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CAN CAPITALISM LAST?

CAN CAPITALISM LAST?

by

FREDERICK ALLEN

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CONTENTS

Introductory p 11

The patent contradictions between poverty and glut—The avoidance of the problem by the bourgeois economists—The optimism of Mr. Keynes—And the obstinate facts of poverty—Sir Josiah Stamp appeals to the economists—"Intelligent scepticism"—The weather-vane of Mr. Keynes's opinions—His neglect of the factor of rising productivity—The importance and persistence of this factor—The aim of this work to analyse the dilemma of failing purchasing power and its significance for the future of capitalism.

CHAPTER I *Purchasing Power* p 25

The market controls capitalist production—The concept of finished goods—Its relation to "consumers' goods" and "capital-goods"—The ultimate importance of consumers' purchases—The volume of purchases—And purchasing power—The constituent parts of the market.

CHAPTER II *The Utilisation of Purchasing Power* p 43

The relationship between purchasing power and purchases expressed as a coefficient, E —Purchasing power devoted to investment—Investment in production—Enlargement of the market by credit expansion—Unproductive investment—Absorption of purchasing power by the financial circulation—Bank balances as hoarded purchasing power.

CONTENTS

CHAPTER III *Some Root Causes of the Dilemma* p 57

Hypothetical conditions under which no overproduction can exist—The difficulty of maintaining these conditions—The importance of the profitability of investment—Why the problem does not exist in the U.S.S.R.—Why capitalism cannot copy the U.S.S.R.—Bankruptcy of the High Wages Theory—Determinants of the level of wages and Marx's theory of the subsistence level—Its relationship to collective bargaining—Statistics of nutrition and the subsistence level—The Wages System the barrier to the consumption of commodities.

CHAPTER IV *State Expenditure* p 75

Effects on purchasing power of ordinary taxation—Deficit financing—Roosevelt's deficit financing—Mr. Keynes's public works proposals—A State monopoly of credit expansion?—Albertan Social Credit—Its affinity to hire-purchase.

CHAPTER V *The Repercussions of Purchases and of the Failure to Purchase* p 88

The tendency for inequalities in the volume of purchases to aggravate themselves—The nature, and limits, of the repercussion—Its varying strength according to the state of trade—Further analysis of the workings of repercussions—The danger and the difficulties of the use of mathematics in economics illustrated by the nature of repercussions.

CONTENTS

CHAPTER VI *The Increasing Productivity of Labour* . . . p 102

Repetitive Investment—Ameliorative Investment—The persistence of the trend of rising productivity—The distinction between labour—and capital-saving investments unnecessary—technological unemployment and rationalisation—The effect of rising productivity upon purchasing power—The cheapening of commodities and the enlargement of the whole economy—The fact of such an enlargement in nineteenth century Britain—Investment the mainspring to expansion—Capitalist productive relations hinder a rise in living standards—Unwillingness of the accumulating class to consume the enlarged output—Hypothetical case where living standards cannot rise at all—The process of a net shrinkage of purchasing power—Mr. Keynes's equilibrium—An inherent weakness in capitalism—The boon of waste—Armaments—Advertising.

CHAPTER VII *Further Considerations on the Problem of Productivity* p 137

The need to keep theory in close touch with reality—The failings of the bourgeois economists—The existence of trade cycles and the course of nineteenth century industrialism tend to confirm the theory—The mutual destruction of capitals under competitive conditions—The importance of qualitative changes in capitalism.

CHAPTER VIII *Foreign Trade and Imperialism* . . . p 152

The limitations of trade with backward countries—The transformation of native communities into complementary economies for the imperialist power—The economic technique of imperialism—The joint stock company and foreign investment—Finance capital and heavy industry—Foreign investment as a stimulus to the scale of production—Its limitations as such—The development of colonies into advanced capitalisms—Imperialism as a solution for world capitalism.

CONTENTS

CHAPTER IX *Monopoly Capitalism* . p 177

Competitive capitalism can only flourish with rapidly expanding markets—Little really competitive industry left in Britain—Competition runs itself to seed—Engels on competition—Factors facilitating monopoly—Monopolies for colonial exploitation—Monopoly transfers purchasing power from the consuming masses to the wealthiest capitalists—The monopolist tends not to pass on the benefits of reduced costs to the consumer—Monopoly restricts destructive investment—The initiative of monopolies—The case of the railways—Scientific investment by monopolies—How production can expand under monopoly—Illusions as to the effects of “new demand”—Summary of the influence of the trend to monopoly upon the community’s purchasing power.

CHAPTER X *The Rate of Interest* . p 203

Mr. Keynes’s “natural” rate and “market” rate—Lowering the rate of interest as a stimulus to investment—The housing boom—The manipulation of the interest rate cannot be relied on to induce investment expansion—Mr. Hawtrey and monetary policy—The influence of rising prices.

CHAPTER XI *Some Crises Considered* p 215

(a) *Crises of Competitive Capitalism*

Adam Smith and the earliest crises—No overproduction in the pre-capitalist era—Steam power and some crises of the early nineteenth century—Crises of over-investment and Marx’s description of them—The relation of crises of over-investment to the general analysis—Crises of overproduction of commodities—The economic necessity of imperialism.

CONTENTS

CHAPTER XII *Some Crises Considered* p 237

(b) *The Imperialist Heyday*

The value of imperialism in providing markets—The imperialism of the 'eighties—The role of gold mining—The prosperity of the 'nineties and the early twentieth century—The enormous rate of growth of the capitalist economy.

CHAPTER XIII *Some Crises Considered* p 246

(c) *Post-War Crises*

Post-war capitalist opportunities and the early slump—The re-construction of Europe—A stable price level—Accumulating overproduction beneath the stability—The Wall Street crash not a primary cause of the slump—The speculation no accident—The early signs of the slump in the world as a whole—The necessary expansion only possible in certain circumstances—The armament boom of 1937—The deepening severity of crises—Is there a "rock bottom" to a slump?

CHAPTER XIV *Palliatives* . . . p 259

The transference of purchasing power from one country to another by protective tariffs—Government subsidies—State restriction—Germany the extreme case—Wage-cuts in times of crisis—Currency depreciation—Armament expenditure as the favourite form of deficit financing and as a possible solution.

CHAPTER XV *Concluding Remarks* . p 280

The capitalist social relationships are at the base of the problem—No solution to the dilemma in sight—Capitalism will not simply "collapse"—Living on make-shifts and destruction—The attitude of the social classes—A solution demands the abolition of the employer-employee relationship.

INTRODUCTORY

The patent contradiction between poverty and glut—The avoidance of the problem by the bourgeois economists—The optimism of Mr. Keynes—And the obstinate facts of poverty—Sir Josiah Stamp appeals to the economists—"Intelligent scepticism"—The weather-vane of Mr. Keynes's opinions—His neglect of the factor of rising productivity—The importance and persistence of this factor—The aim of this work to analyse the dilemma of failing purchasing power and its significance for the future of capitalism.

DURING THE MIDDLE AGES it was generally believed that the earth was flat. In our age of geographic enlightenment it is hard to understand how the intellectual arbiters of that epoch contrived to maintain this belief, and why mariners never tested the belief by sailing to the end of the earth in order to find out what it really was like. Russian school-children, it is said, cannot understand why the working people of other lands are so foolish as to tolerate the capitalist system. No doubt it will be marvelled in a future age that with all the patent contradictions and insufficiencies of the nineteenth century economic structure, so few people set themselves to enquire into the basic causes. Just as we now stigmatise the

Middle Ages for their witchcraft, so it will be then said of us, that with millions underfed, underclothed, overcrowded, diseased, ignorant, we forced millions to remain idle, though clamouring for work.

I suppose many thinking people are tired of this Poverty amidst Plenty talk. More exactly, they shirk the nervous strain of thinking about something unpleasant. How easily the eye hastily shuns gloomy news of rising unemployment! For presuming to write upon a subject at once so disturbing and so commonplace, the author would fain tender his apologies, but that the answer to the dilemma is still playing truant.

Neither the professional bourgeois economists, nor the "crank" amateurs have solved the central contradiction of our age. For having even broached the problem, the author will no doubt be dubbed "crank", for he has violated the taboo of respectable political economy.

Yet it is not for those who themselves have failed, and even given up the trying, to deride. The modern bourgeois schools are never tired of declaring Karl Marx "out-of-date" and "disproved", at a time when our economic difficulties show modern bourgeois theory to be largely

irrelevant. Meanwhile the millions remain short of food and clothing and houses. With over 1,500,000 unemployed, we are told (1937) that we must damp down the "boom".

Diagnosing our present troubles as "growing pains" (*Essays in Persuasion*), Mr. Keynes says that we may confidently expect the British standard of life to be four to eight times as high in one hundred years' time. Imaginations are flushed by the vast new productive powers which science is putting at the disposal of society. We are tantalised with the possibilities of a one-hour working day, with the universal enjoyment of that standard of life at present restricted to the few at the top. It comes as a shock that a 7½-hour working day is "quite beyond the financial resources" of the London Passenger Transport Board. At a recent teachers' conference, it was related how children in Cumberland were given eggs and did not know how to eat them because they had never had them before. Children in Barnsley had refused custard, butter and bananas, because they did not know if they would like them.¹

Where is the barrier between the utilisation of these productions forces and the viciousness

¹ Conference of National Federation of Class Teachers, Sept. 1937

of the modern world? The economists cannot answer. The public, bewildered, has no faith in the experts and would agree with Hartley Withers¹ that "those among the rest of us who have ever tried to get light from economics, while we grope our way to a solution of our present difficulties, have generally found that its exponents usually contradict one another and often also themselves. . . ."

A typically passive fatalistic attitude to the future of our civilisation is revealed in the film "Things to Come", purporting to be based on a book by Mr. H. G. Wells. The first part of the story, leading up to the destruction of society by a world war, and a reversion to a primitive economic system, contained little beyond the bounds of possibility—until a symbolic race of scientists drop like the *deus ex machina* out of the sky, to take charge of society in the last stages of self-annihilation, and lead it to the era of prosperity. Where they came from was not at all clear, nor how they had managed to escape being drawn into the universal destruction. Sir Josiah Stamp, in his presidential address to the British Association (1936) must also have recourse to the *deus ex machina* in the form of a

¹ *Sunday Times*, Oct. 4th, 1936.

“benevolent dictator” who will apply our modern knowledge of diet “and increase our stature by two inches”. This address was nothing more than a cry for a solution of the economic dilemma. He voiced the inner feeling of many scientists in that gathering who must have noticed that their researches were only sure of utilisation when they devised new engines of destruction. If a scientist invents a method of producing goods with less human effort, and thus, as he may think, enrich mankind, he is the more likely accused of throwing men out of work. There is no doubt that Stamp’s complaint against the economist expressed the feeling of frustration in that assembly. Taking as his subject the reactions of science upon society, he deplored that “the economist, perhaps more surprisingly, rarely acknowledged any duty to study this phase of his subject”. It is indeed astounding that the economists should refuse to investigate this most critical of economic problems. After years of the ravages of the economic crisis, no economist can tell us how to link up our productive forces with the demands of a poverty-stricken humanity. Why should it be necessary for Sir Josiah Stamp to appeal to them to make this a subject of “specialised research”?

Mr. Frank Murphy, Chairman of Murphy Radio, Ltd., asked the professional economists pointedly¹ how they would propose to raise the standard of living. He challenges them to do one of three things:

- “(a) State that it is not a fair question to address to the professional economist, giving their reasons.
- “(b) Outline constructive proposals.
- “(c) State that they are not capable of making proposals.”

The only person who attempted to give an economic answer was Commander Stephen King-Hall. No single professional economist took up the challenge. Nor have the professionals fared any better in interpreting the recent great depression. “It is a melancholy reflection,” remarks the *Economist*,² “that the depression of 1929–33 has come and (perhaps) begun to go, and yet our understanding of the trade cycle is scarcely greater than it was before. The crisis has produced a vast outpouring of books, pamphlets, and official reports; and the opinions of economists have inclined this way and that

¹ *Economist*, Jan. 2nd, 1937.

² Sept. 9th, 1933.

with the swing of events, only to return, in most cases, to an intelligent scepticism as the attitude best fitted to so complex and baffling a problem." In that last score of words is summed up the renunciation by the bourgeois school of any scientific treatment of the dilemma of purchasing power. What scientist would dare to admit that he found the problems in his own field of research so "baffling" that he gave up the task, and relapsed into an attitude of "intelligent scepticism"? This is precisely Mr. Dennis Robertson's reaction when he states:¹ "I believe that the trade cycle, *for mysterious reasons of its own*, did begin on the up-grade in the middle of last year." Is this the frame of mind of the twentieth-century scientist, or the Babylonian astrologer reading the heavens? Not only does this economist, a typical representative of the bourgeois school, admit blandly that he does not know the causes of the trade cycle, but adopts a mystical, attitude which precludes scientific investigation. The economists may retort that in every field of science there are unsolved problems, the origin of life, the nature of space and matter, the formation

¹ Speaking at the Liberal Summer School, reported in *The Times*, Aug. 9th, 1933.

of the solar system. True, but despite the enormous difficulties of investigation—difficulties which the economists are spared—scientists do not renounce their calling. Research into the problem of purchasing power and recurrent economic crises presents few difficulties. The relevant data dealing with the workings of our economic institutions, with bank credits, outputs of firms, prices of commodities, wages, unsold stocks, employment, are already at hand or could be collected at little expense. No lack of statistical evidence can be pleaded. At a point where the facts demand attention, the bourgeois schools have not the courage to collate them into a positive theory. Economic theory is in a state of anarchy, like the system from which it springs.

This characterisation of the bourgeois economists would be too sweeping if it did not make an exception of Mr. J. M. Keynes, whom no one would accuse of a lack of courage in formulating theories. His complaint is rather too great a “propensity” to General Theory, no sooner propounded than discarded. The Mr. Keynes of 1936 renounces the theoretical edifice of the Mr. Keynes of 1930. Whereas in the *Treatise on Money* our economic troubles consisted in the

inability to make investments equal the volume of savings, we learn in his latest work¹ that investment *must* equal savings, whether we want it or no. One can imagine that the lesser priesthood, once already led to say blasphemous prayers, are wary of accepting the new incantations. Who is to know whether the Mr. Keynes (1938 or 9) may not declare Mr. Keynes (1936) a heretic?

Mr. Keynes must be congratulated, however, for showing no symptoms of the "intelligent scepticism" which is paralysing his colleagues. He hears the challenge of society to the economist. In the preface to his latest work he (quite correctly) criticises his *Treatise* in that "the dynamic development was left incomplete and extremely confused" (p. vii). In the newest work he promises us "a study of the forces which determine changes in the scale of output and employment as a whole". Surely this is the kernel of the problem, to be able to understand, with a view to regulating if possible, the amount of commodities produced and of men employed. Such considerations naturally call to mind our modern mass production processes, with the specialisation of labour and scientific technique,

¹ *General Theory of Employment, Interest and Money.*

resulting in a constant saving of human effort, and an ever-growing output of commodities. Lest any reader should minimise the significance of this phenomenon as a "dynamic" factor, it is well to give some indication of the strength of this trend. Between 1922 and 1927 in the U.S.A. the output per man was raised by 3·5% per annum. The total increase in labour productivity between 1925 and 1929 in Germany amounted to no less than 27·5%, or 5% annually.¹ Even from 1924 to 1930 in Great Britain, a period often characterised as one of technical stagnation compared with advances in other countries, the output per head of workers in the chief manufacturing and mining industries increased by as much as 21% (3·2% annually).² Yet in nearly four hundred pages of scholarly reasoning devoted to the study of the dynamics of output, Mr. Keynes fails to give the least consideration to this pre-eminently dynamic phenomenon. In the whole of the work, and ironically enough in the chapter headed "The General Theory of Employment Re-stated", he gives it but one mention—to say that he will ignore it—"We take as given . . . the existing technique."

¹ League of Nations, *Course and Phases of the World Economic Depression*.

² *Statist*, June 21st, 1930.

How, we ask, can the general theory of employment be stated without considering that every year fewer men are needed to produce the same output, and that in consequence, there must at least be a *tendency* to dispense with men? Has this really no bearing on the theory of employment?¹

At this point we are brought to the theme of this essay. It is an attempt to give a theoretical outline of that dilemma of purchasing power or of "distribution" which has come to dominate the economic activity and hence every aspect of the civilisation of the capitalist world. No attempt is made to write an economic history of capitalism. Facts are only given for illustration, or to test the *prima facie* probability of the conclusions reached at each stage of the argument. Much of the theoretical exposition will be familiar to the "professional" but it is not for him alone that the analysis is intended. While it has been

¹ Let the reader compare this gap in Mr. Keynes's most recent theoretical formulations with the following extracts from an Essay, 'Economic Possibilities for our Grandchildren,' written by Mr. Keynes, in 1930:

"The increase of technical efficiency has been taking place faster than we can deal with the problem of labour absorption:"

"It is safe to say that technical efficiency is increasing by more than one per cent per annum compound."

"We are being afflicted with a new disease of which some readers may not yet have heard the name, but of which they will hear a great deal in years to come—namely, *technological unemployment*." (Italics by J. M. K.)

found necessary to embark upon lines of reasoning to which the reader without special training in economics may not be accustomed, every effort has been made to make the text comprehensible to the non-expert.

There is probably no single idea in this work which has not been already stated by someone else. Certainly Karl Marx understood and described the main processes herein studied. And I believe that only Marx's analysis of the capitalistic productive relations can demonstrate convincingly why our present economic difficulties are things which must be, so long as these capitalistic relationships persist. Furthermore, Marx's economic terminology is the best for his analysis, and indeed necessary thereto. Nevertheless, I have not used the specifically Marxian economic terms in this essay, firstly because it has not been my object to re-state Marx's basic theory,¹ and secondly, because they may cause misunderstandings and difficulties to all but the very few who are conversant with them.

Finally, it must be borne in mind, that while Marx laid bare the inherent weaknesses of

¹ Those who require a short and clear exposition of Marx's theory of value cannot do better than refer to John Strachey's *Nature of Capitalist Crisis*.

capitalism, he did not live to see them reach their climax, and could not, therefore, study them in their fullest detail and development. The purpose of this essay is no more than to give a summary of the principal of these weaknesses as we are able to see them now.

CHAPTER I

PURCHASING POWER

The market controls capitalist production—The concept of finished goods—Its relation to “consumers’ goods” and “capital-goods”—The ultimate importance of consumers’ purchases—The volume of purchases—And purchasing power—The constituent parts of the market.

“The limits of production are determined, not by the number of hungry bellies, but by the number of *purses* able to buy and to pay.”
(F. Engels to Lange, 1865.)

THE POPULATION OF the world, excluding Russia and China, is estimated to have increased by 13% between 1913 and 1929. The production of wheat did not increase by a similar extent,—only by 10%. Yet strangely enough, stocks of wheat increased from year to year, until, in 1929, they had swollen to twice their normal size. “If there was overproduction, therefore, it must have been caused by a falling off in demand.” Such is the phlegmatic conclusion of the League of Nations Committee of Economic Experts.¹ But why the falling off in

¹ League of Nations, *Course and Phases of the World Economic Depression*.

demand? Are we really to believe that the world has reached such a state of well-being that people are eating less bread in favour of more varied foods? Again the League of Nations experts supply us with an answer: "While a world wheat surplus threatens economic stability, pellagra and beri-beri, both diseases which the consumption of wheat would eliminate, continue to take thousands of lives every year."¹ Engels's observation of seventy years ago has become one of those platitudes which it is found convenient to ignore. He who does not pay, neither shall he eat. A man is a market if he has a purse. No matter how many hungry bellies there are, hunger can only become a demand on the market if it can take the form of purchasing power.

The market is the arbiter of capitalist production. A widening of the market, and production races to the new limit. In every industry, in every enterprise, the market is the regulator of the scale of production. The size of the market says how many men shall be employed. *If only* those hungry bellies, those shabby backs, could express their needs on the market, the Age of Plenty

¹ *Nutrition and Public Health*, published by the Health Organisation of the League of Nations 1936, quoted by *The Times*.

would be here, gone would be the square miles of gaudy advertisements, gone the armies of salesmen, the slogan would be Production and Plenty and Leisure and Culture. But no! He who doth not sell, neither shall he produce.

The market must be the starting point of any study of the stagnation of world production, the causes of world poverty, and the periodic crises of overproduction and unemployment. For this purpose, it will be necessary to split up the market into its constituent parts, and enquire whether any or all of the parts are capable of sufficient expansion to burst the bonds upon production.

First, however, it is essential to be clear about the terms that are used, since words about whose definitions there seems at first sight to be no confusion, may cause an analysis to go awry because they have imperceptibly altered their meaning. One such term is *market*, which shall be defined as the volume of purchases of *finished* products during any chosen period of time.

The term *finished* goods needs explanation. This means those commodities which, having been purchased, come into the hands of their consumer or user, and no further labour is

expended on them for the purpose of making them anything different from what they are. They have taken on their final shape, whether it be a biscuit, a house, a donkey, a motor lorry, or a printing machine, or a battleship or a road. On the other hand, wheat, or pig-iron cannot be called finished products because no one would think of buying them except in order to perform upon them some further act of production. Even tea in a London warehouse, or canned meat in a grocer's shop, is not a finished product in the strict sense of the word, for the last stage of production, their placing in the hands of the consumers, has yet to be performed. Of course, a printing machine will spend the whole of its life in the process of production, but it is in the production of other commodities, and not of itself, that it is engaged. It is being used in production, not being produced. It may be reasoned that a printing machine, for instance, is not a finished product in the most fundamental sense, because the values incorporated in this machine only receive their final use in the form of print. For some purposes, it may be convenient to adopt such a definition, but for the purpose of studying the market, it is more suitable to define as a finished product anything which, after its

purchase, has no further work done upon it, bar maintenance.

The logic of the definition consists in the fact that every day, with our present industrial organisation, quantities of unfinished goods are offered for sale, and bought, either to be held for speculation, or to be further worked upon. Now there would be no sense in adding up the volume of these sales in order to measure the market, because a product, in the course of its making, may be subjected to numerous such sales, and so be counted several times in the calculation. For instance, the metal contained in a piece of iron ore may be sold a dozen times before becoming a steel rail. If, however, one firm owns all the processes of production, the metal becomes acquainted with the market only once, in its final form as a rail. No sensible person would maintain that because—only, say, one-sixth the amount of money payments has been made, that the market has shrunk in size. Consider, as the extreme case, the speculation in wheat on the Chicago market. One consignment may change ownership fifty times. Eliminate the gambling, and the market for wheat is unimpaired. Such *payments in production*, as we may term the sums of money paid for unfinished goods, may

be ignored here, and considered of no more significance than the book entries in the costing accounts of any large firm.

We must note in passing that the difference between payments in production and purchases constituting the market does not correspond to cash or bank payments. Both can be made by either means. The only importance which payments for semi-finished products have, is that, firstly, monetary resources, both in coin and bank balances, may be devoted to them, which, if free, might increase the purchases of finished goods; and secondly, that their continual purchase and repurchase may absorb parts of incomes which might otherwise be more usefully spent. These points are dealt with in a later chapter.

The qualitative difference between a purchase in production and a purchase of a finished product is seen in this way. If a £10,000,000 payment in production is eliminated, the effect will be negligible provided that credit is not scarce. On the other hand, the failure of a purchase of £10,000,000 of finished goods will cause a serious shrinkage in the market, and, together with its economic reactions, a considerable drop in production and unemployment.

Similarly, a Stock Exchange transaction of £100,000,000, given no scarcity of credit, will have negligible effects for the purpose of the study of the market, but a sudden demand for £100,000,000 of finished goods may have spectacular effects upon the market.

It follows necessarily from the above definition, that when we speak of *purchases*, we mean the removal of finished goods from the process of production and distribution, such finished goods including of course foodstuffs, shirts, furniture, and all that are usually called consumers' goods.

It will be noted that the concept of finished goods cuts across the more general categories of "consumers' goods" and "capital goods". This distinction has its importance in economic theory, and is essential, for example, in a general description of the capitalist economic processes. It will be used from time to time in this work where the argument requires it. At this stage, however, the category of "finished goods" allows of a more fundamental analysis. A flow of money comes on to the market in the form of payments for the commodities produced. Once an article is finished, it is, in the normal course

of things, sold. The act of selling supplies the producing industry with the funds with which to pay out the incomes which originate from that industry. In other words, there is a very close relationship between the sale of a finished product and the volume of purchasing power accruing to those connected with the industry, and to the community as a whole. For the study of this relationship, it is of no import whether the payment is in respect of finished consumers' or goods finished capital goods. In either case the firm selling the commodity has received the funds with which to pay wages and salaries, dividends to the shareholders, and to make other disbursements which, to their recipients, are incomes. For those who have accustomed themselves to the concepts of consumers' goods and capital goods, and find it difficult to think in terms of finished goods, it may be easier to consider finished goods as the total of consumers' goods plus capital goods, less raw materials and semi-manufactured and untransported commodities.

Purchasing power, the next term which requires definition, is not synonymous with the volume of purchases, although their interactions are so close that one can often use either term

indifferently in a general sense. For the purpose of an exact analysis, however, it is essential to avoid confusion in the use of the two terms; for the divergence between the volume of purchases and of purchasing power gets to the root of the analysis. Of recent years there has been a general realisation of the importance of "purchasing power" owing to the flagrant anomalies of overstocked markets and poverty which has puzzled thinking people. Certain non-professional economists, chief of them J. A. Hobson, and, more lately, Fred Henderson, have quite correctly centred their arguments around the problem of failing purchasing power. It is the great merit of J. M. Keynes that he has forced the professional economic world to think along these lines. Since the term has been so divergently used, there is all the more reason for giving it a precise definition, and taking care to use it as a strictly scientific concept.

The idea behind purchasing power is the control over commodities given to people by reason of their incomes. It is obvious that, in general, commodities can only be taken off the hands of producers if people buy them, and they can only buy them if they have the incomes to provide the purchase money. Of course people

do not dispose of their incomes on consumption goods alone. The well-to-do regularly devote a part of their incomes to investment, that is, they buy capital goods. In either case, whether an income is devoted to personal consumption or investment, it takes commodities off the market and places funds in the hands of producers. Secondly, as will be discussed in detail later, some people do not spend the whole of their incomes, i.e. part of the purchasing power which accrues to them is not utilised. The actual purchases which people make out of their incomes constitutes the bulk of the volume of purchases. Except by such extraneous factors as the creation of bank credits, which can be left out of account for the moment, the volume of purchases cannot exceed the bulk of purchasing power from which it springs. On the other hand, the volume of purchases can be less than the originating mass of purchasing power if on balance people are withholding part of their incomes. Thus we have two variables. It will be necessary to examine, firstly, how the volume of purchasing power changes, and, secondly, how much of this purchasing power comes to fruition in a volume of purchases and constitutes a market.

What, then, fixes the aggregate of purchasing power from which the volume of purchases springs? Paradoxically enough, its chief source is the volume of purchases. We are faced with the old conundrum of the egg and the hen. It has been seen how the volume of purchases is fixed by the purchasing power. It now remains to show how the purchasing power is determined by a volume of purchases, not that volume which it itself generates, but a *previous* volume. Earlier in this chapter, it was seen how any firm or business distributes the proceeds from the sale of its products among the different individuals attached to it. The firm benefits by other people's purchases; these funds it hands over to its workers, managers, directors, shareholders, etc., as their incomes or purchasing power. Similarly, the volume of payments made to industry as a whole is re-distributed and the funds become the volume of purchases of the community. Purchasing power, and the volume of purchases, generate each other in never-ending cycles. The volume of purchases of one phase becomes the purchasing power of the ensuing phase. Out of the purchasing power thus generated the volume of purchases of the succeeding cycle is born.

