The A + B Theorem

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[The following article examines the A + B Theorem of Major Douglas and deals specially with Mr. Gaitskell's criticisms in *What Everybody Wants to Know About Money* and in THE NEW AGE of February 28, 1935.]

It is easy to exaggerate the importance of the theorem, and it might even be claimed that the devotion of too much attention to it is playing right into the hands of our opponents. For they will always prefer to contest a difficult and abstruse topic rather than fight on a field where the plain facts of everyday life bear witness to the inadequacy of the orthodox arguments. A good example of this attitude lies close to hand. In *The Engineer* of June 7 and 14, 1935, appeared an attack on Douglas Social Credit by Dr. W. H. Coates, Ph.D. Dr. Coates' criticism, when it was a criticism (I say this deliberately, because a good half of his article consisted of an excellent description of the working of the banking system, with which no Social Crediter would disagree), dealt almost entirely with theoretical considerations. Towards the conclusion of his article he said: —

If Major Douglas' allegation is fundamentally wrong, as it is here suggested that it is, and as every serious student of monetary matters has found it, then there is little need to enter into any detailed examination of the methods by which Major Douglas proposes to distribute additional purchasing power, which shall at the same time either bring about a fall of prices, or, if no fall of prices is required, shall place in the hands of individuals additional purchasing power and shall at the same time so harmonise with our existing monetary system that it causes no inflation.
And Dr. Coates was as good as his word: he did not enter into any detailed examination of Major Douglas’ proposals.

The A + B Theorem can be expressed as follows:

A factory or other productive organisation has, besides, its economic function as a producer of goods, a financial object—it may be regarded on the one hand as a device for the distribution of purchasing power to individuals, through the media of wages, salaries, and dividends; and on the other hand as a manufactory of prices--financial values. From this standpoint its payments may be divided into two groups:

GROUP A — All payments made to individuals, (wages, salaries, and dividends).

GROUP B. — All payments made to other organisations (raw materials, bank charges, and other external costs).

Now the rate of flow of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of flow of prices cannot be less than A + B. Since A will not purchase A + B a proportion of the product at least equivalent to B must be distributed by a form of purchasing power which is not comprised in the description grouped under A.

We do not have to look very far to find evidence that the existing monetary system is distorted, and in particular that there is to-day a deficiency of purchasing power. The following phenomena lend support to that view: –

(a) The fact that the difficulty nowadays is to sell, not to produce.
(b) The fact that all countries, including creditor nations, are trying to export more than they import.
(c) The fact that debt is continually mounting up.
(d) The fact that national schemes which are physically possible, i.e., the men, materials, power, food to feed the workers, etc. are, all there, are scotched because the "cost" is too great.
(e) The fact that the schemes which are put into operation are only made possible by the aid of loans. Purchasing power of the future is distrained upon to meet a
cost which is physically liquidated at the time the scheme is done.

(f) The fact that physically possible plans to spread work all break down on the barrier of cost.

(g) The fact of poverty in conjunction with unemployment. If there is insufficient wealth in the world there ought to be plenty of opportunity to increase wealth, \textit{i.e.}, labour ought to have a high saleable value, and there ought to be little unemployment.

(h) The fact that the total incomes of the country are distributed equally to all, the amount available for each family is about £270 per annum. It is estimated that in America on a physical basis the income available for each family could be about £1,000 per annum, and in this country it should not be much less.

So we see that rightly or wrongly the A + B Theorem does explain the facts.

The above phenomena are exactly what one would expect to find if the theorem were true. We have here, however, only a verification of the theorem, not a proof. When we come to the theorem itself we are up against the difficulty of making clear exactly where the money which does not appear as purchasing power goes. This is a point which may easily be slurred over, and yet no matter how one juggles with A and B, with diagrams and 200, 400, 600, \textit{etc.}, the inquirer will feel that something is eluding him, even though he may be unable to put his finger on anything wrong in the explanation, if he cannot see where the gap is. Now the places where the lost purchasing power is hidden are not really far to seek. I will put them into three categories which are really only different forms of the same thing: 1. Saving by the Public; 2. Bank and Company Reserves; and 3. Accumulations of Capital. In the following discussion I shall show how each of these factors in turn causes a disparity to occur between the money available to buy goods and the costs of those goods.

