two sets of producers will leave the consumers exactly where they were. If you have not the money to buy a loaf of bread, and someone exchanges it across the road for a pint of milk on your behalf, how can that enable you to buy the pint of milk? People say: "Oh! but we must export goods in order to pay for the food we import." *But if the exported goods are beyond the buying power of the population, so must be the food that comes back in exchange.* International trade is *in the end* only barter, and if the things going out and coming back are unpurchasable by the communities, this trade is—to use the orthodox economist's favourite jibe at credit reformers—just like living by taking in each other's washing. The only advantages in international trade are (1) when it enables communities as producers to save their labour, and (2) when it enables them to diversify their consumption. If there be a place abroad where nice things grow of their own accord, by all means let us get them from that place in exchange for something else which we may be making so easily that it may be said almost to make itself of its own accord; let us not try to do everything ourselves. In that way we are able to spread our purchasing power over the greatest variety of consumable things with the least expenditure of personal energy in either of the

countries concerned. But mark this: the people's purchasing power *has got to be sufficient to be spread over these imports*: which means, *a priori*, that it has got to be sufficient to be *spread over the exports*. We may not *want* to buy the particular goods we are exporting, but we must have in our purses (or at call) *as much money as those exports have cost*.

Let us return to the two islands. If the unsaleable ploughs were interchanged between them, the result would only be unsellable Western ploughs on the Eastern island, and *vice versa*. And the same result would occur even if the surplus in the Western island were not ploughs, but something which the Easterners could make use of—say it were fish. When the fish came to the Eastern island it would, *ex hypothesi*, be valued at £750. But against that value there would be no money in the island. So the only remedy in that case would be for the banker to issue £750 of credit. And to make a clean job of the transaction he would, in these circumstances, have to *give* it to the community. It will be seen that this is exactly the remedy which was indicated by a consideration of the problem in the first place. We have travelled out into the region of international trade only to find that the remedy is a *purely domestic one*. Not until the home market is provisioned with money *sufficient to defray the total costs of all home production as and when it becomes ready for sale* can the exchanging of it or any part of it abroad do us an atom of good.

But why is this not realised? The answer is because the people in control of our credit system do not wish it to be realised. If they were to put the British people in a financial position to buy *all* production, the initiative of *economic policy* would for the first time lie in the hands of the public. As it is, the initiative remains in the hands of the credit controllers, who discipline us to abstinence by restricting the flow of money, representing to us that the difference between what we might

have consumed, and what we are allowed to consume is a national good, and not, as it really is, a national evil. They prove it by *figures*. They quote enormous "values" in terms of pounds, shillings and pence, but carefully suppress the fact that these sums have no more actuality *as purchasing power* than those island plough-makers' £1,500 "worth" of plant and stock. These "values"—these "savings"—what are they? Not actual sums of money which may be spent, but simply a record of sums of money which were cancelled before they could be spent. They are not purchasing power, but a tale of surrendered purchasing power.

However, there is this bright side to the case. In the last analysis not even the credit-controllers will find it possible to make such a system work. It can no more function in Britain, Europe, or even in America, than it could in the island we have been talking about. They are beginning to realise it too. But the lust of power is a refractory vice, and it behoves all intelligent citizens to study the credit question for themselves, and to do their utmost to quicken the conversion of their financial overlords.

## VI.

### International Loans

A NATURAL question which will occur to anyone who has not given much attention to the fundamentals of economics will be this: "How is it that international trade has continued so long without breaking down?" The answer is that the breakdown has been delayed by the process of *lending* the surplus—*i.e.*, by *overseas investments*. To go back to the last phase of our illustration—the divided island. The two groups on separate islands were there presented as being at the *same stage of civilisation*—both producing unsellable surpluses by similar methods. But what if one of the islands happened to be what we shall call a backward island—an

island on which there had been no industrial development? To consider this, we will re-unite our divided island, and suppose that the original islanders happen to discover a second island of the sort described, the inhabitants of which grow corn by primitive means, and live very frugally. We will call their island New Island, and the original island Old Island. Now the banker on Old Island gets to hear that the soil on New Island is much more fertile than that at home. So he calls together the plough-makers and addresses them in this fashion :—

“Gentlemen,—You are at present in this position : you possess £1,500 of value in a factory and ploughs, but there is no *demand* for them on this island in any way approaching that figure. But I have a scheme to put forward. It has to do with New Island. I am informed that the soil there is so rich that corn could be grown with only a half the labour and ploughs that we have to use here. I propose to enable you to supply the New Islanders with ploughs. They have no money to pay for them ; but that is a small matter. I shall go over there and fix up a foreign loan of £1,500. I shall have some share forms printed—300 of them, of £5 each. These will be called New Island Government Bonds. They will pledge the New Islanders to pay back the principal with interest, just as in the case of the Debenture shares I have told you about. As soon as they agree to borrow the money I shall create a credit for £1,500, and issue it—not to them, mark you, but to you, as and when you export ploughs up to that value to them. Thus you will recover by your overseas trading the £1,500 costs you owe me, and which you cannot recover by sales at home.”

This is agreed to. Let us now stop to review the finances of Old Island immediately before the issue of this export credit. At that moment the corn-growers have their £1,500 clear profit. It will be remembered that they borrowed £500 originally, sold their corn for

£2,000, and repaid their loan, thus having £1,500 left. Seeing that the plough-makers are now going to be financed again by the banker, there is no need for the corn-growers to invest their profit with them. We will suppose they are going to use £500 of it to prepare the next harvest (as we assumed before), but are keeping the other £1,000 on deposit with the banker. As to the plough-makers, they owe the banker £1,500, but have no money. At this juncture the new credit of £1,500 is issued. It is paid by the banker to the plough-makers, and they, in their turn, send ploughs to New Island to that cost. (We are ignoring the question of profit.)\* If we now suppose the plough-makers to devote this £1,500 to repaying their first loan, they are now seen to be free of debt. (We will assume that they do not have to pay any of it out in current wages because, by assumption, the ploughs are the old surplus, and not current production.) So much as concerns them. The New Islanders get the ploughs and formally owe £1,500 to the Old Islanders, although for the moment they really owe it to the banker, who holds the New Island Government Bonds to that amount. Next we come to the banker. Assuming him to follow

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\* Our ignoring of the element of profit in our monetary figures may cause some readers to think that we are ignoring the question of profit itself. But remember that we are illustrating a principle and not describing a process. When the corn-growers sell their corn to the islanders, these islanders include them themselves. So you can imagine, either (1) that they have retained some of their £500 loan and distributed the remainder as wages—in which case they can buy their share of their corn when harvested; or (2) that they have distributed the whole £500—in which case they retain some of the corn and charge £500 for the rest. So long as realised profits are expended on consumption they cancel out in this manner. On the other hand, where these profits are not so expended or not wholly so, they must be noted—as we have noted them, as in the case where the £500 worth of corn was sold for £2,000.

modern banking procedure, he will not be content to tie his money up largely in bonds; it is his policy to keep money as "fluid" as possible, "in case it is wanted by his clients"! (Readers must here pretend not to know that banks can create money at will.\*) So he takes steps to float the New Island Bonds—to *get the home investment market to absorb them*—that is, he wants to get the Old Islanders to pay him back his money and take the Bonds in exchange. Now the only possible investors are the corn-growers, who have £1,000 free to spend outside their business. To them the banker goes, and he unloads Bonds on them to that value. The other £500 worth he has to keep, and they figure in his books as a *bank investment*. Next he applies the £1,000 to cancelling part of his export loan, and that money is cancelled like the other, and goes out of existence.