For the purpose of the analysis the description above was simplified. In the first place, a firm can hoard part of the proceeds from its sales just as an individual can. In this case the volume of purchases would generate a smaller purchasing power in the next cycle. Conversely, a business may enlarge the purchasing power by disgorging previous hoardings, or by borrowing and spending money which the banks have created by credit expansion. In the latter case, the volume of purchasing power may be enlarged so as to be absolutely greater than the purchasing power from which the main bulk of it originated. Conversely, again, if an industry is repaying more bank loans than it is taking out new ones, and the banks are contracting credit, then the volume of purchasing power distributed will be less than the previous volume of purchases. Generally speaking, nevertheless, the volumes of purchases and purchasing power can be regarded as generating each other in a series of cycles. This does not mean to say that factors such as the provision of funds with which to make purchases from other sources than out of the previous aggregate of purchasing power can be ignored. In fact one disturbing factor, the tendency to distribute less purchasing power in the form of

wages and salaries because production is becoming more efficient, will be seen to have very deep-lying effects.

Purchasing power, in summary, can be defined as the command over finished goods which is given to an individual by virtue of his personal income. The individual may choose either to buy consumption goods, or buy a machine or factory, i.e. invest, or just hoard the funds at his disposal. Although the definition covers the ability to buy all finished goods, the general willingness of individuals to spend their income on consumption has a special importance in that, excluding production for deliberate waste or futility, all production is for the ultimate purpose of consumption. One cannot continue for ever artificially to stimulate the market by the manufacture of capital goods if the volume of consumers' purchases is deficient. In other words, it is of no use continually to build factories and machines in order to build factories and machines *ad infinitum*.¹ Thus the volume of

¹ Granted that such a way of running an economy would be absurd, it may be asked at a later stage in the argument of this book exactly why capitalism should not be run in complete defiance of consumers' demand. Why should not industries be run to supply and repair machinery, to make and repair machinery, in such a way that industry is kept busy because capitalists are creating a never-ending demand for capital goods without concerning themselves with the ultimate product which the mass of machinery is destined to produce? That

consumers' purchases is not only an important constituent part of the market; indirectly and ultimately, it is the gauge of the whole market, including that part which constitutes capital goods, however financed.

It may have struck the reader as contradictory that whereas purchasing power was defined as an ability to buy *goods*, it was referred to as the *funds* at the disposal of the income-receiver.

this is plainly impossible can be seen in more than one way. (Nevertheless it is important that we do see that it is impossible.) In the first place, it is the proceeds of the sale of the final—consumers'—goods which finances ultimately the purchase and repair of machines. Unless the firm equipped for the production of consumers' goods actually effected sales of such, it would be quite unable either to buy new machinery or maintain such as already existed. Similarly it would be unable to borrow money, having no income from which to meet the interest charges. And so on, right down the scale. Once the ultimate source of receipts—the purchase of consumption goods—has dried up, all other industry must come to a standstill.

Another way of looking at the same problem is to consider all firms making capital-goods as an economic group or community. Any such group, such, shall we say, as a town, can continue to exist, and grow, indefinitely, provided it is economically self-contained, that is to say, can provide for all its own wants. If any part of its wants, say, one-fifth, must be supplied from outside, it must export one-fifth of its total production. In order to enlarge its total production, it must also enlarge the volume of extraneous sales. Now capitalists specialising in the production of capital-goods are in constant need of funds with which to pay wages, salaries, etc., the larger part of such incomes being spent on consumption goods, i.e. spent outside the orbit of the capital-goods making group. If, therefore, the latter group is to maintain its economic existence, makers of consumption goods, directly or indirectly, must buy capital-goods to the same value as those engaged in the capital-goods-making industries must buy consumption-goods. (For ease of exposition, the term "consumption-goods" as used in this footnote is held to include all commodities which will be taken off the market and are not intended for use in industry, such as battleships, public works.)

Purchasing power is essentially a *commodity* concept, and is measured in terms of commodities. Nevertheless it takes a *money* form. If the purchasing power, in its outward manifestation is in the form of pounds, shillings and pence, why is it insisted that it is of necessity measured in terms of commodities? Firstly, an ability to buy *can* only be measured in terms of the things bought. All of us, on our first acquaintance with money, especially bank-notes, must have mused that in the money itself there is no value. The money only represents a power of appropriation over certain commodities. Secondly, a purchasing power conceived of only as a given number of pounds sterling or dollars would lose all usefulness in any theoretical argument if the purchasing power of the pound or dollar itself were to change. And this is known to be constantly taking place.

Lastly, the concept of money in a modern society, with a developed banking and credit system, only has any sense as a unit of accounting, a yardstick. From the point of view of the community any attempt to reckon in quantities of *money* are frustrated in that these quantities are not material objects which obey the laws of the indestructibility of matter, but are mere

claims to commodities, which can be cancelled at will by the holders, or not renewed by the issuer. (The much-debated question of changes in the general level of prices will be considered later.) Finally, certain objections may be raised as to the difficulty of measuring a power to purchase in terms of commodities, because different commodities cannot be added together to give a number. For instance, two carrots cannot be added to three cabbages as such, unless some common characteristic of the two vegetables be taken, such as weight, food value, amount of labour needed to produce, etc. The bourgeois school of economists find the same theoretical difficulty in operating indices of prices levels. But just as a rise or fall in a price-index corresponds with what we have in mind when we speak of prices rising or falling, so we could compose an index to measure what the ordinary citizen would understand by a change in his ability to buy commodities.

In the following chapters will be examined the constituent parts of the market in order to discover exactly why it is subject to the manifest limitations, and whether these limitations are capable of removal. The constituent

parts of the market can be catalogued as follows:

1. That part of personal incomes which is spent on individual consumption, such as food, clothing; also more durable consumers' purchases, such as furniture, houses. For our purpose it does not matter how long an article lasts. The purchase of a private aeroplane will have the same effects on the market whether it crashes in its first flight or not. The feature of purchases in this category is that the buyer has no intention of using the articles in *production*, but only for his individual enjoyment. The personal incomes must be sub-divided into the following qualitatively different classes: *employers'* incomes (profits, dividends), *employees'* incomes (salaries, wages), and *institutional* incomes (rents, royalties, interest on State bonds, unemployment allowances, pensions, etc.)

2. Purchases of finished goods for use in production, whether bought by individuals (out of incomes, or with borrowed money), by joint-stock companies, or governments.

3. Sales of commodities outside the economy under consideration, i.e. to foreign lands and to colonial (backward) territories.

4. Purchases by public bodies (the State, local authorities) of finished goods, i.e. equipment not intended for further use in production, such as roads, war materials.

These constituent parts of the market will be examined in turn in later chapters.

CHAPTER II

THE UTILISATION OF PURCHASING POWER

The relationship between purchasing power and purchases expressed as a coefficient, E—Purchasing power devoted to investment—Investment in production—Enlargement of the market by credit expansion—Unproductive investment—Absorption of purchasing power by the financial circulation—Bank balances as hoarded purchasing power.

IN THE PRECEDING chapter the distinction was drawn between purchasing power and the volume of purchases. Not every one spends the whole of his income. On the other hand, some individuals,¹ by their ability to borrow, or to issue claims to commodities (bank credits) are able to spend far more than the amount of their incomes. Nevertheless, it has been seen that the purchasing power, accruing to the total of individuals comprising the community, must have a large influence on the volume of purchases, which influence it shall be the purpose of this chapter to examine. For the sake of brevity we can refer to the relationship between the purchasing power

¹Of course everything said about the purchasing power etc. of "individuals" applies equally of companies, institutions, and all other corporate bodies capable of receiving and spending an income. It does not affect the argument, if, for simplicity, we lump all such together as individuals.

and the volume of purchases arising from such as a coefficient of efficiency of purchasing power (E). For instance, if the whole of the purchasing power accruing to one individual takes the form of purchases, i.e. is spent within a certain normal period, we can say that $E = 100\%$. If, on the contrary, the individual fails to spend any of his income, $E = 0\%$. If three-quarters of the income is spent, then $E = 75\%$, and so on.

Although individuals may exercise a certain range of choice as to whether they spend or hoard, their ability to choose is largely determined by the size of their income. A working man, for instance, with a family to maintain, will save a very small fraction, if any at all, of his earnings. We can say that the coefficient of efficiency of his purchasing power approaches, or is at, the maximum ($E = 100\%$).

When considering the E of incomes large enough to allow of a certain surplus above needs of living, the question becomes much more complicated. There is no doubt that if money is hoarded in a stocking or a mattress, the E of this part of the income $= 0\%$. But very few people choose this form of saving in these days. Many people "save up" in order to make some large purchase, or for a holiday, to get married, buried,

etc. So long as there are the usual number of people indulging in this form of saving on the one hand, and the usual number spending their previous savings on the other, there is no effect upon the volume of purchases, and $E = 100\%$.

The most prevalent form of saving, and that with the most complicated effects, is the withholding of a portion of one's income in order to make an investment, that is, to buy an asset in some form or another with a view to an annual money return. While the act of saving in itself, that is, the mere failure to spend, completely cancels the purchasing power, the resulting investment may be of a type which, by placing purchasing power in the hands of people who would not otherwise obtain it, exerts a compensating expansive effect on the market. For example, if a rich man employs workmen out of his current income to build a mansion, this would have no detrimental effect on the volume of purchases. Similarly, if a capitalist invests his savings in a newly floated company, so that the funds raised are expended in building factories, making machines, employing architects and engineers, then E is substantially maintained at the maximum. In any such investment, however, some part of the new capital will be absorbed by

purchases of land, which do not directly generate any flow of purchasing power. Furthermore, there is likely to be some lag of time between the subscribing of the funds to the new company and their actual disbursement in the form of wages and salaries. Consequently, if purchasing power formerly spent on consumers' purchases is diverted to this type of investment, which will be called *investment in production*, the market will suffer a shrinkage, but only a very inconsiderable one, and possibly none at all.

Not all investments in production are made out of voluntary and deliberate saving of individuals eager to acquire a profit-yielding asset. Banks, in the normal course of their activities, make advances to business concerns for the purpose of financing additional turnover, or of providing the funds to build additions to the industrial establishment. By arrangement with his bank, a business man has a credit opened in his favour, upon which he can draw as it suits him. The bank has not considered whether another of its customers has deposited a similar amount. It is confident that it will have the funds to meet whatever demand its depositors make at any one time. The advance to the business man, which is a claim over commodities, in short, a

power to purchase, is simply created. In so far as it is utilised for the purchase of finished goods, or to pay incomes, and no doubt it will be, the market is expanded.

A similar expansion results from the sale of an existing security, either industrial stock, or Government bonds, so that the seller may use the cash in some productive process. Any investment in new plant, additional volume of output, wages, salaries, fees, however financed, constitutes an enlargement of the market.

We must now consider what is the effect on the market of withholding from consumption of *income-money* in order to make a non-productive investment. Such are purchases of land, *existing* houses, factory plant, machines, stocks and shares, and Government Bonds which are not new issues. About the effects on production of such a single purchase, considered alone, there can be no doubt. If a man, who normally goes on an expensive summer holiday, spending, say £100, omits to go on this holiday, and instead buys War Bonds, the hotel keepers, amusement artists, etc., whom he formerly patronised, would find the demand for their services diminished by £100. Nor would the act of purchase of £100 worth of War Bonds serve to increase the takings

of any trader, nor the wage or salary of any employee. There is a net loss of purchasing power. The £ of the £100 under consideration has become 0%. Every year large amounts of income-money find their way into such unproductive investment. What would otherwise be disastrous effects on the market are counter-balanced either by other people expanding the market by such methods as have been discussed in the above paragraphs, or because the seller of the War Bonds does not allow the money they realised to lie idle.

Should this counteracting investment fail, the market is exposed to a net shrinkage. Suppose that some people get tired of buying new furniture, and follow a fashion of furnishing their homes with antiques. No one would deny that the furniture-manufacturing trade would suffer from loss of business and unemployment. Antique dealers would enjoy an expanded market and old ladies living in country cottages would realise large amounts of cash for their old pieces. If the old ladies hoard the money thus received, the purchasing power diverted to antiques may be described as "dammed up" in the circulation of existing finished goods without ever becoming an income again.

This damming-up of purchasing power assumes more serious proportions on the Stock Exchange. In connection with dealings in stocks and shares there are always money (bank) balances held by jobbers, just as anyone who is continually making and receiving payments of money keeps a margin, lest, for a short period, he must make payments in excess of his receipts. Owners of stocks and shares, for one reason or another, are continually selling some and buying others, involving large cash payments. Furthermore, there is a section of the community which regularly invests its savings in the well-established "safe" shares of existing firms. The whole range of payments made on account of Stock Exchange, or money market transactions, may be termed the *financial* circulation. So long as this circulation does not absorb quantities of purchasing power without disgorging a similar amount, no harm is done to the market.

The critical question is, whether the financial circulation *can* absorb or dam-up quantities of income-money on a sufficient scale to cause a shrinkage of the market in a capitalist economy as a whole. In short, whether E can equal 0% permanently, or for a considerable period. It has already been shown that the very act of buying

an industrial security out of income, rather than, say, a motor-car, increases the delay before the income takes the form of a purchase, i.e. the purchasing power is temporarily dammed-up. We have to consider whether this purchasing power, once withdrawn from the market, ever finds its way back again. Suppose that a rich man, having saved £1,000 of his income, wishes to buy railway stock. His broker will then look for some owner of railway stock who wishes to sell, and in due course the transaction is made. The £1,000 of purchasing power is now at the disposal of the former owner of railway stock. If he straight away buys a motor-car with it, the market has its £1,000 restored, and except for the small delay, no harm is done. But the new owner of the £1,000 may not want a motor-car. He may have sold "railways" because he preferred another investment—shares in L.P.T.B.—which he in due course buys. Now the L.P.T.B. will not increase its capital expenditure automatically, because someone has bought a quantity of its shares, so that no expansion can be looked for in this direction. Following further the fortunes of the £1,000, it is now part of the bank balance of the man who wanted to sell "London Transport". Similarly, the reason for his sale may

have been that he preferred "breweries", in which he in due course invested. And so on, without end. The £1,000 income-money becomes a permanent part of the financial circulation; the market loses a clear £1,000.

We naturally next enquire whether this can happen on a sufficient scale to cause a serious or even perceptible shrinkage in the market. What natural limit is there to the volume of share transactions, or to speculation in commodities, for that matter, which is in the same category? In fact, there is nothing to prevent tenfold increased activity on the Stock Exchange, or in the commodity markets, and a considerable diversion of incomes to such. Witness the speculation in wheat futures connected with the Chicago market, indulged in, out of their normal incomes, by innumerable members of the public, besides by professionals. As more people demand securities, or commodity futures, so their prices go up, and larger amounts of income-money can be occupied in a single transaction. (In this description of the working of the financial circulation, it has not been overlooked that a large increase of income-money making its way into the financial circulation will encourage the flotation

of new companies. In this way the invested incomes once more take the form of wages, salaries, etc., and the purchasing power is not lost. However, with Government stock, an increase in the price is not the chief factor which induces governments to borrow. Furthermore, in certain trade conditions, income-money entering the financial circulation will not even indirectly generate any investment in production. Even in the circumstances when it does, there is no saying that as much purchasing power is created by investments in production as is absorbed by the financial circulation. It is only being considered here whether income-money can find its way into financial channels, and never re-emerge as purchasing power.)

In the above argument, it was assumed that the owner of a bank balance uses it after an interval, either short or long, in order to make some purchase or other, even though it be a financial transaction. In other words, he passes on the balance to someone else. But if he likes, he can allow his balance to lie idle. His saving, or someone else's saving, becomes a hoarding just like the money kept in a stocking. The banking system has become a repository for

hoardings. Purchasing power is withdrawn from its function of buying commodities, and is neutralised, exterminated.

The objection may be made that such an occurrence is unlikely, but during a trade depression, when business activity is perhaps little more than half the normal, the prices of the goods which *are* produced are low, dealings in securities are meagre, and the prices are only a fraction of the boom prices, in short, when the demand for actively circulating bank balances is very small, we find that there is no diminution, but on the contrary a rise, in the level of bank deposits. This would leave us to believe that in such times, deposit hoarding is very prevalent.¹

¹ The deposit accounts of the joint-stock banks reveal how surplus capital can be hoarded. (Deposit accounts cannot be withdrawn, like current accounts, just when the depositor wishes, by writing out a cheque. He must give up to a month's notice to the bank when he wants to make a payment from the account, and in return the bank pays him a rate of interest. The importance of this characteristic is that deposit accounts are not balances of money in use. They are placed there because the depositor has nothing to do with the money for a time, and wishes to keep his wealth in the form of money, i.e. hoard it.) During the years 1923 to 1930 English deposit accounts swelled by £217,000,000. This betrays an accumulation of surplus capital during this period, which holders either did not know how to, or did not wish to, invest. It is impossible to say whether the whole of this £217,000,000 was withdrawn from the volume of purchasing power, but it represents a well into which purchasing power might have been sunk.

It would be natural to find deposit accounts swelling enormously during bad trade, when incomes are hoarded, and conversely, diminishing in good trade, when people invest more freely. This is found to be so. During only three years (Jan. 1919 to Jan. 1922) deposit accounts

Owners of securities fear, no doubt, that their holdings will depreciate in value, and sell while there is yet time. The proceeds from the sale they retain in the bank deposit form, because they do not fancy any kind of security at all, they prefer holding their wealth in money. If the purchaser of the securities paid for them out of his income, that amount of purchasing power has become neutralised.

Let us consider another illustration of the same process. Suppose a capitalist to have taken a

swelled by £321,000,000, which, if representing hoarded incomes, must have caused quite a serious shrinkage of the market.

Furthermore, the size of deposit accounts by no means measures the extent to which purchasing power can be dammed-up in the banking system during times of bad trade. Since the end of 1931 the banks have only allowed $\frac{1}{2}\%$ interest on their deposit accounts, and many people no doubt have not thought it worth while to tie up their money for a month just for the sake of $\frac{1}{2}\%$. Consequently they have probably left their hoarded income on current account, and hoarding becomes indistinguishable from balances kept for the purpose of making payments.

Bankers claim that they receive deposits in order to lend them out again. They never declare, however, that all the income-money which lies hoarded in their hands is invested in production. The most tell-tale figures from the point of view of the maintenance of purchasing power, the amount of *new* advances to industry made yearly, are not published. All we can find out is the volume of advances outstanding. But during a time of depression these consist to a large extent of "frozen" credits, which manufacturers are unable to pay back because their businesses are in a bad way.

The banks certainly did not lend out to industry the accumulating deposits during the period 1922 to 1930, although this cannot by any means be described as a time of bad trade, at least by modern standards. For the most part the funds were used to buy Government securities and other "safe" investments. That is to say, purchasing power was purely and simply cancelled so long as the depositors were content to leave their money idle.

profit of £1,000 from his undertaking. That is to say, if he is a stocking manufacturer, he will have employed men and women, paid rent and rates, bought raw materials, fuel, light, etc., and will finally sell his product for a £1,000 more than he paid out to all these factors in production. If his output fetches £10,000, he pays out £9,000 and retains £1,000 for himself.

In contradiction to Major Douglas's argument, all the parties in the productive process (including capitalist) have a sum of money *accruing* to them equal to the market value of the output. If the whole of this £10,000 was automatically spent within a normal period, there would be sufficient purchasing power to cover the whole of the output, and there would be no shrinkage of the market.

But the employer may allow his £1,000 to remain deposited in the bank, because he does not know how to invest it. Or he may buy £1,000 worth of industrial stock, or other securities from someone who prefers to hold a cash balance. It looks very much as if the banking system can be a well in which purchasing power can be for ever sunk. It may be argued that *ultimately* the deposit must be spent either on consumption, or on investment in production. But in practice a

deposit may lie idle for years, in which time the shrinkage of the market and the consequent overproduction and unemployment will have caused repercussions far larger in extent than the original loss of £1,000 purchasing power.

CHAPTER III

SOME ROOT CAUSES OF THE DILEMMA

Hypothetical conditions under which no overproduction can exist—The difficulty of maintaining these conditions—The importance of the profitability of investment—Why the problem does not exist in the U.S.S.R.—Why capitalism cannot copy the U.S.S.R.—Bankruptcy of the High Wages Theory—Determinants of the level of wages and Marx's theory of the subsistence level—Its relationship to collective bargaining—Statistics of nutrition and the subsistence level—The Wages system the barrier to the consumption of commodities.

IT MUST APPEAR obvious to everyone that the wealthy classes have a greater range of choice than the poorer as to whether their purchasing power shall be utilised or not. To save or not to save, to hoard or to invest, are for them matters of daily decision as to the use of a considerable part of their income. For the working man the level of his wages, and the prices of commodities, and rent, leave little choice. I do not know of any estimates of the amount of saving done by the British working class and the British capitalists. An American specialist on the trade cycle, Wesley Mitchell,

quotes interesting estimates for his own country. He gives the saving of employees (in the early 1920's) as only 5% of their wages and salaries. Since a large proportion, even of this 5%, must be deferred expenditure, rather than genuine accumulation, each individual employee will save (i.e. not spend on consumption) only a negligible proportion of his income. American business men do 68% of all the saving of the community. Provided that a state of affairs somewhat similar exists in all advanced capitalist countries—and there is every reason to believe it does—the decisions of capitalists and the firms they control as to the disposal of their surpluses is the main factor in determining the E of purchasing power as a whole.

It is evident that if E is 100% in all cases, no problem of overproduction, could exist. *Incomes do actually accrue to individuals sufficient for the whole output to be taken off the market.* Nor need this statement be qualified by the proviso of a stable price-level, for if $E = 100\%$ there is no reason why prices, on a free market, should be a disturbing factor. Everybody's incomes, including profits, being spent, would revert to the employers and enable them both to cover their previous outlay, and enable them to pay out these incomes

on the same scale again. Prices would assume that level which would enable the whole output to be absorbed. Overproduction could, in such a case, be caused only as a result of an industrialist's miscalculation—itself no fundamental cause of disequilibrium. Furthermore, this proposition holds good even allowing for increases in production, say, owing to an increased productivity of labour. True, certain frictions and temporary overproduction in certain trades are likely to arise in the event of purchasing power being shifted from one class to another, but, again, these frictions cannot generate a fundamental disequilibrium. Provided every section of the community spends the whole of their incomes, however uneven the distribution of incomes may be, no permanent or critical overproduction can arise. It should be borne in mind, however, that though there may be no overproduction, there may be unemployment. The aggregate of purchasing power may be spent, that is, may take all the available goods off the market, but this aggregate in itself may be insufficient to employ fully all the available workers. For instance, in a time of "boom" such as the 1928–9 period, or that of 1937, it is unlikely that total expenditure falls below the volume of purchasing power

distributed—nevertheless, in both periods we find a considerable number of unemployed.

The analysis is centred, consequently, on whether it is at all difficult to obtain the state of universal $E = 100\%$, or whether there are forces continually upsetting this equilibrium, and/or making its maintenance more difficult. We have seen that purchasing power can be cancelled, and that it is the high-income groups who have the option of utilising their purchasing power or not. The question resolves itself as to whether capitalists can be relied on to give all that accruing to them an E of 100% . Now what is the general function of the capitalist (nowadays, the stock and share owning section)? After all, a capitalist must have capital; this was probably accumulated by the saving of either himself or his fathers. The more he saves, the greater capitalist he becomes. Not only is he in a better position, as the owner of great wealth, further to increase his income and his rate of return on his investments, he becomes a more influential member of the community, socially he is more sought after, his daughters are presented at Court. He becomes one of those for whom the world is made. To accumulate, therefore, is the watchword. No capitalist family or individual who values their

favoured position, can afford to be left behind in the race. It is out of the question for them to spend the whole of their income on consumption. There is, in the words of Keynes, "a propensity of the wealthier classes of the community to save". Furthermore, much of the national income is concentrated in the hands of men so wealthy that they would find it extremely difficult to get rid of their incomes on personal consumption, even should they so wish. Neither can individual acts of munificence negate this fundamental tendency to accumulate. It is an ingrained habit, arising from the nature of men living under certain social conditions.

Even the process of accumulation of wealth need not destroy purchasing power and upset the balance of the market, provided the savings are all invested after a normal interval in such a way that E still equals 100%. Let us consider what this means. It is not enough for savings to be invested in existing stocks and shares, or land or houses or Government securities; they must be invested *in production*. At no distant time these savings must take commodities off the market to the same extent as if their owners had bought consumption goods. The savings may purchase capital-goods, or, paid into other pockets, may

be spent on consumption. Should any saving fail to reappear on the market, the volume of purchases of the community is restricted, there is a surplus of commodities, the now familiar state of overproduction.

Under what conditions do the holders of wealth fail to invest in production? Surely when they can find no profitable outlet for their investment. What, after all, is the point of incurring the risk of an investment without the profit to make it worth while? The profitability of new investment, in fact, determines whether these savings find an investment in production, and whether the volume of purchases is maintained.

With profitability, we are back again at the market. He who does not sell, neither shall he make a profit. New capital in search of profit has prospect of success along two channels. Either it can serve to expand the production of commodities manufactured according to existing methods, or it can employ an improved method of production. In practice, naturally, a unit of capital may take advantage of both opportunities, but its profit-making capacity may be conveniently examined, first as an expander, secondly as an innovator.

During the period of Britain's commercial monopoly, when new markets were opened to absorb repeated expansions of the scale of production, it would not be true to say that there was no market problem, but this problem had not become the critical dilemma of capitalism as we see it to-day. Now, except during the brief adolescence of a new industry such as wireless, automobiles, there is no question of profit from mere expansion, and in the case of such youngsters as artificial silk, the limits of the market came as a crude shock. Why production cannot expand, and be absorbed, to give the higher living standards so yearned-for, is puzzling to both none-expert observers and to the professional economists. The dilemma is all the more aggravating, since in the U.S.S.R. the miraculous seems to have happened, unrestricted expansive production has become possible. Output seems limited only by the rate of growth of the productive resources, a rate far in excess of anything ever known in capitalist development. When the new consumption goods are put on the market, they are snapped up immediately, for wages have been increased to provide the purchasing power necessary. The rising standard of life predicted by Mr. Keynes is coming to

pass, but in a manner and in a place most disconcerting for him and his theories.'

