

Capital and Income

By

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“Accountancy, like graphic delineation, is a two-dimensioned art which attempts to portray the realities of a three-dimensioned world. It records two sets of reciprocal money values; and cost accountancy records costs in terms of money value with human value left out. Within the limits of accountancy an accountant is unable to define the significance of money.”

Foreword

The following has been compiled at the request of friends who seem unable to rest contented and happy with the troubles which already afflict them; and who, not aspiring to be heroes in the strife, yet object to be like dumb driven cattle.

Consequently, an attempt has been made to set down some ideas in simple language and form for simple folk who, strange as it may be, exist as a part of society, possessing the majority of bellies and sorts of individual and intuitive wisdoms which will need to be estimated in the aggregate rather than on an average. Sometime, the social mass will begin to move at an ever-accelerating pace, and then it will be better for the mass to be set in motion and motivated by reasoning rather than by emotions, bewilderments, and bedevilments of objective and subjective origins. It will not pay to muddle the ox which treadeth out the corn.

The ideas hereafter presented are more suggestive than explicit, having been reduced to the simplest terminology and ideation, and may be likened to straws at which men clutch when they think they are drowning.

Traditionally erudite readers, if their fleeting attentions be first captured, will probably convince themselves of their ability to recognise in the subject matter, concepts embodied in the philosophy of the Boeotians, for most of the ideas have been stolen from "The Satire of Truth," a thesis submitted in the dark ages to the long-established and well-endowed Schools of Boeotia.

Appropriate to the circumstance, James Branch Cabell has recorded a jot which I have here taken the liberty to quote:

"Before each tarradiddle,
Uncowed by sciologists,
Robuster persons twiddle
Tremendously big fists.

"Our gods are good," they tell us;
"Nor will our gods defer
Remission of rude fellow'
Ability to err."

A bit of premonitory wisdom which, Janus-like,
looks both ways.

– J. T. H.

Melbourne, March, 1936.

Capital and Income

(1)

ESSENTIAL ATTRIBUTES OF MONEY.

The essential attributes of money are functional, and money is performing its function when it is being used. Consequently, the idea of dispossession should always be associated with a true conception of the nature of money. Held, or possessed, money is static and its attributes are then potential. The normal and necessary use of a unit of money is to act effectively as a medium of exchange in a production-consumption cycle, and having acted effectively the unit of money is functionally cancelled.

Production means transformation of grosser materials into materials of enhanced value in respect to their utility or aesthetic qualities, and rendering of services directly or indirectly associated with transformation of material.

Consumption, in so far as money is concerned, means final exchange of goods brought to their last transformation in production. Realistically, consumption means disintegration of qualities by use or from effects consequent upon the passage of time.

Capital as hereafter used means money, and corresponds to the "loan capital" of the orthodox economist, a term used in contradistinction to fixed capital (material capital) and to capital represented by latent energy and psychological potentiality as well as the realisation of psychological satisfaction.

(2)

TWO KINDS OF MONEY.

Functionally money is of two kinds—Capital and Income. One kind of money is convertible to the other kind at the choice of the possessor of money. During the functional existence of a unit of money it may change from one kind to the other kind. Before demonstrating this in detail let us define the two kinds of money in the way in which we are now regarding them.

Income is money expended by individuals for purchase of ultimate consumption goods, and is money which spenders do not expect to recover in respect to the goods purchased. Such money so used, is rightly regarded as spent. Income is the only kind of money which will finally remove goods from the market and consume them. Income is money which finally extinguishes an equivalent cost.

Capital is used to purchase goods and services on capital account, and capital used to purchase goods, in contradistinction to income does not finally extinguish cost.

(3)

THE FINANCIAL-ECONOMIC CYCLE.

Let us now trace two separate £1's in their financial-economic cycles. The two pounds issue from a sum of reserved capital (money saved from potential income or profit) or from a bank loan (an issue of credit). The two £1's are used in production. One pound (Capital £1 A) is paid away for service and its possession is transferred to a worker and becomes potential income. This £1 A is spent as income in the purchase of ultimate consumption goods and extinguishes £1 of cost and replaces £1 of capital, or repays an equivalent bank loan. Its financial-economic cycle is complete because it can only issue again as a financial agent in a subsequent cycle.

