PAMPHLETS ON THE NEW ECONOMICS
No. 16

THE A + B THEOREM

BY

H.M.M.

PUBLISHED BY
STANLEY NOTT LTD
69 GRAFTON STREET, FITZROY SQUARE
LONDON W

PRICE: SIXPENCE NET

Printed in Great Britain

THE A PLUS B THEOREM

THE A + B THEOREM

By

H. M. M.

STANLEY NOTT LTD.

69 GRAFTON STREET FITZROY SQUARE

LONDON

THIS EDITION
FIRST PUBLISHED IN 1935
PRINTED IN GREAT BRITAIN BY
WESTERN PRINTING SERVICES LTD., BRISTOL

THE A PLUS B THEOREM

By H. M. M.

I

THE world is at a crisis, probably the greatest in its history. It is called upon to solve the problem now known everywhere as "Poverty Amidst Plenty," but is failing to do so, a failure which leads directly to revolution or war, and must ere long destroy civilisation itself if not rectified; and it is failing because those who direct its affairs, governments and government officials, bankers and economists, leaders of thought and business men, are facing the problems of a power-machine age with Stone Age minds.

Though it is perfectly evident that we can produce goods of all descriptions in almost boundless profusion, with a decreasing amount of human effort, and can, therefore, if we will, provide everybody with increasing leisure and all the physical means to a full and satisfying life, they persist in believing that it is possible to distribute to the community the output of a constantly accelerating productivity through the constantly contracting channel of wages, salaries, and dividends. It cannot be done.

Fifteen years ago Major C. H. Douglas, in *Economic Democracy*, and in subsequent books, demonstrated its impossibility; and he crystallised his demonstration in the

A plus B Theorem, the following statement of which is taken from *The Monopoly of Credit*:

"In any manufacturing undertaking the payments made may be divided into two groups: Group A: Payments made to individuals, wages, salaries, and dividends; Group B: Payments made to other organisations, raw materials, bank charges, and other external costs. The rate of distribution of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of generation 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."

As money and credit bulk largely in the discussion that follows let me set down a few facts concerning them before discussing the theorem itself: it may save some repetition later on.

All trade and industry is run on credit. That is not always apparent because many business firms, chiefly retailers, never borrow from the banks at any time; but investigation will show that they are usually only saved from borrowing by the fact that the dealers and manufacturers they buy from do it for them, and are able in consequence to allow them a month or two's "credit" before requiring them to settle their accounts—that is, in many cases, time enough to sell their goods for cash before they have to pay for them.

Money in the common everyday sense—coins and notes—is merely the small change of credit, and gets into circulation only through the creation of credit, by the banks. It is withdrawn from circulation and immobilised —which, in effect, is the same as ceasing to exist—when it is paid into a bank as savings, or to pay off a loan or

reduce an overdraft; and it returns to circulation again when savings are withdrawn, or when it is wanted in connection with new issues of credit. But all money operations are merely ripples on the surface of credit operations; and despite any apparent evidence to the contrary money has no independent life of its own apart from movements of credit.

Credit is the all-important factor, and is created by the banks out of nothing at the mere cost of paper and ink. It flows out from the banks to the community as income —and debt—via the channels of production, and flows back again to them, in repayment of debt, via the channels of consumption, when the community spends its earnings; and, when repaid, it is cancelled and ceases to exist. It originated out of nothing and has to return again to nothing when its cycle of operations is complete.

It should be noted particularly that all money and credit, in being spent, is on its way back to the banks to cancel loans and extinguish purchasing power. Banking policy demands it; and the pressure of interest charges ensures compliance with the demand.

These are all perfectly orthodox statements of fact which need not be argued here; but if their truth is not immediately apparent to the student it will be found fully established in the writings of H. D. Macleod (*Theory and Practice of Banking*), R. G. Hawtrey (*Currency and Credit*), and Reginald McKenna (*Post-War Banking Policy*).

It is also desirable, for clear understanding, to divide credits into two groups—new credits, and replacement credits. New credits are those which reach the community as income—wages, salaries, and dividends: replacement credits are all other credits. These latter are not income to anybody: they merely pay off and replace older credits

—either earlier new credits or earlier replacement credits—and serve to transfer goods from one trader to another *within* the productive system; but not being anybody's income they are powerless to transfer goods out of the productive system for final use or consumption by the community.