Let us return to our analysis of the market under capitalist conditions. Why is the expedient of the U.S.S.R. not applicable? In the device of raising wages to absorb the goods, in a capitalist economy, we immediately see difficulties. This very idea, the High Wages Theory, was in fact very fashionable in certain Socialist circles in Britain a few years ago, and it must be admitted, if only it could be operated, the market problem would disappear completely. Of its general impracticability, in an otherwise individualistic, profit-making society, there is now no question. Henry Ford has been able to set a standard of high money wages and survive. But he was enjoying exceptional profits because he was technically in advance of others in his industry, and considering the intensity at which his employees work, and the rate at which they must become nervously worn out and useless for mass-production, it is doubtful if the wages are so high, after all. If we reflect upon the difficulty, sometimes the impossibility, of persuading numerous enterprises to combine to raise the prices of their own products, for their own immediate advantage, what hopes have we of persuading

groups of employers to combine to raise wages, for the benefit of other producers, and to their own temporary disadvantage? Even given this feat of persuasion, think of the temptations for the unsuccessful firm to evade the arrangement, and maintain a profit balance by nibbling at the pay-roll. There is the additional difficulty that already affects wages in our exporting industries, that the payment of high wages would ruin the international competitive position of British capitalism. To explore the possibilities of international high wage agreements in the present international situation is to border on the ridiculous. So long as we cannot reach international agreement on armaments, so long as we cannot prevent one State from committing acts of aggression against another, there is no hope of extending purchasing power by a high wages agreement.

The common-sense solution of the market problem—to increase spending power as production grows—cannot be imported from the U.S.S.R. without the fundamental changes in social and productive relationships which she has introduced. Neither is it possible to rely upon a spontaneous trend of wages to rise. Enquiries conducted by the League of Nations show that there was no significant change in the

world consumption of foodstuffs per individual between the immediate pre-war period, and the later 1920's. This matter is so crucial that it will be well to examine closely exactly how wages come to be what they are, and whether, under capitalistic conditions, their level can be adapted to solve the problem of markets. It is quite certain, at any rate, that the standard of living does not increase because there is a surplus of consumable commodities. Quite other laws regulate the level of wages under capitalism. Karl Marx advanced the general proposition that wages tend towards a level just high enough and no more to enable the worker to maintain his existence and to reproduce his own kind. From the date of the publication of the first volume of *Capital* (1867) until the early 1900's, British industrial production, and the rise in the workers' standard of living lent themselves to a superficial and biased interpretation which was declared to disprove Marx, and the modern bourgeois school, under the leadership of Alfred Marshall, was not slow in pronouncing him out-of-date. It was not true, they declared, that a subsistence level was a prime factor in determining the level of wages. In its stead, there was advanced a theory of the distribution of the national

income between capital and labour and land, which was an extension of the principle of supply and demand to a situation where the market analysis of supply and demand did not apply. This theory has had to be relinquished on the showing by Maurice Dobb that the shares of capital and labour were not precisely fixed by the market conditions, but that the relationship was more like a barter transaction, in which commodities could be exchanged according to the bargaining or bluffing faculties of either side. Bourgeois economists have now no generally accepted theory of what determines the sharing out of wealth between capitalists and workers.

The failure of the standard of living to rise in recent years, and the lack of any other theory, suggest a re-consideration of Marx's proposition, both as regards its theoretical plausibility, and its accordance with facts. Marx's own words show a sense of realism which his detractors deny him: "The wages are regulated on the one side by a natural law; their minimum is determined by the physical minimum required by the labourer for the conservation of his labour power and for its reproduction." "The actual value of his labour power (wages) differs from this

physical minimum, it differs according to climate and condition of social development, it depends not merely upon the physical, but also upon the historically developed social needs, which become second nature.”¹ It must be especially noted that there is no denial of the possibility of a secular tendency of wages to rise, nor of widely differing standards of living in different countries. Nor does Marx deny that for periods, and in places, wages can be below or above the level of subsistence. Referring to wage movements during the recent depression in the U.S.A., the *Economist* said: “In some cases, unskilled wages were driven below subsistence level—‘lower than the English dole’ is one description—and no end of the process appeared to be in sight.”² We know well, also, that a temporary local shortage of labour, utilised by trade unions, will bring wages above the level recognised as that of subsistence. Marx was aware of this, but drew extensively on the economic and political history of British capitalism to show that special measures are taken by the dominant class to secure a plentiful supply of labour, to create an industrial reserve army which will obviate that much-feared labour shortage. The “Jungle” of Upton Sinclair depicts

¹ *Capital*, vol. iii, p. 1,000.

² *Economist*, Sept. 9th, 1933.

how American employers, by their own characteristic methods, overcame this shortage.

To rival the subsistence theory of Marx, it might be contended that wages, in a modern industrial community, are fixed by collective bargaining. That the pressure that workers and employers can put on each other does widely influence the wage level, there is no doubt. But this explanation is complementary to, not an alternative to, the subsistence theory; it merely describes one of the processes by which the latter works itself out in practice. It is a truism that wages do not permanently fall below the subsistence level. However, with certain unimportant exceptions, minimum wages are not fixed by law, nor do employers refrain from lowering wages from considerations of the subsistence level. If a capitalist can get labour at a certain price, he takes it for granted that the workers can maintain themselves at that wage. What actually happens is that an attempt to deprive any section of workers of their "social needs", which have "become second nature", is met by the resistance of these workers. This resistance is more or less effective, according as the workers, through trade union organisation, by their readiness to withdraw their labour as

a body, etc., can bring weighty "arguments" to bear in the collective bargaining. Beneath the outward forms of the conciliation machinery and wage agreements with which we are so familiar, there is the feeling in the mind of the worker that without a struggle he is not going to relinquish the social habits to which he is accustomed, and, furthermore, that he *is* going to claim the improved amenities of life, decent housing and sanitation, wireless, entertainment, leisure, which he knows modern industrialism can give him, and which are becoming for him a "social need". True, in the England of 1936, we find the agricultural labourer working for considerably less than the miner, and the miner for little more than half the wage of the London busman. In each case their respective bargaining powers and the economic position of the industry have forced an adaptation to differing subsistence levels, and all current bargaining takes place on the basis of these conventional social needs.

To those who would reject Marx's proposition of the subsistence level, the new science of nutrition gives a cogent answer. Only those who are the most impervious to facts can now assert that the standard of life of the British worker is now so high that we can no longer talk of mere

subsistence. The findings of the Health Organisation of the League of Nations finally scotch the "comfortable standard of life" point of view:¹ "No country in the world can claim that the whole of its population is satisfactorily fed. Poverty and ignorance, but mainly poverty, are to blame.

"The so-called 'protective' foods, richest in minerals and vitamins—milk, green vegetables, fresh fruit, eggs—are also the most expensive, and in all countries beyond the means of great masses of the population. In Great Britain, between 10 and 25% of the population, the report states, 'cannot afford a diet of the type and quality now known to be essential as a safeguard against malnutrition and disease'.

"In the United States over 22% of the school-children investigated up to 1924 showed symptoms of malnutrition; and 'the fact that the greater part of the population of Africa and Asia suffers from insufficient and faulty feeding is no longer a secret'."

Sir John Orr comes to the conclusion that the income of approximately one half of the British people is insufficient to enable them to partake

¹ *Nutrition and Public Health*, by E. Burnet and W. R. Ackroyd, Health Organisation of the League, *Times* summary.

of a diet assuring them the best physical development. His conclusions are supported by the observations of numerous British sanitary inspectors, who have shown that the lack of "protective" foods, and bad housing among the working class makes them much more prone to disease than the well-to-do. Perhaps Marx's "natural law" of capitalism is not so wide of the mark in the twentieth century after all!

For the purpose of the main argument of this book, whether one is in agreement with Marx's postulate or not, it is sufficiently established that wages will not conveniently and automatically rise in order to take the surplus of goods off the market. The above-mentioned bulletin reports that even in the United States there was not enough land under cultivation (in 1935) to supply the whole population with a liberal diet. The difficulties of the U.S.A. administration in the years leading up to 1935 over the disposal of the wheat surplus come as a sharp paradox and do not allow of complacency as to the automatic expansibility of the market. Of the failure of wage-payments and of sales there is, on the other hand, no doubt. The U.S. Department of Commerce¹ estimates that in 1933 the total

¹ *Economist*, Sept. 5th and 19th, 1936.

remuneration of employees was nearly 45% less than in 1929, constituting a fall in the national income, and a shrinkage of the market of 28%. More aggravating still, perhaps, is the failure of the consumption of the wage and salary earning masses to expand significantly even in the "prosperity" periods. The authors of the *Course and Phases of the World Economic Depression* note that the increase in the output of consumers' goods was limited during the 1928-9 boom to luxury articles, such as cars, radios, and refrigerators, due to heavy Stock Exchange profits.

In summary, the relationship of worker to employer, by which wages and salaries, and hence a large part of the community's purchasing power and its market, enter the capitalist's balance sheet as "costs"—to be kept as low as possible in order to maximise profit—presents a rigid barrier to the enjoyment of the amenities with which, technically, modern industry could supply us. There is no question of jerking us up into a land flowing with milk and honey, so long as the jerk is not powerful enough to lift us over the barrier of the wages-profit antagonism. Marx, "out-of-date", saw this seventy years ago: "We remark by the way that the 'social demand', that which regulates the principle of demand, is

essentially conditioned on the mutual relations of the different economic classes and their relative economic positions.”¹ And “the sale of commodities . . . is limited, not only by the consumptive demand of society in general, but by the consumptive demand of a society in which the majority are poor and must always remain poor”.² The subsistence level is the face of that hideous incubus, the market problem.

¹ *Capital*, vol. iii, p. 214.

² *Capital*, vol. ii, p. 363.

CHAPTER IV

STATE EXPENDITURE

Effects on purchasing power of ordinary taxation—Deficit financing—Roosevelt's deficit financing—Mr. Keynes's public works proposals—A State monopoly of credit expansion?—Albertan social credit—Its affinity to hire-purchase.

THE ANALYSIS OF the market has shown so far that the part of the flow of purchasing power which accrues to employees may be reckoned as utilised, spent; the remainder finds its way into the hands of that class whom we may call the *accumulators*, who, as individuals, can be reckoned as not spending the whole of their income. While the first class make full use of their purchasing power, the total amount placed at their disposal is rigidly limited; the E of that at the disposal of the second class we have seen to depend upon the attractiveness of investment in production.

This chapter will deal with the possibilities of enlarging the market by one form or another of State expenditure.

In so far as the State confines itself to the expenditure of current revenue, it is in the

position of a private person, spending income, and thus giving an E of 100%. If a government places a tax on, say, sugar or tea, it is subtracting so much purchasing power from the people who consume these articles, that is, the millions of wage and salary-earners whose E approaches 100%. The effect on the market, in consequence, will be negligible. Should a tax fall on accumulators, however, who are hoarding a part of their income, then, provided that as a result of the tax they decided to hoard less, the act of the government enlarges the market. Purchasing power whose E is very low has been appropriated and given its maximum efficiency. The effects of such a tax on accumulators would vary according to the state of trade. If investment offers such poor prospects that practically all accumulated savings are hoarded, such as probably happened in 1931 and 1932, the tax would considerably increase the volume of purchases. This also holds good of a time when Stock Exchange speculation becomes so active that savings are not invested in production, but go to swell the financial circulation, as in America in 1929. But it may well be that either the E of accumulated savings equals 100%, or that accumulators save and hoard a similar amount

despite the increased taxation, that is, they cut down their consumption to pay the tax. In this case the tax will fail to enlarge the market. In general conclusion, it may be said that so long as a government only spends more or less out of revenue, it can exert no decisive influence by way of taxation on the volume of purchases, and in some circumstances none at all.

In recent years there has come into prominence a heresy of public finance, influentially supported by the Keynes school. They maintain that not only is it permissible for a government to spend what it has not received, but that in times of bad trade this is its positive duty. The State is exhorted to borrow money, and "pump it into circulation" by extensive public works schemes. Now it is incontestable that if a public authority make money payments to employees on a large scale, without depriving any other potential consumer of these funds by taxation, the result is a net expansion of purchasing power and consequently of the volume of purchases. And if the operation is large enough, and prolonged enough, the problem of markets would be overcome. Let us call such a policy of the State *deficit financing*.

Deficit financing was actually carried out by Roosevelt on an enormous scale during the recent depression. No attempt was made to balance a budget. During 1936, for instance, of a State expenditure of \$8,879,000,000, only \$4,116,000,000 was covered by revenue. Purchasing power was distributed to the unemployed, to farming interests, to recipients of war bonuses (no less than \$1,673,000,000 to this category alone), so that during the fiscal year, the public debt had risen by \$5,100,000,000 (or well over £1,000,000,000).¹ The results have been tolerably good, sufficiently good at any rate to enable Roosevelt to win an election on the plea of "Look what you were like four years ago, and see how prosperous you are now". Deficit financing was decisively rejected by the British Government during the worst years of the crisis as unsound. Who was right, Roosevelt or Baldwin? Both, in their way. The American President, with only a minute Public Debt compared with the imposing £7,000,000,000 odd of the National Debt of Britain, could envisage a moderate addition with equanimity. The payment of interest on the British debt already absorbs over a quarter of the Budget.

¹*Economist*, Sept. 19th, 1936

It did not need much calculation to show that deficit financing during time of peace would soon bring this country into a totally unmanageable budgetary situation. For example, if £500,000,000 had been borrowed at 3% during each of the four worst years of the crisis, this would have saddled us with an interest payment of £60,000,000 a year until such time as we were in a position to pay it off.

Stating the case for British deficit financing in *The Times*, Mr. Keynes argued that the saving on the dole of workers re-employed, and the enlarged receipts from taxation in the more prosperous community would return a large part of the expenditure on public works. As regards the saving on the dole, inasmuch as the financing does not involve a deficit, but merely substitutes expenditure on wages for unemployment benefit, then however desirable from other points of view, the volume of purchases is not increased. Similarly, if money is repaid by the increased yield of taxation, the initial expansion caused by the expenditure will be counteracted by the shrinkage generated by the repayment, (provided that repercussions each way are the same, which is considered later). Mr. Keynes's remedy, in effect, depends upon completely

curing the depression before the repayment of any of the loans is asked for, and finally repaying them furtively in the ensuing prosperity, if any, in the hope that trade will be so active as not to notice the shrinkage of purchasing power. It may be well to illustrate this point. Suppose £100,000,000 had been borrowed by the State in 1931, and spent on public works, and that as a result of the immediate re-employment, the Government saves £30,000,000 on unemployment benefit. The deficit financing would have been £70,000,000. Now if the slump had not been cured in 1931 by this dose of extraneous purchasing power, it would have been necessary to incur another deficit of £70,000,000 in 1932. But if, according to Mr. Keynes's reasoning, the 1931 dose had indeed improved trade, and taxation receipts rose sufficiently to repay the first £70,000,000 borrowed, the deficit of 1932 would not really represent new borrowing at all, but simply an extension of the 1931 debt, having no effect whatever on purchasing power. Similarly, if any part of the 1931 deficit were repaid in 1932, by so much would the 1932 dose lose its effectiveness, and do no more than postpone the shrinkage which the eventual repayment must entail.

The inevitable conclusion is that a substantial deficit must be incurred, growing from year to year during the depression. The repayment of the deficit during the years of prosperity, upon whose advent the argument depends, offers new difficulties. Can anyone be sure that Great Britain, or any advanced industrial community, will ever again feel sufficiently sure in its prosperity deliberately to shrink its purchasing power by "paying-off" the last depression? 1936 was considered a year of comparatively good trade, with nearly 2,000,000 unemployed (including those cut off from benefit and not registered at the exchanges). What would be the feeling during 1937, 1938, 1939, etc., supposing these are "good" years, at having to repay the slump expenditure, and consider the temptation of our statesmen to allow these repayments to fall in abeyance, not to mention political exigencies such as the £1,500,000,000 re-armament programme. I think we must reconcile ourselves to the conclusion that deficit financing means a permanent enlargement of the National Debt. The U.S.A. may afford this luxury—for a time—but for Britain, still paying off the Napoleonic Wars, dismayed at the enormity of the debt on the Great War, and wondering what the Budget position will be

like after the next, the expedient of deficit financing could not be envisaged. Those mainly responsible for the guidance of our capitalist society are evidently of the same opinion, for the arguments of Mr. Keynes have failed to convince.

To those less worried by consideration of "practical politics" an alternative seems attractive. It is generally admitted now, even by bank chairmen, that the banking system does create credit out of nothing, and actually has the audacity to lend these created funds at a profit. A firm requiring funds with which to extend its business is allowed by arrangement to draw cheques up to a certain amount, the banks from their experience knowing that the vast majority of payments are made by cheque, and that they will be called upon to make only a small proportion of their payments in hard cash. Since the cheques on the banks are accepted as payments for commodities, the banks merely issue additional claims for such. These claims, finding their way directly or indirectly into the pockets of consumers, become purchases and expand the market. When a State issues paper money without withdrawing an equal value of currency from circulation, it does precisely the

same thing. It issues claims to commodities, which, put in the right hands, become purchasing power. What is there to prevent the State from taking over the monopoly of the issue of those claims to commodities which take the form of bank credits? Instead of paying the large banks a rate of interest on Treasury Bonds, etc., which have been financed in the first place by credit creation, the State would issue credit, and indirectly, purchasing power, without charging itself any rate of interest. There would seem, then, to be no limit to the amount of deficit financing in which the State could indulge without any embarrassment, since future budgets would not be encumbered with an aftermath of interest payments. Naturally the State could use its discretion in doling out purchasing power so as not to raise prices more than necessary to counteract the falls of a developing slump. The scheme is technically sound, and morally attractive. One could exercise the imagination in extending the principle. Why, for instance, pay interest on the National Debt, when one can re-fund the whole of it at no more cost than that of book entries? The State could assume a monopoly of credit creation, and lend at interest as do now Joint Stock banks. It is doubtful if there would be

any need for taxation. If all the public works schemes which human ingenuity could contrive were exhausted, the State could make money presents per head of population at such intervals as were necessary to maintain the volume of purchases. When the American Congress allocated U.S. Government bonds to all those who participated in the war, and then later agreed to cash these bonds, this is exactly what was happening.

As further refinements of the proposition are developed, it becomes more and more evident that the whole institution of interest payment on private capital is abolished. But the lending of money at a rate of interest, whether this money is created, or otherwise obtained, is the preserve of the class of owners of capital. The right to charge a rate of interest is the most important device of the mechanism by which this class obtains and accumulates its wealth. Abolish this device, and the capitalist system is as good as abolished, which brings us outside the scope of this book. It is here a question of analysing the market problem within capitalism, not outside it.

Even operated on a moderate scale, say just in order to institute a public works programme à la Keynes, the issue of credit by the State would be seriously damaging to capitalist

interests. Besides suffering the loss of interest payments from the Treasury on the actual credit created by a State bank, the City would find that with the Government being taken off the market as a borrower, the general rate of interest would slump disastrously. However, these losses would be pinpricks beside the admission of the principle of the State issue of credit. This is not a solution which is likely to appeal to the dominant elements in a capitalist society, even if it were a matter of saving that system from economic crisis, and possible supersession by another social order.

We come to the conclusion that deficit financing, in any form acceptable to capitalist interests, is a hand-to-mouth opportunist measure, the resort of a society which is pre-occupied with overcoming the difficulties of the moment, without thought of the confusion it may be preparing for itself on the morrow. In any case, a regulated deficit financing which has to be repaid is no antidote to any inherent wastage of purchasing power which may manifest itself in the capitalist system—a line of enquiry which will be pursued at a later stage.

Any discussion of deficit financing would be incomplete without a mention of the social

credit scheme being operated at the time of writing by the Douglas Credit Government of the State of Alberta, in the fond belief that purchasing power is thereby expanded. This Government issues one-dollar notes in the form, I believe, of wages to relief workers. Once in circulation these bills only remain valid provided a 2c stamp is affixed every week, so that after fifty weeks the note is still worth one dollar, but the public, by dint of 2c stamps, has repaid this dollar to the State. The process may be described as a hire-purchase arrangement without interest charge, foisted upon the general public, and its influence upon the volume of purchases is similar to the hire-purchase schemes with which we are familiar.

Little importance can be attached, of course, to the impulse to pass the bill on quickly so as to avoid paying one's share of the 2c repayments, although it may be amusing to conjecture which classes of the community would be the most likely to be landed with the notes on the stamping day. Provided alternative money is in circulation, people would just get rid of these notes first, or perhaps buy their groceries a day earlier or later. Mr. Alberhart's object is to swell the volume of purchases, and this

indeed would be the effect upon the coming into circulation of the notes, just as a purchase by instalments of new furniture or a new house immediately puts purchasing power to the full value of the article into the hands of its producers.* But just as it is obvious to any "hire purchaser" that he enjoys the full use of the article before he has paid for it, so it becomes equally obvious to him that so long as the instalments are being paid off, he must refrain from other purchases of their amount. Similarly, the Albertan public will find out that collectively it must refrain from purchases to the extent of 2c per week for each dollar note in circulation, until after fifty weeks it has restricted its purchases by precisely a dollar for each dollar of extra purchasing originally presented to them. The expansive effect of the social credit will be, by the end of the year, precisely nil.

CHAPTER V

THE REPERCUSSIONS OF PURCHASES AND OF THE FAILURE TO PURCHASE

The tendency for inequalities in the volume of purchases to aggravate themselves—The nature, and limits, of the repercussion—Its varying strength according to the state of trade—Further analysis of the workings of repercussions—The danger and the difficulties of the use of mathematics in economics illustrated by the nature of repercussions.

DURING THE WORST years of the recent depression, when economists seemed to realise the importance of spending-power for the first time, one heard the semi-facetious tale of the man who spent a shilling at the right time, and so cured the slump. His expenditure placed a shilling in the hands of the shopkeeper, who was able to buy extra stock to this amount. The manufacturer, in turn, passed on the shilling to an employee, who would promptly spend it in a shop once again, and so the shilling would go round and round, creating a new demand for all sorts of commodities, until trade was booming once more. While it was realised that something was wrong with the argument,

this multiplying effect of a purchase was found to be intriguing, and Mr. Keynes has given it a letter, K. According to the value of K, the repercussions of a purchase will multiply the original expansive effect upon the volume of purchases.

Of course a shrinkage in purchases will have its repercussions as well. Suppose that for some reason or other the amount of commodities purchased were to fall off by 10%. Where one hundred workers were previously employed, now only ninety would be needed. The ten men displaced would not be able to make their customary purchases, consequently the demand for commodities as a whole would fall still further. The second diminution in purchases would in turn cause workers to be displaced. These would once more be unable to make their customary purchases, causing another wave of unemployment, and so on until, so the argument runs, no one would be employed at all, and everybody would be starving. Absurd as is this conclusion without the qualifications which bring it into relation with reality, it must be realised that the logic is perfectly valid, and that indeed a very strong tendency exists, in a capitalist economy, for every variation in the volume of

purchases to be exaggerated by successive repercussions.

What brake is there, then, to the tendency? Mr. Keynes¹ considers his multiplier of repercussions to be largely dependent on the proportion of their incomes which people save. For instance, the boom caused by the shilling of the story would have come to a premature end if the shopkeeper had put the coin in his child's money-box instead of utilising it to replenish his stock, or buy a seat at the cinema. Similarly, if every one saved a penny of the shilling as it circulated, after eleven repercussions the stimulus would have worn itself out. As will be seen later, this is a very rough-and-ready description of the process. What actually happens is that the failure to spend each penny of the shilling sets up a wave of repercussions in the opposite direction, which will certainly tend to cancel the original repercussion. Whether they will exactly cancel it, and no more, will be considered below. For the present, we can say that the tendency to save a part of income does certainly act as a brake to the unlimited exaggeration of any expansion in expenditure. But suppose the repercussion be a negative one, that

¹ *General Theory of Employment, Interest and Money*, 1936.

is, to consist of a series of shrinkages in the volume of purchases. Obviously, a tendency to save a part of the incomes which continue to be received could not act as a brake on the shrinking. On the contrary, it would accelerate the decline. Nor is there a general tendency to overspend a part of incomes to act as a brake on the landslide.

To judge by the extent of the fall in production in the advanced capitalist industrialisms during the recent great depression, it appears that the fixity of a certain proportion of incomes is the main brake which prevents society from crashing downhill to the level of absolute unemployment and absolute starvation. The malignant nature of a repercussion set up by a market shrinkage lies in the tendency of employers to dismiss workmen when trade becomes slack, the consuming power of these workmen being then removed from the market. Now if every one were working for himself, obviously no such thing would happen. We could not imagine any barrier of purchasing power intervening between a peasant and the corn which he grows and consumes himself. Similarly, the dilemma was absent in the craftsman economy of a medieval township, for as soon as one craftsman became idle, it would pay him to make an exchange with

another in a similar position. It is only in a capitalist economy, where production is, by wage-labour, liable to be thrown idle when demand slackens, and incapable of work on its own account without the co-operation of capital, that the repercussion phenomenon can occur. It follows, therefore, that if in a capitalist economy there are certain incomes not sensitive to every variation in the market, and consequently not liable to dry up as soon as demand fails, then the spending power of these incomes will provide a brake to the downward run. In this category are salaries, etc., of servants of the State and of industrial "key" men, unemployment payments, interest on Government securities and a large proportion of "safe" industrial dividends, debenture interest payments, and indirectly the incomes of all engaged in the industries ministering to their wants. That the British volume of production decreased less than the German or American in the recent economic crisis may be ascribed to the more perfected system of unemployment payments, to the fixed incomes from our large National Debt and overseas investments.

The most significant characteristic of the tendency to repercussion—one, incidentally,

which seems to have been overlooked by Mr. Keynes, and which is of paramount importance for his remedy of deficit financing considered above—is the extreme variability of its strength with the state of trade. In the depth of an economic crisis, stocks of all commodities have been piled up, to form a mighty barrier to further productive initiative. There may be one or two years' supply of all the principal commodities in stock, as against a normal stock of six months' consumption. Any moderate expansion of purchases in these circumstances would merely result in drawing off a small proportion of the stocks. The wholesale merchants would certainly not utilise the purchase price in order to replenish already overabundant stocks, being only too glad of the funds to cancel the credits carrying the commodities. The purchasing power would simply cease to exist, since the banks would not be in a hurry to place another credit in such trade conditions even were there a demand for it. The surprisingly small expansive results of the first few months of Roosevelt's deficit financing in 1933 may be attributed to the vast sums needed to absorb the dead weight of surplus stocks upon productive activity. The same result would have been achieved had the

holders of stocks agreed to destroy them and cut the losses. I do not know if any estimate has been made of the surplus stocks of all commodities destined for the British market which had accumulated by the time of the recent crisis. At any rate, the value must have amounted to more millions of pounds than the British Government could afford to spend on public works. A British public works policy in a slump period would have to reckon with a large proportion of its repercussions being nullified almost immediately by the world stocks of essential foodstuffs which it could never hope to absorb.

Conversely, the unfavourable repercussion of any diminution in purchases would be damped down by the accumulation of stocks. Either the shrinkage of the market may not be noticed in time, or producers of goods whose production occupies a long period, such as agricultural products, ships, would not be able to cease production. Or a speculation in commodities, such as is characteristic of the later recovery from a depression, and the forerunner of the next slump, may artificially stimulate production and cause an accumulation of stocks. In this way, deficiencies in purchasing power, which are in reality present all the time, are temporarily

covered up, and, of course, set up no negative repercussions. Once the extent of the overproduction becomes apparent and the market "breaks" there is a partial cessation of production and the repercussions burst forth with redoubled fury. Whereas variations in the size of stocks prevent undue exaggeration of fortuitous fluctuations in the market, they only serve to postpone and hence intensify any underlying and fundamental shrinkage.