1. \textit{Saving by the Public}. I am here referring to net saving, \textit{i.e.}, the balance of new saving over the spending of past savings. If the public has exactly the correct amount of purchasing power to meet the costs of goods
which emerge on the market and some member of the public saves, then there is immediately a deficiency. This applies equally whether the saving takes the form of hoarding, leaving money on deposit or purchasing securities. There is not likely to be much doubt of this as regards the first two forms, but the last requires some investigation. A member of the public may buy securities either from a bank or from some other member of the public. If he purchases from a bank his money is cancelled out of existence. The bank wipes off an asset on one side of its accounts and a cash liability, *i.e.*, the public's money, on the other side. If he purchases from another member of the public then as the second member does not spend his receipts on consumable goods (which is the spending of past savings which I have specifically excluded) he must use it in his turn either to hoard, to leave on deposit, or to purchase securities from a bank. He may perhaps use it to repay an overdraft. This has exactly the same effect of making a gap between purchasing power and costs. Thus to take a specific example a manufacturer uses an overdraft to build a factory. The money passes via contractors into the hands of the public and may be considered to be the very money that is later saved. The manufacturer floats a company, issues shares and repays the overdraft with the proceeds of the sale of the shares. The money and the overdraft are now cancelled. The manufacturer has, however, to recover the cost of the factory in the prices of the goods made. The saving has thus caused a deficiency of purchasing power. Make no mistake; it is not merely depreciation which has to be recovered. I agree that depreciation costs may be re-issued as payments for keeping the factory in good order. The money value of the shares has sooner or later to be recovered. The public's saving has really become transformed into an accumulation of capital, and this point will be considered in more detail under heading 3.

2. *Bank and Company Reserves.* Here again a specific example will show best how the deficiency of purchasing power arises. Suppose a bank lends a manufacturer £1,000 and demands £1050 back at the end of a year. Where is the extra £50 to come from? There is
only one source. It must have formed the contra to a loan of £50 made to some other manufacturer. When the £50 is collected through the first manufacturer there is left £50 debt for which no money exists. But some of the £50 will be returned to the public, for, say, as interest on the accounts of some of the recipients of the £1,000 before it was drawn back and repaid, £30, say, as bank wages, salaries and general renewal expenses, and £5, say, as dividends to shareholders. But there will always be a residuum, say, £5, which will be held back and not returned to anybody. It will be put to reserve or used for writing down the bank's assets. Whichever use is made of it the same result holds. Somebody owes a loan of £5 to a bank, to meet which no money exists in the country. This £5 will appear as costs in the price of somebody's goods because that is the only way in which the debtor can endeavour to get himself out of debt. Hence costs of goods on sale will be £5 more than there is money in the country, and the price cannot be reduced without the manufacturer going bankrupt. It should be noted also that the reserve may or may not be shown in the bank's accounts, i.e., it may be shown as a direct allocation to reserves or, alternatively, it may be hidden by being used to write down the book value of the bank's assets. It is well known that banks have large hidden reserves.

A company reserve is a charge in the prices of goods which is not distributed as wages, salaries, and dividends. A deficiency of purchasing power as compared with costs results just as when the public saves. The difference is that saving by the public serves to decrease the money available to buy goods without reducing their price, whereas the building up of reserves increases the price of goods without adding to the public's purchasing power.

It may be argued that the money saved will be available later on as purchasing power. This may be so, but it will be too late; the damage will already have been done. The reserve will be utilised, it is true, not, however, to supplement incomes, but to write off capital or write down book values which have been lost because of the earlier deficiency of purchasing
power. We have, in fact, a pretty little vicious circle. The reserves are formed or the savings are made in order to provide for possible unfortunate contingencies. A train of causes and effects is thereby set into operation which has the inevitable consequence of bringing into being those very unfortunate contingencies which were to be provided against.

