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.

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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 implements 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 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?

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

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 Westerns 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