In demonstrating above the process of repercussions, it was necessary to analyse it stage by stage. Such a method is permissible in order to have a theoretical picture of the phases of the movement originated by a purchase, but in practice it would be very difficult to attempt to follow the general phases of any specific repercussion such as that set up by some major disturbance to purchasing power, such as a crop failure, a war. The widely divergent lengths of the productive processes so break up the repercussions into fast and slow waves that no general periods or cycles can be determined. In considering the economy as a whole, however, the problem is simplified in that opposite repercussions, occurring simultaneously, can be relied on to cancel each other out. It is merely a

question of tracing the repercussion of some net variation in the volume of purchases upon the purchasing power, and hence the purchases, of the next phase. And this net resultant repercussion will be significant or not, according as the stocks of commodities are small or large. The community's purchasing power must be conceived as a *flow* meeting a counterflow of goods appearing on the market. Where the rate of flow of purchases diminishes without a corresponding diminution in the production of commodities, a surplus of stocks accumulates. Any resulting fall-off in production in turn further reduces the flow of purchases.

Finally, it should be remembered that the tendency to repercussion does not in itself tell why the major variations in the market occur. They explain nothing of the underlying causes, only magnify them. Their importance for this analysis is that they show the absolute necessity in a capitalist economy of not allowing any net shrinkage in the market to arise.

There is a tendency among some modern economists to fly to a mathematical formulation of their ideas. I do not deny that within an economic science there is not an immense scope

for mathematics, but to resort to mathematical symbols and equations before the actual economic processes are understood only serves to shield superficiality and unscientific method—in the same way as the medieval practice of alchemy, and the positive religious doctrines as to the shape of the earth, stultified scientific research. Perhaps the gravest fault of the economists, especially of the monetary theorists, is a subservience to some general, usually traditional, equation, into which the whole dynamic of the capitalistic economic processes is forced. The result is an over-simplification of such trends as are analysed, and the neglect of others. An equation can only describe one particular logical relationship. When an economic analysis is centred around an equation, attention is concentrated on this one relationship, as if it gives a complete explanation of the whole mechanism whose behaviour is studied. This is like trying to explain the whole mechanism of the internal combustion engine by the equation of the power generated at various engine speeds. Obviously this is an important part of the description, but a great many more equations would be necessary before the engine was completely described. In studying economic

relationships we have the further complication that causal relationships become operative after varying time intervals. For example, the concept E (coefficient of efficiency of an investment or of purchasing power) will vary for any one investment according to the interval that elapses between the making of the investment and the observation of its effects. A man may buy shares in a new enterprise, and for six months the capital he has subscribed may lie unused ($E=0$). After nine months half of it may have been used in paying salaries and wages ($E_{50} = 50\%$). After a year all of it may have been absorbed ($E=100\%$). Consider the time element in E in conjunction with Mr. Keynes's K , the multiplier of repercussions, and one realises what enormous complications the time factor introduces. In the above example, the withdrawal of the funds from current consumption by the capitalist, and their lying idle for six months, may have caused a market shrinkage not only of their own amount, but may already have induced other capitalists to curtail their production in view of this shrinkage. The repercussions will persist after the six months, and even after the year, when the original market-shrinkage will have been remedied. Now when half of the new

capital is once more, after nine months, placed in the flow of purchases, the favourable repercussions will be sent chasing after the previous unfavourable ones, and so on during the absorption time of the whole capital. In the meantime, owing to varying trade conditions, the multiplier K may have changed. It may be contended that the difficulty may be overcome by composing a formula of the *final* effects of an act of investment, that is, when all the repercussions have had time to work themselves out. But no such *final* effects exist, nor do the repercussions ever work themselves out. Every act of investment is a permanent contribution to a continuous flow, and one can no more discount the effects of any alteration to the flow after a certain period, than one can declare that after a certain interval, the effects of an historical event have ceased to become operative. Just as every historical event changes the course of history, so every investment changes the course of economic history. A false analogy has been drawn between investment repercussions, and the rings made by throwing a stone in a pond, and the simile is elaborated to infer that every wave of repercussions is weaker than the preceding. For instance, if people spend nine-tenths of

their income on the average, every time the purchasing power which in the material form of the repercussion becomes income, one-tenth of it fails to rejoin the stream of purchases, and the vitality of the repercussion is held to be reduced by one-tenth. But why follow the fortunes of the positive nine-tenths and not of the negative one-tenth? It will have repercussions of the same nature as the positive, although, of course, with a tendency to curtail instead of to expand the market.

Another point which, I believe, Mr. Keynes overlooks, is that at any one time, the multiplier K may be very different for positive than for negative investment. In a state of very bad trade, for instance, the positive multiplier may be cut short because the extra purchases are simply removed from stocks without merchants placing any orders with manufacturers to replenish them. At such a time, on the other hand, any further failure in purchases may induce manufacturers to stand employees off immediately. In such circumstances the repercussions of the negative one-tenth will be more important than the positive nine-tenths.

It would be bold to suggest that these interactions could not be expressed mathematically. But such a feat would be largely of academic

interest. Even if an exact science of conjuncture were elaborated, it is extremely improbable that a capitalist economy would ever impose upon itself the discipline of so regulating personal accumulation, expenditure, wages and profit that the scientific technique could be utilised, and trade fluctuations abolished. It is very doubtful if mathematical expression would serve to clarify the general understanding of the processes, and in it lies the danger of complacency in those incomplete descriptions to which the algebra of the economists has been only too prone. Any series of formulae is likely to be a nice mathematical exercise, a scientific blind-alley. In practice, we are driven to a shrewd evaluation of the trends and of their relative strengths, and this we can do without the help of algebraic formulae. The important thing is to understand their general working, so as to summarise their general effects with a serviceable accuracy.

CHAPTER VI

THE INCREASING PRODUCTIVITY OF LABOUR

Repetitive investment—Ameliorative Investment—The persistence of the trend of rising productivity—The distinction between labour- and capital-saving investments unnecessary—Technological unemployment and rationalisation—The effects of rising productivity upon purchasing power—The cheapening of commodities and the enlargement of the whole economy—The fact of such an enlargement in nineteenth century Britain—Investment the mainspring to expansion—Capitalist productive relations hinder a rise in living standards—Unwillingness of the accumulating class to consume the enlarged output—Hypothetical case where living standards cannot rise at all—The process of a net shrinkage in purchasing power—Mr. Keynes's equilibrium—An inherent weakness in capitalism—The boon of waste—Armaments—Advertising.

SHOULD ANY algebraically minded economist still feel optimistic as to the possibility of incorporating these economic reactions in a general formula, let him consider another effect of an investment in production which has not yet been taken into account in this analysis. In the introductory chapter reference was made to what seems to me an important gap in the analysis of Mr. Keynes and others of the "dynamics" of capitalism, namely the effect

of an investment upon the general productivity of labour. Quite apart from the statistical and historical evidence for such an effect, it is hardly necessary to point out how this tendency must exist so long as new capital is invested with the purpose of producing goods more cheaply (Cf. the methodical proof by Böhm-Bawerk that a more highly capitalised process is the more efficient). Likewise there is no need here to digress upon the theoretical difficulty of measuring exactly the changes in the productivity of labour. The same difficulty exists in respect of indices of industrial production, prices, etc. The productivity of labour, of course, is measured by the quantity of commodities which are produced by a representative unit of labour under given industrial conditions.

Theoretically, investments in production may be classified as *repetitive* or *ameliorative*. A repetitive investment merely provides additional implements of production of the type generally in use, or, precisely, the productivity of the labour which will be used with these implements is equal to the average productivity of labour already engaged in that branch of manufacture. This type of investment need not concern us much here. It cannot be said that its ultimate

effects upon the productivity of labour or the economic development of society are nil, because a larger scale of production, by providing wider markets, makes economies in other industries practicable. The importance of repetitive investment is of a negative kind—it is capable of expanding the market without any after-effects by way of heightened labour-productivity.

It is the ameliorative investment which has the interesting effects upon the volume of purchases. It consists in the provision of an improved means of producing commodities, i.e. whereby the productivity of labour is increased. Naturally an investment can be either highly or slightly ameliorative, that is, increasing the productivity of labour by much or by little. By the expression “technical progress” it is admitted that investments as a whole are ameliorative; and the general tendency to an increase in the productivity of labour under capitalism has been statistically ascertained. In fact, the unfailing regularity of this trend is remarkable. In the introductory chapter were given some figures to show its strength in recent years. The most convincing was that between 1924 and 1930—a time when British industrialists were being blamed for not keeping up-to-date—the produc-

tivity of labour in Britain rose by 21%. Between 1930 and 1936, which includes a long period of crisis and depression when industrial investment was at a standstill, the inexorable trend persists, British labour productivity rising by 11.5%.¹

It is highly unlikely that during any period of capitalist production the productivity of labour decreased, or even remained stationary. The facts go to show that we can regard this process as a law of capitalist economy, a law which has never been given its due prominence by the bourgeois schools, and one of tremendous effects. Besides being statistically demonstrable, the law is, theoretically, not only feasible, but inevitable. Unless there is an extraneous expansion of the market, repetitive investment would be unprofitable. A capitalist will not generally be able to capture a part of the market unless he can produce commodities more cheaply. Nor will a firm already in possession of the market refrain from reducing costs if it sees an opportunity. No more succinct example of the workings of this urge can be given than the following comment of the *Economist*² upon the development of British coalmining:

¹ This figure is derived from the Board of Trade index of production and trade, and the numbers in employment.

² June 1st, 1935.

“Although the tonnage disposable in 1934 was still about 32 millions below the level of 1929, the profits nearly equalled those of the last pre-depression year. This is a notable achievement. It is due to the growth of mechanisation, to the parallel reduction in the total of workers employed, and to the consequent increase in the output per manshift and the reduction in labour costs per ton raised.”

A new process, whether introduced by an existing firm or a new competitor, may be reckoned to lower the cost of production. Either the capitalist uses less labour or his capital expenses must be less per article produced. If the saving is made on his labour costs, no one would deny that the labour-productivity has been increased. Let us consider the case of a so-called capital-saving investment. This means that the capitalist is able to cut his cost of production either because he has effected economies in raw materials, fuel consumption, etc., or he has reduced wear and tear in his machinery, or he has adopted a newly invented process which needs a less expensive machine to do the same work. Whichever variety of capital-saving takes place, the effect for our purpose is the same. If he can produce the article with less raw material, the demand for the latter

will relatively shrink, relatively fewer workers will be employed in its production. If we imagine so many hours of human labour incorporated in the raw material, less hours of human labour will be included in the final product. If the capitalist has reduced wear and tear, he need purchase new machines, or replace their parts, less frequently. Less labour is expended on machine production and repair. In this way, also, there is a saving of *labour* if cheaper machines are installed. It may be objected that even if less labour is needed to provide the fixed capital for any process, this may not mean the employment of less labour in the process as a whole. Actually, the chances are that an improvement increases, rather than decreases, the proportion of capital to labour in its own stage of manufacture. But the fact that the investment is ameliorative means that the cost of production *as a whole* has been reduced. If a saving in capital cost were more than balanced by an increase in labour costs, the improvement would not be adopted. Hence it is seen that even a so-called capital-saving improvement dispenses with labour, and increases the general labour productivity of the economy as a whole. The only difference between a labour-saving

and a capital-saving improvement is that the former effects an obvious saving of labour in the process under consideration, while the latter effects a hidden saving of labour in an earlier process. The one saves living labour, the other the labour embodied in the raw materials and implements. The difference is immaterial to the argument and in future will not be made. There is, however, one possible relevance in the distinction. A labour-saving improvement entails the dismissal of employees, and the loss of purchasing power of a very high E. On the other hand, a capital-saving improvement will dispense with capitalised labour units, so that the incomes of accumulators, with a low E, are impaired as well. But this is only a small factor bearing on our evaluation of a trend, and does not justify our making the above distinction in ameliorative investment.

Our conclusion is, at this stage, that all ameliorative investment raises the productivity of labour, that is, fewer workers are employed for a given output. This constant tendency to what is called "technological unemployment" has obtained recognition in some quarters. So far as I know, nevertheless, no attempt has been made by economists of the bourgeois schools to make an

analysis of it. It has generally been taken for granted that it is something we need not worry about, and that, if we did, it would not make much difference, because technical progress has got to come all the same. It is easier to revert to an attitude of *laissez faire* which assumes that displaced workers will, somehow or other, be re-absorbed. Enthusiasts over rationalisation, which entails an acceleration of the trend, used constantly to reassure us that it means, at the worst, only temporary unemployment. But the matter was not investigated thoroughly. The Economist falls into this easy optimism in declaring:

“No fundamental reason exists why released labour should not be re-absorbed in new industries to-day as it always has been in the past.”¹ Note the completely illogical inference that because re-absorption has occurred in the past, the same result may be anticipated now, in qualitatively different circumstances. This is like saying that because a runner is not exhausted half-way through a mile race, he will not be exhausted at the end.

Let us trace the process with a little patience. It will be necessary to introduce simplifications, which will subsequently be removed. The first

¹ *Economist*, April 28th, 1934.

of these is that there are a large number of firms providing each article (competitive conditions); and the second is that the market for the commodity whose production is cheapened is inelastic. This latter means that whether the maker raises or lowers the price, the public buys the same quantity. Suppose a general improvement to be adopted among manufacturers of shoe-laces by which production costs are lowered by 10%. Competing among themselves, the manufacturers pass this saving on to the consumers. The demand for laces being inelastic, the latter will not, because of the price reduction, buy laces rather than string with which to tie parcels, nor chew them rather than buy toffee. The industry finds that its total receipts have been cut down by 10%, and the workers in that industry find that, collectively, they earn 10% less wages. As a group their purchasing power has been cut down by a corresponding proportion. Note, however, that the public will still have their saving on the price of shoe-laces in their hands as purchasing power. If they dispose of this on other consumption, that is, *E* is not reduced, there is no diminution on the part of the community of the power to purchase.

A more detailed statement of the process is as follows. The loss of purchasing power in the bootlace industry (10% decline) sets up a round of negative repercussions, starting with a fall in those articles generally bought with a wage-earner's income. The saving by the community on bootlaces, on the other hand, releases an exactly equal amount of purchasing power, which, if spent, sets up a compensating positive repercussion, similarly beginning with the commodities usually bought by a wage-earner. It is possible that the negative repercussions will have a short start because the bootlace workers may be stood off before the price of laces is cheapened. On the other hand, there will probably be some investment in production necessary to instal the new process, which will make good the gap, so that, coming at the time it does, the delay between the onset of the two opposite repercussions will be unimportant. The negative and positive repercussions, therefore, will cancel each other out, and the volume of purchases remains unchanged. Of course, the expansive effect of any investment in production initiating the new process is here left out of account, except in its coincidence with any possible time lag.

Let us now withdraw the proviso of an

inelastic market, and suppose the economy is effected in production of furniture. The lowering of prices by 10% may encourage the public to spend 20% more on furniture. It does not matter for the illustration whether the furniture trade workers receive 20% more wages, or whether 20% more are employed (we suppose employers are forced to pass on their share of the increased returns to the workers). The furniture trade has 20% more purchasing power. But the public cannot spend again the additional money with which it has bought furniture, and must correspondingly reduce its purchases of other commodities. Other trades have been deprived of the purchasing power for the benefit of the furniture trade.

Similarly, it can be shown that with any elasticity in the demand for a commodity, or change in the total receipts of an industry, the aggregate money receipts of the community are not affected by a cheapening of the cost of production. The public may transfer a part of their incomes to furniture from other commodities. The volume of incomes has not increased, and consequently there are no additional funds with which to swell the volume of employment, or pay higher wages. Nevertheless, the com-

munity's output of commodities has risen, and through the channel of falling prices what may be termed the *commodity-purchasing power* of the people has been increased. But the consuming power, measured in terms of the work embodied in these commodities, the *labour-purchasing power*, remains stable. There has been a good deal of loose thinking on this point, especially by advocates, or apologists, of rationalisation. It has been assumed that the extension of demand due to the cheapening of an article entails an expansion in the general purchasing power, as measured in labour, that is to say, that all available reserves of labour will be absorbed by the extension of the demand for commodities.

At this stage it may well be enquired how exactly the whole scale of capitalist production, of consuming power, and of employment, can be expanded. We know that the capitalist system has given scope for a many-fold increase in population. For example, the population of the United Kingdom nearly doubled between 1821 and 1901, and the growth of American population must have been far more rapid. In the foregoing analysis no allowance was made for any swelling of purchasing power by an investment. It was implicit that the furniture trade,

in reverting to the output of cheaper goods, only made a negligible capital investment. This is quite feasible. The trade may have discovered that if they turned out a cheaper variety of furniture, greater numbers of people would consider the purchase worth while. Let us add the complication that the industry, at considerable expense, reverted from a handicraft technique to a mass production. Large new factories may have been built, and large investments of new capital made. Provided that unemployed workmen were available, additional employment would be given, and with it the volume of purchasing power would be increased in an absolute sense, which would be magnified by repercussion. This swelling of purchasing power, which may be termed an *investment expansion*, is of course ephemeral,¹ lasting only so long as the actual invested funds are being put into circulation in the form of wages, salaries, profits, rents, etc. As a result of the investment expansion, the public can proceed to buy 20%

¹ Ephemeral in the sense that the purchasing power and repercussions generated by the investment do not spell a permanent enlargement of the market. Fresh initiative is always needed to replace one investment with another. Should the new investment fail to materialise, a wave of negative repercussions begins to chase the positive repercussions of the former investment. Nevertheless, an investment does perform the function of jerking consuming power up to a higher level.

more furniture without causing a net diminution of incomes in other industries. True they will still transfer part of their incomes from general consumption to furniture, but the circulation of the invested funds will make good the deficiency for other producers. Since the funds have been made available with which to pay the extra wages, there can now be an increase in employment. There has been a net increase in the volume of incomes; production has risen not only on account of the greater efficiency of furniture workers but also because more men are engaged in the production both of capital goods and consumption goods.

Even if the investment expansion in the furniture industry was insufficient to enlarge the market significantly, investments in other industries may be taking place opportunely, and so allow the furniture trade to take more purchasing power without other trades suffering. For example just as the cheaper furniture is coming on to the market, a large investment in house-building may be made, the purchasing power generated by which would raise the level of general purchases, so that industry as a whole would feel no deficiency by the transfer of incomes to furniture. Nor need this process fail in times of

full employment. An investment expansion may be generated by paying higher wages to those already employed instead of employing additional men. There would be a net addition to incomes, and consequently to purchases, just as if extra employment had resulted. :

On a superficial review of these conclusions, it may be thought that the dynamic factor of increasing labour productivity is not so decisive after all, that the movements such as those described above cancel each other out, and provide no further basis for analysis. One important conclusion, at least, has emerged so far. The notion that a capitalist economy grows according to some natural law, like a tree—always taken for granted by the Alfred Marshall school—has no basis of fact. It cannot be said that all reserves of labour will be absorbed just because the labour is available, any more than it can be said that stocks of consumable goods will be consumed because there are people physically capable of consuming them. The touchstone to expansion is seen to be the degree of new investment concurrent with the appearance of the new goods and the new labour on the market.

It is now time to remove one vital proviso from the analysis. In considering the effects of raising the productivity of labour, it was assumed that, by a lowering of prices, the benefit of the technical progress would be passed on to the consumer. In a competitive capitalism, both Alfred Marshall and Karl Marx would agree, the prices of commodities would fall as their cost of production was lowered. Hence the increased productivity of labour need never leave a surplus of commodities on the market, because producers would be able so to lower prices that the public, with its existing money incomes, would be able to absorb the whole output. Capitalists would continue to enjoy an average rate of profit, the same number of workers would remain in employment despite their increased productivity.

There is, then, a tendency, under competitive conditions, to pass on the reduced cost of a commodity to the consumer. In innumerable instances, the factory production of men's suits, the mass production of cars, etc., this process is a matter of everyday experience for each one of us. But if the market is to absorb the whole of the enlarged production which the increasing labour efficiency is throwing upon it, the standard of living of the community must rise in proportion

to its increasing productivity. In fact, we know that this does not happen, at least not always, and as a matter of course. Besides the prices of commodities falling, wages can fall, and do so when bad trade and unemployment give employers the superior bargaining power. It is quite true that during the nineteenth century, as a whole, real wages rose considerably—by 80%, for instance, between 1850 and 1900.¹ But whether this corresponded to the increase in productivity is doubtful. The curve of real wages is a fluctuating one, rising sharply in times of good employment, and falling in bad.² Only because capitalism did on the whole succeed in solving its market problem during the nineteenth century were real wages able to rise. During the period 1900–14, real wages fell decisively, by about 10%. The rise between 1920 and 1935 of 15% is not nearly as great as

¹ According to the best estimates obtainable.

² Sir William Beveridge should have known better than to attempt to show, by correlating real wages and unemployment, that the lower wages the workers will accept, the more will be employed. All his correlation shows is that there is an element of rigidity about wages, so that a fall in prices will enable workers to buy more commodities and vice versa, until wages have had time to adjust themselves. In the post-war years, the period that Sir William uses, price falls were associated with periods of bad trade, and therefore with unemployment. The temporary rise in real wages, caused by the price fall, coincides with the rise in unemployment. The common cause of both is the state of trade, and not, as Sir William would have it, the willingness of the workers to accept lower wages.

the growth of labour productivity during this period.

During the past generations, ideas of what is a tolerable subsistence have changed, and unemployment insurance has improved the bargaining power of the worker. Considerations such as these, which determine the general level of wages, have little or nothing to do with how much a worker can produce. At any rate, no one would maintain that real wages rise *because* labour productivity has been heightened, as a direct cause and effect. In certain circumstances the reverse could be argued.

In defining purchasing power and the volume of purchases it was emphasised that although these may take a money form, they are essentially commodity concepts. For instance, in discussing how an expansion of the whole economy could take place, extra purchasing power was shown to come on to the market, via investment, in the form of income-money. A shrinkage of purchasing power may take the outward form of a reduction of money incomes, but, fundamentally, it means that the quantity of goods which the people can buy with their money incomes has diminished. The index of real wages is a measure of purchasing power for

the great mass of the community, the working class, when the number of workers remains stationary. Consequently, if real wages do not rise to the extent of the increased labour productivity, it cannot be assumed that the community will be allowed to retain the benefits of the latter which it has received by way of price reductions. To be true, the incomes of salary-earners may remain fixed in terms of money, so that falling prices would increase their purchasing power commensurately with the rising productivity. But such incomes only absorb a small proportion of the national income.

The remaining important category of incomes are those which arise from the sharing-out, by one means or another, of the profits of industry. Such incomes, those of private employers, shareholders, etc., have the important qualitative distinction from the other categories that they are not subjected to the restraint of being "costs" in anyone else's balance-sheet. This class aims to maximise its income, and there is no other class in a position to impose upon it rigid limits. But we have seen in a previous chapter that to accumulate, rather than to spend all its income on personal consumption, is the social behaviour of this class. If the accumulators could bring

themselves to absorb whatever surplus of commodities the rising labour productivity has generated, and which the working masses are not allowed to consume, we would still be justified in accepting the proviso that the community as a whole will be able to absorb all the benefits of this rising labour efficiency. The actual position, in the words of Marx, is that we are faced with the contradiction of "consuming power based on antagonistic conditions of distribution, which reduces the consumption of the population to a variable minimum within more or less narrow limits. The consuming power is furthermore restricted by the tendency to accumulate, the greed for an expansion of capital."¹

To maintain that none of the expanding production is absorbed by a rising standard of living owing to the tendency to the subsistence level, would be a mechanical and unrealistic attitude. We know that rising living standards have contributed in the past to this absorption, but we have no guarantee that they will continue to do so in the future. However, for the purposes of analysis, let us imagine a state of affairs where *the increased productivity is not in the least compensated by rising living standards, nor consumed by capitalists,*

¹ Marx, *Capital*, vol. iii, p. 286.

etc. If we revert to the illustration of an improvement being made in the production of bootlaces, then the position is now, that the standing-off of 10% of the bootlace workers causes a shrinkage in the market for wage-earners' purchases. But since, by hypothesis, the rest of the community cannot avail itself of the purchasing power which has been released by the cheapening of the laces, the total volume of purchases is reduced. For the purpose of a more realistic illustration, let us suppose that the price of bread is lowered, and that, nevertheless, there is no significant increase in the amount demanded. At the same time, wages are reduced, so that the working class is neither better nor worse off than before. They spend 2s. less on bread per week, and receive 2s. less wages. They consume exactly the same amount in commodities. Their commodity-purchasing power has not been impaired. But there is less labour than before embodied in their consumption; their labour-purchasing power has been reduced. As far as they are concerned, they do not notice this. It is the workers and farmers engaged in the improved process of bread-making who find that a certain number of them are without employment. The total money-income of this

industry, and its commodity-purchasing power has been reduced. There is a net shrinkage of the market, measured both in money purchases and commodity consumption, which will be magnified by repercussions.

Without burdening the reader with the detailed application of this case to commodities of varying elasticities of demand, it can be seen that for commodities as a whole, any increased efficiency of labour, faced with a complete rigidity of living standards, must throw men out of work by the exact extent of the increased efficiency. For instance, if the same number of workers produce 3% more goods each year, and the community is unable to absorb a single additional article, then every year 3% of the workers must be stood off. In the case of the furniture workers, the elasticity for whose product was so great that a reduction of 10% in prices induced the public to spend 20% more than previously on furniture, the employment in the furniture trade would nevertheless increase. Since, by hypothesis, however, total consumption could not increase, the demand for other commodities must decline proportionately, and the labour of the community having become more efficient, there must, by so much, be a reduction in employment.

The proposition can be formulated thus: If the standard of living of the community cannot rise, every increase in labour productivity will not only cause, by so much, a reduction of employment, but, by eliminating the purchasing power of the displaced workers, will set on foot a series of unfavourable repercussions, and finally, result in a net shrinkage of the market. This, so long as the shrinkage is not counter-balanced by extraneous investments in production. The proviso as to the rigidity of living standards should be borne in mind. The usefulness of the analysis is not in the least vitiated by showing that the standard of living can, and mostly does, rise. To the extent that the standard of living does not rise sufficiently, in such measure will the cumulative shrinkage become a reality. In capitalist economies where, by one means or another, special measures are taken to prevent a rise in living standards, as in the Fascist states, the argument becomes the most literally applicable. As far as Britain is concerned, it must be remembered that nearly a quarter of the working population is engaged on production for export. It is not only a question, therefore, of ensuring a continuous rise in domestic, but also in world, purchasing power. For the

tendency to growing labour efficiency applies none the less to export manufacture.

When we speak of a net shrinkage in the market, it is important to envisage the actual process. In the above examples of the effects of greater labour efficiency, it was assumed that industry was competitive, and that capitalists were unable to make special profits, say by maintaining prices despite lower production costs. In this case, the bulk of purchasing power accruing to all engaged in the trade, i.e. both workers and capitalists, would be lowered except in cases of extreme elasticity. Manufacturers would require smaller sums to finance current production, and would either fail to renew bank credits, or leave their own funds unused. So much purchasing power in its monetary form would have been cancelled. If, on the other hand, capitalists, holding a monopoly, or having some other special advantage, are able to turn the greater labour efficiency into profits for themselves, the purchasing power is only cancelled if they fail to invest or spend these profits. Purchasing power would have been diverted from employees' to capitalists' use, from a higher to a lower E.