The other £1 (Capital £1 B) is used for purchase of capital goods—i.e., goods to be used up, or incorporated in production. It passes to an antecedent producer to extinguish £1 of his cost and replace his capital or repay his bank loan to an equivalent amount. The financial-economic cycle of this £1 is also complete. Each £1 in its cycle is functionally cancelled. But the latter £1 has not finally extinguished a cost. Its use generated a capital cost for the last producer's goods. This cost, up to the present, remains unrecovered.

(4)

CHANGE OF MONEY AND COSTS.

In the above statement, where profit has been disregarded for the sake of simplicity, we see how a unit of money can change from capital to income, and from income to capital (£1 A). We can also see how a unit of money (£1 B) can be transferred as capital, how in its cycle it never becomes income, and how it can extinguish a previous cost and be

cancelled, but at the same time generate an equivalent cost. Thus capital used for purchase of goods on capital account does not finally extinguish cost in its cycle.

(5)

THE DOUBLE FLOW OF MONEY.

A perception of the nature of capital and income, as above indicated, does not conclusively provide proof that the money value of income derived from production is less than the money value of the costs of that production. To seek proof, or otherwise, of this contention it will be necessary to consider the origin and fundamental nature of capital. However, the statements show that, at any point of time, money used in production is taking two courses to its cancellation. One portion becomes income which finally extinguishes cost. Another portion is a transfer of capital, which in its own cycle never becomes income, and which in its own completed cycle does not finally extinguish cost. The statements also show that total cancellation of money must be carefully distinguished from total cancellation of costs, which are generally accepted as legitimate demands for money. The statements further show that money to extinguish portion of cost in the cycles we have been considering must come from some source external to those cycles. Here and now, in parenthesis, the reader is requested to note and remember that this money must be created in relation to achieved production, it must be effective in finally extinguishing cost, and, consequently, must be of the nature of income. It must not be created in relation to new production, and be of the nature of capital which generates new and additional cost. Under existing practice money is created as capital and the ability to create this money gives power of virtual ownership of all production and control of all economic activities. This power is too vital to remain vested in a profit-making monopoly which owns and administers a defective financial mechanism. (Cf. Sec. 10). A clear and definite understanding of these points is essential to an understanding of the working of the intimately associated financial and economic systems, for total production is constituted by the sum of complete and incomplete cycles as above demonstrated.

(6)

VELOCITY OF CIRCULATION.

The proper and effective use of money can only be perpetuated by using it in normal production-consumption cycles. The velocity of circulation depends upon the rapidity with which money completes the cycles. It is sometimes assumed that money recovered as capital in the normal production-consumption cycle can be effectively and properly used for purchase of ultimate consumption goods, and such assumed use in rapid and frequent sequences is presented as an illustration of velocity of circulation. A seller of goods who misuses his recovered capital like income is not increasing the velocity of circulation: he is retarding it. Moreover, he is spending capital, and if he be a business man or a financier is soon regarded with suspicion by his associates. Yet economists regarded by many as "sound" have used the capital spending assumption in support of their demonstration of velocity of circulation. Their illustration is of this nature: A butcher can sell meat and in return receive £1. With this the butcher buys groceries; the grocer with his £1 buys petrol, and so on. Of course, the last seller could come back and start the train over again, "velocity of circulation" depending upon the rapidity with which buyers could travel between retail establishments and the celerity with which sellers could get rid of their turnover. Need we pursue the matter further?

(7)

NATURE AND FATE OF INCOME.

Income originating from capital proceeds from production and confers the power to consume (potential income). When money is spent as income it extinguishes an equivalent cost in a production-consumption cycle and restores capital which can be used in a subsequent cycle where it generates a new cost. Income is sometimes called effective demand because it finally removes goods from the market. Potential income can be diverted from a return to its source, whereby it fails to extinguish cost and leaves a production-consumption cycle incomplete. Thus, potential income can be saved and capitalised to initiate another cycle. One unit of money, by saving and capitalisation, can generate two or more equivalent costs, but can only extinguish one equivalent cost. This results in goods remaining on the market unsold and unconsumed. The full significance of saving with capitalisation should be well pursued, for thrift is lauded as commendable, although the thrift of a to-day corresponds to an unpaid debt of a yesterday and a national debt of a morrow. Moreover thrift is an imperative necessity in a world of economic insecurity.

