

Mr Hawtrey's Giraffe

Part II

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IV

THE much-abused but resilient A + B theorem is still a thorn in Mr. Hawtrey's flesh, and he has what he evidently regards as a new and devastating criticism to make, since he makes it twice; once in the introduction to his book,¹ and again in the chapter devoted to Social Credit. The argument is so neatly condensed in the introduction that it will serve well here to open the subject. This is what he says:

"The concept of a deficiency of purchasing power, on which the whole fabric of Social Credit is built, means two different things, and not merely different, but contrary. At one stage it means an excess of money over goods and a consequent dilution of purchasing power by a rise of price; at another stage it means an excess of goods over money. The tacit assumption in the mind of the supporter of social credit is that, if the excess of money over goods co-exists with the excess of goods over money, the deficiency of purchasing power is doubled. With this impregnable redoubt in the background the conflicts over the outworks are mere skirmishes. All the arguments of the orthodox economist are put out of court because he has missed this fundamental principle."

Dear Mr. Hawtrey. That last sentence is meant to be sarcastic, of course, but what a funny thing the subconscious is. Perhaps he had a fleeting memory of having said something three years before which contradicted his new argument. It is a fact that in his debate with Major Douglas at Birmingham he gave a brief outline of the best orthodox account of how goods and services are produced and distributed, while money is created, issued, withdrawn and destroyed, with a description of a period of inflation followed by deflation. It would be tempting to 560 criticise this account, particularly where he begged the whole question which was being debated in one crisp sentence: "Payments by one trader to another cancel out." But we are concerned here only with the concluding sentence:

"This account of the relation of the credit system to productive activity differs from that of Major Douglas in that it reaches the conclusion that an excess of demand IS just as likely to occur as a deficiency."

Careful comparison of this conclusion with the new argument discloses that Mr. Hawtrey has discovered that the A + B theorem does take into account an "excess of demand," but that (oh, horror!) it treats it as a dilution of purchasing power. This Social Credit is even worse than he thought it was. The curious thing is that he admits, as will be seen, "the rise of prices which is caused by the dilution as a decrease or deficiency of buying power. That usage," he says, "is quite defensible, for the rise of prices does diminish the command over goods represented by a given money income."

It is as if Mr. Hawtrey, confronted by a giraffe, exclaimed, "There it is, but I don't believe it."

Now the curious thing is that Major Douglas actually supplied at Birmingham the clue to the reconciliation of the apparent contradiction that worries Mr. Hawtrey so much. He said:

"When Mr. Hawtrey says that it is possible to have an excess of demand, I think what he means is that it is possible to have an excess of demand for consumable goods, in which I agree with him. It is possible to have this excess of demand by making a large quantity of goods which are not

intended to be sold to the public and using the purchasing power distributed in making these goods to buy consumable goods."

After that it was really rather criminal of Mr. Hawtrey to be so slipshod. He should at least have said "an excess of money over consumable goods." The whole passage is sloppily worded in the eyes of a Social Crediter, trained to accuracy of expression (note, for example, how he misuses that word "doubled"), but Mr. Hawtrey is an economist, and moreover could plead that the passage quoted is only in the introduction. That, however, is no excuse for leaving out the word "consumable." Besides, it is also left out in the main argument.

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Mr. Hawtrey begins his main argument on page 296 by summarising the A + B theorem (quoted in full below²). Summaries of the A + B theorem are frequently misleading, but, as Mr. Hawtrey's argument is not affected, there need be no complaint about this one in its context. He then makes a remark that calls for extended comment before proceeding to his main argument.

"The sentence 'A will not purchase A *plus* B,' has been taken both by critics and by supporters of Major Douglas to mean that there is an inherent deficiency of demand. This interpretation has derived support both from the nature of Major Douglas's remedy, since his subsidy takes the form of the creation of additional purchasing power, and also from some direct pronouncements of his own."

I should like to make a plea here for the King's English and for commonsense. A theorem is not a parable that it should require interpretation; it is a proposition which can be demonstrated by argument to be correct or incorrect. Mr. Hawtrey is engaged upon the attempt to disprove it, and it is his business to deal with what Major Douglas actually says and not with anybody else's so-called interpretation of it.