In order to carry the analysis still further, it

will be convenient to start from the supposed state of equilibrium as formulated by Mr. Keynes in his *Treatise on Money* (1930). This is a state of things where the volume of purchases balances the volume of purchasing power; there are sufficient investments in production to counteract the shrinkage of the market due to hoarded accumulations, i.e. income-money not disgorged on current consumption. The volume of purchases equals the actual purchasing power, since people either spend all their incomes, or someone else spends it for them. Mr. Keynes takes no account of any possible net shrinkage in the volume of purchasing power itself. In the circumstances which we have analysed above, we have seen that this net shrinkage is a constant *tendency* in a capitalist economy, due to the continual technical progress. Given, then, an increased technical efficiency, the volume of purchases can still equal the purchasing power (i.e. investment = savings), and yet men will be thrown out of work. The quantity of *commodities* produced may remain the same as previously, but the number of men required to produce them has diminished. The state of equilibrium has been reproduced, but on a shrunken scale as far as employment is concerned. Furthermore, in the

ensuing phase, purchasing power and the volume of purchases will shrink from a monetary point of view as well, so that unfavourable repercussions will be generated. If the original amount of employment is to be maintained, investment in production must not only equal the accumulation; it must be sufficiently in excess to compensate for the purchasing power which has been cancelled. It may be that the whole of the advantage of increased efficiency has materialised in profit. Then it is only a question of investment up to the amount of the accumulation. But this accumulation will be greater than the previous amount of investment, and investment in the ensuing phase must needs be greater than in the previous. In any case, the maintenance of the level of employment demands a growing volume of investment. From another point of view this is all the more evident. If the consumption of the community may not rise per head (and that is our hypothesis) and labour grows more efficient, an increased production of capital goods, or a greater waste, is necessary to keep all employed.

Let us suppose that a capitalist economy is becoming productively more efficient by 2% a year, which is not an unreasonable assumption

for the post-war years. Whereas in one year one hundred men produce a given output, only ninety-eight are needed in the next. Only ninety-eight have wages to spend. It is evident that purchasing power, and, unless otherwise compensated, the whole market, has shrunk by 2%. *In order to maintain the employment level, there must be net increase in the volume of investment equal to 2% of the whole national income.* I do not know of any estimate of the proportion of British incomes which are saved and invested. For the purpose of this illustration let it be taken as 20%. Then, in the ensuing phase, investment must equal 22% of the national income, that is, the amount of investment must increase by 10%. Now, generally, one cannot increase investment without still further increasing labour productivity. After all, capitalists do not invest to maintain the community's purchasing power and employment, but to make a profit or draw dividends. Only investment in the form of State deficit financing could avoid raising productivity. As soon as the second dose of investment has taken the form of new instruments of production, yet more labour will be dispensed with, so that out of the hundred originally employed, just over ninety-six will remain in work. The com-

compensating volume of investment must rise to nearly 4% of the national income, and will in turn generate greater labour productivity. If successive doses of investment continue to make labour more productive on the same scale, the compensating amounts of investment in the next phases must increase by geometrical progression. Actually, for lack of suitable placings for their funds, accumulators may get used to a reduced rate of profit, that is, they would initiate improvements which give a smaller increase in labour efficiency. Nevertheless, the amount of investment would need to increase absolutely from phase to phase, but the necessary increases would be smaller in proportion to the amount invested. The rate of geometrical progression would only be retarded. Our conclusion may be stated thus: so long as consuming power cannot increase, and labour productivity rises, the volume of investment must grow in proportion to the net saving of labour in order that employment may be maintained and a market shrinkage averted; and the rate of growth must be in geometrical progression so long as the productivity of investment remains constant.¹

¹ It is interesting to compare this conclusion with that of Marx: "We find that an accelerated accumulation of total capital (accelerated in geometrical progression) is needed to absorb an additional number

We may bring the proposition nearer to reality by allowing for some rise in the standard of living, insufficient, however, to absorb the whole increased production. Then the necessity for a cumulative growth in investment persists: it need not equal the total increase in productivity in this case, but just that increase in productivity which the higher living standard is unable to absorb.

In a modern capitalist economy, this failure of the living standard to absorb the growing productivity is a reasonable assumption. Such statistical data as are available indicate that this has been the case in the post-war years. The conclusion is an alarming one. It might be termed fantastic, did not the economic history of this period show equally fantastic phenomena which give a plausibility to the conclusion of this analysis.

The crux of the dilemma facing an advanced capitalism consists in where to find a profitable placing for the ever-necessary volume of investment, in the face of the general rigidity of the market limits. If we gauge that the failure of purchasing power does in fact become operative,

of workers, or even, on account of the continuous metamorphosis of the old capital, to keep in employment those already at work." (*Capital*, vol. i, p. 695.)

outlets must be found for a continually growing stream of investment. The demand for profitably utilisable inventions and new fields for investment becomes insatiable. Should the dizzy round lose its momentum, should the propelling power of investment once fail, the whole mechanism jams; the chronic shortage of purchasing power, the heaped-up stocks of unsold commodities are familiar to us in the phenomenon of the economic crisis. Not only is a relapse predicted by the reasoning of this chapter, it is shown to become more and more inevitable the longer it is delayed. Each feat of enlarged investment calls for a larger to follow, and makes the ensuing feat more improbable.

Why, with the onset of a crisis, the whole economic structure is not completely paralysed, is discussed in another part of this essay. Suffice it to consider here why the tendency does not work itself out quite so mechanically as our analysis might seem to indicate. There are what may be called certain mitigating or alleviating factors which are able at times, and for a time, to counteract the relative deficiency of purchases, and hold off the crisis.

If an increase of saving and investment aggravates the tendency, a decrease will abate

it. For instance, if we can persuade the accumulating class not to dispose of their surpluses by investments in production, but by buying luxury motor-cars or houses or yachts, or make benefactions to hospitals, this spending will maintain purchases in lieu of the investment of the funds coming into their hands. It has not that awkward effect of increasing the labour productivity for the ensuing phase. The giddy round has been decelerated. In fact, if all investments in production were forbidden, so that the productivity of labour remained stable, and we were commanded to spend the whole of our incomes, we should enjoy the theoretical state of equilibrium. Needless to say, such a policy would be impracticable under capitalism, and in any case undesirable. With the productive capacity society has at its disposal, we could not tolerate a remedy which barred us the use of its fruits merely because we could devise no economic structure capable of standing the strain of the increased capacity. There would be too many to argue new wine in new bottles.¹

¹ Actually, during the Middle Ages the guilds imposed very stringent regulations against the use of more than a certain recognised number of mechanical devices, but they prohibited mechanical production at its beginning, not in its maturity.

To return to the formal logic of the argument, there is no need, of course, for savings to be absorbed by personal consumption. It would do equally well to produce anything of an unproductive nature, rather than invest in productive resources. No matter where the waste, so long as it is wasted expensively. The paradox could not be better illustrated than by Mr. Keynes's ironic suggestions; wealthy men might be persuaded to build pyramids to receive their mortal remains; or they may comfort their souls by buying church masses; the community might finance the burying of bottles of bank notes in disused coal-mines and the digging them up again. The conduct of wars, the most preposterous means of waste, is the only one in which the capitalist economy has so far indulged in sufficient measure to interrupt the vicious circle of growing productivity, and temporarily to banish the market problem. It is not necessary to have a war in order to indulge in this solution of the market problem, at any rate not right away. The piling up of armaments has a very considerable mitigating effect. There is little doubt that the German economy under the National Socialist government has considerably reduced unemployment

by armament financing, and to a certain extent so has Britain.

One other alleviating factor must be noted. As the acuteness of the market problem takes the form of sales difficulties in individual firms, more elaborate sales organisation and greater publicity are needed. All too familiar are the armies of newspaper canvassers, travelling salesmen, and the advertisements which decorate every spare patch in our towns. The *Economist*¹ has estimated that £85,000,000 a year is spent in Britain on advertising in the strict sense of the word. It points out that the "first and most striking feature" about press advertising "is that the amount spent upon it is rising year by year". If expenditure on press advertisement is growing it is reasonable to assume, and it can be generally observed, that more money is being spent each year on all forms of such socially wasteful expenditure. A few years ago, the president of an advertisers' association claimed that no less than £200,000,000 a year was spent on his trade. Naïvely, he was drawing attention to the value of his calling because of the money it put into circulation, and the work it gave. He was more fundamentally correct than he

¹ Feb. 20th, 1937.

realised. All these canvassers and salesmen produce nothing, in any ultimate sense. They are a net cost on industry as a whole. Certainly they do not make the labour of an ensuing phase more effective. They come within the category of the blessed waste which holds us from whirling up and up until our wings melt and we collapse into the abyss. Competitive marketing and distribution perform the same social function. Between 1923 and 1929, employment in the distributive trades in Britain increased by 400,000 persons.¹ In the U.S.A. a similar tendency is seen. In 1930 industries *producing* commodities were occupying a 6·8% smaller proportion of the total employed community, while trade engaged a 2·3% greater proportion—numerically, an increase of over 1,800,000 persons.¹

Finally, it must not be inferred that the *tendency* to market shrinkage which has been deduced precludes an absolute expansion of the whole market; nor must it be objected that because capitalism has in the past continually enlarged the whole scale of its economy, supporting now 45,000,000 people in Britain where once a handicraft production only made room for 5,000,000, events have proved the analysis

¹ *Economist*, April 28th, 1936.

to be invalid. The mainspring to expansion, apart from extensions of the market into non-capitalist spheres, has been shown to be investment. So long as investment is so great as to expand absolutely the volume of purchases, the whole scale of production will be jerked up to a higher level. Once, however, the higher level has been achieved, the same tendency to deficiency of purchases comes into play once more. The secular rise in nineteenth century capitalist production, punctuated by economic crises, is not only consistent with, it also supports the conclusions of, this analysis.

CHAPTER VII

FURTHER CONSIDERATIONS ON THE PROBLEM OF PRODUCTIVITY

The need to keep theory in close touch with reality—The failings of the bourgeois economists—The existence of trade cycles and the course of nineteenth century industrialism tend to confirm the theory—The mutual destruction of capitals under competitive conditions—The importance of qualitative changes in capitalism.

THE THEORY OF the market as so far outlined, however abstract in appearance, was based upon the observation of such modes of behaviour as were relevant to the enquiry. For example, it was implicit that in the economy under observation men co-operated for the production of commodities in a certain special way, that of employer and employed. It was also noted that the expenditure of incomes constituted an important part of the market for these commodities. The laws of behaviour, both of men, and their contrivances and products, which we have accepted as our data, are for the most part simple and incontestable. Such contentiousness as may arise will be in the laws of working of the economy as a whole

which are deduced from a study of its constituent parts. When new, and especially when startling, conclusions have been deduced, it is essential to re-examine the object studied to see if the discovery can possibly be in accordance with the facts. Of all the theoreticians who have studied material phenomena, the economists have perhaps been the greatest defaulters in this mental discipline. Neatly finished hypothetical edifices, based on incomplete data in the first place, have evolved into an economic metaphysic rather than an accurate description of bourgeois industrialism. The modern bourgeois economists have no more considered the verity of their description than chessplayers bother about the absurdity of the functions of their kings and queens in the light of the modern practice of constitutional monarchy. As industrialism developed, that is to say, the data changed, no attempt was made to re-adapt the theory to explain the changed conditions. In the words of Mr. Keynes, "professional economists, after Malthus, were apparently unmoved by the lack of correspondence between the results of their theory and the facts of observation."¹ Alfred Marshall, the Mohammed of the British bourgeois

¹ *General Theory of Employment, Interest and Money.*

school, gives no indication, even in the latest edition of *The Principles of Economics*, published in 1920, that he is aware of the existence of economic crises. When we consider that even in the nineteenth century these periodic convulsions were the most serious problem facing society, we realise to what extent Marshall's religious belief in the inherently robust health of capitalism led him to minimise these disturbances and build up a theory irrelevant for their explanation. Similarly, Mr. Keynes admits that "I had not then (i.e. *Treatise on Money*) understood that, in certain circumstances, the system could be in equilibrium with less than full employment". He is in effect saying that he neglected the elementary scientific precaution of testing his conclusions by reality at every stage, and thus allowed a serious divergence to creep in between his final conclusions and the thing studied.

It must be considered whether the deductions of the previous chapter fit themselves in with the large aspects of the capitalist economic structure. In the competitive economy which has been analysed, there was deduced a tendency to a failure of purchasing power, a piling up of stocks of commodities. If, during the predominantly

competitive capitalism of the nineteenth century, these crises had not existed, the theory would have lacked reality. Actually, these breakdowns have occurred so repeatedly, and at such frequent intervals in Britain, and in every country where a capitalist economy has established itself, that no state of trade could be described as normal. No sooner did trade struggle out of one depression than it raced towards the next. The serious nature of these cycles can be gauged from the American depression of the 1870's which according to Wesley Mitchell lasted five and a half years. The deductions from his statistical method must be quoted owing to their importance for the verification of this analysis: "The durations of business cycles may be regarded as the net resultants of a multitude of factors which are largely independent of each other. If there is any dominant factor or set of factors, which tends to reproduce cycles of uniform duration, its influence is greatly modified by a host of other factors combined in ways which vary endlessly. This conclusion has an important bearing upon the theory of business cycles and the methods by which the theory may be improved." In the first place, a possible confusion must be forestalled. The sufficiency of the volume of

purchasers is not one of these factors, it is the actual phenomenon whose behaviour is studied. A "business cycle" may be defined as a group of periodic variations in the sufficiency of the volume of purchases. We have shown these variations to be dependent on several factors including the amount of investment in production, itself dependent upon the profitability of business. When we start to count the determinants of this profitability we meet a host of technical factors, themselves depending upon the progress of science, combined with considerations of a political nature such as the acquisition of territories; or even legal changes, such as the law permitting the modern form of the joint stock company; and monetary factors, such as the improvement of the technique of credit expansion, aided by the periodic plentifulness of gold. Subsequently, some of these crises will be studied in their more detailed aspects for the further verification of the theory.

Given that severe failures of the volume of purchases have repeatedly occurred ever since our society adopted a predominantly capitalistic economy, it may be argued that nevertheless the theory does not coincide with reality, since the progressive acceleration of investment

(on the basis of a more or less stable standard of life of employees, and constant saving by all classes) necessary to maintain the level of purchases, ought long ago to have led to the supersession of capitalism as completely unfit to cope with the modern forces of production. Since capitalist production has indeed expanded to enormous dimensions compared with its beginnings, our analysis would demand that for considerable periods investment was in great enough excess, not only to maintain purchases, but also to enlarge them considerably. The following conclusion of Sir Walter Layton,¹ the result of direct observation, and not a theoretical deduction, admirably bears out this analysis: "It is true that the inventions and other changes of the industrial revolution has begun to stimulate production long before the end of the eighteenth century, but *the growth of industry moved at an accelerated pace throughout the whole of the nineteenth century.*" (My italics.) Those who nevertheless maintain that the general conclusions are still out of accord with historically observed facts, probably neglect, firstly, the progressive development of the world market as an external mitigating factor especially for Great Britain, and,

¹ *An Introduction to the Study of Prices.*

secondly, underestimate the volume of investment normal under competitive conditions. The expansion of the market into non-capitalist territories will be discussed in a subsequent chapter. Let us proceed to evaluate the extent of investment in a competitive industrialism.

Let us suppose that a competitive capitalist learns of an improvement that has been brought out in his process of manufacture. He will no doubt calculate how great a capital outlay the adoption of the improvement will entail, and by how much he can increase his profits. He may come to the conclusion that it will be necessary to scrap the whole of his existing plant, which cost £10,000, and invest in a new, costing another £10,000. With the old plant he would probably be earning an average rate of profit of, say, 10%. The improved plant would of course yield a higher rate, such, for example, that a capitalist with no old plant to bother about could invest £10,000, and receive $12\frac{1}{2}\%$. But the capitalist already established in the industry will look upon the profitability in a different light, for the earnings on the new plant will have to bear the interest charges on the old capital, as well as on the new. It could not be expected to earn the 10% profit of the

scrapped plant as well as the $12\frac{1}{2}\%$. In fact the new outlay of £10,000 would only give a single $12\frac{1}{2}\%$ profit. In other words the additional outlay would only yield a net increase of profitability of $2\frac{1}{2}\%$. Considering that the average rate of profit was 10% , the capitalist would on first thoughts not consider the improvement worth while. But on second thoughts he may reflect that if he does not adopt the new process, someone else may, and that in order to remain in business at all he must keep up-to-date. A competitor undercutting him by ever so little could drive him off the market completely. Furthermore, to a capitalist who does not own the old type of plant at all, the calculation is entirely different. Whereas to the firm who must scrap existing plant and make the new process pay the interest charges on both, the increment of profit is on $2\frac{1}{2}\%$, to the newcomer it is $12\frac{1}{2}\%$, because he will have only one £10,000 invested. If this rate is above the prevailing rate for new investment, the new entrant will come on to the market and render the plant of the other capitalists obsolete, which, of course, he does not mind in the least. Whether the established capitalist will in fact scrap his old plant or not will depend partly upon his individual

temperament and clear-sightedness, and partly upon his ability to raise new capital. If he is far-sighted enough, he will realise that the main danger of a rival may not be so much in forcing him to sell his goods somewhat more cheaply, and so reduce his rate of profit. (For instance, once the improved plant becomes the general mode of production it will only earn the average rate of 10% and not $12\frac{1}{2}\%$, in which case any old plant still existing would earn only $7\frac{1}{2}\%$.) The danger of new entrants will be in overcrowding the industry, so that as a result of cut-throat competition profits may be reduced to nothing or turned into losses.

For the purpose of the analysis it is unnecessary to enquire exactly how many established capitalists of the competitive era did actually invest in new plant or allow their plant to become out-of-date. If they do invest in the new, the old capital is quite obviously destroyed. If they do not, new entrants to the industry will build the improved plant and force the old out of existence. The important consideration is that large amounts of capital are purely and simply destroyed by competing capitals; the volume of investment may be very large indeed. On the other hand, the increase in the productivity of labour is

small, perhaps infinitesimal.¹ The slight tendency to shrinkage of the market, in so far as it is not negatived by rising living standards, is counteracted by the investment expansion to such an extent that an expansion of the whole scale of the economy becomes possible. This mitigating factor of what we may call the mutual destruction of capitals, must be removed when we consider a monopolistic society.

It must not be assumed that this destruction takes place so smoothly as the analysis might seem to indicate. Most likely a capitalist owning a valuable plant, and receiving a 10% profit would not be able to scrap the lot. Nor would he allow himself to be immediately driven off the market by another who was earning $2\frac{1}{2}\%$ greater profits by reason of a more efficient process. To remain in business he would reduce prices of his goods also, and be content with a $7\frac{1}{2}\%$ return once the new process had become the predominating one and was earning the general rate of profit. While he had been unwilling to invest new funds at less than 10% it is better to take $7\frac{1}{2}\%$,

¹ Layton quotes Mr. William Fowler as saying (1886): "wages have greatly increased, but the cost of doing a given amount of work has greatly decreased, so that five men can now do the work which would have demanded the labour of eight men in 1850." Such a cumulative productivity gives an annual increase of 1.3% compound interest—a much lower rate than in the more monopolistic twentieth century capitalism.

or even 2%, than nothing. Nevertheless, the likelihood that the older plant will remain in use does not deter the new entrant. He knows that in a phase of cut-throat competition he will be in a better position to survive. Both new and old plant will remain in production so long as the market is expanding sufficiently. Or profits may be maintained artificially by rises in the price level resulting from some extraneous influence such as an increased output of gold. But once the market has reached its limit, or the prices become steady or fall, a crisis of over-production will ensue and the less efficient firm would be driven out of business, and its plant, as capital, destroyed. The general law of the mutual destruction of capitals is obeyed, only it takes place by spasms, dictated by external circumstances, rather than evenly.

One further explanation is needed in viewing capitalist development in the light of this general analysis. It might be contended that the potentially malignant tendency of rising labour productivity, constantly at work in a capitalist economy 150 years old, ought by now to have brought us to the extreme of absurdity; that however small the excess of productivity over the rise in living standards, the required compen-

sating volume of investment should by now have reached altogether unmanageable proportions. The fallacy in this point of view is that the development of modern industrialism is not merely a question of a growth in size. It is not merely a question of quantitative change, of a growth of population, of gradual increase in the standard of life, of increasing labour productivity, of finding new overseas markets as they were needed, in which framework the trend of mounting investment could proceed undisturbed. The environment is changing not only by enlarging its scale; the nature of capitalism has been changing. The decision of the most influential capitalists in Britain and in other countries to develop overseas empires introduced one of the important changes of quality; the partial or complete adoption of the monopoly form of industrial organisation is similarly a qualitative development. Even the invention of the steam engine, the abolition of the Corn Laws, were changes in this category, allowing the effects of labour productivity to work themselves out on a different basis. Each change of quality, engendered by the necessities of the market problem, provide a temporary solution of the dilemma, give scope for renewed

expansion in different circumstances. The staving-off of the impasse of complete incompetency proves nothing as regards the possibilities of the perpetual existence of capitalism. It cannot be argued, that because capitalism has so far solved the problem to the extent at any rate of remaining in existence, that it will continue to do so. Because one blows up a balloon to a certain size, this does not mean that the process can be continued indefinitely, as might be thought by someone who was ignorant of the elastic properties of rubber. At some stage the quantitative change must resolve itself into a change of quality—the balloon will burst. In the development of capitalism, it is the qualitative changes, hidden by the all too apparent quantitative growth, which mark the milestones of its progress. Without due regard for these qualitative changes, any theory of purchasing power and the limitation of the market must appear mechanical. The capitalist system cannot be studied as if it were a clock, where the precise effects of winding up and running down can be relied upon to repeat themselves. For the actual cog wheels are changing in size, new ones are added, and others fall into disuse. To the stock objection to the main argument,

namely, why has not the whole thing run down long ago, the answer is that qualitative developments have intervened to give capitalism new leases of life. Some of these, of which the chief are the exploitation of foreign markets, and the imperialistic development of backward countries, will be examined in later chapters. Nor need it be supposed that these developments were fortuitous. It will be seen that the dominant sections of the capitalist communities, faced with a limit to the market, lacking rigidity only by its tendency to shrink, took practical steps to burst the bond. The detailed policies of the national capitalist groups are rather within the sphere of politics than economics, and need not be examined here. However, the economic effects of each qualitative change will be analysed in order to ascertain to what extent, and for how long, the menace of market deficiency has been kept at bay. It will be useful also to enquire what scope for qualitative change the capitalist system still has, short of losing its capitalist character, and what the effects of these changes are likely to be on the market problem.

It follows that one cannot erect a theory of economic crises as an isolated piece of reason-

ing, as one may develop the differential calculus. No set formula is adequate to account for those phenomena, characteristic of the whole history of capitalism, which have been grouped under the names of economic crisis, business cycle, trade fluctuation, etc. These must be regarded as the outward manifestations of stress in the economic structure as a whole, such as it was at the time. And the essential features of the capitalist system which survive all its changes of quality, however outstanding, give these stresses a common background in the limitation of the market.

CHAPTER VIII

FOREIGN TRADE AND IMPERIALISM

The limitations of trade with backward countries—The transformation of native communities into complementary economies for the imperialist power—The economic technique of imperialism—The joint stock company and foreign investment—Finance capital and heavy industry—Foreign investment as a stimulus to the scale of production—Its limitations as such—The development of colonies into advanced capitalism—Imperialism as a solution for world capitalism.

FACED WITH THE reality of the limitation of existing markets, one would expect sellers to search for new ones further afield. Even before production was on a capitalist basis, the merchant communities of Venice, London and the Hansa towns depended upon an external trade. But the object of their transactions was not so much to dispose of goods, in modern parlance, to find outlets for trade, but to find *inlets*. They were concerned to import the luxury goods of the East for sale to the feudal nobility and the merchant princes. Whereas now a merchant concentrates on finding a market for the disposal of British goods, the medieval merchant concentrated on procuring

supplies of the Eastern rarities. For centuries the characteristic of trade with the East was the transport thither of the precious metals in order to pay for the Oriental imports into Europe. Even up to Adam Smith's time, silver was one of the most important articles of export to the East.

The development of large-scale industry in Britain from the latter part of the eighteenth century, commonly known as the industrial revolution, completely reversed the motives for foreign trade. The productive resources of British capitalism multiplied several times the productivity of labour compared with the handicraft system of the pre-capitalist era. The continent of Europe was made an outlet for commodities. Britain was in the happy position of a single developed capitalism with an enormous market with which to solve her market problem. It is not intended here to recount the fortunes of British manufacturers during the nineteenth century. A few illustrations from their historical development will be given in a later chapter, not with the pretension of economic history—that is beyond the scope of this work—but as a checking up of the theory as further elaborated in this chapter.

Now it is axiomatic in our general analysis that provided an illimitable market can be found, the capitalistic tendency to over-production has no terrors. It will be of interest, therefore, to examine the limits, if any, of foreign markets. Let us take the case of a manufacturing community trading with a people still strange to mechanical tools. Because of the enormous advantage enjoyed by the industrialised community in productivity of labour, and hence in the prices of commodities, profits will be very large. For example, manufactured goods, such as cotton shirts, may be exchanged for products which are not subject to mechanical production in either country, such as hides, or raw silk or corn. The manufacturing country may be able to exchange the labour of one cotton operative for that of five peasants, meanwhile feeding the operative on no such greater amount of corn or other necessities. So long as these, what we may term *backward* markets, are open and capable of extension, so the industry of the advanced country will be expanded in proportion. In addition, the operatives in the industrialised community will probably be able to take advantage of the demand for their labour in order to raise their class to a higher standard

of life, thus providing an extension of purchasing power in the home market. Another part of the influx of wealth will be devoted to the employment of a new class of clerks, travelling salesmen, as well as the maintenance of independent merchants, all providing a wider and more varied demand for consumption goods. The community purchasing power will be shifted to repeatedly higher levels.

Against this must be offset the extremely low standard of life in the backward community. In the first place, its productive power is very low, and, secondly, it must make all exchanges on unfavourable terms, since it must offer the labour of five of its natives for that of one operative. No tendencies exist which will raise this standard of life. Besides having the advantage of technique, the industrial community will have a well-developed merchant organisation confronting the isolated and ignorant primitive producers, and will be capable of driving a hard bargain with them. We know that after centuries of trade between industrial countries and backward territories, such as India or China, the latter are able to improve their living standards little if at all by this trade. Even in 1936, a correspondent of *The Times* writes the

following¹ in a study of Indian diet, "There is every reason to suppose that the removal of these handicaps (i.e. parasitic infection and inadequate diet) would have an effect on their physique and mental energy which would seem little short of miraculous. If one could impose (sic) boots, mosquito nets, and good square meals upon all Indians, thus going far towards banishing hookworm, malaria and underfeeding, India would become a very different country." It has been calculated that if only every one of the 359,000,000 Indians, let alone the 450,000,000 Chinese, could be permitted to buy one more cotton garment a year, there would be no talk of idle factories in Lancashire.