(8)

NATURE OF CAPITAL.

Capital is a store or fund of money acquired or created for a necessary and definite purpose. It confers the power to produce. It performs two functions:

1. It provides a means of sustenance for labour while the labourers are engaged in work.
2. It provides a fund for the purchase of goods for production.

Capital makes three claims:

1. It claims the privilege of earning interest.
2. It claims the privilege of legal protection by the State.
3. It claims the privilege of replacement if used in production.

(9)

ORIGIN OF CAPITAL.

Capital is established in two ways:

1. By capitalisation of savings from potential income and from profit, the latter being the potential income of entrepreneurs. By capitalisation of savings, potential income is diverted from its primary obligation and is not spent to extinguish directly a cost in an existing production-consumption cycle. If invested in new production it initiates a new cycle and generates costs equivalent to its sum, but only becomes potential income to an amount equal to its sum less the amount used for purchase of goods on capital account. (Cf. Sec. 3.) Capitalisation of savings must be distinguished from saving, which temporarily withholds potential income from spending. Probably a large proportion of deposits in Savings Banks represents money saved and reserved for future spending, and the same is true, to a much less extent, of deposits in trading banks. Also investment in new production must be distinguished from investment which is an exchange of capital. For example, money saved may be used to buy a house (fixed capital) or shares (claims to capital or fixed capital). Here we are dealing with exchanges of capital to which statements above are not applicable.

2. By the creation of bank credit. The creation of bank credit is essentially a creation of capital for production. An issue of bank credit is regarded as a loan and constitutes a bank asset until the loan is repaid and cancelled. Bank credit is transferred during its use by credit instruments which include cheques, bills and currency. The relative amount of currency deemed necessary is nowhere in the proportion of one-tenth of the current credit issue. Consequently, the current credit issue is limited by the banks' holding of currency and of currency equivalents such as Treasury Bills, which are regarded as claims for currency upon the central bank which could be realised upon demand. With a continuously functioning and expanding industry, the currency limit of credit determines the rate of credit cancellation. The rate of cancellation is indicated by comparing the average amount of credit uncanceled at consecutive periods of time with the total amount of credit issued during the periods of time. For example, if the average amount of credit if the average amount of credit uncanceled per day, week or month of a year was £500 millions and the total amount of credit issued during the year was £3000 millions, then the rate of cancellation would have been 500/3000, equals 1-6th of a year, equals 8 2-3rd weeks. This would indicate the average life of a bank loan was 8 2-3rd weeks. Where bank credit is used to purchase goods on capital account the rate of cancellation of credit in relation to the rate of consumption of the goods is a vital factor in the marketing of goods. (Cf. Secs. 11 and 13.) An issue of bank credit (less hoarding) creates a deposit or deposits to a like amount. Each deposit may be:

1. Set against a loan previously granted by his bank to the depositor to reduce the loan wholly or in part.
2. Set against a similar loan less than the deposit, when the depositor is credited with the difference.
3. Credited in full to the depositor if the depositor has had no previous loan from his bank.

(10)

BANKS DO NOT LEND THEIR DEPOSITS.

In related banking areas there is established for a point of time records of depositors' debits and credits (reciprocally bank credits, loans, assets and bank debits, deposits, liabilities), which constitute a balance of the areas. In related competitive banking areas it is necessary for banking business to proceed correspondingly step by step, as far as possible, for, otherwise, a particular bank might find standing against it at the end of a computing period a considerable balance in favour of another competitive bank. Consequently, banks tend more and more to become amalgamated or "associated," the latter having been recently styled "a gentlemen's agreement."

Bank deposits standing to the credit of depositors are bank liabilities, and, consequently, banks cannot lend their deposits. When banks lend money they do not decrease any depositor's deposit; on the contrary, they increase the flow of deposits to the banks and increase standing deposits to the extent that potential income arising from the new loan is capitalised or reserved for future spending. The recall—not the issue—of bank loans decreases bank deposits, as does also sale by banks of securities on the open market. To repay a loan to a bank or buy securities from a bank deposits are withdrawn and the sum of deposits in banks decreased. A loan from a bank originates from a new creation of credit and is not an issue of depositors' money. A bank loan must be carefully distinguished from a private loan. The latter is only a transfer of existing capital. A banker who attempts to suggest that he lends his depositors' money makes statements not consonant with fact, and contrary to the rigid canons of his practice. Reputable bankers, envious of their ethical integrity

have never attempted to make such a suggestion and their classical recordings bear witness to the honesty of their purpose.

