THE DOUGLAS THEORY

A Reply to
Mr. J. A. Hobson

By
Major C. H. DOUGLAS

Author of

"Credit Power and Democracy,"
"Economic Democracy," etc.

LONDON: CECIL PALMER
Oakley House, Bloomsbury Street
W.C.1

SIXPENCE NET.

The DOUGLAS THEORY

A Reply to
Mr. J. A. Hobson

By

Major C. H. DOUGLAS

Author of

"Credit Power and Democracy,"
"Economic Democracy," etc.

LONDON: CECIL PALMER
Oakley House, Bloomsbury Street
W.C.1

The Douglas Theory: A Reply to Mr. J. A. Hobson

IN dealing with Mr. J. A. Hobson's criticism of my theories on Credit, it seems desirable to follow the order which he himself employs. This order is:—

(1) The general implication of the theory.

(2) An examination of certain details of the analysis.

(3) A "destructive" criticism of the remedial proposals based on (2).

(1) It is to be noted that, as might be expected from a critic possessing Mr. Hobson's qualifications, there is no disagreement with my statement that the root factor in the whole industrial crisis and problem is lack of effective demand.

But at this point the fundamental divergence begins. In his own explanation of the acknowledged fact, he says, "I trace this failure, not to any lack of the monetary power to purchase all the commodities that could be produced, but to the refusal of those in possession of this power of purchase to apply enough of it in buying consumables, *because they prefer to apply it in buying non-consumables, in other words, to buying capital goods.*" (My italics.)

This represents a radical cleavage, the static versus dynamic cleavage of attack on the problem. Mr. Hobson regards it as an explanation; I would present it to him as a fact arising out of a defective credit system.

Considered as an explanation, it carries the implication that it "ought" not to be so, that improvement demands its elimination; it leads to the assumption that, e.g., the financial system is reasonably blameless, and only man is vile. That, again, leads to the conclusion that all our troubles are due to a bad Governmental and administrative personnel, and if only Mr. Clynes in Parliament, and Mr. Thomas on the railways could be put into power, all would be well.

Considered as a fact, it is one of the many premises of which to take cognisance in suggesting methods by which to achieve the greatest enhancement of opportunity of the greatest number. In other words, both Mr. Hobson and I see a world whose financial mechanism is failing to deliver the goods. Mr. Hobson implies that a change in the nature of the steam which provides the motive force is required; I suggest that the valve gear wants re-designing. Both theories are conceivably tenable; it is a matter for personal judgment as to which line of action is likely to produce the earlier result.

(2) (a) "the central charge is that a large part of the money representing the cost of production, and helping to swell the selling prices, is not available to buy the articles produced. . . . etc."

(b) "The second and more fundamental reason is that large advances of bank credit are utilised by manufacturers and enter into the prices of the final product. . . ."

Mr. Hobson says in regard to (2) (a): "Now the fallacy of this argument might, I think, be apparent from the preposterous nature of the assertion that only a few per cent. of the price value is available as effective demand"; and in regard to (2) (b): "In point of fact, it is not true that the bank advances, by which the business men at the various processes financed their trade, are costs which enter final prices."

In regard to objection (2) (a), it is a simple statement of fact to say that as the majority of the working population are wage earners, paid weekly, and spending within a few per cent. of the whole of their week's wages in the current week, it is a physical impossibility for the wages of the current week to buy the production of the current week; it is not in the market to buy. It probably will not come into the market, on the average, for at least six months. They are buying the production, or part of the production, of a fairly long past week, by drawing on the purchasing power which goes to make up the costs of an unspecified quantity and variety of goods which will be delivered sometime in the future. To reiterate categorically, the theorem criticised by Mr. Hobson : the wages, salaries and dividends distributed during a given period do not, and cannot, buy the production of that period; that production can only be bought, i.e., distributed, under present conditions by a draft, and an increasing draft, on the purchasing power distributed in respect of future production, and this latter is mainly and increasingly derived from financial credit created by the banks.

But further, because the general level of prices above cost is equal to money/goods, these drafts on future production still further raise present prices, hence general increased production under present conditions means either rising prices (instead of falling prices) or unemployment and failure of distribution. Prices cannot fall below cost plus a minimum profit, under present conditions, since profit forms the inducement to produce.

To put it another way, the rate at which money can be spent this week does not depend at all on the goods which can be, and are, supplied this week, and is not part of the cost of the goods which can be supplied this week. An increase in the money paid this week is identical with any other form of money inflation under present circumstances—it widens effective demand, stimulates production, and raises prices. The real price paid for the *consumable goods* bought this week is approximately a week's production of both capital and consumable goods (including exports) to be supplied at some future, and increasingly future, date, and there is nothing in the arrangement which guarantees that a larger amount of *consumable* goods per head can be bought in the future as a result of a larger amount of money distributed this week, *vide* the war period.

Now I do not suppose that Mr. Hobson will, on consideration, question these statements, but it is quite clear that he does not appreciate their importance. He does not appear to see that it results in the whole production of the country, both tangible and intangible, whatever its magnitude and however strenuous the conditions under which it is produced, being paid for by the concrete consumption of the country over the same period of time, and that there is no direct relation (although there is a most important indirect relation) between these two. Fundamentally, under the present financial arrangements, the price paid for anything is what it will fetch; and the price paid in purchasing power to the community as a whole, by the financial system as a whole, for its co-operation in production does not depend primarily on the production or the productive capacity at all—it depends on what purchasing power the individuals who form the community will accept, i.e., how much money they can acquire *and* what prices they will agree to pay, for that part of the production they want to buy. The community of individuals unquestionably sets a very low price on its co-operation, i.e., it will agree to a very unfavourable ratio of money to prices, a price which does not give it purchasing power over more than a fraction of total production.