The sentence "A will not purchase A *plus* B" means 562 one thing and one thing only.³ Mr. Hawtrey, in the last sentence of his chapter, compares some of Major Douglas's calculations to a misprint in the multiplication table, but here we have simple addition and subtraction applied to symbols. Either A will or will not purchase A *plus* B. If not, then 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.

Very seriously indeed I suggest that Mr. Hawtrey read the theorem again carefully, and try to understand exactly what it says. It does not just say there is an inherent deficiency of demand, it says something subtly but vitally different from that. It says that there is an inherent deficiency of demand *unless something is done to supplement it*.

As a protagonist of the orthodox theory that the present financial system is self-liquidating, Mr. Hawtrey has to prove one or the other of two things. He has to prove that the rate of flow of purchasing power to individuals is not A but A *plus* B, or else that a proportion of the product at least equivalent to B *is in fact* distributed by a form of purchasing power not comprised in the descriptions grouped under A. In doing so it is not enough for him to make emphatic assertions on the strength of his eminence in the financial world. His theoretical position is that of an eminent professor of Newtonian physics confronted by the challenge of Einstein—orthodox but shaking. But his real position is much worse than that, for he has to defend a theory which is responsible for the existence of a National Debt of £8,000,000,000, with a third of the population unable to spend as much as 6s. a week on food, while measures for limiting the production of food and discouraging the import of food are in full swing for the purpose of protecting *prices*; to say nothing of other evils.

It will be his business to prove that any money apart from A which is used to purchase A + B has not left outstanding any cost which must still be defrayed, and that 563 any cost that has been defrayed is not at the expense of another cost left outstanding.

For example, on page 302, Mr. Hawtrey, dealing with the item of cost known as depreciation, says:

"If it is invested either in the business itself or through the investment market, it is made available directly or indirectly for the production of new capital equipment, which will generate [he, presumably, means 'distribute'] incomes.

"Nevertheless investment is a separate act, without which the surplus depreciation allowance *would* tend to cause a deficiency of purchasing power. And it undoubtedly does sometimes happen that such funds, even if not accumulated in cash, are applied to paying off bank advances."

In fact it is admitted here that when a trader charges for depreciation in his price and obtains his price from the public, he does so at the expense of an equivalent deficiency of purchasing power to meet the price of all the goods that remain unsold. But the next point made is that the money so obtained may be distributed again in the production of new capital equipment. Quite so, and, so far as it is paid to individuals, it will be available to buy the unsold goods mentioned above. But it is included as a cost in the charge for new capital equipment which can be met only by the creation of new money. The deficiency has merely been transferred from one account to another.

Again, on this subject of depreciation he says:

"The practice of applying depreciation allowances to the repayment of bank advances is an absorption of cash. But the tendency to cause a deficiency of demand will be counteracted if the banks create equivalent advances in other directions. And this they will seek to do in order to maintain their advances in due proportion to their cash reserves."

Unfortunately for Mr. Hawtrey, this is a perfect example of the situation described by the A plus B theorem in actual operation. Here, in quantitative terms, is the situation he has described in respect of one only of the items included in Group B in the theorem.

The price of a batch of goods is A + B, and B is a depreciation charge. The purchasing power distributed in respect of it (according to Mr. Hawtrey) is A, but the trader gets his price A + B, so that the general pool of purchasing power, which we will call x is now x - B; a proportion of the general pool of goods at least equal to 564 B must be distributed by a form of purchasing power to be described by Mr. Hawtrey.

B has been cancelled by the bank and the deficiency remains unless, says Mr. Hawtrey, the banks create equivalent advances in other directions. That is to say, another trader gets a loan and the amount is B, which he uses in his business. He charges it all into his price, so that even if the general pool of purchasing power were thus increased from x - B to x, the price values attached to the general pool of goods have been increased by the same amount B and the original deficiency still remains. Worse, it has been augmented, for when the trader received the loan he used it to create two groups of costs, group A and group B, so that the general pool of purchasing power is still something less than x though more than x - B. So Mr. Hawtrey has his work still to do, and has already made his position more difficult.

If he knew it, his position is impossible, for he has yet to face the fact that Major Douglas has shown in his various works the methods, the efficacy of which is steadily decreasing, by which the present lunatic financial system endeavours to provide the new money with which "a proportion of the product at least equal to B must be distributed," but to do so in such a manner that (a) the power to monetise the credit of the people does not pass out of the hands of the money monopoly which has filched it, (b) the monopoly retains control of the lives of individuals by dictating the terms on which they shall obtain the purchasing power which is their license to live (the most

stringent condition being the nerve-shattering necessity to compete for paid work in an employment market steadily depleted by technological improvement), and (c) the monopoly can dictate the policy of Governments who have to borrow all their funds from it and then compete with the price system to extract taxes from a pool of money insufficient to meet both, so that Governments can be solvent only when their people are insolvent.