A question in this form is sometimes propounded: "If banks create liabilities against themselves by accepting deposits, why do they accept deposits, and, in some instances, pay interest on them?" The chief reasons why banks accept deposits are as follow:

1. It enables banks to recover currency, which forms the basis for further credit loans.
2. It enables bankers to control the money market and determine rates of interest and discount.
3. It establishes banking "intelligence," giving decisory knowledge of the financial standing of individuals, groups of individuals, and subsidiary financial agencies, such as insurance corporations, trustee companies, stock exchanges, and discount and acceptance houses.
4. It enables banks, by accepting fixed deposits, with interest inducement, to limit the extent of their current liabilities.

There are other reasons, involving matters of policy rather than matters of practice, which need not be detailed here. These reasons have been summarised by Mr. Reginald McKenna, who stated: "And they who control the credit of a nation, direct the policy of Governments, and hold in the hollow of their hands the destiny of the people." Lest this be considered an isolated opinion, Dr. Walter Leaf's statement to the International Chamber of Commerce is given. Dr. Leaf said:

"The Banker is the final arbiter of the World's Economy." ("The Times," June 19, 1921.) This dictum was confirmed by the "Financial Times," September 20, 1921, when, in a burst of irate candour in criticism of Mr. Lloyd George, Prime Minister, it published: "Does he, and do his colleagues, realise that half a dozen men at the top of the big five banks could upset the whole fabric of Government finance by refraining from renewing Treasury Bills?"

The outstanding defect in banking as it now exists resides in the power of banks to create capital, with the necessity to cancel it prematurely, in relation to the rate of consumption of capital goods produced by the agency of the credit. This premature cancellation of credit is not usually a wilful destruction of needed money, but a condition imposed by the requirements of existing banking practice. The ability to create capital and determine the course and method of its use gives to bankers immense power which needs social control. In Australia, about 80 individuals control key industries and banking, with the directorates directly or indirectly interlocked. The effects have become obvious to interested observers and we see a concentration of industrial and credit control with lineal associations, and patronage and preferment spreading into all spheres of social and political administration. This constitutes a danger, the possible effects of which cannot be estimated for the future assurance of a stable and efficiently co-operative society.

(11)

ACCOUNTANCY.

Accountancy, like graphic delineation, is a two-dimensioned art which attempts to portray the realities of a three-dimensioned world. It records two sets of reciprocal money values; and cost accountancy records costs in terms of money value with human value left out. Within the limits of accountancy an accountant is unable to define the significance of money. Ask an accountant to deal with the following hypothetical data within the limits of his art:

A sum of £1000 is borrowed from a bank and used for the erection of a factory. The £1000 is distributed to those taking part in the erection. The possessor of the factory floats a company and sells 1000 one pound shares and takes back £1000 with which he makes payment to the bank to redeem his loan.

The accounted result would show in existence:

1. Real wealth (the factory) valued at £1000.
2. Claims to wealth (the shares) valued at £1000.
3. Equivalent money—nil.

From the society here represented the medium of exchange has entirely disappeared. Claims to wealth could be bartered for real wealth indefinitely, but there is no income to enable the consumption of wealth. This condition, as far as accountancy is concerned, is deemed to be satisfactory, and it illustrates in effect the financial history of the formation of joint-stock companies. The nineteenth century and the past part of the twentieth have witnessed an enormous growth of joint-stock companies. To estimate our capacity to produce and consume we must keep tally of every financial-economic cycle.

To found a true accountancy we must introduce a third dimension. In the foregoing example we should be able to envisage a debit on the human side, necessitating in the cycle a corresponding credit which might be a reflection of the potentialities of the factory as something apart from the material embodied in the factory. Those potentialities have come

from social co-operation (the increment of association), and have become inherent in a complex producing mechanism as a result accruing from the endowments of a social heritage.