That the limits of the backward market are surprisingly narrow is a matter of commonplace observation. The first and most obvious limitation is that the backward country will have so little to offer in exchange for the manufactured imports. It can respond to the new luxury demands of the industrialised capitalism by sending them wines, silks, providing them with entertainment when they travel. We know that the Britons of the eighteenth century availed themselves abundantly of these amenities. Or, as mentioned above, the

¹ Aug. 14th, 1936.

backward territory can send agricultural products and other articles which even in the industrial state are made without the use of much capital. But there are very rigid limits to the supplies of these surpluses which a primitive community can spare, in the case of agricultural products, or obtain, in the case of ivory, hides, etc. Furthermore, the flood of imported goods would tend to upset the balance of the backward community. Cheap manufactured cotton goods caused acute distress among the village craftsmen of India, and thus tended to lower the purchasing power of the community in general. The solution which Alfred Marshall would have suggested to these unfortunates would have been that they should turn to the production of those commodities which British capitalists would buy. That this happened to a certain extent is true—how British imperialism fostered this development is a subject for later study—but the Indian cotton weaver and others in his predicament were prevented by the rigid feudal, religious caste structure of his society and by a chronic lack of capital for turning to other trades. In summary, it is seen what a low saturation point these backward markets have, and how soon an industrialised capitalism, disposing of its

manufactures to these markets, reaches the limit of absorption.

Let us picture a capitalism which finds itself in this impasse. It finds itself confronted once more with a volume of purchasing power which, within the practical sphere of the necessity for disposal of current output, is fixed. It is not necessary to reiterate the whole analysis of the effects of increasing labour productivity. Suffice it to say that as soon as more efficient processes of production are initiated, the dilemma is exactly the same as in the closed system which was previously analysed. Although the capitalist has grown large and become more powerful, the pursuing dragon of overproduction has grown larger too.

Out of necessity invention, and so the British capitalists took very practical steps to remove the barriers immanent in the undeveloped colonial territories. It was often found that the primitive tribes were unwilling to allow their simple, albeit stable, economic organisation to be broken up by manufactured goods, just as the medieval craftsmen limited the number of looms which each man might own, and the number of journeymen and apprentices in his service. Perhaps the tribe would place confidence in the warnings of

their priests or "medicine men", or the males would simply prefer to work at their own primitive agriculture than to produce raw materials for the white man. In these circumstances we find the whites conducting military expeditions against the backward race, either to force their rulers to make trade treaties, as in the case of the conquest of the India, or of the Boxer wars, or else simply to seize their territories, and force the indigenous race to work on plantations as wage labourers, with the incentive of the chain-gang, and the rhinoceros-hide whip. "To this must be added the wish to convert the heathen to Christianity, and missionaries proved to be great pioneers of the British Empire. But even this philanthropic and missionary work had an economic value. The converted native has to be taught a trade, he makes things for exchange, he develops new wants, and becomes a better customer for British goods."¹

By a variety of means, political, economic and religious, Great Britain and, after her, other would-be imperialist powers, managed to transform the primitive peasant lands into territories producing the raw materials necessary to feed British industry and the British wage-earners

¹ Knowles, *The Economic Development of the Overseas Empire*.

—tea, coffee, rice, copra, cocoa, rubber, raw cotton, to mention only a few of the chief. Where minerals, especially gold, diamonds, etc., could be extracted profitably, this was done mostly with native labour. The tribal organisation of the primitive people was broken up, and they lost their handicraft skill. They had become wage-earners like their white brothers, but with an immensely lower wage. Where the indigenes were “lazy”, that is, preferred their own way of life to working on plantations, the males were, and of course still are, subjected to a poll-tax in money, which they can only obtain by working so many months in the year for the white man.

It can be easily seen that a colonial territory which can be taught to produce for the white man’s needs, can absorb and *pay for* more of the white man’s products. The market has been enlarged.

The above process represents only one aspect of modern imperialism. The distinction between such a state of development and purely trading capitalism is that the advanced country takes active measures to change the backward economy, and this chiefly by the investment of capital. The plantations could not have been established

without capital investment. But this is only a beginning of the flood of capital from the advanced to the backward community which is characteristic of imperialism. In order to transport the raw materials to the coast, and to open up new territories, railways must be built. In the cities which grow up as depôts and business centres in the colony (Bombay, Buenos Ayres, Hong Kong, etc.) roads must be made, tramways installed. Improved cultivation may demand expensive irrigation. However, before we can appraise the effects of this financing of the development of the backward territories, we must turn again to study the progress of the mother capitalism.

In the earliest days of merchant enterprise the collection of capital for investment abroad was a cumbersome business. No individual had sufficient funds concentrated under his control to risk on colonial investment. Such enterprise was left to corporations which were granted monopoly rights by Royal charter, and which developed the characteristics of minor States within their allotted territories. The establishment of the joint-stock company of limited liability provided the framework within which large concentrations of capital could be brought together, the

subscribers being prepared to run the risk because only a small portion of their individual capital would be involved.

The joint-stock company form had also played an important part in the growth of heavy industry, where large masses of capital are required for the installation of a single plant. As the capitalist economy advances an ever greater proportion of the labour power of the society is devoted to the manufacture of capital goods. As Böhm-Bawerk expressed it, it became more worth while to exploit the longer, more efficient productive processes. Labour would be devoted to making machines to make commodities, rather than to making the commodity without the aid of machines. The engineering industry would grow in importance; with it, and with the development of steam locomotion, ever greater quantities of iron and steel would be demanded. The accelerated rate of investment which nineteenth-century capitalism for periods was able to achieve, showed itself in an enormous expansion in the manufacture of capital goods. Heavy industry became equipped to cope with this tempo of acceleration. Should investment once become unprofitable owing to a failure of the volume of purchases to maintain its acceleration,

heavy industry has to bear the brunt of the failure. While the demand for other commodities may slump badly, the demand for "heavy" goods may practically cease. In fact, we know that in all the slumps of the "steel age", heavy industry has suffered by far the most severely. This is all the more significant in that heavy industry, requiring vast masses of capital, was owned by the most influential capitalist groups. Finance capital, the generic term by which these dominant elements are aptly characterised, is connected on the one hand with the banks and issuing houses of the City of London, and on the other with the staple industries of the country, above all, heavy industry. When investment ceases to be profitable, this class is hit in a double manner; it can find no outlet for its surplus, ever-accumulating investable funds, and it forfeits the profits of its largest investments. It is natural that it should be attracted by the new fields of investment overseas which provided it with a solution of all its difficulties. An investment in a backward territory, say the building of a railway, would absorb the accumulated surpluses. The demand for the steel rails and locomotives would set the idle furnaces and rolling mills in operation again. It seemed as if nothing could be planned

more neatly. So capitalism entered into its latest phase of imperialism.

Let us consider the process by example. If £100,000,000 be invested in a colony or semi-colony (i.e. a backward territory not formally under the flag of an imperialist power, but sufficiently under the influence of one to render investment secure, as Egypt), it has been shown by experience that about half, £50,000,000, will never enter the foreign exchange market at all, but will be spent on capital goods at home. This amount of extra purchasing power will accrue chiefly to heavy industry, and will have precisely the same effects as if it were an investment in production of the type we have already considered. The second £50,000,000 of the "exported" capital will be paid out in wages and salaries, and for raw materials in the colonial country. Now according to the laws of currency exchange, the £50,000,000 sterling in the hands of another State must sooner or later find its way back to Britain by way of purchases of British goods. Sometimes one State prefers to nurse the currency of another, either as a backing for its own circulation or as a means of manipulating the rate of exchange, but it is out of the question for any considerable proportion of

the claims for pounds sterling placed in foreign hands to remain hoarded or "nursed". A pound sterling is only of use to buy commodities in Britain. Even if the colonial country had sold the pounds for francs, and bought commodities in France, the French nation would still have the pound sterling on its hands, which it, in turn, could only convert into commodities in Britain. Not only, therefore, are the £50,000,000, but ultimately the whole £100,000,000 spent in Britain. The effect is the same as a £100,000,000 investment in the home industry (given E the same, and there is no reason to believe it much different). We have shown above how the initiative for the expansion of production, and the requisite growth in the volume of purchases, rests with investment. To an advanced capitalist economy such an increment of purchasing power comes like a bolt out of the blue. Little wonder, then, that if finance capital can hurl these bolts, it will not hesitate to do so. British capitalism, in the heyday of its imperialist investment, was exporting regularly scores of millions, sometimes hundreds of millions a year.

Let us consider certain limitations to this sovereign method of stimulating purchases. In the first place, it would be of no use to invest

such large amounts that British industry could not cope with the ensuing demand for capital goods and other exportable commodities. If Britain had invested, say, £500,000,000 overseas, and her labour and plant capacity only enable her to produce £300,000,000 more goods, she would have had either to borrow capital herself from abroad, or relinquish the gold standard and suffer a depreciation of her currency, that is, reduce the real value of the exported capital. But by the nature of the case, this objection is irrelevant. If the imperialist power can only so much as obtain orders to keep all her plant busy, her market problem is solved, and profits are good.

The second limitation arises from the very profitability of investment. If an imperialist power has invested so much abroad that the dividends accruing to her capitalists equal the exports of new capital, no external stimulus to expansion of the scale of production exists. The £100,000,000 invested abroad would be none other, as far as the international money exchange is concerned, than the £100,000,000 dividends which the imperialist power would be handing back to the colony. The foreign exchange market would be unaffected, and no net expansion of

the volume of purchases would result, although, to be true, the enlarged scale already existing could be maintained by a certain stable demand for heavy investment products, and the parasitic consumption of the imperialist bondholders. The payments of interest by the colonies would take the form of exports of raw materials and food-stuffs. In this way, but for the tendency of rising labour productivity in the future, a rough balance might be obtained.

The most serious limitations are on the side of the colonial country. So long as the capitalist economy maintains the flow of investment, the colony has no difficulty, so far as her currency exchange position goes, in making the interest payments on the loans. The new loans provide her with, say, pound sterling with which to meet the sterling interest payments. Should the new investment cease, as it did from Britain during the crisis and following depression of 1929, the colony must export an enormous net surplus of commodities, or else default in its debts. The latter happened to a large extent in the years following 1929, with the result that the British capitalists have since been discouraged from making overseas loans. In other words, the outlet of imperialist investment is denied to the

capitalist economy as a mitigation of its problems of purchasing power.

Even when the flow of new investment is maintained, certain limitations are imposed by the ability of the colony to produce and sell exportable commodities. Even though new investment may balance interest payments, commodity transactions are required. We have mentioned that approximately half the loan is spent in the mother country, and sent out in the form of products of her heavy industry. Consequently an investment only benefits the exchange position of a colony by half its amount. It cannot be argued that if £100,000,000 are invested annually and the colony makes interest payments on previous loans to the extent of £100,000,000, a state of exchange equilibrium is reached, and that the colony need not find exportable commodities. In this case, the new investment would only cancel out £50,000,000 of the interest payments on the foreign exchange market. The colony would still have to export £50,000,000 approximately of commodities. Alternatively, if a colony is to be completely exempted from the export of commodities to meet its interest payments, it must receive new investment from abroad to twice the amount of these obligations.

In the early days of overseas investment, the latter proposition would have been easy, and assuming that from the point of view of the individual capitals the project proved profitable, investment found no limit in the capacity of the colony to make interest payments. By 1929, however, British capitalists were claiming about £270,000,000 a year in interest on their foreign investment. In no one year was anywhere near double this sum, the approximate amount necessary to exempt borrowing countries from meeting their interest obligations in kind, forthcoming from the British capitalists. The default of the debtor countries to the extent of £100,000,000 during the crisis years demonstrates their difficulties in exporting a great enough money-value of commodities. It must not be thought that the colonies were physically incapable of producing enough wheat and mutton and beef and rice, etc.; on the contrary, they were able to produce too much, considering the rigidly limited purchasing power of the industrial population of the mother country. They produced so much that their output became unsaleable on the market, and they could not command large enough money returns with which to pay interest on their

debts. Once more we find the limited purchasing power of the masses as the great stumbling-block to capitalist development.

It is not only a question, therefore, of a colony's producing a sufficiently large commodity surplus, but of producing articles which are readily acceptable in the markets of the industrialised power. But the characteristic of colonial production is the small variety of its products, a large number of colonial territories being dependent upon the demand for a single commodity. If those territories which have already been opened up by railways, and given over to specialised production, can already meet the demands for the characteristic commodities of that area, there would be no object, from the point of view of profitability, in opening up new territories by building more railways. As a safety-valve for the surplus accumulation of the imperialist power, the colony would cease to function. The mining of precious metals provides a field for investment considerably wider than agriculture or transport, but obviously such also has its limits in the world demand for valuables at prices which make their mining profitable. In summary it may be said that every colonial territory, as a colony pure and

simple, has its saturation point for investment. (The development of colonies into independent capitalist economies is considered later.)

It follows that every imperialist power must sooner or later renounce active investment overseas, except it can gain economic influence in fresh territories capable of producing new varieties of commodities compared with those produced by the older colonies. To withhold investment means the renunciation of the main stimulant to an expansion of its economy, of its most effective antidote to the slow poison of rising labour productivity. With its heavy industry developed on the basis of large-scale investment both at home and abroad, the cessation of the demand for capital goods can be imagined to have disastrous results upon an economy inherently so unstable.

Actually, the evil day is postponed a little. The colonies do not remain mere suppliers of raw materials, foodstuffs, and valuable minerals. A complete capitalist economy tends to develop. The "white" colonies, or Dominions of the British Empire are now just as much capitalist economies as the U.S.A. before the Great War. In India we find the growth of a cotton and jute manufacturing industry,

financed largely with British capital. Once the saturation point of investment had been reached in transport and agriculture, British capital encouraged the formation of a manufacturing industry, so long as it was largely financed by British funds. By employing cheap native labour the colonial manufacture has been able to undersell British-made products, and at the same time yield extremely profitable returns. The flow of imperialist investment has thus been maintained for a while at the price of the destruction of the market for British manufactures. One group of capitalists solves the difficulty of placing its surplus capital by ruining the market for other capitalists. The parent imperialist power may be denied this last outlet for colonial investment either because native capitalists, in the teeth of the opposition of the imperialists, launch the new industries and put up the funds themselves, or because some other imperialist power gets a foothold in the colonial territory. For example, Britain was unable to prevent American capital from invading Canada.

Although the "white" colonies may develop into advanced industrialisms on the pattern of the mother country, this is extremely difficult

for the coloured peoples so long as they remain under imperialist rule. It might be thought that India, with a market of 359,000,000 souls, should be capable of development into a first-class industrial nation. Why, in fact, has this not taken place considering that much younger colonies such as Canada and Australia have achieved this position? The reason is that although these millions exist, their social conditions are such that they provide only a scanty market for manufactured products. A peasantry living on the bare necessities of existence comprises 92% of the population. The Director of Health of Bengal¹ describes their conditions thus: "The present peasantry of Bengal are at present taking to a dietary on which even rats could not live for more than five weeks. Their vitality is now so undermined by inadequate diet they cannot stand the infection of foul diseases." Yet according to official statistics the amount of good land lying uncultivated has increased ever since 1915. The cause of the poverty is not overpopulation but the system of land tenure and money-lending, which deprives the peasant not only of funds to buy necessities, but even of the

¹ In his Report of 1928.

small capital needed for his primitive cultivation. Millions of such peasants can hardly be considered an inexhaustible market for manufactured goods. Nor can the social and political system which eliminates their purchasing power be changed without jeopardising that political domination by which the imperialist power guarantees its investments. The Indian peasantry is not an isolated case. The masses of the land-workers, the large majority of the population of the earth, find themselves, except in Russia, with an ability to buy manufactures rigidly circumscribed by their small money incomes. The rigidity of their level of poverty is illustrated by the League of Nations economic experts¹ who consider that the net advance in the output of textile raw materials between 1925 and 1929 of 8% had proved too rapid.

We have so far studied the relations between a single imperialist power and its colonial territory. It has been appreciated that the stimulus to purchasing power has been so great that a qualitatively new kind of capitalism has been created. So long as the possibility of continuing the process existed, imperialism seemed the saviour of capitalist society. There

¹ *Course and Phases of the World Economic Depression*, p. 18.

was necessary, in other words, a repeated opening-up of virgin territory, since the process in each colony could only be operated once, after which a series of limitations barred further profitable investment. But British capitalism was not the only one to reach the advanced state of a highly developed heavy industry, where the external market became a necessity of her existence. France, Germany, Italy, etc., followed hard on her heels, so that instead of a single capitalist community exploiting the riches and labour power of the earth, we find several in fierce rivalry, carving up the earth's surface into preserves for their own particular exploitation. The development of the U.S.A. and Japan and several other capitalist economies, including the British Dominions, to a point where external markets are essential, means that there are not enough backward territories to go round. Imperialism may have been a temporary solution for those first in the field; as a permanent solution for the market problems of all the legion of advanced capitalist economies it offers not the slightest prospect. This does not mean to say, of course, that imperialism offers no solution for any Great Power. The measure in which one capitalist

economy can gain or retain control of large backward territories to the exclusion of its less powerful rivals is a political question which has dominated the international arena since the Boer War, which involved the world in the Great War, and which even yet, if the imperialists have their way, may plunge us into another war for the re-partition of the earth.

CHAPTER IX

MONOPOLY CAPITALISM

Competitive capitalism can flourish only with rapidly expanding markets—Little really competitive industry left in Britain—Competition runs itself to seed—Engels on competition—Factors facilitating monopoly—Monopolies for colonial exploitation—Monopoly transfers purchasing power from the consuming masses to the wealthiest capitalists—The monopolist tends not to pass on the benefits of reduced costs to the consumer—Monopoly restricts destructive investment—The initiative of monopolies—The case of the railways—Scientific investment by monopolies—How production *can* expand under monopoly—Illusions as to the effects of “new demand”—Summary of the influence of the trend to monopoly upon the community’s purchasing power.

FOR THEORETICAL REASONS it was necessary to leave out of consideration a change of quality which had taken place concurrently with imperialist expansion, and whose effects on purchasing power have been no less decisive. The supersession of competitive industrial forms by those of a more or less monopolistic character is the tendency with which it is now proposed to deal. Whether the monopolies in home industry were extensively formed prior to definite acts of imperialist expansion, such as in Germany or the U.S.A., or after, as with

Britain, are historical matters, determined by the imperialistic opportunities of the various advanced economies, and the strength of competition, both internal and external, which they had to face. Whether preceding or following imperialist expansion, monopolisation had its origin in that same barrier which confronted, all the competitive manufacturing capitalisms scouring the world for markets.

If a competitive industry has limitless markets ever opening before it, it can afford the luxury of its own anarchical way of existence. It will not matter much if capitalists are over-optimistic in their estimate of the market. Nor will excessive company promotion be disastrous. The growing market will absorb the incipient overproduction with, at the most, temporary periods of glut. As may be expected, the competitive industrial form is superseded by monopoly groupings first in those capitalist economies which are denied the pick of the markets, such as in the younger capitalisms of America and Germany. Nevertheless, the trend to monopoly is not confined to these countries; it is working powerfully, albeit in a subtle manner, throughout British industry.

There has been little public feeling in this country, as in the States, demanding a

prohibition of trusts. We have had no spectacular figures, such as the Rockefellers, gaining a hold upon our national resources, nor the Carnegies dominating our heavy industry. Nevertheless, monopolisation has been for some years, and is now, the dominant trend in our economy. Let the reader try to name a profitable British industry still run on competitive lines. Beer-brewing would probably be the first named. But even here the competition is of an exceedingly limited degree. Besides the interlocking directorates and controlling holdings of shares between one company and another, each firm has its traditional selling areas, what in colonial areas would be termed concessions. Further, the prices of the commodity tend to be fixed, no doubt by arrangement. The automobile and wireless industries may serve as other examples of profitable competition. Both are new industries with a wide and not yet fully exploited market. The phase of overproduction and fall in profitability has not yet been reached.

It seems to be a law of capitalist economy that, faced with a non-extensible market, a competitive industry will sooner or later run itself to seed. The crude method of adapting supply to demand, the hazard of individual

estimates, the speculation by ill-informed persons in time of boom, the difficulty of the elimination of antiquated plant, result in a chaos of over-production, and destroy profitability. In the words of Marx: "To the extent that only one-sided exchanges are made, a number of mere purchases on one hand, a number of mere sales on the other . . . the balance can be maintained only on the assumption that the value of the one-sided purchases and one-sided sales is the same. . . . These conditions become so many causes of abnormal movements, implying the possibility of crises, since a balance is an accident under the crude conditions of this production."¹ Let the masters of the British cotton industry read and note. Wrecked by a mad speculative expansion in the post-war boom, combined with a serious shrinkage in its market due to foreign competition, a large section of the industry has become derelict. That part which remains in operation is still engaged in a competition which destroys profitability. Far from such fierce competition engendering new and more efficient means of manufacture, à la Alfred Marshall, the reverse is the case. Profits are so low that, on the

¹ *Capital*, vol. ii, p. 578.

one hand, existing producers have not the funds to instal up-to-date plant, while, on the other, new capital is not attracted.

The inability of competitive industry in modern market conditions to keep itself technically efficient, spells its doom. The present plight of the British iron and steel industry is aptly summarised by a special correspondent of *The Times*.¹ "Moreover, the lack of organisation and the multiplicity of units led to an intensive and destructive competition—the well-known consequence of surplus capacity—which served only to increase costs by dispersing an inadequate volume of output over the whole industry instead of concentrating it upon a smaller number of more efficient units. The lack of dividends, too, made the raising of fresh capital impossible, with the result that technical equipment in the industry, which before the War had already begun to lag behind, was left distinctly inferior to that of our more advanced competitors on the Continent and in the U.S.A."

Compare this sorry record with the steady profitability of some of our great trusts—Imperial Chemical Industries, Lever Brothers (boasting to control 62% of the British soap

¹ Aug. 15th, 1933.

trade), Woolworth's, and Marks and Spencer capturing certain lines of retail distribution, while the great combines of Boots, International Stores, etc., have a predominant share in other lines; the London Passenger Transport Board, and the financial group controlling the provincial bus services; Imperial Tobacco; Tate and Lyle. One could add to these a vast catalogue of firms having a partial or complete monopoly in their particular line; or of firms exploiting a market in small groups, between whom price-fixing arrangements exist. Even in iron, steel, coal and engineering we find large groups dominating certain sections. Low's cartoon of private enterprise in the U.S.S.R.—a pedlar selling bootlaces—is becoming more and more true of the sphere of competition in British capitalism. Engels's editorial note in *Capital*¹ gives an excellent summary of the dialectical necessity of the merging of competition into monopoly: "The daily increasing speed with which production may to-day be intensified on all fields of great industry is off-set on the other hand by the ever increasing slowness with which the markets for these increased products expand . . . the results are a chronic

¹ Vol. iii, p. 518.

over-production, depressed prices, falling or disappearing profits; in short, the long-cherished freedom of competition has reached the end of its tether and is compelled to announce its own palpable bankruptcy.”

Even where a section of heavy industry is not organised in a monopoly for production, it will probably be so for destructive, or restrictive, reasons. The shipbuilders have combined to eliminate over-keen competition by destroying shipyards. British iron and steel producers participate in the international price-fixing cartels and in barring new entrants. The *Economist*¹ admits that the British Iron and Steel Federation has an influence such that the mere withholding of its approval from any new enterprise would amount to a veto, of which a practical example was the discouragement of the projected new Bessemer steel plant at Jarrow. The British coal industry had sunk so low in the degeneracy of its competition that it had to be forced in 1930 to re-constitute itself into a highly organised monopoly, with very satisfactory effects on its profits. British agriculture is now being subjected to a similar process. It can be said of British industry

¹ July 8th, 1936.

that if we have not yet complete monopoly, neither have we competition. And this tendency of monopolisation becomes stronger every year.

The concentration of production with a few firms permits price-fixing arrangements either of a formal character, the cartel, or informally by a "gentlemen's agreement". The very expensive plant typical of modern manufacture serves to deter new entrants, who fear the hostility of existing firms. (Liefmann shows how German cartel monopolies were generally successful where the smallest economical unit of capital was large enough to frighten new competitors, and vice versa.) Both this characteristic of modern capitalist structure, and the rigidity of the market, have the monopoly form as their most natural outcome. In so far as competition fails to develop into the form which its own dialectic prescribes, it ends in disaster.

The imperialist exploitation of backward territories was for the most part operated through the agency of large concentrations of capital having a monopoly or "concession" in particular areas. Just as the institution of the modern joint-stock company had permitted the large concentration of capital for

heavy industry, so it made possible the financing of imperialistic monopolies. Thus the British North Borneo Company, the Royal Niger, the Imperial British East Africa and the British South Africa Companies were formed on a monopoly concession basis between 1884 and 1889. The Canadian Pacific Railway was opened in 1886, enjoying a practical, if not statutory, monopoly concession over that part of North America. The enumeration of the concessions for the working of minerals and raw materials, of which oil takes the first place, is unnecessary here. The position can be summarised as far as Britain, the leading imperialist power, is concerned, by saying that during the active imperialist epoch many of her home industries preserved a real, others an apparent, competitive form, but that overseas investment chose the monopoly type. Sometimes the monopoly was operated directly through the colonial government, which dutifully paid out the dividends to the bondholders, as in the case of the State-owned Indian railways. Knowles writes: "The colonial governments are compelled to obtain all their requirements, whether they be materials costing millions for railway or harbour construction, or small articles costing

only a few pounds, through the Crown Agents. . . . In this way is contracted the business of no less than forty-four colonies and the greater part of the capital expenditure of colonial revenues is spent in the United Kingdom, unless she cannot supply the goods. . . . Crown Agents also conduct the issue of loans.”¹

Now that the actuality of the enquiry has been established, the effects of monopoly upon the problem of markets must be studied. A reasoning with the simplified concept of absolute monopoly is not vitiated by the fact that in practice monopolies are seldom absolutely complete. The argument will apply to any degree of monopoly, even if it be merely a certain restriction of free competition. The strength of the tendency, of course, will vary with the degree of monopoly.

The object of the formation of a monopoly is, by one means or another to restrict the supply of a commodity so that its market price is enhanced; or, conversely, to limit the purchases of the raw materials required by the monopolised industry, so that supplies can be obtained at a lower price. In either case, a *monopoly profit* results from this restriction. Let

¹ Knowles, *The Economic Development of the British Overseas Empire*.

us take first the simple, classic case of the formation of a monopoly which restricts absolutely the output. Suppose ten firms, each employing one hundred men and each having an output of one hundred commodities a year, be formed into a single trust, which supplies the whole market. If this trust continues production on the old scale it may expect to receive the aggregate profit of the ten firms previously operating. It knows that if it cuts down the supply and creates a shortage on the market, prices will be raised. Unless the cost of production rises steeply with a smaller output, it will receive a greater margin of profit. The first effect is that, since fewer workers are employed on the smaller output, their purchasing power is lowered. The volume of purchases has been diminished, production is on a smaller scale, and of course one may expect the market repercussions as analysed in a previous chapter. On the other hand the accumulating class have received additional purchasing power in the form of profit. Instead of selling one thousand articles a year, the trust sells, say, nine hundred. Only nine hundred men are now employed. As regards the increase in profit, this will depend upon the nature of the

market. If the output consists of a necessity, such as bread, only a small restriction would enable the monopoly to charge very high prices, for people must eat bread. However, if a monopoly attempted to restrict the production of motorcars, it is doubtful if prices could be raised a great deal without discouraging buyers. In the above example, we will take first the case where the extra profit is exactly equal to the wages of the dismissed workmen. In other words, the total purchasing power accruing to all connected with the industry remains unchanged. If the profit-making class neither spend nor invest their additional income, the effect will be as above, that is, a net diminution of purchasing power. But they can be relied upon to pass on a certain proportion of this, but not so much as the previously employed workers. E is lowered, and consequently the volume of purchases is reduced. Whether the aggregate income of the industry is diminished or increased, this conclusion still holds; there has been a transference of purchasing power from employees, with a high E , to accumulators, with a low E . If the aggregate income is increased, purchasing power is transferred to this trade from others, and will fall into the hands of the

monopoly capitalists. Unless the public has transferred its purchases from industries where even higher monopoly profits are being earned than in this one, purchasing power is diverted to a lower E.