(2) (b). I do not understand what Mr. Hobson means by this. He himself explains in his next paragraph that bank credits are used by manufacturers "to pay wages, salaries and dividends to producers of raw materials, plant, etc." If these have not gone into costs, where have they gone?

I do see clearly, however, that again the purely static conception of the question has evoked his comment, as evidenced in the tenses used in the paragraph to which reference has last been made. There is implicit in his argument the idea that a bank only lends its own and its customers' money. A bank lends new money; to quote Sir Edward Holden, the late Managing Director of the London City and Midland Bank—"Bank loans create bank deposits." Space will not allow of the treatment of this most important question, and there is already a considerable literature on the subject. The rise in the figures of total bank deposits during the past twenty years proves the dynamic theory up to the hilt, if any proof is needed. I suppose Mr. Hobson would not contend that it does not matter from where, in its cycle of revolution, money originates, for if he does so contend, I shall at once demand his assistance in setting up a bank-note factory!

At this point it may be convenient to deal with what, in effect, is Mr. Hobson's definition of credit. It is so important that it seems desirable to quote it in full. He says, ". . . Credit can only work by reason of the prior production of a surplus stock of food, clothing, etc., reserved from consumption by those who owned it and might have consumed it but preferred to 'save' it and to make a store which could enable these more lengthy processes of production to be financed and rendered economically possible. The credit furnished by bankers draws on this stock of savings. The bankers do not, indeed, themselves own these stocks of real savings; they get them mostly from depositors and lend them out as 'credits,' taking as their charge for the utility of this service the difference between the interest paid to them by their customers and that paid by them to their depositors."

Unfortunately, like so many of these "simple," "intelligible" (i.e., familiar) "explanations of the part played by bank credit in financing trade" it is not, I think, even approximately correct. If it were, I should agree that "it furnishes no support to the Douglas Theory."

So far as Mr. Hobson's own explanation is concerned, a moment's consideration will show that a bank loan does not form a draft on the specific goods in the possession of the bank's depositors; it simply acts, during the second portion of its cycle, in which it is being returned to the banks through the medium of prices, as a diluent of existing claims on goods, belonging to the community as a whole and not to the bank's depositors in particular. Bank money will buy any goods, not merely the goods the bank's depositors are alleged to have "saved."

But it is much more important to realise what part credit does play, than what it is not.

A banker lends credit, which is not his, but public property, because he expects to get something; in his case, interest. An employer, in his turn, lends the credit (wages, salaries) because he expects to get something, production, from which he will get profits. The individual consents to work for money, which derives from credit, because he expects to get goods, which to him are profits. So far from the modern large-scale credit system resting solely on a basis of "savings," as Mr. Hobson would suggest—on something done in the past—it rests more and more on a correct estimate of something to be delivered in the future. "Faith (belief, credit) is the substance of things hoped for, the evidence of things not seen." That is a succinct statement of the part played by credit in the psychology of production.

The conception advanced by Mr. Hobson is, of course, exactly that which the banker would like the public to accept, and which, no doubt, quite a large number of the rank and file of bankers themselves take for granted. It suggests that banking is simply a private pawnbroking transaction between borrower and lender. This is, unfortunately, not true. The question of collateral security, which may or may not be present, is quite immaterial; every credit transaction definitely affects the interests of every person in the credit area concerned, either through the agency of prices, or by the diversion of the energies available for production purposes. Incidentally, this is not an argument for nationalised banking, which, like all "nationalisation," is an administrative measure, it is an argument for socialised credit.

Mr. Hobson's criticisms of the concrete proposal put forward in 1919 in the Draft Scheme for the Mining Industry really rest on his conception of the real basis of credit.

He says, ". . . such a Producers' Bank might work . . . if (the prime essential) enough of the money paid in were left for a considerable time undrawn." This is exactly the same argument as that employed by those tragically mistaken persons who said that the First World War could not last three months as no country had the money for a lengthier period. The war lasted more than four years; and in 1918 every country, except, possibly, Russia, which had destroyed the operation of credit, had more money, and, what is much more important, more productive capacity, than when it began. The "prime essential" of the workability of a bank founded on the

Mining Industry is not what "savings" it can hold; it is that those connected with it are able to affect, by affecting co-operation, "the correct estimate of something to be delivered in the future," which the community desires, e.g., coal. The question of the "money" in the bank is a mechanical question, just as the provision of more currency to finance war production was a mechanical question, solved, even if badly solved, in seven days. I do not say that the problem is a trivial one; it is not. But it is in no sense fundamental.

In other words, the real essential basis of credit is not money; it is the capacity to *deliver* (not merely to produce) goods and services; which involves the agreement to co-operate of the whole community.

In regard to the last paragraph of Mr. Hobson's article, the answer is substantially that "the whole market price" paid by the existing banks for their use of public credit is simply a very small part of the purchasing power value of that credit. The proposed banks use their whole credit power for the benefit of their depositors.

There is no incentive to thrift provided by the Scheme for the simple reason that, in my opinion, monetary thrift is a wholly ineffective method of achieving the economic security at which, presumably, it aims. The wealth of a community is increased by spending, not by saving—an apparent paradox with which on consideration I feel sure Mr. Hobson will agree. What is true of the community would be true of the individual if the results of his spending accrued to him, which at present they do not.

C. H. Douglas.

Printed by National Labour Press, Ltd., 8 Johnson's Court, Fleet St., E C. 4; also at Manchester and Leicester.—11358

Reprinted from
THE SOCIALIST REVIEW
with permission of
the Editor.