

THE FIG TREE

Quarterly

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The Convention of Cost

By R. L. NORTHRIDGE

CONVENTIONS have their uses; if we had to think out, from first principles, a course of action or a situation every time some decision had to be taken, we should get nothing done. Conventions save time and mental energy. They are the invaluable and well-memorised formulae that we apply almost instinctively to all the problems of living.

We are only too apt, however, to forget that, if there is such a thing as ultimate truth, we certainly have not as yet discovered it. Modesty, indeed, hints that such a commodity might prove a little too much for the apparatus we carry within our skulls. Even the most valid convention, therefore, must be based upon what is at best a qualified section of reality, and if our problems shift, as all problems have a way of shifting, out of that section, the convention increasingly fails to give us the results we desire.

This unfortunate outcome, of course, might have a speedy remedy; a prompt reference to first principles would show where the convention was at fault and suggest sound methods of making it once more a reasonably correct reflection of reality. The trouble is that, just as the majority of slave-owners became the property of their own slaves and for the same reason, the out-worn convention is usually the very last thing to be questioned. Instead, desperate and unavailing attempts are made to alter reality, while anyone who hints that, just possibly, the convention might need a little overhaul is dismissed as a crank and an iconoclast. Let us face the brutal truth: the one thing *homo sapiens* will not do, save in the very direst extremity, is to "*think again.*"

An example is afforded by Euclidean geometry. For two thousand years the axioms of Euclid and the geometry founded upon them were regarded as absolute truths; "a straight line is the shortest distance between two points" was as valid on earth as it was at the back of the spiral nebulae. Quite recently, however, it was found when

considering problems involving immense magnitudes and almost infinite degrees of smallness that Euclid's geometry gave results not in accordance with the observed facts. It became apparent that this geometry, with the axioms upon which it rested, was merely a convention, corresponding well enough to reality so long as the magnitudes involved did not approach the limits; quite a number of other geometries could be constructed just as logically from other axioms, and it became merely a matter of selecting the one that best fitted the observed facts. Yet Lobachevsky and Bolyai, the first inventors of a geometry differing from Euclid's, were thought to be mad, and Gauss, who had privately held similar opinions, confessed that he had been afraid to publish them.

So much for the natural power of convention upon the human mind; when it is reinforced by all the resources of vested interests, it dies hard indeed, though the problems to which it prevents a solution may be of vital importance to every civilised human being.

The main force of a convention is that it masquerades as ultimate and axiomatic truth, and habits of thought are so strong that only a particular and very special type of mind will have the originality to question it. A very good instance is afforded by our mental attitude towards a distributive system based upon Financial Cost.

Cost is arrived at by adding together all the financial disbursements occurring in the production of a commodity and dividing the total by the number of articles produced. In practice, this method is applied only to the calculation of overhead charges, the wage and material costs being calculated and added specially for each individual article, since the articles turned out by a factory are not usually all identical. Price is arrived at by adding a financial profit, which may be regarded as the cost of the entrepreneur's services. The financial disbursements referred to, which must, of course, be paid ultimately to individuals, are exchanged by them for the product they have helped to make.

In favourable circumstances, more may be asked for the article; during a slump less may have to be accepted temporarily, but normally, and so long as the firm flourishes, price as thus computed measures the exchange-value of the article. Price, based upon the costing process

just described, must be maintained, otherwise financial sanctions are incurred which result in the firm going out of business.

Now all this is simple enough and quite logical within its own frame of reference. What we have to notice is that this frame of reference is entirely arbitrary, and that a system based upon the idea of financial cost is merely one method of distributing the available communal product. Other systems have been experimented with by Russia and by Japan, at least as regards their export trade, and it is entirely practicable to construct any number of perfectly logical methods, and to select whichever corresponds best with reality. For instance, the entire man-hours worked by the community during a given period might be computed and this total taken as the total production cost of the period, this cost being assessed over the various units of production by any convenient method, the community purchasing the goods by “man-hour tokens” distributed according to the number of hours worked by each individual.

Arbitrary and indiscriminating though such a system would be, it would nevertheless ensure a natural solvency and an effective demand upon the entire output—results which the present system, superior in other respects, signally fails to accomplish.

It is not proposed to discuss the failure of the present system, beyond noting that the prime symptom is a failure of effective demand, and that it contains no arrangement for directly equating total costs with consumers' incomes. What we have to do is to consider the nature of the physical reality underlying the notion of Cost in order to discover, firstly, why a distributive system that worked reasonably well at certain times now fails to give satisfaction and, secondly, what changes or modifications are required to secure acceptable results.

Now, in a physical sense, the cost of any given programme of production is the material and energy used up (or, strictly speaking, converted) in the course of carrying it out. If Robinson Crusoe sowed a bushel of corn, while maintaining himself by consuming a further four bushels, the resulting crop of, let us say, twenty bushels cost him five bushels. The real cost of a bushel to him was a quarter-bushel. Regarding the crop as money, however,

the price of a bushel cannot be less than a bushel; he cannot part with a pound for anything less than a pound if he is to continue in business. Nevertheless, the *physical* price (at which alone the goods can be cleared) must be less than financial cost in the same ratio as consumption is less than production—in this instance, 5 : 20.