Here, again, King Charles's head must be exhibited. Under the present system we actually capitalise those existing potentialities, but the capital is created on behalf of private ownership for **new** production and is not justly and effectively created on behalf of social ownership for consumption (depreciation costs) as an essential factor in an existing financial-economic cycle. Under the ideal accountancy envisaged above all **new** credit would be created in relation to **new** production—not in relation to past production—in order to help make every production-consumption cycle complete and self-liquidating. Our lending institutions do not lend on material production realised, but on the capacity to produce at a profit. They, when lending, take liens over fixed assets but they actually monetise potentialities which embrace the willingness for social co-operation and the use of endowments of the social heritage.

(12)

HOW THE FINANCIAL SYSTEM OPERATES.

To begin to understand how the present financial system operates we must first envisage a financial system starting under existing conditions and subject to changes in its fundamental elements. In the following illustration arbitrary numerical units of value have been used, but the results would not differ in their significance if other numerical units had been used. The illustration involves issues of credit and the investment of savings in production, and the first stage is given in two parts to include both financial mechanisms. In this stage it is assumed that capital costs have not entered, for we are witnessing the establishment of capital (bank deposits) and fixed capital (capital goods), and, consequently, as yet all money has been distributed as potential income (labour cost). The terms applied and the changes implied should be evident from an understanding of previous sections. The items have been lettered for facility of reference.

PART 1.

A. Credit issued = 1600	B. Cost of production C. Potential income	} = 1600	D. Savings and profit capitalised = 800	{	F. Uncancelled credit G. Unconsumed goods H. Bank deposits
			E. Income spent = 800	{	I. Cancelled credit J. Consumed goods

PART 2.

Bank deposits invested (H) = 800	L. Cost of production	} = 2400	N. Saving and profit capitalised = 1200	{	P. Uncancelled credit Q. Unconsumed goods R. Bank deposits
Credit issued = 1600	M. Potential income		O. Income spent = 1200	{	S. Cancelled credit T. Consumed goods

SUMMARY.

Credit issued (A.K.) = 3200		Goods produced (B.L.) = 4000
Credit cancelled (I.S.) = <u>2000</u>		Goods consumed (J.T.) = <u>2000</u>
Credit uncancelled (F.P.- H.)	Bank deposits (R.)	Goods unconsumed (G.Q.) = <u>2000</u>
(Bank loans and assets) = <u>1200</u>	(Bank liabilities) = <u>1200</u>	

This illustration shows:

1. Bank assets balanced by bank deposits. (Cf. Sec. 10.)
2. Unconsumed goods on the market corresponding in value to savings and profit capitalized. (Cf. Sec. 7.)

3. That profit cannot be acquired except at the cost of an equivalent loss (unconsumed goods).
4. A lack of income to consume goods and finally extinguish cost. Note that bank deposits, 1200, constitute capital—not income. (Cf. Sec 3.)
5. That increased production and investment of saving cannot overcome the lack of income. (Cf. Part 2 of illustration, where savings and profits are invested and production increased from 1600 units to 2400 units.)
6. The nature of a capital cost. (Cf. Sec. 14.)

Again note that the 1200 units of bank deposits constitute capital which could be used to purchase, out of the 2000 units of unconsumed goods, 1200 units on capital account for production or retail sale. The 1200 units of capital transferred in the purchase would restore part or whole of the 800 invested units of part 2, and cancel part of the 1200 units of bank loans; or would restore none of the 800 units and cancel the whole of the units of bank loans. In either case 1200 units of goods unaccompanied by income would go forward and generate equivalent costs in the next stage of production. Income to meet the capital costs of those goods could only be derived from subsequent production, which would include capital costs (non income), plus labour costs (potential income), as minimum requirements of costs.

Without considering the effects of further capitalisation of savings and profits it should be seen how the costs, and unrecovered costs, of industry must be ever-increasing, with the result that piling up of unsold goods becomes cumulative. This inevitable result brings about a condition which has been designated “over-production” and which is characterised by a period when goods appear to be redundant, when bank deposits and unredeemed bank loans have accumulated to, or beyond, the safe limit, and when consumption decreases relatively to production. On the surface the period presents the similitude of extreme luxury on the one hand accompanied by actual, acute poverty on the other hand. History has told on many occasions that these are the premonitory signs before the crash; the crash today being deferred by specious advertisement and propaganda, and the widespread increase of term-selling. The co-existence of apparent luxury and dire poverty engenders the fallacious and futile belief that if incomes were more equitably distributed all would be well. The same futile belief finds its expression in an imposition of increased direct and indirect taxation.