From all of which it can be seen that Mr. Hawtrey is defending an irresponsible and tyrannical system of government by money. Which brings me back to the main argument once more.

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Mr. Hawtrey's main argument must be stated in his own words:

"In the chapter following the enunciation of the *A plus B* formula he [Major Douglas] deals with the creation of credit. When a banker creates credit, for example, by allowing an overdraft, he enables production to take place. The borrower and those who supply him⁴ get to work, and 'all those concerns are distributing purchasing power to individuals, in the form of wages and salaries, ahead of production, which causes a rise in the price of existing ultimate commodities, the only commodities that individuals buy' (page 33). This is the dilution of purchasing power already described in 'Economic Democracy.' Yet on this very same page the *A plus B* formula is summed up in the proposition 'that the current flow of wages, salaries and dividends is less, much less, than the current flow of price values of articles produced.' The former proposition asserts that there is an excess of purchasing power over goods, which forces up prices; the latter asserts that there is an excess of goods over purchasing power. How are they to be reconciled?"

After what has already been said every reader will be itching to point out to Mr. Hawtrey the enormity of his error. With apologies to them and in deference to him I must dot some i' s and cross some t's. Neither of the propositions asserts either of the things he says they assert. The former is very precise and refers to a distribution of purchasing power *ahead of production* causing a rise in the prices of *ultimate commodities*. The latter refers to the *current flow* of wages, etc., being less than the current flow of *price values* of articles produced.

Purchasing power is not quite the same thing as money; it is money in relation to price. One pound is money and it has the power of purchasing five articles priced at four shillings, but only four if their price is raised to five shillings. Take Mr. Hawtrey's phrase, "an excess of goods over purchasing power." That is not what we should say; it is not precise—try it with five articles and a pound; you will find it depends on the price of the articles, and Mr. Hawtrey does not mention the price. What Major Douglas says is that the current flow of wages, etc., is less than that of *prices* of articles produced. That is 566 precise – try it with five-articles-a-week-at-five-shillings and a-pound-a-week.

The two propositions that have to be reconciled for Mr. Hawtrey are not what he says they are. It is very easy for Mr. Hawtrey to be superior and devastating about propositions he has mangled to suit the easy flow of his pen. It would be very easy to score off him by rewriting the propositions in some way which suited me, so I invite the most careful and suspicious scrutiny of what I am about to say by way of reconciling two propositions which *are* made by Major Douglas.

They are two propositions, and they are separate. One is a major and the other a minor proposition. To take the major first, contained in the *A + B* theorem (quoted in full on page 561), it is contended that there is an inherent deficiency of purchasing power in relation to prices if purchasing power and prices are both regarded as a flow, which is the correct way to regard them, and is how Mr. Hawtrey regards them, as a subsequent quotation will show.

If we isolate a given period of time to illustrate the major deficiency we must at least compute the total book values of all consumable goods, and of all capital and intermediate goods produced in a given period of production, against the total of wages, salaries and dividends distributed in respect of production *during the same period*.

Let us suppose that in the period chosen the purchasing power distributed in respect of *all* production is sufficient to meet the prices (book values) of all finished consumable goods, and that they are all bought and consumed. This, I take it, is the situation which would satisfy Mr. Hawtrey's sense of fitness, and it leaves all the remaining goods unsold, but it also leaves outstanding all their book values, which the public will have to pay in the future, since all costs must be defrayed by the public. Now it may be true that purchasing power has been distributed in the past in respect of all these costs (as a matter of fact Mr. Hawtrey has already demonstrated that it is not true for those allocated costs called depreciation), but it is clearly irrelevant since it has already been withdrawn in previous periods in the purchase of consumable goods. In other words, the public has made the goods and paid for them, but the costs are still outstanding and a proportion 567 of them will be included in the cost of goods produced in the next period, and the remainder in succeeding periods.