3. Accumulation of Capital. How is capital accumulated (by which I mean money capital), and where does it come from? If gold is mined and brought to this country, fresh money has entered and can be used to form capital. But there is many times the amount of capital in the country than there is gold. Where else can it come from? To a limited extent the Treasury can make money by the issue of silver coins, such as Jubilee crowns. But this is not enough. In the main the money to form capital can only come as the credit entry which balances debt to the banks. Now the distinguishing feature of capital is that it is money used primarily not for the purpose of helping the distribution of goods and services, but for obtaining a control of the means of production so that it can increase itself. To take an example of how the accumulation of capital causes a deficiency of purchasing power, consider a manufacturer who has accumulated profit which he has placed to reserve and who now wishes to extend his factory. In the first place, by accumulating his reserve he took from the public more money than he had distributed. When he builds his extension he distributes the reserve and makes good the public's inherent deficiency of money. But he has built an extension to his factory, and he will endeavour to collect the cost of the extension in the price of the goods made by the factory. This is irrespective of depreciation, which may be immediately distributed as payment for renewals. The position is similar to the one described at the end of the discussion on saving by the public. But the money cannot be collected (except at the temporary expense of somebody else) because it has never been distributed. Yet the factory has value, and should form a good basis for the expansion of capital. We have in fact the capitalist's dilemma. He
is trying to accumulate capital in the form of money, which money can only be formed as the contra to a bank loan and which must therefore go into somebody's costs. But there is nothing available to meet the costs except the capital, which cannot be used for that purpose without being "eaten," the capitalist's nightmare. The discussion at this point may seem to have travelled some way from pure A + B, and yet this aspect is fundamental and must be brought to light before we can really get hold of the theorem. Now there are only two ways out of the dilemma, the Marxist way and the Social Credit way. It is subconscious appreciation of this fact which causes the vitriolic opposition to Social Credit from Communists. The Marxist way out is to disrupt the whole capitalist system (in practice this has not been found to be easy, vide Russia, where capitalism is creeping back). The bourgeois Social Crediter, however, sees no objection to the accumulation of capital so long as (1) the lack of buying ability caused by the accumulation of capital can be overcome, and (2) the ownership of capital can be diffused. Now these two objectives are attained by the National Dividend, the first by paying the National Dividend out of new creations of credit and the second by distributing the National Dividend equally to all. Irrespective of particular remedies, however, the A + B Theorem has reference to what is happening now; the attempt to accumulate capital with its attendant effect of causing a deficiency of purchasing power is most certainly occurring.

The above general discussion forms an essential background to the A + B Theorem in the form that Major Douglas presents it. I propose now to discuss the various interpretations placed upon the Theorem by Gaitskell in What Everybody Wants to Know About Money. Mr. Gaitskell is one of the members of the committee selected by the Labour Party to state the Labour attitude towards Social Credit, and I deal specially with his attack on Douglas Social Credit because it is probably the best criticism that has yet been made of the A + B Theorem, and because it is extensively quoted by other opponents of Social Credit.

In order to examine the theorem with reference to
something concrete, Gaitskell considers the production of woollen cloth in five stages. He uses the following diagram: —

This diagram has two meanings. It may either represent the successive stages of the production and retailing of a certain amount of cloth, or it may represent different stages, occurring simultaneously in the production of five amounts of cloth. In THE NEW AGE of December 28, 1933, Adamson embodied these two meanings in the following elaboration of Gaitskell's diagram. Each period is assumed to be of equal duration and cost, and A payments are made during each stage to those engaged in industry.

Now in the first place the diagrams are incomplete. The B costs only refer to money which has already been paid out in the earlier stages of production. They ignore the factors of saving, reserves and accumulation of capital which are going on all the time. Furthermore, all the A payments in the diagram are distributed in advance of the marketing of the goods. In real life, dividends are distributed afterwards. Although the factors
omitted are of importance in a later interpretation of the A + B Theorem, it will be convenient to ignore this now.