So now we can tabulate the position :—

The banker holds £500 value of Bonds.

The corn-growers hold £1,000 value of Bonds.

The plough-makers hold nothing, but owe nothing.

The corn-growers have £500 in hand for their business.

The New Islanders owe £1,500 to the Old Islanders.

But now we have to consider the question of the New Islanders' repayment. We will suppose that they use their ploughs on their rich soil to such good effect that they get harvests of twice the quantity of corn *per plough used* (which is a convenient way of measuring

\*We are not ignoring the objection that the banks' freedom to create credit is limited by the amount of legal tender issued by the Government. The distinction between the banks and the Government is false in the sense that the Government sets the pace to the banks; the truth is the reverse; *the banks are the Government*, and whatever amount of legal tender the political Government issues it is under the advice or the decrees of the real, the financial Government.

their success) than it is possible to raise on Old Island. What will this mean? That it will be *cheaper* to import corn from New Island than to grow it on Old Island.

Let us consider the meaning of "cheaper" in this sense. Leaving the question of money alone, it here means that more corn can be imported from New Island per plough exported than could be grown in Old Island per plough used; that for, say, twenty ploughs sent abroad the Old Islanders could get more corn than if they used the twenty ploughs at home. That is a healthy position, or might be so but for one fact, and that is (as was pointed out in our first chapter) that the Old Islanders' economic policy is *to consume as little corn as possible*. All the same, their banker's financial policy is to see that the New Islanders repay their loan (with interest); and this repayment must be received as corn from New Island—for the simple reason that that is all the New Islanders are producing. So a problem arises: if corn is to come into Old Island, and the islanders are to eat no more than before, less of it must be grown at home. But if that happens, fewer islanders will be wanted in the home corn-growing industry. This, in itself, need not necessarily be a bad thing, but, again, it must be remembered that the Old Islanders had agreed with their banker that nobody should draw a money income unless he *did some work*. So, unless they alter this rule, the importation is going to be a bad thing—it is going to deprive either all the corn-growers of a part of their income, or some of them of all their income—probably the latter. Thus the social evils of poverty and destitution will raise their heads there. This is familiar ground to everybody, and we need not elaborate the argument.

But what is not so familiar is the reactions of this situation in the purely financial region of stock and share values. The corn-growers on Old Island used £500 for their production. Let us assume that the quantity of corn being produced and consumed is nor-



mally 200 quarters, at 50s. a quarter. Now let us assume that the New Islanders are in a position to send 200 quarters across to Old Island. Suddenly someone on Old Island would become a corn importer, and he would be financed by the banker. The lowest price of corn at home being 50s. a quarter, he could import the New Islanders' corn at anything less—but let us say 40s. a quarter. We'll imagine him to offer them that price. He signs a contract, and the banker creates a credit for £400, and issues it to the importer.\* The corn comes in, and the importer offers it to the Old Islanders at just a little margin below 50s.—say, 49s. He disposes of it all for £490. But where has the £490 come from? It has come out of the £500 which the home corn-growers have been paying out for services in preparing their own harvest. So, by the time they reap their corn—which has cost them £500—the islanders have only £10 wherewith to buy home-grown corn. That marks the end of home corn-growing. Land will go out of cultivation and work will stop. And with work, income.

But what about the corn-growers' £1,000 of New Island Bonds?—their "savings"! Cannot they live on these while they are turning round to find some new job to work at? But to be "lived on," savings must be in the form of money. These savings are in Bonds. So the Bonds must be turned into money. But where are the buyers? The only money available is £10 in the hands of the islanders generally, and £90 profit the importer has got. Therefore, the maximum *market price* of the Bonds cannot exceed £100. (It may be less, if the people who have the money are not keen on buying the Bonds.) "But surely the banker will create and issue £1,000 of money, and give it to the corn-growers in exchange for the Bonds—that is only fair, seeing that he took away and destroyed money to

\* The importer uses it to pay the New Islanders. (See Chapter VII.)

that amount when he 'floated' them?" That is a common-sense suggestion. But the banker will do nothing of the kind. He may *lend* some new credit to the Bond-holders, but even so, the amount he will lend will be *less than the market price, i.e.*, less than £100. (You cannot go and borrow more money on a security to-day than you can sell it for.) So our corn-growers lose £900. Reflect back on the origin of their money, and you will see that as soon as they invested it they lost it. They thought that it would remain intact and produce interest for them, whereas, in the nature of things, the crash we have described was inevitable. Their investment was destined to put them out of a job. And the very circumstance that destroyed their job destroyed the value of their Bonds. The lesson to be learned here is that there are savings, and savings. Savings of money, *as money*, kept on current account (or even in stockings) are sure. But when money is once parted with in exchange for *something which is not money* (even if it be the giltiest of gilt-edged securities) the power to *command that sum of money* has been lost, and whether you can ever again re-exchange your non-money securities into money, and what amount of money you may be able to get back, these things are entirely dependent upon what amounts of new credit may be in circulation at future dates: and the power of deciding those amounts lies exclusively in the hands of the controllers of the credit system, and not those of the actual "savers." In practice the loss is not so steep or sudden as we have shown, but the principle is at work all the time, and its consequences can be confirmed by the actual experiences of most ordinary investors at the present time.

## VII.

## International Repayments

THERE is one point in the last phase of our illustration which the reader will require to see elaborated. It has to do with the £400 credit which the banker created and advanced to the corn importer to enable him to pay the New Island corn-growers for the consignment of corn. The point is this: What became of this £400 in the meantime? We have to show how this £400 is dealt with as between the two islands, supposing them to employ the same principles of financing their "international" trade as are employed to-day. It will be remembered that the £400 was the total cost of the corn that the importer on Old Island proposed to buy from the corn-growers on New Island. Now the clearest method of visualising the subsequent process is to imagine that the Old Island banker had previously taken his son over to New Island and put him in charge of a bank there. Then all is plain sailing. As soon as the New Island growers ship the corn they *draw a bill* for the £400 on the Old Island importer, and send it to him. This bill is in principle nothing but an unsigned I.O.U. When the importer receives it he adds his signature, thus making it *his* I.O.U., and sends it back to the New Island growers. These people then take it to their banker (our old banker's son), who *discounts* it for them; that is to say, he *creates a new credit* of £400 and pays it over to them. (The amount he pays is something less than £400—for a banker must make a profit—hence the term "discounting"; but the point may be ignored here.) The Old Island importer now owes the £400 to the New Island *banker*. In due course he settles this debt, using for the purpose the loan which his own banker had made him. He may be supposed to transfer the £400 in the form of a cheque drawn in favour of

the New Island Bank, and payable by the Old Island Bank. In any case, it will be seen that the *final* settlement for this overseas corn-transaction takes place *as between the banks* of the two islands, and not between the exporter and importer. This is typical of all international trade settlements at the present time.