From this illustration it becomes obvious that the real price of anything—the price at which Nature makes the goods available—is expressed by the ratio

$$\frac{\text{Rate of Consumption}}{\text{Rate of Production}}$$

and that it does not greatly matter what convention we adopt for the computation of cost, so long as the price to the consumer is modified correctly by this expression.

Price today equals financial cost (including profit); physically, the cost of production is consumption. These are not the same, except in a special instance – when consumption exactly keeps pace with production. In such circumstances, when all the money paid out by industry (cost) has been recovered for the product as price, *everything* will have been sold, and the ratio between Consumption and Production is unity. In normal circumstances, with modern methods of production,

$\frac{\text{Consumption}}{\text{Production}}$ is considerably less than unity, so that $\text{Cost} \times \frac{\text{Consumption}}{\text{Production}}$ is well below the selling price

of the product as at present computed, for appreciation of material assets greatly exceeds depreciation, including consumption of consumable goods.

The application of the Consumption/Production ratio to price is an extension of the Income and Expenditure principle, which is the basis of accountancy and is used to regulate the monetary affairs of every business. If income (Production) is in excess of Expenditure (Consumption), then

$$100 \times \frac{\text{Income} - \text{Expenditure}}{\text{Income}}$$

gives the average percentage of profit on each transaction, and if it were desired to pass this profit on to the customers it could be done by multiplying the selling price, made up as was usual, by the value of the

expression $\frac{\text{Expenditure}}{\text{Income}}$.

The excess of Production over Consumption in a modern community represents the communal profit in real wealth on

the production-programme for the period, and can conveniently be distributed by the same method. When it is not so distributed, it must pass quite automatically into the hands of those institutions which create money.

The community's money has been exhausted by the purchase of the values expressed by the term Consumption, and it cannot buy in addition the increment of goods representing the real profit on the period's work (Production - Consumption). Though these goods may be for the most part capital assets, the public, as individuals, is entitled to the financial means of acquiring them, otherwise they must pass under the control of the banking system and be entered against the community as debt. For all production must, in one way or another, be consumed, and all consumption is charged against the community as price or as taxation. The increment of profit in each period thus becomes a mounting debt.*

It is not difficult to see why the present methods of computing price worked with tolerable success during long periods of the world's history. Before solar energy was employed in the productive process, each year's production was very nearly balanced by its consumption: capital equipment, the form "saved" production usually takes, was primitive and its value, as compared with the value of the consumable product, was very low.

Cost x $\frac{\text{Consumption}}{\text{Production}}$ was practically equivalent to cost: the problem had not then begun to move towards the

limits.

Nevertheless, there is a considerable body of evidence to show that, where any important civilisation was built up, with its cities, mines and other aggregations of capital,

the ratio $\frac{\text{Consumption}}{\text{Production}}$ became appreciably less than unity, and that the destruction that eventually over-

and that the destruction that ultimately overtook these attempts at an organised society proceeded from a failure

*"A Balanced Budget . . . is simply a statement in accounting figures that the progress of the country is stationary, i.e., that it consumes exactly what it produces, including capital assets. The result of the acceptance of this proposition is that all capital appreciation becomes quite automatically the property of those who create an issue of money, and the necessary unbalancing of the Budget is covered by Debts." — C. H. Douglas: "The Alberta Experiment," pp. 184, 185.

to solve an economic problem strongly resembling our own. Sabotage and restriction of output were not unknown (though it has been reserved for our own ingenious advisers to give these terms a rapturous emphasis), but the real likeness resides in the growth of debt which, in the Roman civilisation, removed the patrician from his estate, the peasant from his field and the craftsman from his implements, and, finally, the solvent buyer from the market.

Consumption

Since the ratio $\frac{\text{Consumption}}{\text{Production}}$ is now considerably further from unity than at any time of which we have

Production

record, it becomes increasingly urgent to apply it to the prices of all goods for sale. If this is not done, and done soon, we can expect no other fate than that which overtook earlier civilisations possessing no knowledge of the "true unit of account," or lacking the will to employ it.

A Way They Have

A "Bernik" is a controller of taxes, and this one was employed in Bulgarian Macedonia. Two peasants, considering that they had been overtaxed, complained before the tribunal of IMRO, which found them in the right. The revolutionaries informed the "Bernik" that these people must not pay the amount he had charged. "Let them pay first," said the "Bernik," "and they can claim a refund later." He was seized, his shoes taken from him, and, barefoot, he was put on the road to Sofia.

"Give me back my shoes," implored the King's representative. But this incensed his judges and they removed his trousers, and at the point of the revolver he ran towards Sofia. So he made his entry into the capital. All taxpayers, alas, do not live in Bulgaria! – *From "Terror in the Balkans," by Albert Londres.*