In the past the position has been palliated by bankruptcy, writing down of capital, losses of invested capital, and sale of goods below cost. Governmental borrowing has seemed to afford temporary relief, but has resulted in making the condition worse. A reversal of any or all of these means and policies cannot correct the effects of the fundamental defects in the operation of the existing financial system.

(13)

PREMATURE CANCELLATION OF CREDIT.

As shown in section 11, credit is prematurely cancelled by new issues of shares, and as shown in Section 9 the average life of a bank loan can be estimated in terms of weeks. The figures used in Section 9 were not arbitrarily chosen, but were taken as representing approximately the credit statistics of Australia in so far as these statistics could be obtained. Short term loans are usually adequate to transfer goods from one section of industry to another, but are not adequate to cover long periods of depreciation of capital goods used in the processes of production. Obsolescence of capital goods must also be included with depreciation. The premature recall and cancellation of credit influences cost accounting in that the depreciation rate of capital goods, accounted in terms of money, is greater than the realistic rate of depreciation of capital goods. Money in the financial-economic cycle is functionally cancelled at a rate greater than goods are consumed. The premature cancellation of credit is by far a more important factor in making costs greater than incomes than is the capitalisation of savings and profits, though the premature cancellation factor is much less evident in any superficial examination.

(14)

NATURE OF A CAPITAL COST.

There is only one primary cost in production—labour cost. Capital cost is a re-embodiment or duplication of a past labour cost. If we turn to the illustration of Section 12 we will see the total labour cost is represented by 1600 plus 2400 = 4000 units. Of this labour cost, consequent upon the distribution of 4000 units of potential income, 2000 units were spent, with 2000 units of goods consumed, while 2000 units were saved and capitalised. On the market 2000 units of goods were left unconsumed, and if these goods were purchased on capital account for retail sale or use in production they would generate 2000 units of capital cost—a past labour cost embodied or duplicated in additional costs. Hence, when there is a demand for reduction of costs in production, labour costs must first be reduced, for present capital costs are equivalent to past labour costs which cannot be reduced, and future capital costs will be equivalent to present labour costs. It is of no use for the worker to kick against the wall of fact which stands between the producer on one side and the consumer on the other. Producers and consumers should wake up and direct their kicks elsewhere, for the producer is not less guilty than the worker of misdirecting his kicks.

(15)

INTEREST AND PROFIT.

Under the existing financial system, where capital is issued for production, interest and profit cannot be obtained from any programme of production without equivalent losses affecting part of the production. Labour costs are distributed in their own financial-economic cycle, but interest and profit are allocated costs which can only be fully met by appropriating future issues of credit and in this respect can be classed with capital costs.

When considering any reform of the existing financial system, investigators should not be sidetracked by concentrating their attention on interest and profit, which can be made distributed costs as are now labour costs. Attention must be concentrated on capital costs, which cannot be made distributed costs, for they represent costs already distributed in the past; and capital used for purchase of goods on capital account never becomes, and cannot be made to become, income in its own financial-economic cycle.

(16)

SIMULTANEOUS PRODUCTION AND CAPITAL INFLATION.

It is sometimes assumed that during a period of production sufficient potential income is issued to cover the total costs of production of the period because production of capital goods, which proceeds simultaneously with the production of ultimate consumption goods, provides potential income to supplement potential income derived from the production of ultimate consumption goods. Both sums of potential income are then sufficient to purchase ultimate consumption goods, and when this purchase has been effected the producers of ultimate consumption goods are able to pay for the capital goods and all producers have recovered their costs. This means that at the end of a producing period—say, a financial year—each section of industry can produce a satisfactory cost balance-sheet and proceed to the next period with similar anticipations. This condition could only exist if:

1. There were no profits.
2. There were no capitalisations of profits and savings.
3. There were no premature cancellations of credit.
4. Consumption were proceeding at the same rate as production