At this point the New Island Banker's account is square. He had advanced £400 to the New Island exporters, and he has now received back a cheque for £400 drawn on the Old Island Banker. Now, in the ordinary way, he might let this debit and credit cancel out, thus destroying the original credit. But he has to take into consideration the fact that the proceeds of the sale of corn must be applied to the reduction of the New Islanders' bonded debt (of £1,500) to the Old Islanders. The modern method of paying off debts of this kind is to establish what is called a *sinking fund*. In the present illustration this amount of £400 would represent the first instalment of allocations to such a "fund." (Of course, it is not a fund at all: that term is merely a euphemism for an obligation to pay off the principal of a debt.) The New Island banker is in this dilemma: If he sends back the cheque to the Old Island banker to pay off and cancel £400 worth of bonds, his original advance to the New Island exporters remains unrecovered, and he must get that amount from somewhere else in order to balance his books. On the other hand, if he does not pay off the New Islanders' debt, he is putting them in the position of what is commonly called *repudiating* their national financial obligations. So he pays. In doing so, he acts, of course, in consultation with the New Island Government, in whose name the original international loan was contracted. Where, then, is the missing £400 to come from? Obviously from the Government—which is to say, from the citizens of New Island. The money must be raised by *taxation*. See what this means. It means that the whole of the revenue of the corn exporters, which naturally they

would require to use for another cycle of corn production, has to be given up again. That the money was received by only a section of the population, and is now to be yielded up by the whole population, does not affect the final result, which is that £400 of legitimate earnings of the New Islanders have to be extracted from them and cancelled out of existence by their banking system. Trade will suffer from shortage of money; unemployment will set in, together with all the evils associated with it.

Let us tabulate the position on the two islands after this has happened.

On Old Island :—

The banker holds £100 of Bonds.

The islanders have £10.

The importer has £90.

The corn-growers hold £1,000 of Bonds.

If we choose, we can go on to imagine the banker prevailing on the importer and islanders to invest their £100 in his last £100 of Bonds. In that case he would take and cancel their money; and then there would be no money on Old Island—all that would be there would be the £1,100 face value of valueless (because unsellable) Bonds.

On New Island :—

There is no money.

The New Islanders still owe £1,100 to the Old Islanders.

No more need be said to prove that international trade is in the grip, from first to last, of the banking system. The buyer in one country cannot place an order without getting an advance from his banker; the seller in another cannot execute the order unless he can discount the "bill" with his banker. Really the banking system interposes itself as the great *Middle-man*, without whose assent nothing can be done. Now this middle-man may

be made useful, but not until his accounting system is freed from the defects which we have been demonstrating.

But it is of no use to complain of these defects if you accept the economic policy under which they arise. You must first realise that such defects must persist of necessity so long as economic policy is based on the idea of restricting Consumption in order to accumulate Savings in order to finance Production. If you accept that policy as sound, you cannot challenge the defects—for then they are not defects, but efficient methods of administering the agreed policy! But we have seen that such methods result in (at first) the fleecing of the public by the producers through inflated profits, and (subsequently) the fleecing of the "profiteers" through the taking and destroying of their profits in return for "investment securities." If our general reasoning has been followed carefully, it will be realised that the *very act of investing realised profits in new production destroys to that extent the opportunity for selling that production.*

Most readers will by now be in a position to realise the necessity for an entirely new economic policy—that of *encouraging Consumption in order to remove restraints on Production.* Once that is accepted, a financial scheme to accord with it will be seen to be necessary. Such a financial scheme must embody two principles: (a) that there shall be no restriction on the amount of loan credit which can be usefully employed in production; and (b) that the remuneration of the producer shall be made to depend on the *quantity* of output he sells in his home market, and not, as now, on the price he charges for it. This means that there must be an expansion of credit without an increase in prices, or a reduction in prices without any accompanying contraction of credit. Everyone can see the theoretical possibility of this, if he will put out of his head for a moment the teachings of "sound finance." The

only condition under which an additional flow of money *must necessarily mean* a rise in prices is one where production is *already at its maximum*. But when men and machines are standing idle, with natural resources in material on one side of them, and an unsatisfied demand for the means of life on the other, the financiers' plea that to set them all at work will not increase the general well-being is clearly false. What does it come to? It is as though the banker said: "If I issue you more financial licences so that you can produce more food, clothes and shelter, these licences will not procure you any more of these things." What? Have financiers discovered a flaw in the law of the conservation of energy? Will an increase in applied energy result in no increase at all in energy-products? If an *extra* man plants an *extra potato*, will its state of *extra-ness* make it sterile—or its progeny of new potatoes inedible? Here be metaphysics! Whatever the hitherto concealed explanation of the mystery, it is evident that any community which bases its economic policy on the assumption that the financiers are right will be involved in ceaseless conflict with itself; for, as an organised body of producers, it will aim at consuming less in order to produce more, while as an aggregation of human individuals it will constantly be impelled by the love of life itself to consume all it can, and refuse to co-operate in production if its instinct to consume be frustrated. No system can persist which assumes that the prosperity of all depends upon the personal penury of each—that the Abstinence of the Citizen constitutes the Nourishment of the Community!

## VIII.

## Principles of a New System

LET us illustrate the principles of a new economic system by going back to the place where the banker first issued the new credit. We will let him issue the £1,500 again to the plough-makers, and the £500 to the corn-growers. We will again assume the total £2,000 to be passed out as wages. It will be clearer if we imagine *all* the islanders, masters and men alike as sharing this money equally as wages for service—thus ignoring the question of "profit," and that of whether one person gets more money than another as personal income, for neither question is fundamental. What *is* fundamental is the question of the ratio which the *total amount of all their money* bears to the *total amount of all their costs*. Now it is clear that, so far, the money distributed to these people is equal to their costs. There is £2,000; and there is corn costing £500, and a factory and ploughs costing £1,500.

From this point there can now be a divergence in procedure. In the earlier case the agreed policy was to limit consumption, and the financial method of enforcing it was to permit the whole £2,000 to be charged by the corn growers for their harvest, which had cost £500. Suppose we assume, now, that the new agreed policy is to promote consumption. In that case the corn could be sold to the islanders for its cost, £500, and be consumed. The growers would repay the banker £500, who would destroy the money. This would preserve the equilibrium, for the islanders would have £1,500 left, as against the plough-makers' factory and ploughs costing £1,500. If the islanders *as private individuals* desired to buy the factory and ploughs, they would be able to do so, and that would enable the plough-makers

to recover all their costs and repay the banker, who would destroy the money—whereupon everyone would be ready to start the next round. But the islanders, as consumers, do not want a factory and ploughs (remember that the ploughs, etc., in this illustration typify all goods used in production, and not articles of consumption). So we are brought to the question whether the plough-makers need have laid out so much money in their business; in other words, in what proportions should "capital" and consumable goods be produced? In the present case, if the corn-growers could make use of all the ploughs to increase their next harvest, well and good, the plough-makers would not have overdone their job. But if not, then clearly money and energy would have been applied in excess to plough-making, to the neglect of corn-growing. For the future the proportions would be altered. Now, under the old economic policy, such an alteration would be hotly resisted by the plough-makers, for if they made fewer ploughs, they would get less money. Under the new economic policy this result need not ensue, as we shall see later on; it is sufficient for the moment to point out that, even if it did, the plough-makers would at least be in no worse position than before, when they produced more, but *could not sell it*. We will leave that particular point here; it is not really important, because in framing a new economic policy the difficulty involved in it would be foreseen and guarded against by a general estimate of the aggregate needs of the community—at any rate of their first essentials of life. For instance, the requirements of Britain's population in food, clothes and shelter could be got down on paper next week, and the inventories and costs of the preparatory work a week or so after. It may sound difficult to new ears, but it is child's play compared with the wild guesses on which capitalists have to base their development programmes to-day (e.g., the cotton mill boom

and the orgy of rubber planting, followed by an orgy of rubber restriction).