The effects of monopoly upon purchasing power in this first stage of the analysis do not look very startling. But it has been seen from previous reasoning that the E of purchasing power cannot be lowered without diminishing absolutely the purchasing power of the ensuing cycle (see Chapter I). The question therefore presents itself whether a monopoly can be formed without lowering E. In the above analysis were shown the effects of monopoly upon purchasing power in its money form. It is easier to follow the fortunes of E by thinking in terms of commodities. In all the cases considered, the commodity purchasing power of the community was lowered by the fall of the output of the monopolised industry. The community suffers a loss equal to the values which the dismissed employees no longer produce. This is true so long as the capitalists do not utilise the monopoly profits and no other industry is expanded by an extraneous release of purchasing power. (The latter alternative is self-explanatory, and

we will only study the utilisation of purchasing power by monopoly capitalists.) Provided these recipients of monopoly profits invest them all in production immediately, the displaced workmen will be re-engaged, the values and the commodities will emerge once more. The only effect will be a certain transference of the productive forces from consumption goods to capital goods. And here is the vital conclusion; still greater outlets for investment must be found, even than under competitive conditions. Should the monopoly capitalist not be attracted by the prospective profits of new investment, or should he fail to dispose of his enhanced income on personal expenditure, *E* indeed falls, and the volume of purchases shrinks. The perennial difficulty of the capitalist economy has been magnified.

The same conclusion is valid of a far more extensively practised form of monopoly than the pure example studied above, namely when an arrangement is made to check the natural fall in prices resulting from an increased labour productivity, and showing itself on the market by an over-production of commodities. Previously, it was seen that in a competitive capitalism, capitalists were forced to pass on this increased

productivity of labour to consumers, so that, as long as employees' incomes were not lowered in proportion, the community consumed a larger output of commodities and labour was not displaced. Thus was made possible the steady rise in the standard of living in Britain throughout the nineteenth century. If a monopolist avails himself of more efficient productive methods without passing the advantage of lower costs on to the consumer, he must dismiss employees; the output, and therefore the commodity purchasing power of the community, remain unchanged, but fewer workers are employed, and less is paid out in wages. Once again there is a transference of purchasing power from the employed community to the accumulating class, hence a fall in E.

Just as the artificial maintenance of prices after the cost of production has fallen causes a transference of purchasing power to capitalists, so any attempt to raise prices to the general consuming public must have a similar effect. On the other hand, if the prices of diamonds were raised, say, by a successful cornering operation, it would be a matter of no great social concern. The capitalists controlling the diamond industry would, by raising their prices,

be depriving the people who buy diamonds of a certain amount of purchasing power. Purchasing power of a low E would be transferred to monopoly capitalists, thus retaining its low E. But if monopoly capitalists, by raising prices, mulct the general mass of consumers of their purchasing power, they are reducing the ability of the community as a whole to take goods off the market.

The almost universal restriction of supply and the price-fixing of primary materials illustrates the type of monopoly which robs the masses of humanity. World price-fixing cartels for rubber, tin, tea, etc., have the effect of reducing the purchasing power of the peoples of the world. The League of Nations economic experts have noted that in the period of incipient over-production prior to 1929, there was a general tendency to the formation of monopolies and a refusal to let prices drop.¹

Either by refusing to let prices find their natural level, or artificially raising them, the monopoly capitalist reduces the ability of the consumer to buy commodities. The dilemma of the market assumes a form far more acute than in a competitive capitalism. It was seen

¹ *Course and Phases of the World Economic Depression*, pp. 53 and 69.

(Chapter VI) how a steady rise in the general standard of living was the only really effective balancing factor against the shrinking purchasing power caused by the increased labour productivity. Unless the standard of living (i.e. the consuming power of the masses) rises, the heightened productivity must result in lessened employment. This latter in turn means the further curtailment of purchasing power, and so on in the vicious circle of repercussions. Monopoly hinders the rise in the standard of living, and thus deprives capitalism of its most effective safety valve. The only alternative left to the monopolist is investment, and ever more investment. All the purchasing power which he has stolen from the consumer he must invest in production. Otherwise the dreaded market shrinkage sets in. Much more so than under a competitive capitalism, each dose of investment must be greater than the last. The greater the monopolisation of the economic structure the more literally must investment be made at an accelerated rate if the size of the market is to be maintained. If one dragon of over-production pursues the competitive capitalist, a hundred are at the heels of the monopolist.

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When discussing the effects of changing labour productivity in a competitive economy there was noted a tendency to the mutual destruction of capital as an alleviating factor. New investment would be attracted by a very small increase in efficiency, it being a matter of no concern to one capitalist whether or not he render the plant of another obsolete. In this way, the volume of investment could be very large and the increase of productivity relatively small. Unless compelled to do so by competitive conditions, a firm would not invest in new plant, and scrap the old, unless it could thereby gain a net addition to its profits sufficient to pay interest on both old and new capital at a remunerative rate. The monopoly is removed from this compulsion. Whereas under competitive conditions it could have been forced to instal plant, yielding, say, $2\frac{1}{2}\%$ more profit, or, as an alternative, be superseded by a more modern plant, as a monopoly it fears no rivals, and would not make the investment unless the net gain was at least, say 6% . Consequently, the destructive investment would disappear in a monopolistic society, and the volume of investment as a whole would be seriously curtailed. On the other hand, what investment was made,

would raise the productivity of labour far more than under competitive conditions. We may expect, then, a smaller amount of investment than under competitive conditions, but what investment there was, would be of a more disturbing character. Each investment would introduce a greater technical change, and consequently induce a more drastic rise in productivity. Investment distributes purchasing power; but monopoly invests less. The greater the rise in productivity the more pressing the market difficulty: monopoly accentuates the productivity per unit of investment. The disturbing factor is greater, the alleviating factor weaker under monopoly capitalism.

Reverting to another previous conclusion, we saw that an imaginary static capitalist economy could be maintained, if all improvements in technique were forbidden, and people commanded to spend the whole of their incomes. Might it not be argued that a monopolistic economic structure would bring this "ideal" nearer? Fearing no rivals, a trust need not adopt technical improvements, or even from sheer inertia, no improvements would be made, the shareholders of the trust being sufficiently social-minded to be content with a modest

dividend rather than upset the apple-cart by the unsocial behaviour of increasing efficiency. Such an assumption or "hope" would be flying in the face of all the ascertained facts concerning great monopolistic trusts, and the owners of capital who direct their policy. On first thoughts the lack of the compelling drive of competition might be expected to damp down the trend towards technical improvement. One may have the railways in mind as instances of monopolies that have not modernised their equipment as much as might have been expected. If the railways were competitive to-day, there is little doubt that we should have seen far more attractions offered to their customers. Vast quantities of rolling stock still in use would have been scrapped, we should have enjoyed brighter and cleaner stations, many more lines would have been electrified. One's first impulse is to blame the companies for inertia, and hold them up as examples of the lack of initiative of a monopoly. It is hard to say without inside information on railway economics whether it would have been of advantage to these monopolies to have adopted a more forward policy. From pronouncements of railway chairmen one gains the impression that the companies' experts

have calculated the profitability of modernisation very carefully, and it is likely that the explanation is not that of inertia, but simply that it does not pay the railways to scrap existing equipment until it is practically worn out. It is one more case of the monopolist refusing to indulge in destructive investment at his own expense. (In the *Economics of Welfare* Professor Pigou showed how it paid tramway monopolies to maintain old equipment, whereas the public interest demanded the installation of new.) The by no means backward attitude of the railway companies to those forms of rationalisation needing little or no capital expenditure (such as dispensing with the services of employees made redundant by speed-up and higher labour organisation) does not give the impression of "sleepiness". The prompt acquirement of large and sometimes controlling interests in their potential rivals, the provincial bus companies, betrayed an alertness worthy of a Rockefeller. It is quite true that many a local electricity or gas company is backward and hide-bound, but these do not represent the most prevalent monopoly form of our times. In the up-to-date trust we find little or no tendency to renounce the prospect of increased

profit which technical advance affords. The vast organisation of trust shareholders, ranged tier upon tier according to a complicated order of precedence for the sharing of the profit, are no easily satiated tribe. Probably the capital will have been inflated in anticipation of monopoly profits, so that the nominal rate of interest does not seem high. Furthermore, those who have the active conduct of the business have probably retained a large number of ordinary shares, that is, the repository for all the extra profits of the enterprise. Rather than any inertia, we find the monopoly trusts devoting sums to technical research on a scale which a competitive capitalism could not dream of. Consider the army of research workers employed by the I.C.I., Unilever, etc., or the continual drive for curtailing labour costs on the part of the L.P.T.B. Besides being able methodically to evolve the technical improvements, the large trusts have at their disposal immense concentrations of capital with which to build large and more efficient productive units. Research does not only take the form of increasing technological efficiency; specialists are employed to study economies of organisation, office routine, means of carrying out work

with less hands, working out the most efficient manual operations for each job. Increases of efficiency of this latter type have the normal restrictive effects on the market, but generate not even an ephemeral alleviating effect by way of an investment in production.

It must not be thought that in the phase of monopoly capitalism the whole scale of production cannot be enlarged. Just as in a competitive economy, however, it is necessary to have not so much a new act of investment producing commodities not made before, as a net increment of the volume of investment sufficient to enlarge absolutely the volume of purchases. For example, it is not enough to produce goods of a new type, say radio receivers, and "create" a new demand. Such a "new demand" is created only from the point of view of the individual manufacturer. Unless at the time the volume of investment as a whole has been increased absolutely, and sufficiently to generate an absolute expansion in purchasing power, the money spent on radios will in reality be subtracted from the purchase of other commodities. It is possible, of course, that some such new "want" or demand may cause such a boom in investment that an

absolute expansion of the market takes place, and the standard of living is permanently raised by the new "want" becoming a conventional necessity. The crux of the matter is not that people are now buying something new, but that the profitability of investment, and living standards have been raised. Assuming that the money spent on radios is simply diverted from the purchase of, say, pianos or gramophones, the ultimate effect upon purchasing power will be purely fortuitous, depending upon whether the workers and employers in the radio industry share out the purchasing power accruing to them in the same proportion as it was shared out in the piano or gramophone manufacture. If employees get more, E will be increased, and contrariwise.

The restriction of the volume of investment because it does not pay the monopolist to scrap existing plant does not extend to manufacture for a "new" demand, provided that the monopolist producer reckons not to spoil the sales of his other lines. So long as the purchasing power he hopes to capture is transferred from other commodities he will not be concerned. Thus there is room even in a monopoly capitalism for a vast volume of investment to

develop some revolutionary advance in technique or an outstanding invention which is commercially exploitable. The problem is to find such an outlet, and to maintain the higher level of production once the investment is completed.

We are now in a position to summarise the special difficulties presented by the market problem in a monopoly capitalism:

1. The monopolist raises prices artificially, or by maintaining prices prevents the benefit of more efficient productive methods from being passed on to the consumer. Purchasing power is taken from the community in general, and appropriated by the monopoly capitalists. Unless they can find a means either of consuming or investing all the extra purchasing power accruing to them, the market shrinks and unemployment and overproduction are the result.

2. Large masses of capital are no longer destroyed in favour of new, slightly more efficient capital. Hence the volume of investment is reduced, and it becomes more difficult to maintain the volume of purchases.

3. Far from the urge to increased efficiency being lessened, investment is made more

“scientifically”, i.e. as a result of elaborate technological research, and less haphazard business calculation. The growth of productivity is further heightened relative to the volume of investment, and the market shrinkage is all the more drastic.

In short, the secular trend of increasing labour productivity persists, while the series of alleviating factors which were noted in a competitive capitalism tend to be eliminated. The dilemma of productivity is left to work itself out in all its purity. More literally does it become true that in a restricted market, the volume of investment must grow at an accelerated rate. A relapse due to the failure of this growth will be more catastrophic, and the forces, if any, capable of re-establishing prosperity will have to be immensely more powerful.

CHAPTER X

THE RATE OF INTEREST

Mr. Keynes's "natural" rate and "market" rate—Lowering the rate of interest as a stimulus to investment—The housing boom—The manipulation of the interest rate cannot be relied on to induce investment expansion—Mr. Hawtrey and monetary policy—The influence of rising prices.

IN HIS *Treatise on Money*, Mr. Keynes recognised the difficulty of maintaining an adequate volume of investment. This led him to evolve the theory of a "natural" rate of interest. In any given technical and economic conditions, a small amount of capital could be invested to earn a large profit. If it is required to invest a larger amount, the outlets for the most profitable investment are found to be already filled, and recourse must be had to the less remunerative outlets, and so on; the larger the amount of investment required, the lower the rate of interest it can command. This is true both of a competitive and a monopoly capitalism, and the propositions as to the mutual destruction of capitals, in either case remain valid. Mr. Keynes rounds off his theory with the concept of a "market"

rate of interest, that is, the rate at which money can be borrowed. Now the volume of investment required to maintain purchases can only be borrowed and invested in production provided the lenders do not demand a higher rate of interest than industry can afford to pay, that is, the "market" rate must not be more than the "natural" rate.

In the foregoing analysis this conception was summarised in the term a *profitable* outlet for investment, in other words an opportunity for investment which promises to yield a rate of interest high enough to attract capital. Mention was made of the difficulty of finding outlets for the ever larger amounts of investment necessary to avoid a slump. It was never denied that, provided these outlets could be found, the market problem would be solved. Nor is it denied that if only investors could be made content with *any* required small rate, i.e. the "natural" rate, the outlets for investment would always prove sufficient. This of course may entail locking up capital in plant to yield as little as $\frac{1}{8}\%$ or even less. The "natural" rate may even be negative. Instead of a lender receiving an addition to his capital, he would have to pay people to borrow it. The "natural"

rate may be negative just at the time when investment is most needed to right the balance, that is, when there is an accumulation of stocks and prices are falling. Under these conditions new production could only be envisaged at an absolute loss, and in fact neither the producer would think of borrowing, nor the financier of lending, on such terms.

Nevertheless, the larger openings for investment which a fall in the general rate of interest render practicable are an important consideration, and must be embodied in the general analysis. Let us suppose that investors, finding it impossible to place their capital at 7%, are prepared to lend it at 4%. There would be firms, no doubt, who could borrow capital and increase their efficiency to pay 4%, to whom 7% was out of the question. In order to pay the 4 % interest, they would have to increase the productivity of labour, but not so much as if they had to pay 7%. So long as any rate of interest is required, and this must always be assumed in a capitalist economy, the trend to increased labour productivity is present. But the lower the general rate of interest, the slower the rate of growth of this productivity. An accelerated counteracting growth of investment

is also required, but the lower the rate, the slower the rate of acceleration needed.

It is seen that changes in the rate of interest do not invalidate the analysis so much as modify the evaluation of tendencies. The important point now to be estimated is the elasticity of this rate of interest, in other words, the degree to which it will obediently lower itself in order to stimulate investment. It has already been remarked that the circumstances under which it is most necessary to stimulate investment, namely a trade crisis, are just those where no rate of interest, short of being a negative one, would prove attractive. But given business conditions which are not in a state of crisis, let us examine the workings of the mind of the investing capitalist. In the first place, he will reckon on an element of risk. While it may be worth while risking his capital at 10%, he would not consider doing so at 5%. If there is a difference of, say, 3% between speculative and "safe" investments, this may be taken as the risk factor. Any investment in production is to a certain extent speculative, even if undertaken by a monopoly trust, while some industrial speculations may only attract new capital with a risk allowance of 10 or 20%. Until risk is

eliminated there is always an element of rigidity in the rate of interest expected of *industrial* investment, and that is the kind of investment which counts most. The nervousness of investors, even in 1936, accounted a relatively prosperous year, was so great as to render the interest fall inadequate to cause an investment boom. Despite a rate of interest lower by $1\frac{1}{2}$ to $2\frac{1}{2}\%$ than in 1928-9, investment was only 63% of the amount in that year. To overcome the reluctance to invest, resort has been had to Government guarantees, such as on various electrification projects.

The second element of rigidity in the rate of interest arises from the option which a holder of accumulated funds enjoys to invest, or to hoard, until trade prospects are better. Suppose, for example, that the "natural" rate of interest were to settle down permanently at $1\frac{1}{2}\%$, it would take many years before investors accustomed themselves to this low level, and funds would be hoarded for this number of years. There is no way of ascertaining the future rate of interest, so that a capitalist will not sink his money in a $1\frac{1}{2}\%$ proposition if he thinks that by waiting even so long as five years he could get 3 or 5%. In practice, we see from

the recent crisis and depression that capitalists do indeed hoard, rather than invest at low rates.

When it is borne in mind that to hoard accumulated surpluses aggravates the market problem, it is extremely doubtful if a general fall in the rate of interest would be an alleviating rather than an aggravating factor. That is to say, a fall in the prevailing rate may discourage, rather than encourage investment.

By way of exception to this general conclusion we may take the house-building boom which has played a large part in the relative prosperity of the year 1936. This was facilitated by the lowering of Building Society mortgage interest rates by stages from $6\frac{1}{2}\%$ in August, 1928, to $4\frac{1}{2}\%$ in April, 1935. During the year ended 30th September, 1936, nearly 340,000 houses were completed. At an estimated cost of £500 per house, investment in building amounted to £170,000,000. With the market repercussions coming at a time when the surplus stocks of the depression had been largely liquidated, and accompanied by a considerable expenditure on armaments, such an amount would be quite capable of causing an absolute expansion in the volume of purchases, and inaugurating a phase of "prosperity".

With investment such as in residential building, however, special circumstances rendered the fall in the interest rate more than usually stimulative. In the first place, the demand for houses—at suitable rents or mortgage instalments—is enormous, and exceedingly elastic. To lower the interest from $6\frac{1}{2}\%$ to $4\frac{1}{2}\%$ on a £500 mortgage means a saving of 3s. 3d. per week, an important difference to the millions of the lower middle and working classes who are buying houses. Secondly, what risk factors there are can be eliminated, either by fire insurance payments, etc., or the payment of a deposit by the mortgagor to cover his payments should he default. Thirdly, the house may be reckoned to have a life long enough to amortise the capital outlay, even though the repayments may be comparatively small, and spread over as long as twenty years. Industrial plant, on the other hand, can be reckoned as becoming obsolete in much less than this period, in fact, it is hard to predict how soon plant may fall out-of-date. Hence the necessity of large amortisation payments. And the larger these are, the less decisive is a change in the interest rate. In addition, it would be extremely difficult to insure against the loss of one's capital in

an industrial venture because of possible obsolescence, or to insure against the upset of business calculation due to varying trade conditions.

In summary, the lowering of an interest rate can only stimulate capital investment to a significant extent where this "pure" interest rate forms the predominant capital charge upon the enterprise; in other words, where the risk factor is negligible, and where amortisation charges are small. In addition, the market for the capital investment must be elastic, and the investor must be persuaded not to bide his time for a better opening. These considerations so narrow down the field where a lowering of the interest rate becomes stimulative—practically all investment in production is ruled out—that it cannot be accounted either as a serious retarding influence upon the growth of productivity, nor as an expansive influence upon the volume of investment.

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Since the above was written, I learn that Mr. Keynes has rejected his concept.¹ "I am now, he says, no longer of the opinion that

¹ *General Theory of Employment, Interest and Money.*

the concept of a 'natural' rate of interest, which previously seemed to me a most promising idea, has anything very useful or significant to contribute to our analysis." However, the above arguments apply none the less to the usefulness of his new concept, the "neutral" rate of interest which he tentatively puts forward, that is to say, the "natural" rate which is consistent with full employment.

More than any other, Mr. Hawtrey has made much of the supposed efficacy of a changing rate of interest, and of "monetary policy" for the elimination of trade cycles. He has been the leader of the school of bourgeois economists who believed that trade crises were largely a matter of the central banking systems of the chief capitalist powers not knowing how to maintain a stable price level. Before the recent crisis it was generally assumed by professional economists that by a clever manipulation of the price level, slumps could be avoided, and they were fond of tracing every unfavourable turn of trade to some maladjustment of interest rates, prices, supplies of gold, etc. Their proposal was, that when trade became stagnant, and prices began to sag, extra credit, and of course the accompanying cash if necessary, should be

placed at the disposal of industry. Their argument seemed to be supported by the history of British prices during the nineteenth century, when each big gold rush provided the basis for an expansion of credit, a rise of prices, and stimulated industrial activity. The special conditions under which the gold was able to raise the price level will be dealt with later. When the boom broke in 1929, and prices slumped in an unprecedented manner, what some bankers had said¹ became obvious, namely that one could offer capitalists credit, but they would only utilise it and convert it into purchasing power if they saw a way of doing so profitably. If they declined to borrow the money and transform it into purchases, there would be no increased demand for commodities, and prices would not rise, or stop falling, as the case might be.

Where the price-level, for one reason or another, does rise, it does not stimulate industrial activity by increasing the volume of purchases. On the contrary, since wages and salaries do not rise immediately in proportion, the volume, measured in commodities is decreased. Trade is stimulated, firstly because business men are

¹ Report of Federal Reserve Board, U.S.A., 1923.

encouraged by a windfall profit, the market value of the commodities having risen as it were while they sleep, and secondly, exactly for the reason that temporarily their payments in wages and salaries are not raised, leaving them a wider margin of profit. The evident increase in profitability of business attracts investment, which does indeed tend to enlarge the market. But once the price rise has been effected and wages-bills rise in proportion, the sources of the extra profitability disappear, and business men find themselves in, if anything, a worse position because there is a greater amount of capital equipment producing for the same restricted market. Nevertheless, if there are unemployed workers available, or if those already employed are allowed to retain any increased real wages they may have won during the period of prosperity, or if for any other reason a new market has been opened, the scale of production may be permanently raised to a higher level. Sir Walter Layton's conclusion from his study of nineteenth century prices corroborates this view: "The argument . . . that business expands more freely in periods of rising prices, would seem to be of no great importance in the long run, though it may

apply to some extent in short periods and to the opening up of new business enterprises in which the element of speculation plays an important part."

As was seen earlier in this analysis, the main-spring is a stimulation of investment in production. Apart from sheer gambling or currency inflation, prices of commodities, and of course of consumers' goods, can only rise when there is a demand for them; in other words, when the purchasing power of the community is being used to spend more money on these commodities. But we have already seen that purchasing power and the volume of purchases depend upon the amount of money paid out in incomes, that is, in the main, the amount of employment given by industry. Prices are primarily the *resultant* of industrial activity and cannot change (short of speculation or inflation) except in accordance with the variations in the volume of purchases, which depends largely upon the adequacy of investment in production as a compensating factor.

CHAPTER XI

SOME CRISES CONSIDERED

(a) CRISES OF COMPETITIVE CAPITALISM

Adam Smith and the earliest crises—No over-production in the pre-capitalist era—Steam power and some crises of the early nineteenth century—Crises of over-investment and Marx's description of them—The relation of crises of over-investment to the general analysis—Crises of over-production of commodities—The economic necessity of imperialism.

WE HAVE NO record of economic crises in our sense of the term in pre-capitalist eras. There were frequent famines, crises of *shortage*, but no difficulties of glut, general unemployment and inability of the markets to absorb all that has been produced.

No sooner, however, are the capitalistic relationships formed than the familiar crisis of unsaleability makes its appearance. When the first crisis occurred, or who first recorded its occurrence, I do not know. In his *Wealth of Nations*,¹ published in 1776, Adam Smith describes a financial crisis the main features of which remain typical until the 1860's. It was

¹ Book IV, Ch. I, p. 10.

what may be termed a crisis of over-speculation. Purchasing power in the hands of capitalists was attracted by long-term investment, so that there was not enough capital with which to conduct current business. In the description of Adam Smith: "This complaint, however, of the scarcity of money, is not always confined to improvident spendthrifts. It is sometimes general through a whole town, and the country in its neighbourhood. Overtrading is a common cause of it. Sober men, whose projects have been disproportioned to their capitals, are as likely to have neither withdrawal to buy money, nor credit to borrow it, as prodigals whose expense has been disproportioned to their revenue. Before their projects can be brought to bear, their stock is gone and their credit with it. They run about everywhere to borrow money, and everybody tells them they have none to lend."

It is hard to fix the earliest time by when the British economy could be said to be predominantly capitalist. Before Adam Smith's time the country was certainly largely agricultural, although the capitalist wage-relationships were well established. Overseas trade consisted in bringing in luxuries, silks and spices from the

Indies, slaves from Africa, iron and timber from Virginia, furs from Canada. To facilitate the collection of these commodities, trading forts were established, or small colonies maintained. The backward regions were not exploited in the imperialistic sense. What is more important, the commodities were sold to the noble class, drawing their revenues from the land in the form of rents, tithes and other dues of a more or less fixed nature. The predominant economic structure was institutional in form. The chief worry of the cultivator was not where to find a market for his agricultural surpluses. The landlord would decide this for him. Nor did the landowner-noble feel himself obliged to accumulate, to save his current income in order to invest it in some profitable enterprise. In any case there were few, or no stocks and shares to be bought (save the occasional speculations in overseas trading companies or in adventurous expeditions, and these were insufficient to form a basis for a stock exchange or regular accumulation).

A moneyed man of the seventeenth century or the earlier part of the eighteenth, finding himself with a surplus of produce, might build himself a new mansion, employ craftsmen to

make a new carriage, tailor fine clothes, paint his picture, or make furniture and beautifully wrought plate; or else he might decide to lay out his gardens in the new fashion, or if he was more progressive than the rest, devote himself to the improvement of his estate. The inherent difficulty of the nobleman was not how to accumulate, and once having accumulated, how to spend money. His difficulty was rather the reverse, how to lay his hands on sufficient revenues to live up to the fashion. He certainly needed little encouragement to spend the whole of his income. And since, from his landholdings, or through the feudal State machine which was at his disposal, he could lay his hands on whatever surpluses might be produced, the feudal society never knew the bugbear of overproduction.

Yet by the time Adam Smith was writing the *Wealth of Nations*, the notion of accumulating funds with the object of investing them at a profit must have caught on sufficiently to cause him to notice a crisis of over-speculation. Note, however, its peculiarly local nature, "It is sometimes general throughout a whole town, and the country in its neighbourhood." The gentleman in question, perhaps in company

with his fellow merchants or landowners, had no doubt spent all their spare cash upon some promising local project, and had none left either to complete the enterprise, nor even to pay wages in their ordinary run of business or in their households, nor perhaps for their own immediate wants.

The Napoleonic wars were probably the decisive transitional period to the capitalist-industrialist form of society. The British trade in manufactures, especially in articles of clothing, which had grown at the latter end of the eighteenth century, suddenly found itself faced with an inexhaustible market. Not only were the Prussian and Austrian armies equipped by the British manufacturers, and financed by Pitt's subsidies, but the Napoleonic armies needed boots as well. The close of the wars in 1815 was marked, as expected, by a severe crisis of overproduction and unemployment. There being no more subsidies, the continental peoples had to pay for what they could by exports, but in this they were largely prevented by the British import duties.