It we look at Adamson's diagram, we observe that in periods $a$, $b$, $c$, $d$, $A$ payments amounting to 2,000 are distributed. It is not until period $e$ that the final consumable goods costing 1,000 come on the market. Now what happens to the 2,000 distributed in advance of production? Does it form a fund which can be drawn upon to make good any deficiency of money which may subsequently arise? The answer is no. It is absorbed in past savings, reserves and accumulations of capital, and in normal circumstances is not available as purchasing power of the consuming public. From the period $e$ onwards, therefore, the diagram has in it a deficiency of money and it is not surprising that this deficiency may emerge later on. The Douglas A + B Theorem in its first (and according to Gaitskell, most absurd) interpretation is simply another way of exposing the underlying

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ACCOUNTING PERIODS

T1, T2, T3.

**Accounting Periods.**

TIME.
deficiency. Consider what Douglas says, "Now the rate of flow of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of flow of prices cannot be less than A + B." Take period $f$. The distribution of A payments is 1,000. The costs added to all the goods which are in course of production in the same period are $200 + 400 + 600 + 800 + 1,000 = 3,000$. There is here a deficiency of 2,000, and this deficiency will emerge later on as an actual deficiency between A payments and the costs of final consumable goods as can be seen by tracing out the subsequent history of the goods which were in course of production in period $f$. The following diagram gives this subsequent history:

Total A payments $1,000 + 800 + 600 + 400 + 200 = 3,000$.
Total costs of final consumable articles $1,000 + 4,000 = 5,000$ which shows a deficiency of 2,000 between A payments and the costs of final consumable articles. The posi-
tion in the above diagram is obtained from that considered in period \( f \) (namely, total A payments 1,000, total A + B costs 3,000)

by adding 800 A payments in period \( g \) 
by adding 600 A payments in period \( h \) 
by adding 400 A payments in period \( i \) 
by adding 200 A payments in period \( j \) 

\{ 
\text{which also add into costs of final consumable articles.} 
\}

Thus we get as A payments the original 1,000 A payments distributed in period \( f \) plus \((800 + 600 + 400 + 200)\) added subsequently = 1,000 + 2,000 = 3,000, and we get as costs of final consumable articles the original 3,000 A + B costs added in period \( j \) plus \((800 + 600 + 400 + 200)\) added subsequently = 3,000 + 2,000 = 5,000. The diagram above is exactly the same as would be obtained if fresh production ceased from period \( g \) onwards, and industry were allowed to run down. But it is not necessary to consider that this happens because any fresh production started in period \( g \), and thereafter, is self-liquidating in the ideal conditions depicted in the diagram, \textit{i.e.}, the A payments distributed by this fresh production total up to the costs of the final product. The issue of these new A payments will, of course, precede that of the final consumable articles, and it is these new A payments which make good the deficiency inherent in preceding production.

It may be argued that Douglas proves too much. If the A + B costs in period \( f \) are 3,000, whilst the A payments are 1,000, then exactly the same is true of period \( g \). Hence after period \( g \) there is a deficiency of 4,000, which cannot be justified either as being inherent in the diagram or as emerging later on if we consider the subsequent history of the production carried on in periods \( f \) and \( g \). There is, however, a flaw in this argument. Between periods \( f \) and \( g \) certain costs of period \( f \) are liquidated in period \( g \). Thus 200 passes from the spinner to the farmer, \textit{i.e.}, the spinning B cost of period \( g \) wipes out the farming A cost of period \( f \). Likewise the 400 weaving B cost of period \( g \) disposes of the spinning A + B costs of period \( f \), and so on. Hence costs amounting to \( 200 + 400 + 600 + 800 = \)

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2,000 of period \( f \) are met in period \( g \), and hence the deficiencies of periods \( f \) and \( g \) combined are only \((3,000 - 1,000) + (3,000 - 1,000) - 2,000 = 2,000\) as before. (Of course in the real world as opposed to the ideal world of the diagram the deficiency at a later period may be greater than that at an earlier period by virtue of new saving, reserves and accumulation of capital.) The clue to the difficulty now being discussed is that the deficiency shown by subtracting the A payments distributed in a period from the A + B costs added to production in that period measures the total deficiency up to that period inherent in the industrial system. The deficiencies shown in any two periods cannot be added together, for the A + B Theorem applied to a later period merely restates the position as at an earlier period, plus any fresh sources of deficiency which may have occurred in the interim.