Since all money and credit in circulation represents a debt due to the banks, and as all goods are produced on credit, it follows that a debt, due to and manufactured by the banks, attaches to all goods so long as they are in the hands of business firms, that is, so long as they are being bought to be sold again. This debt is transferred with each transfer of goods from trader to trader, by means of replacement credits, and is only finally paid off when the goods, now probably very much transformed, are bought by a final consumer and paid for out of his income.

Even then, however, there is really only a transference of debt from one cycle of production to another. The goods we buy to-day were produced on credit. The money we buy them with goes to extinguish the debt; but the money itself, our earnings, is accounted in the cost of goods not yet on the market, and represents an undischarged debt due to the banks which must be met in the future; and the same transference of debt takes place whenever consumers spend their money.

From this tremendous power possessed by the banks, to manufacture debts against the community by pledging the community's own assets, and claiming repayment as something due, not to the community whose assets they have pledged, but to themselves, confiscating to themselves those assets in case of default—brought about in most cases by their own deflationary acts—it follows that it is only a matter of time before all the community's assets are transferred or in pawn to the banks or their

satellite institutions. It is probable that, even now, the greater part of the nation's assets—even of people who deem themselves solvent—are in pawn to them, either directly on account of individual loans and overdrafts, or indirectly as joint security for the National, municipal, and other corporate debts.

II

Bearing these facts in mind let us now return to the theorem.

Honest enquirers, on first encountering it, readily admit that the price-values created by any business firm are made up of these two groups of costs—internal payments of wages, salaries, and dividends to its employees and shareholders (A), and external payments to other concerns (B); and they also agree, with rather more reluctance—chiefly because the idea is new to, and startles, them—that the joint incomes of employees and shareholders is insufficient to buy the whole of the firm's output; but they have usually some difficulty in agreeing that what is true of every individual firm is necessarily true of them all taken simultaneously together. The laws of arithmetic require that they should agree; but two considerations tend to make them defer or withhold agreement. The first is, that when they begin to analyse the B payments they discover that they represent wages, salaries, and dividends also, and not being deeply versed in matters of finance they are apt to conclude, without further examination, that this purchasing power is still in existence, and that Douglas's analysis is, therefore, wrong. The second is, that it appears to them that if his analysis is right the economic system should have broken down long ago.

As regards the first point, it is perfectly true that B payments represent payments of wages, salaries, and dividends; but it is untrue that this purchasing power is still in existence. A closer scrutiny reveals that these B payments only *represent*, they do not *constitute* wages, salaries, and dividends. Except for the profit of the traders immediately receiving them—and that duly appears as an A payment in their accounts—they consist wholly of replacement credits which merely transfer goods and debt and pay off and replace older credits outstanding. They are not fresh disbursements of income to anybody.

The goods transferred have a body of costs attaching to them, and these costs, on an ultimate analysis, can be resolved wholly into payments of wages, salaries, and dividends; but these were earned and spent in the past, often a far distant past, and, in being spent, passed out of existence leaving unbalanced costs behind, to be carried, if they are carried, by later replacement credits. They may have formed part of the cost of plant and machinery constructed perhaps twenty years before, or a factory built fifty or more years before; but it is certain that the greater part of the money—all but a small fraction of savings—was spent when it was earned, and also that the banks did not wait either twenty or fifty years for repayment of the credits out of which it came, as they would have had to do if it had remained in circulation. (They were probably repaid within a month or two, most credits being, in fact, repaid within a few weeks of issue.) And it is equally certain that the credits were cancelled out of existence on being repaid.

One difficulty which prevents the man in the street from understanding the theorem readily is that, even when he handles bills and cheques daily, he habitually thinks of money as consisting of coins and notes. He sees

money in these forms passing from hand to hand throughout the community, buying goods and paying for services or liquidating debt; being paid into the banks every little while and then coming out again, and apparently having an eternal or fairly prolonged life; so, although he knows that wages, salaries, and dividends change hands in being spent, when he hears that they pass out of existence he is frankly incredulous.

Nevertheless, his observation, while correct enough as far as it goes, does not go far enough, and consequently misleads him as to what is really happening. Purchasing power does pass out of existence when money is spent, even if cash does not. If it did not it would mean that the banks were not being repaid their loans. But, whatever weaknesses banks may have, a disposition to forgive us our debts is not one of them.

Critics of the theorem would be less liable to go astray if they were constantly to remember (1) that it deals with rates, the rate at which incomes are distributed to the community versus the rate at which production costs and prices mount up; and (2) that rates must be measured and compared over the same periods of time. When they make a balance between incomes and prices, as they almost invariably do, they do it by the simple device of ignoring time and dragging into their equation the defunct earnings of the past, or by confusing replacement credits with personal incomes; and they expect us to assume that bankers are benevolent old gentlemen who never refuse loans, or call for their repayment, or charge interest.