Since the economic system is a continuous process, successive periods flow into each other, so it must be regarded as a flow, and the *A plus B* theorem so describes it. The *B* costs referred to in it are the outstanding costs carried over into any period from previous periods plus any fresh allocated costs and costs in respect of semi-manufactures which the public does not buy.

But, says Mr. Hawtrey:

"To say that 'the wages and salaries (already insufficient to buy the whole production) tend to be diluted in value until they merely represent the subsistence allowance of the persons concerned' (page 34), does not help; the fact is that confusion has been introduced into the subject by Major Douglas's practice of describing the rise of prices which is caused by the dilution as a decrease or deficiency of purchasing power. That usage is in itself quite defensible, for the rise of prices does diminish the command over goods, represented by a given money income. But unfortunately the same expression, a deficiency of purchasing power, is equally appropriate to the case where there is a deficiency of incomes. In the one case a deficiency of purchasing power means an excess of demand in terms of money over supply at a given price level, in the other it means a deficiency of demand."

I am puzzled as to the exact shade of meaning intended by the word "unfortunately," but to return to the period already described, let us suppose that there has been an expansion of capital equipment (armaments, for example, or, if guns annoy Mr. Hawtrey, electric power stations or blast furnaces), so that there is distributed purchasing power in excess of available consumable goods at their book prices. This is the minor proposition at which Mr. Hawtrey boggles. Prices rise. That is to say, sellers add a fresh and profitable allocated cost to the previous book value. Purchasing power is diluted so that a pound, instead, say, of buying ten articles at two shillings, can buy only eight at half-a-crown.

Apart from the painful repercussions of this in the relations between capital and labour (resulting in rising costs), it is clear that the major deficiency has been aggravated (not doubled, Mr. Hawtrey). But what do the traders do with the extra profit? Briefly they do one of four things. They save it, which deprives some other seller of a market for the time being. Now or later they 568 will part with it, however. They will most probably hastily pay back a pressing bank loan which, as Mr. Hawtrey puts it, is an "absorption of cash." Or they will go out and spend it, which is all right, of course; the price rise has merely transferred the right to consume to them. Or they will invest it in their own or some other business, which distributes part of it (the *A* part) but creates an equivalent *A plus B* cost. All these processes, except spending for consumption, aggravate the major deficiency; some more than others. Additionally, the "boom" con-

ditions encourage the installation of new capital equipment, the purchasing power distributed in respect of which will augment the process just described, and the cost of which will be outstanding in the next period.

Now the following paragraph constitutes the entire argument that Mr. Hawtrey advances in support of the assertions he has made—based as we have seen on garbled paraphrasing of the opposing argument:

"In practice all stages of production are in operation simultaneously. Those which cause an excess of demand and those which cause an excess of supply tend to neutralise one another. But if we apply the same description, a deficiency of purchasing power, both to the rise of prices in the one case and to the shortage of money offered in the other, it is fatally easy to be misled into the idea that as each stage of production taken separately tends to cause a 'deficiency' of purchasing power, therefore when they co-exist they must reinforce one another."

Again, the use of the word "fatally" produces an odd qualm. It reminds me of Huxley's definition of a tragedy as "a theory killed by a fact." That is the classical or deductive standpoint. From the realist or inductive view, if a theory is wrong the discovery of the fact that kills it is a triumph. Fatally, fatally—what *does* it mean?

In any event a period in which purchasing power exceeds the prices of consumable goods, that is to say, a "boom" or inflationary period, does not in the world of hard fact occur simultaneously with a period in which purchasing power is less than the prices of consumable goods—a "depression" or deflationary period. Such periods, as is surely well known, alternate with each other to the glory of Mammon.

¹ "Capital and Employment," by R. G. Hawtrey (Longmans, Green, 15s.), which is the subject of this review.

² THE A + B THEOREM

A factory or other productive organisation has, besides its economic function as a producer of goods, a financial aspect—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 *plus* B. Since A will not purchase A *plus* 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.

(Quoted from the Statement of Evidence submitted by Major C. H. Douglas to the Macmillan Committee on Finance and Industry, May, 1930.)

³ Removed from its context, to convey its correct meaning, the sentence should be written, mathematically,

$$\frac{da}{dt} \text{ will not purchase } \frac{da}{dt} + \frac{db}{dt}$$

to indicate rates of flow.

⁴ The argument is taken from "Credit Power and Democracy," in which Major Douglas said, "who supply him *with intermediate products.*"