The interpretation of the A + B Theorem discussed above is the one where A means the payments made to individuals in all stages of production, semi-finished goods as well as finished goods, and B means the payments made to institutions in all stages of production. That A is less than A + B is a direct arithmetical inequality. It has been shown that A plus B is added to costs in a form that will emerge later in the prices of final consumable goods. An actual deficiency of purchasing power may be masked by the issue in advance of the marketing of the goods of A payments for new production. If for any reason the new production is stopped or slowed up the deficiency of purchasing power must be revealed.

Now though all this is unquestionably true and is the way in which Major Douglas first perceived the A + B Theorem (some Social Crediters would say that no-one has any right to place any other meaning on the theorem), it is open to a critic to contend that although a deficiency may be inherent it will never emerge unless new production is stopped, and we have no right to assume that such will happen. Indeed, in a perfectly steady state of self-repeating movement, new production most certainly will not be stopped. The critic, goes on to say that the A + B Theorem, to be of any importance, must com-
pare A payments distributed in a period with the A + B costs of final consumable goods distributed in that period. It is untrue to say here that A is less than A + B as a direct arithmetical inequality. If we turn to the diagram we see that in every period from e onwards the A costs distributed, namely five payments of 200, are equal to the A + B costs, namely 1,000, of the final consumable goods emerging in the period.

Now this is really not surprising since the diagram was evolved with the object of giving that result. We cannot, however, leave the diagram any longer in its elementary form. Let us bring it more into touch with reality by allocating in each stage a B cost which is not simply the cost of the preceding operations. Let us assume that a cost of 10 is charged to reserves in each stage, which reserve may be accumulated to provide for unfortunate contingencies or may later on be crystallised into capital.

Gaitskell's diagram takes the form:—

Now if this were extended into an Adamson diagram just as it stands, there would be a deficiency of 50 in
each period. But we will go further and see what form the diagram must take in order that the A payments distributed during each period shall equal the costs of consumable goods emerging in that period. The ratios between the A and B payments will be kept the same for all periods, namely equal to 19/1 for the farmer, 19/21 for the spinner, etc., but the amounts will not necessarily be the same in each period.

The following diagram gives a possible sequence of operations:

![Diagram]

[For those who are mathematically inclined it may be stated that each diagonal column running from left to right is formed by multiplying the preceding diagonal column by 1.0256494, the root of the equation 190 (1 + X + X^2 + X^3 + X^4) = 1,000.]

While the above diagram does not claim to do anything more than give an indication of the kind of thing that must happen in each period if A payments distributed are to be equal to the costs of consumable goods, it does bring out the important fact that in order that
the economic system should be kept working it is essential that goods in the earlier stages (or, alternatively, for more advanced forms of production, capital goods) should be produced in ever-increasing quantity. As soon as the creation of capital goods slackens, costs exceed money distributed, i.e., the consumer is unable to purchase the consumable goods coming on the market.

Note that this second form of the A + B Theorem does not state in so many words that in every period money distributed cannot be equal to the costs of goods coming on the market; it merely gives the conditions necessary for such to happen. But we are immediately faced with two questions: 1. Is it really necessary or desirable that before we can consume what we can produce we must heap up a mountain of capital goods which may or may not be required later on? 2. Can the Banks be depended on to finance this constant increase of capital goods? The answer to both these questions is, NO!, and as regards the second question in particular, whilst the Banks maintain their present practice of determining the upper limit of their advances to industry by the following rules: (a) Deposits shall not exceed ten times cash, and (b) Direct loans to Industry shall not exceed 50 per cent. of deposits, then their possible advances are limited by the amount of gold in the vaults of the Bank of England (assuming the fiduciary issue is not altered).

It should be noticed how neatly the two forms of the A + B Theorem fit in with one another. The first shows that there is an inherent deficiency of money in the industrial system which deficiency is only prevented from coming to light by reason of the wages and salaries distributed by new production in advance of the marketing of the new goods. The second form shows how it is increasingly difficult to mask Industry's bankruptcy in this manner.