One critic, Professor Copland, Professor and Dean of the Faculty of Commerce, University of Melbourne, in *Facts and Fallacies of Douglas Social Credit*, states that he believes it to be the fundamental fallacy of the Douglas

Credit analysis that it is assumed that the so-called B payments are not distributed to consumers; and he illustrates his belief by an extraordinary diagram which purports to show how money and credit circulate. It is headed: "Consumers' Income and Producers' Costs in Equilibrium."

At the top of his circuit is a small circle marked "Producers' Costs" (A = £100, B = £100 ; A plus B = £200). He shows the £100 of A payments passing direct to another equal circle at the bottom of his circuit marked "Consumers' Income," and the £100 of B payments passing by a longer route to the same circle. On the way the B payments split up into four streams marked respectively:

Producers of Raw Material	= £70
Profits to Shareholders	= £10
Power	= £10
Depreciation	= £10

The four streams then re-unite and enter the "Consumers' Income" circle, which is inscribed: A = £100, B = £100; A plus B = £200.

The whole £200 then passes out of the "Consumers' Income" circle by a route marked "Spent or Invested," and arrives at another circle—which for some unknown reason is made smaller than the others—marked "Consumers' Outlay" (£200), from which it passes back to the "Producers' Costs" circle by a route marked "Paid to Producers."

The circuit is now complete: "Consumers' Income" and "Producers' Costs" are shown to be in equilibrium; and the Professor doubtless imagines that he has proved his case; but it would be interesting to know what his fellow-economists think of his diagram.

It will be noticed that there is no banker in his circuit,

no creation of credit, no repayment of it; and, by eliminating time, he is able to perform miracles of buying with purchasing power which, in the real world, would long since have ceased to exist. It is, in short, an ideal circuit, an imaginary circuit that never was on land or sea.

The diagram shows a closed circuit; so "Producers' Costs" must stand for *all* producers' and distributors' costs, and "Consumers' Income" for *all* comsumers' income.

In the world of reality, as distinct from Professor Copland's dream-world, the £200 of "Producers' Costs" would represent borrowings; and as what is borrowed must be repaid—particularly when banks are the lenders—some alteration in the diagram is clearly necessary.

Of the £100 of B payments shown, the £70 paid to "Producers of Raw Material," and the £10 paid for "Power" would, on receipt, go to repay loans or overdrafts. The £10 of "Profit to Shareholders" is out of place, being an A payment; so, to keep the A and B payments at £100 each, we will lump it in with the three other B items.

Depreciation is actually a book addition to costs which does not represent money paid to anybody, but merely money which it is hoped to collect from somebody in prices. Only then can it be distributed. But as we have assumed that the producers have actually paid out £200 we will assume that the £10 of "Depreciation" shown is money actually spent; but, in being spent, it also goes to reduce loans or overdrafts. Thus none of the B payments reach consumers at all.

When the consumers spend their £100 of A payments the retailers pass it on to the producers in payment for goods received: the producers repay it to the banks from whom they got it; and the banks thereupon cancel it out of existence.

The position then is that the banks have created and lent £200 of credit and been repaid £200. The producers—who in another aspect are also the consumers—have produced £200 worth of goods, and, as a reward for their industry, have received £100 worth. They have also £100 worth of unsold goods on their hands, and there is no money in anybody's hands—whether producer or consumer—to buy it with; so, despite Professor Copland's confident assertion, "Consumers' Income" and "Producers' Costs" are not in equilibrium; and as any new money or credit created and lent will create a new series of costs, the two things never can be in equilibrium, under present conditions.

III

It may be asked next what causes the discrepancy between incomes and prices. It is caused (1) by every deflationary act of the banks which brings about a premature cancellation of consumer credit; and a premature cancellation of consumer credit occurs when the money or credit distributed as the wages, salaries, and dividends which bring goods into existence is recalled and cancelled before the goods it relates to have all passed to final consumers; or, if the goods in question happen to be such things as plant and machinery, if it is recalled at a faster rate than that at which the plant and machinery depreciate. Or, alternatively, it is caused (2) by the failure of the Government, or the banks, to create and issue free to consumers, simultaneously with the appearance of the goods in the consumers' market, sufficient purchasing power to pay the B element in the price of these goods.

