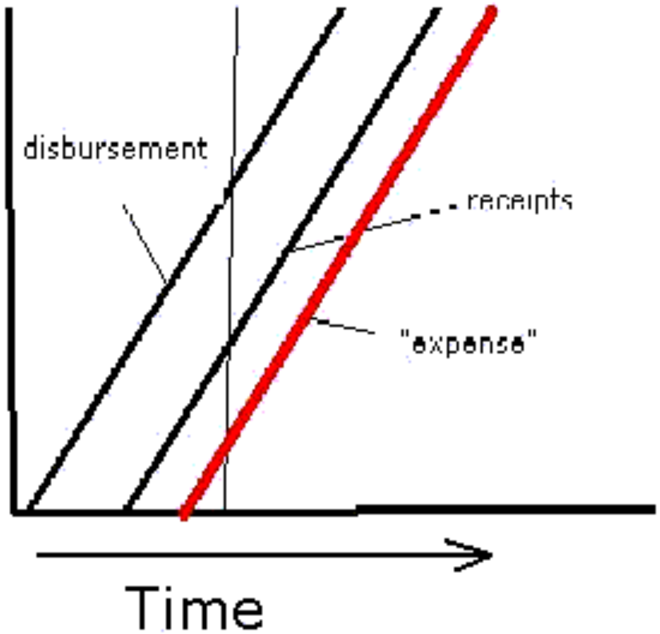
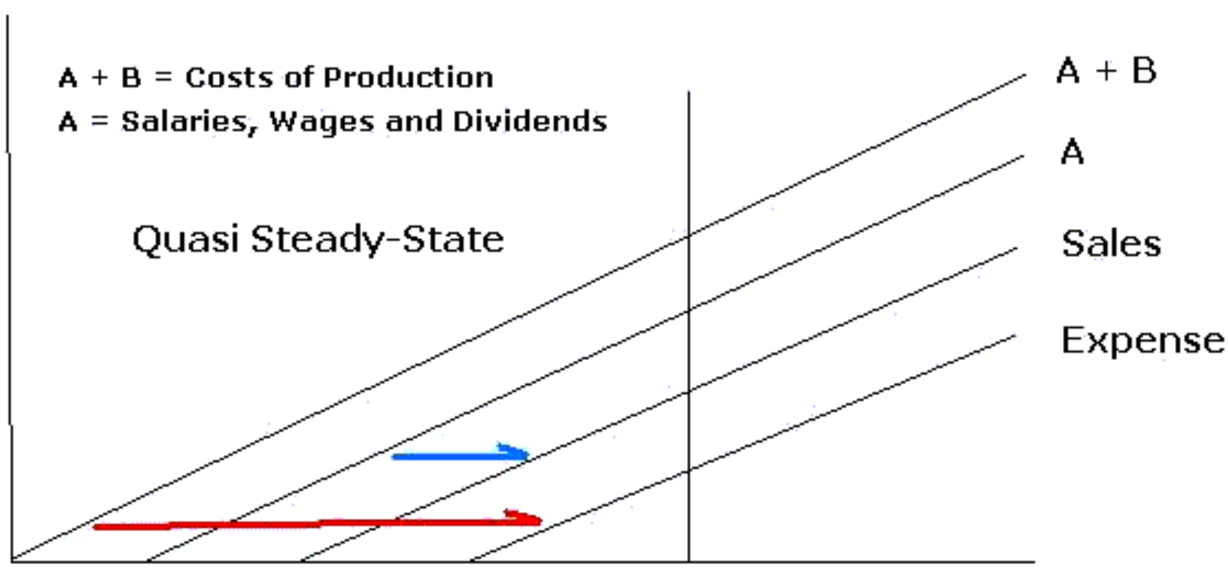
Comments regarding the Social Credit A + B Theorem and its implications.

By William B. Ryan



The accrual accounting "expense" curve is the cash disbursement curve pushed or delayed into the future through the "capitalization" of as many disbursements as possible and the "depreciation" of "assets" acquired through those disbursements for as long a period of time as possible. The result is that what would have been a negative number: *Receipts - Disbursement* (inferred by M->C->M') is transformed into a positive number: *Receipts - Expense = Profit*. The method makes a great deal of logical sense except the determination of what is capitalized and the length chosen for the period of depreciation are quite arbitrary. No better method of accounting could have been devised during an era when accountants did not recognize negative numbers and had not yet discovered the fluxional calculus.



The expense curve is the costs of production curve delayed through time by the conventions of accrual accounting.

The sales curve into final consumption is in "reflux" to the salaries, wages and dividends curve.

(Bill Ryan:-) During the period of expansion, the process of depreciation has the effect of increasing the rate of profit. During the period of contraction, it has the effect of decreasing the rate of profit.

This is separate and apart from the phenomenon addressed by Major C. H. Douglas's A + B theorem,which is where the ratio of A payments--in long term tendency--is falling in respect of A + B, representing a *falling rate of profit" because the reflux from A through sales must be falling in respect of A + B, the costs of production.

The accounting rate of profit therefore has only a cursory relationship to the hypothetical concept of real profit. The concept of "economic profit" presented by economists is something quite different. Besides, economic profit is impossible to measure, and therefore cannot serve as a guide to entrepreneurs and their financiers in determining the course and direction of production. Accounting profit can do that, so long as we realize it is an imperfect algorithm subject to rational adjustment, which is what we do through Social Credit remedies like the National Dividend and Retail Discount.