Now let us take Mr. Gaitskell's five interpretations of the A + B Theorem in detail. They are (What Everybody Wants to Know About Money, p. 368):

"1. Understanding prices to mean the prices of consumption goods, A to mean total A payments, A + B to mean total A plus total B payments, the statement 'A is less than A + B' is clearly true.
Nevertheless, this is unimportant, since we should not expect consumers to have to pay to the retailer the aggregate of all costs, but only the aggregate of the retailer's costs.

"2. The simple argument that A is less than A + B is not self-evident as soon as we realise that A (standing alone) represents total A payments and that A standing with B represents only the retailer's A payments.

"3. The argument that, while the retailer's costs are made up of A payments made in the past, these A payments are not available at the time when the commodity is ready for sale is seen to be untrue so long as production is continuous and there is not on balance a constant tendency for the volume of bank credit to diminish.

"4. If costs be understood to mean the costs of all goods, including semi-manufactured goods and raw materials, then it is true that consumers' incomes—A payments—will not cover them. But at the same time it is not necessary that they should. For in the demand for all goods we can include all B as well as A payments. To say that the possibility of continuing these payments depends on the existence of Bank Loans is true, but does not indicate any 'deficiency.'

"5. If the formula be abandoned in favour of a statement to the effect that 'deficiency' arises out of depreciation charges, then it will be seen that even this is not true providing that workers are employed in replacing the machinery and receive A payments equivalent to the B depreciation charges. Nevertheless, constant capital accumulation makes a certain tendency to deficiency probable. For at any moment the depreciation charges made by industry will tend to exceed the actual sums spent on 'replacement' machinery to the extent that there are new machines against which depreciation is charged but which are not yet being replaced. This appears to be the only case out of all those cited by Major Douglas in which a tendency to 'deficiency' may actually be said to exist. It is one of many factors which have to be considered in any examination of the velocity of circulation of money."
1. and 4. are really different ways of expressing the same idea. A and B refer to all goods produced, and A is less than A + B. Gaitskell considers it unimportant that A + B actually is added to costs in the period of time considered. The whole matter has been dealt with in detail earlier as the first form of the A + B Theorem.

2. has been dealt with fully as the second form of the A + B Theorem.

3. What Gaitskell means is that A payments of the past are made good by an equivalent amount of A payments of the present for fresh production. This is, however no answer to the contention that the past A payments were absorbed in making good savings, reserves and accumulation of capital. The A payments for new production merely mask the underlying deficiency.

5. Gaitskell here grants one of the points made in this note, namely, that the accumulation of capital causes a deficiency of purchasing power.

It would be impossible to study Mr. Gaitskell's articles without realising that he has appreciated and considered many of the points made in this note. Although I come to the conclusion that the A + B Theorem is accurate and is a useful aid to the proper understanding of what is happening in the world to-day, whereas Mr. Gaitskell comes to the opposite opinion, yet I realise that the difference between us is largely psychological and depends more on the goal to which we are consciously or unconsciously aiming than on the aspects of the subjects we are examining. Thus Mr. Gaitskell sees more harm in the maldistribution of incomes (vide his "Nobody can help observing the grave social consequences which may follow continual attempts to lower money wages") than in any possible total deficiency that may arise, whereas I see the reverse. The truth is that both views are important. There are individuals in receipt of incomes higher than any to which they can justly claim to deserve. Such individuals are forced to save, and are thereby a cause of deficiency of buying ability. But saving by a relatively few rich individuals is only a minor cause of deficiency of purchasing power. I could almost subscribe to the maldistribution theory if the hidden re-
sources of institutions were reckoned the major part of the money badly distributed, but I should still question whether even under that theory, the true remedy is to raid all those hidden stores of credit; it may be better to make good the deficiency out of new credits. The danger, and a very serious one, of measures such as high and discriminatory taxation designed only to level out the existing incomes of private individuals is that by ignoring the main cause of the trouble they may only serve to enslave the few who are still free of the Money Power without appreciably improving the lot of the others. But a "levelling" remedy such as the National Dividend which also makes good the total deficiency of personal incomes is in an altogether higher class. It is my hope that the foregoing note will enable opponents of Social Credit to perceive the truth of the much-maligned A + B Theorem.

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