Under the conditions now obtaining, if some traders are able to collect the full price of their goods, others must go short and sell at a loss, or be left with their goods unsold.

The banking system is not related in any scientific way to the economic system or the needs of the community. It originated, so we are told, as far as this country is concerned, in the highly-questionable practice of the goldsmiths of London in creating and lending promises to pay gold they did not possess. They had the honesty to cancel these promises when they recovered possession of them again—only to issue new ones!—but they seem to have overlooked the fact that the circulation of their promises to pay having inflated prices, their withdrawal left those prices correspondingly unbalanced. But perhaps they did not overlook the fact, since no more effective means than unbalanced prices could possibly be devised for compelling traders to resort to further bank borrowings; and without borrowers where would the bankers be?

And banking to this day continues to be run on the same unsatisfactory lines; and its power to do harm has increased as productive capacity has increased, its opportunities for inflating and deflating being so much greater; so that it is now the source of practically all economic, political, and social problems.

It is right that purchasing power should be withdrawn and destroyed with the passage of goods to a final consumer; but it is an error of the first magnitude to destroy it, as is done to-day, when the goods bought are capital goods—plant, machinery, etc.—which merely change ownership but do not pass out of the productive system. In such cases the cost of the goods bought will reappear in the buyer's future prices; but there will then be no money in any consumer's hands to balance it; and the creation of a new B credit to carry it will not mend matters: it will merely delay the day of settlement.

One of the chief ways in which deflation of consumers' purchasing power takes place is through the investment of savings. When the public invest their savings in the shares of any company on flotation their money is used to pay for the buildings, plant, and machinery required by the company. The paying for these things enables the sellers to repay to the banks the credits created for their construction; and the repayment of those credits means also their cancellation by the banks.

Following on this cancellation the company sets to work producing goods; and in its costs it includes depreciation charges to enable it to recover the value of its capital, so that it can renew the plant and machinery when they wear out. That is a perfectly right and proper thing to do. If it did otherwise it would not remain in business long; but the point to be noted is that these depreciation charges constitute a second charge or demand on the public's income for the same lot of capital.

Let me illustrate: If the fixed capital—the buildings, plant, machinery, etc.—of all the companies in the country cost originally £1,000,000—to take a nominal figure—that means that £1,000,000 of credit was, over a period of years, created by the banks and distributed to the public through the channels of production, by way of loans, as income for constructing or creating those capital assets.

When the public subscribed £1,000,000 for shares in those companies that amount was repaid to the banks, directly or indirectly, in liquidation of the original loans, and cancelled. How then can the public, out of its income, put down a second £1,000,000 to pay depreciation charges when it only received one? You cannot

get more money out of the public than you distribute to the public, any more than you can get more than a pint out of a pint pot.

To anyone who may still have doubts as to the accuracy of the A plus B Theorem let me quote a statement of Professor Bowley's written in 1921. "National income," he wrote, "is equal to the total value of goods and services produced or rendered in the United Kingdom, together with interest, etc., from abroad (less payments), the expense of maintaining capital being deducted."

To get at the basic truth of this definition let us simplify it by re-stating it in terms of world-income. The words "interest, etc., from abroad (less payments)" then disappear, there being as yet no inter-planetary trade or financial dealings. The definition then reads: "World income is equal to the total value of goods and services produced or rendered in the world, the expense of maintaining capital being deducted." But as the total *price* of the goods and services produced or rendered *includes* the expense of maintaining capital, how can the world's income, being less than that price by the expense of maintaining capital, ever pay the price? It cannot. Professor Bowley has, unwittingly, enunciated the A plus B Theorem in a different form; and I commend his version particularly to the notice of economists and others who deny that there is any discrepancy between incomes and prices; or, if they do admit it, deny that it is large. Professor Bowley's statement shows not only that it exists but that it is very large, being nothing less than the expense of maintaining the nation's capital. The loss to the community is infinitely greater than even the figures would show; for the existence of the discrepancy puts the whole productive system in chains and prevents it from functioning in the interests of the community at anything but a fraction of its capacity; and what is produced is in the wrong proportions—an excess of capital goods in relation to the output of consumers' goods.

IV

The next point to consider is why, if the Theorem is true, the economic system did not break down long ago.

It cannot be said that an economic system which can only run to an accompaniment of bankruptcy and unemployment; strikes, revolutions, and wars; crime and lawlessness; murders and suicides; squalor, degradation, and wretchedness; overcrowded slums and depopulated countrysides; starvation, preventable disease and death, is running very successfully, or is ever far removed from complete breakdown; but what has delayed that happening hitherto is the great development of loan-credit transactions.