To illustrate the new procedure: assume that the plough-makers have ten ploughs for disposal, and the cost of them £20 each; also that the corn-growers can use them, and therefore borrow £200 from the bank and buy them. The plough-makers receive this £200 and pay it to the banker, who destroys it and cancels their debt to that amount, leaving them still owing him £1,300, against which they still possess their factory, valued (at cost) at that amount. The corn-growers borrow a further £800 (let us say) for wages. They pay out the latter sum in the progress of their operations. The plough-makers, too, borrow £200, and lay this out in wages to make another ten ploughs to replace the others. Now count up total costs against total personal incomes on the island. Costs are:—

(1) Cost of plough-makers' factory, etc., still outstanding .....	£1,300
(2) Cost of ploughs bought by the corn-growers .....	£200
(3) Paid out by the corn-growers to the islanders .....	£800
(4) Paid out by the plough-makers to the islanders .....	£200
Total .....	<u>£2,500</u>

And the total of all money still existing in the hands of the islanders:—

Remainder left at end of first harvest.....	£1,500
Received as above (3) and (4) .....	£1,000
Total .....	<u>£2,500</u>

The equilibrium is seen to be maintained. The money resources of the community are equal to the outstanding

costs of their productive system. Two conditions operate to maintain this balance:—

- (1) That *all* new production is here being financed by means of *new credit* issued by the banker (instead of being financed out of "savings").
- (2) That the community has not hitherto been charged more for its corn than the *actual sum paid out as wages* by the corn-growers.

There has been no inflation of price, and no investment of personal income. And this has been encouraged by the banker's not having required the plough-makers to repay their loan at a faster rate than they are recovering their costs in the ordinary way of business. This banker (unlike the other) does not cancel any money except when goods to the same cost value are *consumed* by the public, or *used up and disappear* in the process of making them. (In this illustration one may consider the ploughs as wearing out in the current season.) On the other hand, it is easy to see that if the old banker came on the scene and demanded his loans back prematurely, his debtors would be obliged to ask the islanders to lend them their "savings." Really, under a system where it was the recognised procedure for the banker to make such demands, they would avoid having to borrow from the islanders in this way by charging them "all the goods would fetch," irrespective of cost. (Which explains the *necessity* for the profiteering, the building up of reserve funds, and the niggardly distribution of dividends which characterise the practice of modern companies under just these conditions.)

But now it is one thing to see the right principle of finance at work in an imaginary case, and another to apply it to a situation which has developed for so long on wrong lines. The present economic situation of modern civilisation corresponds more closely to that of the islanders at the point where they had already paid all their £2,000 for corn, and (through the destruction

of it by the banker) had no funds out of which the plough-makers could hope to recover (even indirectly) the £1,500 of costs that they had incurred. If you were to count up to-day the money "value" at cost of everything in the possession of business organisations (factories, plant, materials, unfinished and finished goods, whether consumable or not), and then count up the money in the possession of the public, there would be revealed a tremendous excess of the first item over the second. The difference would correspond exactly to the plough-makers' £1,500 irrecoverable costs. The problem is, then, how best to restore to the community this deficiency in its purchasing power—how to work up to a general equilibrium between industrial costs and private money resources.

Could it be done by issuing more credit as a loan? Let us see. Suppose that the banker *under the conditions last mentioned* creates and issues £1,500 to the corn-growers, thus enabling them to buy the whole factory and ploughs of the plough-makers. The latter could now repay the banker their old loan of that amount, and he would destroy the money. Having recovered their costs, they would be clear, and can be left out of our reckoning. The islanders, remember, have no money, and will, of course, not receive a penny of this £1,500. What they will receive will be whatever further sum the corn-growers will pay out for services—take any figure, say, £1,000. When the corn is ready for sale, the islanders will have £1,000 to spend on it, but what will be the corn-growers' *minimum* price? It will be £1,500 plus £1,000, or £2,500. So the islanders are short of £1,500, exactly as before. All that has happened has been that the irrecoverable cost of £1,500 has been merely transferred from the plough-makers to the corn-growers. Clearly, then, the loan process is a futile method of restoring the balance. Nothing would do this but the banker's decision to make a *present* of the £1,500 credit to the corn-

growers, thus enabling them to *leave that item out of their price* to the islanders, who would then have to pay simply the £1,000 they had previously earned, and no more.

Now what we have seen happen here happens every day in this and other countries. All payments made by any *business organization* to any other for materials or services merely serve to *transfer a cost standing against the public from one set of account books to another*; they never put the public in even a fractionally better position to meet that cost. The fact is not easy to observe from a survey of present-day business, but that is only because the observer would have to watch, not a single transaction, such as we have investigated, but millions of similar transactions all going on at the same time. But the principle applies to every one of them. The position can be seen in a simple general form. Lock a thousand people up in a hall without any money. Let one of them have with him a stock of dough, with a valuation put upon it of £100. The people in the hall cannot buy the dough. That is clear. Now you can (suppose you are a banker) pass into the hall any amount of credit you like, say, £1,000, as a loan to certain "producers," who propose to turn the dough into bread. These can buy the dough, and re-sell it as many times as they like, until eventually one of them turns out the bread. But if the valuation of the dough enters into the price of the bread, the price of the bread will be £1,100—£100 more than the total holdings of money. On the other hand, if (a) someone in the hall had had £100 of money when the dough came in, or (b) if you, as banker, had lent the producers £900, and given them the other £100 to "pass on to the public," the problem would not have arisen, and all the bread could have been sold.

Constantly, then, we find ourselves coming up against the necessity of issuing a certain amount of credit to the community in the form, not of loans to them as pro-

ducers, but of *gifts to them as consumers*. Now, when we say "gifts" we are straining language, for what is this "gift"? Who is the giver? Whose, ultimately, is the gift? The "gift" is, as we have seen, nothing but a licence to produce and consume—Money. The "giver" is only the person to whom the community delegate the function of making out and recording the licences—the Banker. The ownership of the "gift" is that of the community itself, to whom it is to be "given"! Really there is no "gift" at all. The gift of free credit means nothing, but that the community *supplies itself with extra licences* so as to consume goods as fast as it can produce them. And in the circumstances of the shortage of necessary licences which exists to-day, the "gift" really means a communal creation of new licences *in replacement of those which have been prematurely withdrawn and destroyed*. There is no more a question of the banker "giving" us credit than there would be of the Admiralty giving us a navy! The true place of the banking system is as a branch of the Civil Service, and it should function, like the Admiralty, in administering a national policy, and not in using its privileges to dominate national policy. It can, and should, advise on methods, but it should not dictate policy. And it should submit the reasons for its advice to the real owners of the credit it administers—the general public, whose economic activities alone give credit any meaning and any utility.