The "falling rate of profit" as explained by A + B is false information being reported by double entry accounting, that is always causing the entrepreneurs and their financiers to be shifting their resources into other endeavours, and thereby always resulting in the destruction and waste of real productive capacity.

(Bill Ryan:-) I would say that the real problem is more than labor displacement. I think the primary argument against the present system is its instability.

To address that, I do not favour scrapping the present system and replacing it with something else. In various "reformist" circles that something else would be a one hundred percent reserve "Greenback" system (there are "reformists" who believe the monetary base should be gold and not greenbacks), and in other circles would be some kind of "zero interest" system.

I happen to believe that fractional reserve banking is a marvellous system that is nonetheless not perfect. The utility of fractional reserve banking is under appreciated for its role in enabling the development of modern industrial civilization. I doubt that industrial civilization could have developed and been sustained without it.

The imperfections of fractional reserve banking can be addressed through "Populist" measures of public oversight and regulation. Our policy objective should be to sustain the condition of the permanent boom. I do not believe that the "bust" is the necessary result of the boom.

During the period of expansion there is no "gap" between "prices" and "purchasing power." But, because of labor displacement, the rate of profit is always falling. That fall is always inducing the entrepreneurs and their financiers to pull back from current projects and invest their resources into new projects. That inducement has no relationship to changes in the real factors of production. Real demand is not falling. The apparent fall in demand is entirely the result of the flaw in accounting as is demonstrated through the A + B theorem. But the flaw in accounting is continually inducing the entrepreneurs and their financiers to scrap and thereby waste real productive capacity.

(Bill Ryan:-) Assets are depreciated over time, presumably as they are "used up" or "wear out." In actuality depreciation schedules have little relationship to real usage or wear, but are quite arbitrary. They are however a method to allocate the acquisition costs of assets over time rather than at the time of acquisition. You must admit there is a great deal of logic to this. It would be foolish to "expense" the full cost of a machine tool, for example, at the time of its acquisition. That would understate the rate of profit during a period of investment for a particular firm, and overstate profit in subsequent periods.

I am much more concerned with the effects of depreciation for the economy as a whole rather than its effects for any specific firm. For the economy as a whole, it and other accounting techniques have the effect of *delaying* the expensing of the macroeconomic disbursements curve such that it is expensed against a future receipts curve, where sales are greater than current costs. This has the effect, in an expanding economy, of turning what would otherwise be a negative number into a positive rate of profit.

But in a contracting economy, this has the effect of "expensing" greater past costs against lower current sales, mandating accounting loss even if there is no real loss.

There is no solution to this dilemma directly within the rules of accounting,which pertain to individual firms.

But we may apply accounting adjustment to the economy as a whole, in the form of the National Dividend and Retail Discount [Compensated Price].

(Other Poster:-)
It appears to me that the problem with depreciation is a macro-economic problem, since the consumer is forced to pay for an asset after its completion. This would suggest that the price of goods for sale to the consumer could be reduced by at least the amount of all depreciation charges that the consumer is asked to pay.

(Bill Ryan:-) The problem has its roots in historic cost accounting. It is not amenable to changing the rules of accounting. It is however amenable to macroeconomic accounting adjustment. Accountants must depreciate the actual nominal cost of the asset when purchased. They are not allowed to depreciate a lower or a higher cost. So during the period of credit contraction, depreciated costs which when added to current costs will always exceed sales, when considered as flows, resulting in a continuing accounting loss. This is regardless of the fact that real profit may be constant or actually increasing. But we can add to sales and thereby profits in ways that do not increase the costs of production through the National Dividend and Retail Discount programs. This has the effect of increasing the accounting rate of profit to bring it more in line with hypothetical real profit. Otherwise, a declining rate of accounting profit will cause the entrepreneurs and their financiers to pinch off production perpetually short of the intersection of productive capacity and real demand.

The A + B phenomenon is an effective credit contraction, in that more and more of the flow of bank credit is accumulating as working capital balances in the firms sector itself, with the broadening and lengthening to the structure of production with advancing technology and organization, thereby appearing in costs that are not commensurately reflected in consumer income. So the reflux through retail sales from the costs of production is falling in respect to the costs of production.

The corrective measure for the A + B phenomenon is exactly the same as for overt credit contractions.

Overt credit contractions are the result of structural instabilities in the financial system, and are normally relatively short term phenomena. In principle they are preventable through financial reform and better oversight and regulation.

The A + B phenomenon is long term, relating to the unrelenting displacement of labor, the result of continual advance in science and technology, and improved systems of organization.

(Bill Ryan:-) This (comment above from Other Poster) would seem to say that the "gap" between prices and purchasing power is equal to depreciation. But depreciation actually lowers prices in relation to purchasing power during periods of growth. It increases prices in relation to purchasing power during periods of contraction.

Double entry accounting does not actually measure profit. While we can think of profit we have no way of measuring it in absolute terms. Double entry accounting is an algorithm that relates current investment against future sales. If an individual entrepreneur's profit is increasing by this measure, he is satisfying the demands of his customers, and his credit standing with his financiers and the community is increasing.

When there is labor displacement, real profit is increasing, because productive capacity is increasing per unit being inputted. But rather than reporting a generally increasing rate of profit, the flaw in accounting reports a falling rate of profit--exactly opposite the real facts. So real productive capacity is continually being scrapped and suppressed as entrepreneurs are responding to the false information being reported to them.

The system of accounting is intimately connected with the mechanism of finance,which is an integral component of the system of accounting. It can be reformed fundamentally only through accounting adjustment at the level of the economy as a whole.

We [Social Crediters] do that through the National Dividend and Retail Discount [Compensated Price].

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