In his statement of the Theorem, given at the beginning of this booklet, Major Douglas wrote: " 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."

The form of purchasing power there referred to is at present loan-credit (manufactured debt). Under a Douglas regime it would be a free National Dividend, not a debt.

Loan credit to carry the proportion of the product equivalent to B is advanced, at present, chiefly for capital development at home, capital development abroad, and, when the bankers' hellish brew boils over, for the financing of war. There is a close connection between the export trade and the business of foreign loans; and

students of world affairs know that one of Britain's chief activities since the industrial era set in has been the granting of loans to foreign countries. The reason for that is the fact established by the Theorem that the people of Britain cannot buy all they produce; and as the idea of creating consumer purchasing power to enable them to do so has not yet penetrated the heads of our rulers, some other—foreign—market has had to be sought for the surplus. Without an outlet for this surplus the industrial system would cease to function, under present conditions; but as foreigners are no better supplied with money than ourselves it has had to be created for them. Hence the origin of these foreign loans.

By means of loan credits which were nobody's income, the otherwise unsaleable surplus was used first of all to industrialise Britain, and then the world; and it is no exaggeration to say that most of the industrial capital—plant, machinery, etc.—exported during the last hundred years or so, by means of British loans, was in essence, although not in form or intention, a gift to the world by the British people of their surplus production. Beyond the help it gave in keeping the industrial system running nobody derived a halfpenny of benefit from it.

In *The Times Trade Supplement* of 1st November, 1930, Sir Arthur Samuel, M.P. (formerly Parliamentary Secretary to the Treasury in the Conservative Government) wrote: " Therefore, at a cautious estimate I say we have lost not less than £2,000 million in overseas investments during the last sixty years. . . . It is not unlikely that our loss has been much heavier, perhaps even £4,000 million."

It must be remembered that these exports were not exports to pay for imports: they were surplus exports, forced exports sent abroad in a vain endeavour to capture money. If they had been allowed to take the form of goods to satisfy the British people's own personal needs, and if the necessary money to buy them had been supplied to the public, the history of this period would have read like an account of the Golden Age.

In industrialising the world Britain sowed the wind: she is now reaping the whirlwind. The countries she industrialised no longer need her products. They have, with her assistance, so increased their productivity that they now make for themselves what they formerly bought from her; and they have also so increased their unsaleable surpluses—being cursed with the same faulty financial system as herself—that they must increase their exports, and are eating into both her home and her remaining foreign markets. Each industrial nation would now require a whole undeveloped world to itself as a market to absorb its unsaleable surplus products, if it is to maintain its population in employment. That the nations have to share among them a world no longer undeveloped makes permanent peace between them impossible, as things are.

Beginning now to realise that foreign markets, while the need for them is increasing, are closing all round, and will continue to close as more and more countries become industrialised and therefore, industrially, more self-sufficient, and also realising that there will be little demand for loans for capital development in face of contracting home and foreign markets, our financial rulers, in their search for a scheme which will prevent an absolute economic breakdown and yet leave them in control, have hit on the brilliant, or crazy, idea of financing destruction, restriction, and waste. They seem to argue that this will provide a double dose of work—one in producing goods and the other in destroying them—and so help to solve

the unemployment problem. And as there is nothing to prevent our destroying as fast as we produce, if we organise ourselves efficiently for it, it is probably the nearest approach to a solution of that problem attainable under present conditions.

In a mad world the bankers' brilliance—or craziness—has justification so long as the majority of people continue to believe that employment constitutes the sole admissible title of right to an income, and that unemployment is, in consequence, an evil to be cured instead of what it is, the first instalment, in a perverted form, of the Leisure Era.

In pursuance of their idea the banks are financing companies to buy up productive concerns and scrap them. Ships and shipyards, among other things, have been bought up and destroyed; and further developments and expansions of the idea may be looked for. We are so used to such insanities that they hardly even strike us as being odd; but in a sane world anyone who proposed doing them would be kept under observation; and if he attempted to do them he would be at once interned in some home or asylum where he would have few opportunities of doing harm to anybody, even to himself.

If steps were taken to provide people with purchasing power equal to the value of the goods and services available, their ability to indulge in health and pleasure trips would keep both ships and shipyards profitably employed to the end of time.

V

One of the latest critics of Douglas and the A plus B Theorem is H. T. N. Gaitskell, of New College, Oxford, Lecturer in Economics at University College,