## IX.

### The Fundamental Error in Costing Production

THE veiling of the truth concerning the economic situation to-day is due to the fact that the policy of high finance on the one hand, and the policy of industrialism on the other, are diametrically opposed. And this opposition of objective is possible because two sets of

people respectively frame and administer these policies. What is required, therefore, is that the banks should be the accounting offices of the nation's industries. They should not dictate their own policy, but co-operate in a generally-approved national policy. If you were to imagine the book-keepers of every business organisation in Great Britain to form themselves into a trade union, and to announce that henceforth their union proposed to institute and standardise a certain method of keeping accounts, and that all books should contain certain rulings, and none other—you will catch a glimpse of the incongruity of the present situation. And if you go on to imagine that one of the principles of the union's proposed system of book-keeping was that all expenditure incurred on capital account in any financial period by a business house should be charged in full in its prices during *that same period*, you will get a good idea of the impossible consequences of this independent action. It would mean that any producer who installed a new machine costing £1,000, which would last for perhaps ten years, would have to get back the whole £1,000 in the current financial year. There is no business management but would laugh the whole idea out of court when put up by a book-keepers' union. Yet, when the same idea is put up by the banking system to industry as a whole, it goes through as "sound finance," and nobody dreams of challenging it. When we showed the corn-growers on the island charging the islanders £2,000 for corn which had cost £500, we were showing this very principle at work; for the £1,500 overcharge on the corn was the exact amount of the capital expenditure of the plough-makers. True that it was the corn-growers, and not the plough-makers, who actually collected from the islanders this cost of the plough factory and ploughs, but this clearly makes no difference to the fact that the islanders as a whole paid the cost of the factory and ploughs, in addition to the cost of the corn. When banking

authorities say, as they do, that expansion of credit must necessarily cause expansion of current prices, they are really saying that new capital expenditure must necessarily be paid back by the public as and when it is being incurred—which is exactly what we imagined the book-keepers' union to say. That would be tolerable only if the capital expenditure, when once it had been so paid back by the public, was not charged again later on. But since it is going to be charged again, it is intolerable. If the public gets £2,000 for producing £2,000 worth of factories, plant and consumable goods, and pays the whole £2,000 for the consumable goods alone, it cannot afford to pay a penny piece in the future on account of the factories and plant. The factories and plant must work free of charge, or if not, new free credit must be issued to the public to meet the charge, whatever it is. You can have it either way, but it must be one of these ways.

The distinction between payments made by an industrial organisation (a) to its shareholders and employees, and (b) to other industrial organisations for goods and services is vital. The money "a," when the recipients spend it on consumable goods, *destroys costs*—that is, it reduces the general aggregate amount of unrecovered costs, and so reduces the burden on future prices. But the money "b" only destroys a *particular cost* in the books of the firm which receives it, while it *creates a new one* of the same dimensions in the books of the firm which pays it. As Captain Adams puts it in his *Real Wealth and Financial Poverty*:—"Moreover, it cannot be contended that the money paid away to other organisations has been distributed as purchasing power to individuals. . . . The accounting system is double-entry, and under present conditions failure to maintain the system means insolvency. Therefore, if it is assumed that the £17,542 paid to other firms is entered as sales (or income) by those firms, then equally the £37,867 received from other firms must be entered



elsewhere as costs, and the deficiency of purchasing power is merely moved from one point to another."

The writer is here discussing the analysis of a typical trading account, where it appeared that the firm in question had collected a gross revenue of £37,867, and had paid away to other firms for materials, fuel and so on £17,542. He concludes thus:—"The money issued to other organisations, if distributed by them as purchasing power (*i.e.*, to individuals who will spend it on consumable goods) is included in another cost, and received in another price, in a manner precisely similar to the account here analysed."

This process was illustrated when we imagined the corn-growers buying ploughs and trying to recover their cost in the price of corn. We showed that this would only be possible if at the time the ploughs were sold to the corn-growers, the islanders had *got in their pockets sufficient money to buy the ploughs themselves* if they had wanted to. But since the sum of money necessary for that purpose had been already cancelled by the banker, the ultimate purchase of all the corn was impossible when *any part* of the cost of the ploughs was included in the price of the corn. And this is exactly the situation of the general public under the operation of the price system of the present day.

We are accustomed to the spectacle of the workman "downing tools," and to the sound of violent tirades against direct action; but how few realise that behind it all lies another silent and unnoticed "direct action"—or shall we call it "direct inaction"?—of the consumer. Come into any retail shop and watch. A woman comes in. "How much is that kettle?" she inquires. "Four and sixpence, madam." "Oh! that's too much; I can't afford it"—and goes out. No political purpose in that act of renunciation—no intrigue against the "Constitution"—but, nevertheless, a hold-up of industry by the process of "down purses." It is this woman's financial impotence which is the cause of strikes and

lock-outs. Such phenomena are so many squirms and wriggles of the industrial system to squeeze a price of four-and-sixpence down to this woman's (say) three-and-sixpence. Her husband goes on strike in the hope of putting the missing shilling in her purse, or his master locks him out in the hope of taking the extra shilling off his price.

Clearly the present system of costing and pricing is powerless to settle the problem, and an entirely new principle of distributing purchasing power must be applied.

## X.

### The Case for "Consumer" Credits

WE will now consider the principles of the remedy for the defects that have been revealed in our analysis.

Consider first the implications of the capital development shown in our illustration. We saw that the islanders as a community produced in a certain period of time £1,500 worth of factory and ploughs, and £500 worth of corn. For doing this they received as remuneration £2,000 between them. The "worth" here is a reflection of the cost—£2,000. But the existence of something of "worth" does not connote the co-existence of purchasing power equivalent to that "worth." *This distinction is vital.* Money is Measurement. The money system is a practically costless system of measurements. The term, for instance, "£100" does not express anything concrete at all, any more than if you used the term "100 yards" or "100 tons." It is a measurement of energy expended on past-production, or (in the case of new creations of money by the banks) a measurement of energy about to be expended on fresh production. Hence, the familiar cry, "Where is the money to come from?" has as much or as little meaning as would be the cry, "Where are the tons to

come from? " If all the *physical* elements required for production are present (man-labour, materials, machinery and so forth), any *financial* limitation placed on the full use of these elements is senseless, and the belief in the necessity for such limitation an illusion. To say that the unemployed cannot be put to work, or that our quarter-time factory output cannot be raised to whole-time output because of the *expense* is just like saying, "We could make a thousand yards more of serge, *only we have no yards left*"!! Pursuing this idea, it is to be noted that if all the factors in national production (labour, material, etc.) were in a form in which they could be measured by length, *we could make yards, feet, and inches our money notation*. The only reason we have to reckon in pounds, shillings and pence is because we have to measure simultaneously, not only yards, but tons, bushels, gallons, cubic feet, electric units, as well as abstract things like services. There is one qualification, which is that the Money measure does not measure *the same quantity or volume of goods or services at all times*. But this does not alter the fact that Money is Measurement. It is a matter of common knowledge that the *purchasing power* of Money is liable to constant alteration through variations of price. But this variation can be allowed for, even under the imagined system of lineal measurement. For instance, a draper (in certain cases) has not only to say that a material is so much a yard, but to inform his lady customer what is the width of it. So if she used yards as money—had a "one-yard note" to spend—the purchasing power of her yard would vary according as the material were a foot, a yard, or more, wide. In this case her whole interest would be in what *area* of material she would get for each lineal yard measured off. So the analogy between Money and Length is closer than it seemed.