Under existing financial conditions, profit, capitalisation of profit and savings, and premature cancellation of credit are inevitable. Moreover, and herein lies the fundamental crux of the problem, we do not consume at the same **rate** as the **rate** at which we produce when industry is normally and effectively functioning. Industry must always carry an ever-growing capital and fixed capital overburden. Machines, factories, tools, means of transport, and more than a thousand and one other things do not await their reproduction until existing fixed capital is consumed. From the production of this fixed capital overburden proceeds the potential income which, in the immediate present, and associated with the lesser rate of consumption, makes possible profit, capitalisation of profit and savings, the payment of depreciation costs leading to premature cancellation of credit, and the purchase of new shares of joint-stock companies. The fixed capital overburden must be covered by uncanceled issues of credit, partly made to Governments for production which does not come to the market for sale, and hence the growing taxation consequent upon ever-increasing governmental debts, which are eventually funded and passed on to the community.

The fixed capital overburden represents the excess of production over consumption, and represents the growth of national wealth which is progressively coming into consumption. The main problem is to finance this fixed capital overburden, and increase in production, with **new** credit so that potential income derived from it will not be capitalised or prematurely cancelled, and at the same time conserve equivalent credit so as to be cancelled only at the rate of consumption. Then, the fact that production involves capital cost (duplication of labour cost) introduces a subsidiary problem, the nature of which has been suggested in the foregoing sections—i.e., consumption must be adequately financed. In connection with this, the displacement of human energy by mechanical energy in economic activity is a condition which must also be considered. In these problems financial, economic and cultural factors are intimately associated.

(17)

PRICE

Price contains three elements:

1. Profit.

2. Capital Cost.
3. Labour Cost.

Normally, the lower limit of price is cost, and the upper limit the amount which will be paid. Price always absorbs effective demand. Profit is an element allocated in anticipation; capital cost is an element represented by a cost distributed in the past and allocated in the present in anticipation: and labour cost is an element distributed in the present and available for spending. Profit, when acquired, is the potential income of the entrepreneur and, in a society not yet perfectly altruistic, profit is an incentive for increased and better organised effort. An entrepreneur cannot be blamed for capitalising part of his profit any more than can a worker for doing the same, for, like the rest of society, he lives in a world of financial domination and in a world of economic insecurity. The producer's capitalised profit does give him some temporary say in the direction of his financial policy and insures him to some extent from emergency. Those who would divert attention from the main issue are quite content when the attack is directed to profit.

Capital cost is a demand for maintenance of capital and in a money economy is a necessary and inevitable claim, whether production be under private ownership or under State control. It will always make the cost of production greater than income, and hence the statement of Professor Bowley which showed that national income is equal to the money value of goods and services produced and rendered, the cost of maintaining, capital being deducted.

* * *

Readers of the foregoing statements are urged not to regard them as correct, or otherwise, until they have honestly and impartially considered them to their satisfactory self-conviction.

At the request of many friends, a simple explanation of the mechanism of overseas loans and interest payments is appended.

Overseas Loan.

1. Loan floated in England. English people buy £x millions Australian bonds. £x millions paid into English bank, establishing corresponding credit on behalf of Commonwealth Bank.
2. Australian importers need £x millions' worth of English goods. Through trading banks importers with £x millions buy credit from Commonwealth Bank. Commonwealth Bank has now £x millions of Australian money.
3. Importers with credit in English bank buy £x millions' worth of goods with English money. Goods imported into Australia.
4. Government spends £x millions of Australian money for goods and services and pays Australians £x millions.
5. Australians buy £x millions of imported goods and repay importers.
6. Government has £x millions of debt and pays interest indefinitely.

Those who are sufficiently interested should learn how the East-West (transcontinental) railway was financed and compare this financing with the above.

Payment of Overseas Interest.

Overseas interest is paid through the agency of an export surplus—say, £x millions' worth of wool.

1. Australian pastoralists sell £x millions' worth of wool to an Australian agent and receive £x millions of money and pass out of the transaction.
2. Australian agent sends wool to English agent who sells wool to English manufacturers for £x millions. £x millions paid into English bank.
3. Against £x millions in English bank English agent draws a credit instrument which he sends to Australian agent.
4. Australian agent sells credit instrument to Australian bank and recovers his £x millions.
5. From revenues and taxes Commonwealth Government has collected £x millions, with which it buys the credit instrument from Australian bank, which recovers its £x millions. With credit in English bank, Government pays interest to English bondholders in English money.