Now let us apply this idea of length and area to the islanders' production. Since the plough factory and

ploughs are going to be used up gradually in quickening the future production of corn, we may consider them as representing so much *unfinished corn*—corn not yet ready for consumption. To make this clearer we must remind ourselves that the islanders *could have* grown four times as much corn as they did if they had not made the factory and ploughs. If they had produced £2,000 worth of corn, and still only consumed £500 worth, the remaining corn would correspond to the factory and ploughs. And if you suppose that this remaining corn was not immediately edible, but would gradually become so in the future, you will grasp the idea that the factory and ploughs are, in principle, unfinished corn.

Now let us make a picture. Imagine the *total* production of the islanders to come out of a slot in a continuous strip of (say) dough, four feet wide. It is coming out at the rate of 500 feet an hour. Thus the total *area* of dough made per hour is 2,000 square feet. Next suppose that as it comes out a knife divides the continuous strip into two, one of them one foot wide, and the other three feet wide. The narrower strip is consumable dough, but the wider strip is dough not yet consumable.

Now for the money side of the situation. Suppose the islanders are receiving £2,000 per hour for making the dough. Suppose also that as they expend this money it goes back to the banker, and is destroyed (as we have previously seen). Now in the first hour only the narrow strip is of any use to them. Let them spend their £2,000 on this. And the next hour the same, and so on. Thus, every hour, £2,000 of money is created, distributed, spent and destroyed; and every hour 2,000 square feet of dough appears, and a quarter of it consumed, so that 1,500 square feet are rolled up and saved every hour. But at the end of every hour there is no money in existence, so that there is a constant

hourly accumulation of dough which is unpurchasable by the islanders.

Now the problem is, what is the best way of making this accumulating dough purchasable as and when it shall become consumable? To begin with, let us apply our money measure to the process. In the first hour the total production is measured by the sum of £2,000, and the total consumption by £500 (*not* £2,000; that was the sum surrendered—which is another matter altogether). Put it another way. Every hour 2,000 square feet are produced, and 500 square feet consumed. Whichever way you measure it, the essential result is this—that *production is going on at four times the rate of consumption.*

Now what follows demands close attention, but this attention is worth while. We have imagined the wider strip of dough to be gradually becoming consumable. To aid the imagination, let us imagine that it comes out black, and that it will turn grey, and then white—at which point it is ready to be consumed. Let us suppose that this change requires three hours. First hour, black; second hour, grey; third hour, white. Now let us watch from the beginning the sequence and character of the production and accumulation:—

First hour :	1,500 square feet black dough ; 500 square feet white .....	2,000
Second hour :	(1,500 square feet grey dough) 1,500 square feet black ; 500 square feet white .....	3,500
Third hour :	(1,500 square feet white dough ; 1,500 square feet grey) 1,500 square feet black ; 500 square feet white .....	5,000
Fourth hour :	(3,000 square feet white dough ; 1,500 square feet grey) 1,500 square feet black ; 500 square feet white .....	6,500

Fifth hour : (4,500 square feet white dough ;  
1,500 square feet grey)  
1,500 square feet black ; 500 square feet white .....

8,000

The figures in parentheses show the accumulations of unpurchased dough brought forward from previous periods. Now it will be seen that in the third hour the white dough made (as black dough) in the first hour is ready for consumption, and that thereafter it is accumulating at the rate of 1,500 square feet each hour. The islanders can now *safely* consume *all* of this as it accumulates, because *every hour* there is *an additional* 1,500 square feet of black and 1,500 square feet of grey dough in existence and being carried forward to be consumed later.

To keep pace with this accumulation, the islanders will have to increase their consumption from 500 square feet to 2,000 square feet. They must eat four times as much. Four times! We spoke of a multiple of four just now. In what connection? When we measured up the ratio of *all* production to actual consumption, and showed that production was going on at four times the rate of consumption. So it is clear that in such a situation the *rate* of consumption may be increased so that it equals the *rate* of production, *without endangering the means of future consumption.*

But how are we to bring this about? The islanders are drawing £2,000 per hour, and begin by paying it all away for 500 square feet. Somehow we have now to make this £2,000 stretch over 2,000 square feet. In other words, the purchasing power of their money must be made four times as great—each £1 must buy four times as much. Now there is only one way of making £1 buy four times as much, and that is by *dividing the price of dough by 4*. Hitherto the price of dough has been £4 per square foot (*i.e.*, 500 square feet divided into £2,000). Now it must be £1 per square foot.

## XI.

**Financial Credit Belongs to the Public**  
**The "National Dividend"**

WE can now leave this particular illustration, and in order to apply our conclusions in practice go back to our original illustration.

We will interview the banker on the island. We address him somewhat as follows:—

"Sir,—We wish to speak to you about the condition of these islanders. They are at the end of their first period of production. They have put up a factory and made ploughs costing £1,500. They have grown corn costing £500, which they have eaten. Of the credit which you created and lent to them to do this work, namely, £2,000, you have received back and destroyed £500. The other £1,500 is in the hands of the corn-growers. As against this, you have a debt charge against the plough-makers. Now, supposing the plough-makers sell their stock of ploughs to the corn-growers for £1,500, they will have to use the money to pay you back, and you will then cancel it. For the moment no money will be in existence. Suppose, next, that the corn-growers borrow £500 of you to pay out in wages. The total cost of the corn they produce will be £2,000. But the only money the islanders will have to spend on corn will be £500.

"Now we find that the corn-growers can quadruple their production of corn with the aid of these ploughs, but if they do they will be able to sell only a quarter of it. So unless something is done they will not try to grow any more—and in any case they will drop £1,500. You will observe that the whole dilemma arises because of your definite cancellation of this sum. We therefore suggest that you re-create it and use it to make up the deficiency. There is no need to adopt the awkward

method of distributing it among the islanders; the easiest way is to pay it to the corn-growers, instructing them to take an equivalent discount from their price. Thus they would sell corn to consumers *at one-quarter its nominal cost*, and would receive from you a free grant of the other three-quarters. You must not think you are *giving* anything for nothing. You must regard this £1,500 as representing the unconsumed production of the islanders during the period just ended.

"Now as to the accounting of the transaction. This must be done on a new principle. Your accounts should reflect the real situation on the island. At present you only record what money is out, and what money comes back from your customers, and you are always on the itch to get it back (and cancel it) at the quickest possible moment, as though the prosperity of the island depended on money being scarce. Now suppose you had begun on the new system. When you advanced the £2,000 you would have *debited* the plough and corn enterprises just as before, but at the same time you would have opened an account in the name of the community in general, and therein *credited* them corporately with the same sum. That surprises you. But consider. What were the producers doing? Making real wealth—increasing values. 'But,' you will reply, 'the community also used the money for consumption.' Precisely. And that is when you *debit* them. Well, and what did they consume? £500 worth of corn? So you would have debited them with £500. That would have ended the first period. Your book balance would then have shown the island to be in credit (let us say, entitled to possess credit) to the amount of £1,500. For the first time in your life your books would reflect the true situation, for on the island there would exist a factory and ploughs of that value which had not existed before. Under your old system you would have shown exactly the opposite. This £1,500 would have been treated as a debt due from the island. But now

the credit would be *theirs*, and should only be withdrawn and cancelled as and when they actually consumed, wasted, wore out, or otherwise destroyed the real wealth which it represented. Conversely, on the same principle, suppose the existing value of £1,500 was all in the form of ploughs, and that the corn-growers used them carelessly so that they were all damaged beyond repair at the next harvest. In that case (ignoring other circumstances) the island as a whole would have to be debited with £1,500—which would mean that it would lose its possession of that credit.

“Of course, you would keep the accounts of your individual clients as you do now, but with this difference, that you would not need to worry their loans back from them, except when the state of your national account rendered this advisable—an almost unthinkable contingency, short of a natural catastrophe. There is nothing to be afraid of. In a national sense *no money can ever be lost*. The only loss possible is wasted energy—the making of things which nobody wants. The money, as such, always exists somewhere.”

The possibilities opened up by the application of such a policy to an advanced industrial State like Britain are stupendous. Count up the cost value of all our existing plant and machinery—our railways, canals, mines, ships, factories, etc., and then regard the sum involved as *financial credit due to the community* instead of a capital debt which the general body of consumers must yet defray in prices. That is the meaning of our analysis. The money does not exist, but it can be brought into existence, and circulated as wanted, and applied to supplement the current earnings of every citizen in the country, and, not less important, to provide an adequate income to every citizen whose services to industry are not required owing to the constant adoption of new labour-saving devices. As an

instance, the whole body of unemployed could (if the nation wished) be paid £4 or £5 a week for life—and wages on top of this if ever they were again required to work. But the concept cannot be adequately expressed in terms of money alone—what is so tremendous is the vast acceleration of output which science can bring about, and would already have brought about had it not been for the fact that the labour which it would have displaced as a result would be left without an income, and would have become an extra charge on the incomes of those still left in their jobs. Remove this handicap by distributing our communal credit inheritance, and there would be a reduction of prices quickly reaching one-quarter, and in no long time a tenth, and less, of those ruling now—while all the time money incomes would be at least maintained at their present level.

It has sometimes been objected that you cannot multiply consumption by four, five or ten; and the reason given is that there is a limit to the amount of foodstuffs that can be made available. Well, there is a lot to be said in reply from the point of view of agricultural potentialities; but leaving all that on one side, the answer we emphasise is that the actual demand for foodstuffs would not go up to any appreciable extent. To suggest that just because purchasing power went up four times, eating and drinking would be quadrupled is nonsense. The fact is that the total consumption of food in this country is, on the whole, not far less than it would be if we were all four times as prosperous as we are. It must be remembered that, somehow or other, the poorest of our population are even now being fed up to the survival level, and nobody normally needs to eat much more. The deficiency of food among those who had insufficient would, if made up to a sufficiency, come to a surprisingly small *aggregate quantity*. No; where the new demand would be concentrated would be on the stages above that of slow-growing organic production; it would be on the stages where power and machines

are transforming inexhaustible and ever-ready inorganic material into means of welfare.

Another reply would be that we do not necessarily press for *consumption* to be multiplied by the same figure as would multiply *purchasing power*. A community put in the position to buy four times as much might choose to produce and consume, say, only twice as much, and *halve the time it spent in producing*. Its "dividend" would be in terms of *Leisure* as well as of *Goods*.

We may now state, in principle, what should be done to induce all this new production and consumption by financial methods.

(1) All new production must be financed by new credit.

The necessity of this has been demonstrated. We have shown the paralysing effects of re-investments of profits (and the same would equally apply to the investments out of wages or salaries), and the only alternative to this is to use exclusively new credit for production.

(2) Of this new production, part will be in an unconsumable form, and part consumable. Only the part actually consumed shall be charged against the original credit.

These principles, applied to our illustration, would be obeyed if the banker issued £2,000 as we saw him do at first. Now let us make a new supposition, *viz.*, that the plough-makers had made £1,500 worth of ploughs without building a factory. Let us suppose that their stock of ploughs was sufficient to keep the corn-growers supplied during the next ten periods. Next suppose the corn-growers to produce £500 worth of corn in the first period, and sell it for £2,000, as before. Now in the next ten periods the corn-growers will be buying ploughs with their surplus profit of £1,500, at the rate of £150 in each period, and, as we have already seen, will have to add this figure to the wage cost (£500) of

each period's corn production, and will have to charge the islanders £650, while the islanders will have only £500 to meet the charge. The ploughs used, we shall assume, wear completely out in each period. What the banker has now to do is to adjust his *money figures* in future so that they reflect the appearance and disappearance of what we will call the island's *stock*. At first his figures do this. At the end of the first period (just before the corn is consumed) he has £2,000 outstanding loans against the producers, and the producers hold intact the ploughs and corn which have cost them that £2,000 in wages to themselves and their employees (how it is divided between them does not matter).

Before going further, let us emphasise the fact that while this £2,000 is a *debit against the producers*, it is at the same time a *credit in favour of the islanders* as a body. A bank loan to a producer is an advance made by the banker *as an agent for the community*. So the loan is fundamentally an advance made by the *whole* community to *that section of them* called producers. So the banker appears in two capacities. He has created new credit as an agent for the whole community, and has, therefore, to see that he ultimately gets it back from the particular producers to whom he has entrusted its use. Therefore the credit is a *producer liability*. But equally the banker, in so creating and loaning such credit, has made himself liable to the community, whose credit it really is. Therefore the credit is a *communal asset*. What the producer owes to the bank, the bank owes to the community. The logic of this would appear manifest to everyone if there were instituted a Consumers' Bank, which alone had the right to create credit, and the banking system as we now know it had to borrow this credit from the Consumers' Bank in order to loan it out to producers; for in the ledger of the Consumers' Bank the credit would represent (at first by anticipation) new national assets in goods and plant, whereas in that of the banking system it would repre

sent, as it does now, a producer-liability to return the credit.\* There would, under this dual scheme, be no objection to the banking system recovering the credit as fast as it could (provided it did not dislocate industrial co-operation), because, instead of destroying the credit, which it does at present, it would have to pass it back to the Consumers' Bank to be dealt with as the controllers of that bank—acting in the interests of the community—decided. Supposing that there had been an original advance of £2,000, and that the banking system now returned the whole £2,000 to the Consumers' Bank, the directors of the latter bank, if they acted on sound lines, would not say, "Let us cancel out the loan and the repayment," but would say, "Let us estimate *how much of this £2,000 ought to be cancelled.*" To do that, they would make a record of what

\* But someone may object that the producer may go and waste money by failing to produce what he intended to, or by producing goods which are useless to anybody. In that case, where is the "asset"? The answer is, of course, that there is no asset. Certain *things* would have appeared, but as they had no economic utility they would have to be disregarded—that is to say, they would have to be dealt with in a sound national accounting system as though they *had been consumed or destroyed.* How this will be done appears later. But note that this failure of a particular producer to apply the credit usefully *does not destroy the credit itself.* It only means that he has paid it away to other producers and to employees for materials and services, and now cannot recover it in prices. But it still exists in the general circulation of credit. Really, all that has been *lost* has been energy—work. Finally, as a normal process, only a very small proportion of the *total* issue of credit would be misused in this way. Then, again, it is not correct to regard it indiscriminately as misused. Credits expended in research and other experimental work, even though immediately they create nothing of practical use to the public, and have to be written off in current accounts, will ultimately add to the general *knowledge* and lead to improvements in process. We progress by trial and error, so must incur the wastage caused by the errors; for the "waste" on a long view is a necessary part of development.

*things* had been produced with the aid of the loan, and what *things* had been consumed and destroyed in the same period. Whatever the proportion of physical consumption was to total physical production, the £2,000 would be reduced in that same proportion. Supposing one-quarter of the production had been consumed. Then one-quarter of the credit would be cancelled. That would leave £1,500 of credit still in existence, answering to the amount of still existing production. This credit would be in the possession of the Consumers' Bank. Therefore it could re-issue that credit as a free credit to the general public. Not necessarily all at once, but as and when the existing surplus production entered into the consumable stage, and its cost was accounted\* by the producers in with other elements of cost to make their total price to the consumer. Note that we do not put forward the Consumers' Bank as a scheme; we do so only to help the reader to discriminate between the two aspects of credit. The *administration* of both principles can quite well take place within the present banking system; all that is essential is that *the two principles themselves shall be accepted and applied together.*

So now let us go on with our illustration. In each period the corn-growers would borrow £500 from the banker for wages, and would pay £150 of their own

\* There is an important fact to be emphasised here. If "A" borrows £2,000 and uses it to put up a factory, afterwards works this factory and recovers the amount of the loan in profits, and then repays the bank, he has not *wiped out the cost* of the factory, he has only *wiped out the bank loan* on it. His repayment of the bank advance represents *to him* the purchase of a factory. He has now put *his own money* into the factory, i.e., he enters the repayment as a cost, and will proceed to account this cost by instalments in all his future prices. But the public, having defrayed the bank loan in prices paid to "A," cannot now pay for the factory through future prices. This difficulty is, as we show, met by the issue of the free credit by the Consumers' Bank.

money to the plough-makers. The plough-makers would pay the £150 to the banker, who would write it off his original loan to them of £1,500, until at the end of the tenth period the whole loan would be extinguished. Each £150 of credit would be destroyed by the banker as he received it. Here we see the banker in his rôle of a creditor of the producers, getting back from them the credit *belonging to the consumers*. Now his destroying it is quite sound so far. But he must also act in his other rôle of debtor to the islanders. The items of £150 belong to *them*, for when the banker created the original £1,500 he did so as their agent; further, the credit was valueless as an aid to production without the general co-operation of the islanders. So the whole point now is: Do the islanders require to make use of this money? Clearly they do, for at the end of each period they want £150 in addition to their earnings of £500 in order to be able to pay the £650 which the corn-growers must ask for the corn. So the banker must re-create the destroyed credit and issue it to them. Whether he gives the money directly to them, or to the corn-growers conditionally on their selling their corn for £500, is immaterial in theory, although, as we have previously said, the latter alternative is easier in practice.

By this method it will be seen that what the banker is doing is to restore to the islanders, period by period, a part of their loss in the first period when the development of the plough industry caused inflation of corn prices. And that is the rationale of the New Economic proposals. Apply them, for instance, to the War Debt. A certain number of British subjects hold titles to receive £7,000,000,000 from the whole community. These titles correspond to the corn-growers' title to receive back (altogether) £1,500 from the islanders. But the total amount of money in the possession of the British public is somewhere about £2,000,000,000. This corresponds to the position of the islanders who,

at no time, had more than £500 to spend. The remedy in the one case is the remedy in the other. Either new free credit must be issued to the British public, or else the purchasing power of what credit they have must be made equivalent to that represented by the War Debt. Or to use our illustration—the public must be given £150, or else £150 must be taken off their cost of living. And so with all existing capital charges, and all money costs of *such past production as still survives*.

In conclusion. Remark particularly that at the time we write (September, 1925) not a single one of the many credit reformist programmes which are being popularised touches the fundamental defect in the system. Some of them advocate larger issues of loan credit by the banks. (The proposal to abolish the Gold Standard is not an end in itself, but a means to make more loan credit available.) Others advocate lower interest—some of them suggest even no interest at all. Of the limitation of profits, the elimination of the middle man, and other subordinate issues, we will not speak. But the shortest reflection should show the reader that, even if credit were to be lent free of interest, and in a much expanded volume, and if producers limited profits to a generally-approved margin—these reforms would not of themselves solve the problem of the disparity between Price and general Purchasing Power. Throughout our analyses we have shown this disparity to arise irrespective of interest, and irrespective of the quantity of credit in circulation. There remains a plausible case for limiting *profits*, but their limitation *under prevailing conditions* would only mean that wage and salary earners would become the investing class instead of the “profiteers,” for remember that the current concept is that the development of industry depends upon investments out of personal incomes, and to the extent you forbid your “capitalist” to accumulate investment funds by “profiteering” you must of necessity look to wage and salary earners to provide the



money instead. We have shown at length that the application of personal earnings (however derived) to financing new production is wrong in principle, is unnecessary, and leads to a financial vacuum in which the productive process soon becomes exhausted.

Current attempts to patch up the system go to support the diagnosis that we have put forward. They can be comprehensively described as the Dole system. Firstly, workmen are supplied with money while waiting for opportunities to work; and more recently, the coal industry is being supplied with the same while waiting for opportunities to execute orders. In a short time we shall hear Agriculture crying out for the subsidy. Now all the excitement and fears expressed in reference to this tendency depend upon the false assumption that this money now going out is a *loan*, and must be repaid later on in taxation and cancelled. All the preparations being made for the expected Capital-Labour struggle arise from the same belief, and are so many manoeuvres by rival interests to escape the burden of repayment. But the true line to take is to say, not "Who shall repay the subsidy?" but "Need the subsidy be repaid?" We press the view that the dole or subsidy need never be repaid, but that both should be regarded as a belated payment to the public on account of the stupendous hidden debt of credit owed to them by their financial agent, the banking system. There is only one objection to the present "subsidies"—*we are not every one of us sharing in them*. The distribution is partial, when it ought to be general. And when it becomes general, we have only to discard its obsolete and false name of "subsidy" and "dole," and to clothe it with its scientific name and economic vestment—*The National Dividend*.

The Veil of Finance will have been lifted.