British capitalism was not at a loss for long. The railway and steamship showed themselves to be commercial propositions. It is perhaps idle

to muse upon what would have been the fate of British capitalism without steam power. The railways and ships not only provided immense outlets for investment in production; they multiplied by many times the size of the market for every manufacture, made in fact large scale production, with its *sine qua non* of extensive markets, possible. The economic history of the first two-thirds of the nineteenth century is dominated by the investment possibilities of steam. Let any one who assumes that the accelerated economic development of nineteenth century capitalism to be a permanent characteristic of the age, study the rôle of railway development, not only in provoking periodic crises of over-speculation, but in providing the solution to the subsequent stagnation of trade.

From the end of the Napoleonic wars the ten-year cycles set in. Once the stagnation of the depression is overcome, investment gathers momentum, ending in an orgy of speculation. During the 1824-5 boom £100,000,000 were invested in twenty railway companies, twenty-two banks and insurance businesses, eleven gas companies, twenty-five British and foreign mining enterprises, nine canal, dock and steam-

ship building concerns, as well as miscellaneous other industries.¹ The crisis of over-speculation was precipitated by the opening up of the Spanish South American possessions, resulting in mining speculation to such an extent that much gold was withdrawn from Britain. Consequently credit at home was restricted, and there was not enough cash or bank balances either to continue employment in industry, or to finance trade bills covering stocks of commodities. Despite the reorganisation of the banking and credit system, both after this crisis and after that of the early forties, we find a succession of similar crises, coming to a head because of some restriction of credit or loss of confidence following an important failure. However the root-cause was over-speculation.

Marx gives a very penetrating analysis of the actual process.² He takes as an example process A, in which the circulating capital is turned-over ten times a year, and process B, in which the turn-over is but once a year. He shows how the investment in B strips the market of labour-power, means of subsistence for this labour-power, fixed capital, and materials

¹ Hyndman, *Commercial Crises of the Nineteenth Century*.

² *Capital*, vol. ii, pp. 361 *et seq.*

of production, without replacing any of these elements until the year is completed. "The question is then simply reduced to the problem that society must calculate beforehand how much labour, means of production, and means of subsistence it can utilise without injury for such lines of activity as, for instance, the building of railroads, which do not furnish any means of production, or subsistence, or any useful thing, for a long time, a year or more, while they require labour, and means of production and subsistence out of the annual social production. But in capitalist society, where social intelligence does not act until after the fact, great disturbance will and must occur under these circumstances."

The process can be summarised as follows: All who have accumulated or can command surpluses have devoted their money-capital to a form of investment whose fruits will take a long time to mature. Similarly, bank credits have been used for a similar purpose. Those who have the funds employ the labour, so that besides money, employment is diverted to the production of capital goods. When it is required to perform labour for the more immediate needs of society, such as harvesting,

the labour can only be obtained at a high price, or not at all. No one has spare funds to lend to the grower of corn. Similarly, even supposing the corn is harvested, funds are necessary to buy and "carry" it until the price paid for bread and flour redeems the loan. But no one has the money with which to take the corn off the farmer's hands. He must sell at any price he can get, and the characteristic phenomenon of a slump in prices occurs.

In the first half of the nineteenth century the crisis was often precipitated by the necessity of importing corn at short notice from abroad, either because of a larger demand arising from the increased employment, or owing to a harvest failure. Marx observed that the consequent withdrawals of gold were followed at from one to six months' intervals by a financial crisis.¹

It is unnecessary here to give a detailed account of the vicissitudes and triumphs of this stage of British capitalism. After a short period of business stagnation, returning confidence would once more render openings for investment more attractive. A period of prosperity would invariably engender recklessness,

¹ *Capital*, vol. iii, p. 667.

and terminate in a further crisis of over-speculation. This is the period not only of rapid construction of railways, but of canals and turnpike roads. The difficulty was not the lack of openings for investment, but of too great promise of profit on all sides.

The next depression, that of 1836-9, was relieved by a series of factors. The opening up of China to the British by the First Opium War (1839-41) meant that the British East India Company could now bring opium from India; the Corn Laws were repealed, and an outburst of financial optimism followed which knew no limits. Rail construction once more placed an important part in the ensuing speculation. On the 16th July, 1845, sixty-five Railway Bills received the Royal Assent; between 1845 and 1847, £90,000,000 were spent on railways.¹

The financial crisis of 1848 is probably the purest example of an over-speculation chaos. There were not enough labourers to carry out the innumerable projects of construction. When contracts cannot be completed to time, when shareholders are enquiring when the dividend will be forthcoming, and find the railway still only exists on paper, the result must be a loss

¹ Hyndman, *Commercial Crises of the Nineteenth Century*.

of confidence in this line of investment. The construction companies, unable to borrow money to pay the navvies' wages, stood them off in thousands.

But the outlets for investment were too solidly profitable for a depression to last long. Once the excessive competition for labour and working capital had been cleared out of the way by the liquidation of the least sound companies, construction was resumed. The slack time only lasted for a few months. The recovery was furthermore stimulated by the Californian gold rush of 1849.

The middle of the nineteenth century marked the apogee of the first great period of British capitalism—a time when the malady was over-rather than under-investment. Apart from the jerking of the home market to higher levels on the investment expansion, the progressive remission of British customs and excise duties gave ever greater opportunities to foreign trade. Between 1842 and 1852, foreign trade grew at the rate of £4,304,000 a year. Australia had been colonised to supply the British manufacturers with wool, New Zealand had just been conquered. One may ask how this phase of economic history bears out the present analysis.

It might be contended that the succession of crises enumerated above were due to precisely opposite reasons from what one might expect from the general analysis. The answer to the apparent contradiction is that during this period, capitalist society did succeed in maintaining on the whole the necessary rate of accelerated development. It is not in the overspeculation crises that the theory is best illustrated, but in the ensuing depressions. The shock of the financial crisis, the failure of banks and of just those industrial enterprises thought to offer the best prospects of profit, generated a mood of under-investment. So long as there was insufficient confidence to produce the required amount of investment, the phase of depression continued. In addition, the surfeit of commodities which had piled up in the warehouses following the financial crisis, provided material reason against the resumption of business activity.

On the face of things, it seems as if the crises of this period were the result solely of foolish speculation by capitalists. But is this "foolish", "unguarded" investment purely a matter of human weakness, such that if investors could have been schooled in political economy, they would not have been visited with the retribution

of their sins, and the capitalist society of this period would never have suffered the periodic economic upsets?¹ These orgies of speculation did not take place just by chance. As reasoned elsewhere in this book, it is in the nature of the capitalist to accumulate. The accumulator has an insatiable thirst for good placings for his investment, and the bursts of unguarded optimism which lead to the financial crash are born of his anxiety to place his funds. A contemporary observation puts it this way:² "Unless, therefore, a gradual and adequate extension of the field of investment takes place simultaneously with this steady accession of additional capital, we must be exposed to periodical accumulations of money-seeking investment, which will be of greater or smaller importance according to circumstances." . . . Enterprises which require a large capital for their execution and make an opening from time to time for the excess of unemployed capital . . . are absolutely necessary, at least in our country, in order to take care of the periodical accumulations of the superfluous wealth of society, which cannot find room in

¹ This view is implicit in the descriptions of M. N. Hyndman, *Commercial Crises of the Nineteenth Century*.

² The Currency Question Reviewed, 1845, quoted by Marx, *Capital*, vol. iii, p. 489.

the ordinary fields of investment." These words were published at a time of booming trade, but the preceding seven years of depression (1837-43) were probably dominant in the mind of the author. During these seven years, accumulated profits, finding no outlet for investment, aggravated the depression. It is comprehensible that a major opening for funds, railway construction, for example, should develop into a mania and a crash. If the field of investment had extended concurrently with accumulation during the previous seven years, there would not have been the available capital to pour into railway companies, and the economic dislocation would have been avoided.

Up to the middle of the century crises had been primarily of a financial nature—a dislocation of the means of production due to alternating under-investment and over-speculation. The next crisis, that of 1857, had more modern affinities, but remained essentially of the same type as its forbears. We find the element of a general overproduction of commodities, already apparent before the financial stringency and crash. Engels, writing to Marx in September, 1852, prophesied that the next crisis would be "damned serious". "No crisis is worse than

one in which over-speculation in production is slowly developing. . . . ” However, several factors intervened to delay until 1857 the over-production slump of which Engels had observed the first signs as early as 1852. The limited liability company law of 1855 placed company flotation on an entirely new basis, giving new opportunities for the exploitation of projects needing large masses of capital. Russia was at this time opened up to capitalistic development. With the gold rushes forcing the pace, American industrial production increased threefold in the fifteen years ending in 1856; while the Crimean War (1854-5) was probably the most decisive factor in postponing the crisis. Furthermore, the increased output of gold provided an elastic basis for credit, so that the crisis was not precipitated by a financial stringency. What were for the time vast quantities of gold were pouring into Britain from California and Australia. The Bank of England had abundant financial resources, and was able to avoid some of the worst features of former crashes by suspending the Bank Act and issuing more notes. Whereas in previous crises commodities were unsaleable because the credit with which to “carry” them could not be obtained, in this crisis the goods

could not be disposed of because an excess had been produced considering the purchasing power of the market. There followed, naturally, a period of disastrously low prices, unemployment, and short-time working.

It is interesting in relation to the general analysis to note that although vast territories had been opened up to trade—America, Russia, Australia, the Yangtse (following the Second Opium War, 1856-8)—they offered but a meagre market for British goods. Unless one understands the strict limitations which a purely commercial, non-imperialistic industrialism must encounter when trying to dispose of goods to undeveloped or backward territories, however large, it is hard to realise how there could have been a general overproduction in 1857. Ironically enough, the overproduction was worst in America. So long as manufactures could not be transported to the backward peoples—in 1857 there were only 273 miles of railway in India—so long as the native community had not been broken up and re-formed so as to provide raw materials in exchange for these manufactures, it was of no use to export thither the British surplus production. Before the Imperialistic era the colonies were quite incapable

of providing the constantly expanding market which British capitalism demanded.

During the following decade the market was blessed with a succession of wars, the Italian (1859-60) the American Civil War (1864), the Mexican adventure of Napoleon III, the Prussian invasion of Denmark in 1864, of Austria in 1866, and the Franco-Prussian War of 1870. How often have wars come to the rescue of capitalism! The manufacture of armaments and military equipment, apart from staving off over-production, provided a basis for the development of manufacture and above all heavy industry.

With the end of the wars what we might have expected happened. A short burst of frenzied company promotion was followed by a crisis as early as 1873. New railway construction was abandoned. Capital investment virtually ceased. In outward appearance the crash itself resembled the type of the 'thirties and 'forties in that it started with big financial failures. The depression which followed, however, displayed in an immensely magnified form those new tendencies which had become significant in 1857. What Engels had written twenty years earlier had become literally true;

a crisis of overproduction was taking as many years to work itself out as a financial crisis of over-speculation took months (not that this crisis was not also one of over-speculation; but its length showed more fundamental factors to be the main cause, at least, of its continuance). According to Wesley Mitchell (whose statistical method of diagnosing trade fluctuations tends rather to under-estimate than to over-estimate lengths of cycles) the depression following 1873 lasted five-and-a-half years. In fact, the next fifteen years were of almost unrelieved depression. In the early crises of the century, investment would re-gather its momentum with the return of confidence, utilising the immense reserve of profitable outlets provided above all by railway construction. Frederick Engels, one of the most acute observers of trade conditions in his time, gives his reasons for this great and portentous depression: "The ten-year cycle seems to have broken down now that, since 1870, American and German competition have been putting an end to English monopoly in the world market. In the main branches of industry a depressed state of business has prevailed since 1868, while production has been slowly increasing, and now we seem both here

and in America to be standing on the verge of a new crisis which in England has not been preceded by a period of prosperity.”¹ In the following year he characterises the main features of the depression as:

“(a) especially (acute) in iron and cotton,
“(b) colossal over-production that cannot even bring things to a crisis,

“(c) surplus of disposable capital, rate of discount 1% and 1½%, money on short loan ½%,

“(d) fear of new investments and enterprises, which had already manifested itself in 1867, is the main reason why things are not brought to an acute crisis [i.e. to a financial crisis of over-investment—F.A.]”¹

In 1886 he again emphasises the loss of British commercial monopoly in the face of American and German competition. In his opinion, one of the three could have supplied the world market, and there was nothing for it but chronic over-production. In the same year he writes to Bebel: “This is now already the eighth year of the pressure of over-production

¹ Engels to Bebel, 1884.

² Engels to Bebel, Oct., 1885.

upon the markets and instead of getting better it is always getting worse." The existence of England's rivals precluded a general period of prosperity. "We have entered upon a period incomparably more dangerous to the existence of the old society than the period of the ten-yearly crises."

Engels was right. British capitalism was passing through a critical stage. If no way out of the impasse were found, the capitalist economic relationships, and the class who benefited thereby, were doomed, for capitalism cannot stand still. There was between 1883 and 1888 what Hyndmann describes as a "permanent glut and over-production", most marked in the coal, iron and steel industries. Not that the structure of British capitalism as a whole did not grow; by the period 1885-8 the volume of foreign trade had risen by about 50% compared with the early 'seventies. But the expansion had not been rapid enough. Practically the whole decade 1875-87 had been one of low profits such as are natural in times of general over-production. Walter Layton's diagnosis of the difficulties of these times bears out the general argument: "Capital indeed increased very fast, for the expenditure by the wealthy had not yet

become so lavish as it is to-day, and habits of saving produced a superabundance of capital in a market where the existing demand was already well satisfied."

The Majority Report of the Commission upon the Depression of Trade, 1885, reached kindred conclusions: "That owing to the nature of the times, the demand for our commodities does not increase at the same rate as formerly; that our capacity for production is consequently in excess of our requirements, and could be considerably increased at short notice; this is due partly to the competition of capital which is being steadily accumulated in the country."¹

That some drastic change had to take place in the capitalist world economy was above all obvious to the British capitalist class, as the chief sufferers from the insufficiency of markets. Whether they were aware that the very existence of a form of society was at stake is doubtful. What they certainly were aware of was their inability to sell goods, the lowness of profits, the lack of openings for their accumulated capital, the encroachment of rivals upon their traditional markets, the erection of tariff barriers

¹ Quoted by J. A. Hobson, *Imperialism, A Study*.

against them by the younger industrialisms. "Never say die" may well be the motto of a capitalist class. If a way there was, that way would be found and tried. In their dilemma of the 'seventies and 'eighties the expedient of gaining control of backward territories and developing them into complementary economies proved the golden remedy. Whether the indigenous peoples wanted it or no, they had to borrow British capital, they were forced to have railways, to accept British rails and locomotives, to work in mines, to adapt their economy to produce raw materials, and above all they were obliged to pay good dividends on the capital they had thrust upon them.

CHAPTER XII

SOME CRISES CONSIDERED

(b) THE IMPERIALIST HEYDAY

The value of imperialism in providing markets—The imperialism of the 'eighties—The rôle of gold mining—The prosperity of the 'nineties and the early twentieth century—The enormous rate of growth of the capitalist economy.

DURING THE LONG years of depression this country had learnt the value of the colonies as closed markets for her manufactures.

“The export to the colonies helped to relieve the depression of English industries between 1873 and 1886, and this awakened a growing interest in the possibilities of extending trade between England and her colonies. Great Britain could not stand still, either she must extend her markets, or her increasing population would no longer find employment, she must try to sell increasing quantities or her town population could not buy their food.”¹

It was now a question of developing these colonies systematically, imperialistically, to seize

¹ Knowles, *The Economic Development of the Overseas Empire*.

the best territories in every part of the earth in order to exclude Britain's economic rivals, and to guarantee, by political means, the safety of capital invested overseas.

J. A. Hobson¹ has attempted to show that imperialism did not in fact provide the overseas markets which were claimed for it. He quotes figures of the value of British trade to show that this value increased but little in the years of imperialistic development. The value of our trade in 1894, for example, was the same as in 1873. Such figures are startling until one takes into account the rapid fall in prices over this period. Actually, if one compares the averages for 1871-4 and 1885-8, one will find that the *volume* of trade increased by 50%. By the period 1896-9 the volume had doubled—this in the face of the systematic exclusion of our manufactures from the Continent (in 1878 from Germany, in 1892 from France, and in 1890 and 1897 from the U.S.A.). Far from Hobson's contention being true, that the vast, chiefly military expenditure on colonial expansion had not paid from a business point of view, the exact opposite can be demonstrated. The imperialistic creation of markets gave a new lease of life to British

¹ *Imperialism, A Study.*

capitalism, enabled it to continue that continuous upward swing which is vital to such an economy.

British overseas investment began in earnest in the 1860's. Between 1862 and 1872, according to reliable estimates, £46,000,000 were invested annually. With the depression of the 'seventies the rate of investment was slowed down (1872-82, £27,500,000 annually). It seemed as if the Continental failures of 1873 had discouraged British investment in Europe, while the drive for the appropriation of other parts of the earth did not begin until the early 'eighties, reaching its full impetus about 1884.¹ Investment followed the flag. Between 1882 and 1893, the annual rate was £75,000,000. By the end of the century British holdings overseas must have totalled £2,000,000,000, bringing in an annual income of £100,000,000 a year.

A series of inventions gave scope for imperialist development on a larger scale than hitherto. The introduction of cold storage in 1882 provided Australia, New Zealand and the Argentine with a valuable commodity which they could send

¹ 1884-9, formation of African concessionist companies; 1883, British entry into Egypt; 1886, annexation of Burma and opening of Canadian Pacific Railway.

to Britain in return for steel rails, and in payment of the British bondholders' dividends. Imports of frozen meat doubled between 1895 and 1909. After 1870 steel rails could be produced more cheaply by the Bessemer method, which tipped the balance of profitability in the opening up of undeveloped areas. It became the practice to drive railways into completely virgin territory, not connecting up any towns, but waiting for the towns to spring up along the railway. To this must be added the building of railways with an eye to their military value, as in India. By the 1890's rubber was appearing as a valuable planting industry, supplying yet one more raw material which the advanced economy was willing to take in exchange, or as tribute.

Perhaps the greatest stimulant was the significant rise in gold production after 1891. In 1892 the annual production was 180 tons; by 1910 it had risen to 712 tons. Between 1896 and 1912 £1,000,000,000 of gold were produced. Gold is one of the most ideal commodities for capitalist production. There is no difficulty in selling it. Once produced it is automatically money, sells itself as it were. It has no awkward after-effects like the production of iron, or any other metal, since, not being used in industry

for the most part, it does not tend to render labour more productive, nor precipitate a crisis of plenty. The more gold the world has the more it seems to want. The output was largely absorbed by the building of gold reserves for the central banking systems of the world. In addition, India took £82,000,000 worth in fourteen years up to 1912—more than a tenth of the world supply.¹

Modern methods of gold extraction necessitate expensive machinery—it is no longer a question of dipping a pan in a sandy stream. The £1,000,000,000 worth mentioned above must have called for an investment in plant of considerable expansive effect upon the market.

Nor could the abundant gold have come more opportunely than into the midst of the frantic capitalist development of the world. It provided the necessary credit for the growth of manufacturing industry in Germany and the U.S.A. and of transport in the Argentine and Australia.²

It would be difficult to obtain, without special statistical research, a complete picture of a past phase of a capitalist economy, more especially so, as factors which we now consider vital, such as the volume of investment in production, and of

¹ Layton, *Introduction to the Study of Prices*.

² Layton, *ibid*.

purchasing power, were left out of account, at least as far as statistics were concerned. It can be said with certainty, however, that the last decade of the nineteenth century and the first of the twentieth have all the features of a phase of rapid investment expansion, and an extension of the market equal to the accelerating rate of production. From time to time during the early 1900's it looked as if the volume of investment would not keep up the pace. To judge by precedent, one might have expected a serious reaction after the Boer War, but this and the slight stagnation of 1906 and 1907 was nullified by overseas investment on an unprecedented scale. During the five years 1909 to 1913 new capital issues for investment abroad issued in London averaged £134,000,000. Whether this rate would have been maintained after 1914 if the War had not broken out, and what would have been the consequences of a failure must be matters for conjecture. Not only did imperialistic policy open up and systematically develop new areas. Political conquest and political influence demanded imposing armed forces. Between 1884 and 1889 British armament expenditure had shown little disposition to rise from its average of £31,000,000. By 1898 it had climbed to

£40,000,000. In the following year it jumped to £64,000,000; the wars in South Africa and China (1900-3) sent it up to £124,000,000.

It has been observed in the theoretical analysis that provided the standard of living of the population could be raised in proportion to the growth in the productivity of labour, no crisis of general overproduction need appear. During the twenty years 1880-1900 real wages rose by 41%, which, if the increase in the population be taken into account, gives an expansion of purchasing power of the masses by 68%.¹ There can be no doubt that by whatever the imperialist development, the growth in world industry, gold production and armaments were deficient in keeping pace with productive capacity, the higher living standards made up the balance.

It is little wonder that the pre-war imperialistic era is singularly free from trade depression even of the kind experienced during the 1880's. Crises there were, notably the Baring panic of 1890, but this was rather one of over-speculation. The outlets for investment in American industry, breweries, Argentine State loans and railways,

¹ In considering real wages, I am forced to rely on official statistics for what they are worth.

Mexican railways and mines, U.S.A. rails and colonial loans once more gave the financiers a bilious attack from over-indulgence. It is noteworthy that this crisis produced no aftermath of depression such as many during the nineteenth century.

Considering the rapidly mounting production of commodities in these times, the staving off of a crisis of overproduction was no mean achievement. Between the early 'seventies and the end of the century the production of American primary commodities doubled and trebled. The growth of heavy industry in the chief industrial countries (United Kingdom, Germany, U.S.A., and France) is the most impressive. The average of pig-iron output of the years 1895-9 was nearly two-and-a-half times that of the early 'seventies, only to increase by a further 68% by 1905-8. From an insignificant output in the early 'seventies, steel output in these countries had reached 18,000,000 tons by the late 'nineties, and 40,000,000 tons by the period 1905-8. The extent of the growth of the whole British economy is shown by the threefold increase of the joint-stock banks' deposits between 1870 and 1890.

The observations of this and the preceding chapter bear out the contention of the general

analysis. Capitalism can only cope with the continually threatening tide of overproduction provided outlets for its absorption are made available as fast as production mounts. Only with a continually rising production, with expanding markets at its disposal, can a capitalist economy be in a "healthy" condition, able to employ and feed the working millions that it has brought into existence.

CHAPTER XIII

SOME CRISES CONSIDERED

(c) POST-WAR CRISES

Post-war capitalist opportunities and the early slump—The reconstruction of Europe—A stable price level—Accumulating overproduction beneath the stability—The Wall Street crash not the primary cause of the slump—The speculation no accident—The early signs of the slump in the world as a whole—The necessary expansion only possible in certain circumstances—The armament boom of 1937—The deepening severity of crises—Is there a “rock bottom” to a slump?

IF CAPITALISM IS capable of a spontaneous luxuriant growth, expanding of necessity from its own inherent nature under the impulse of the profit-making initiative of its economic leaders, then in the post-war years it had the opportunity to demonstrate this ability. The nineteenth century growth of capitalist industrialism, stupendous as it was, had made such an outlook a matter of course for all but a few Socialists, of which the “out-of-date” and “discredited” Marxists were the most consistent.

Let anyone who is disposed to reject the argument of this essay provide a satisfactory answer to the question, Why did not post-war

capitalism swing us up in to the promised realm of plenty? If the arguments of this analysis are ignored, the capitalist world of 1919 certainly offered a rosy future—a dawn all too soon overclouded by the cataclysmic slump of 1920. True, this slump probably need never have come about so prematurely but for the over-investment born of this very optimism. Investors learned that it was one thing to build cotton mills to provide the much-needed shirts, and another to sell the shirts to the millions without the money to pay for them. It must have seemed especially hard to realise why the terrible housing shortage due to the practical cessation of building for four years should not guarantee a phase of at least internal prosperity for years to come. It was not only houses that were wanted. People had done without motor-cars, clothes, holidays and innumerable other articles of consumption during the war years. And yet the recovery was nothing spectacular. Very slowly—until 1929—the unemployment figures were reduced; British industry seemed to drag itself painfully, step by step, out of the depression. It never reached a boom. Before industry was working to capacity it was overtaken by the next crisis.

It must not be thought that opportunities for investment expansion were altogether lacking. The motor-car, wireless, artificial silk, gave new outlets for large scale investment and production. Both Britain and America were still actively prosecuting the imperialist policy of investment abroad—notably in South America. In the seven years 1923 to 1929, the U.S.A. exported £590,000,000 and the United Kingdom £650,000,000 worth of capital. Germany and other European States rehabilitated and modernised their industry largely with British and American capital; France and Belgium financed the reconstruction of the war-devastated areas from the same source via German reparation payments.

For the maintenance of stability and for a phase of prosperity, the post-war price-level, once recovered from the 1920 slump, was ideal. The period 1923-9 was one of gently falling prices, declining 8% in Great Britain and somewhat less in the U.S.A. Such a slow continuous fall could not appreciably diminish profits by a fall in value of goods during production and storing, and it must have done something to counteract rising productivity of labour by increasing the amount of

commodities which recipients of fixed incomes could purchase.

Beneath this apparent stability the inherent deranging factors were at work. It has already been shown how the tendency of rising labour productivity was by no means damped down during these years of so-called technical stagnation for British industry. Probably the net tendency to labour efficiency, uncompensated by the mutually destructive capital investment of a more purely competitive capitalist economy, was greater than ever before. Nowhere except in Russia was the essential capitalist relationship of employer-wage-earner relaxed so as to loosen the bonds on the purchasing power of the vast majority of those drawing their livelihood from industry. Stocks of several important commodities, especially storeable foodstuffs and raw materials, were steadily accumulating, towering themselves up until the day when world production would be dammed up and world markets flooded. The excessive stocks of coffee, despite the restriction, had caused a 50% drop in prices as early as 1927. The rubber producers also put off the evil day by artificial price-fixing, which induced additional planting outside the ring, and the last state was worse than the

first. World stocks of sugar began to show significant increases from 1926.¹ Aggravated by the stimulus of the high prices of August, 1924, to January, 1926, wheat stocks were in a similar parlous state.

Manufacturing industry had the same story to tell, but since manufactures are mostly made to order, and their production can be checked when the market is becoming overstocked, the limitation of the market is shown in the surplus capacity of plant. The League of Nations report on the depression notes that: "The cotton, textile, engineering and shipbuilding industries all had a capacity in excess even of the demand in 1928, which was artificially stimulated by the boom." The American automobile industry serves as another example; enormous as was the boom output of over five million cars a year, the industry could have produced eight million.

There is a general impression that the recent slump was "caused" by the Wall Street specu-

¹ The accumulation of sugar stocks illustrates the general trend.

				1,000 metric tons
1913	.	.	.	1,279
1922	.	.	.	1,214
1926	.	.	.	1,950
1929	.	.	.	2,571
1930	.	.	.	3,216

lation and crash. This was certainly the first evidence of the crisis to reach the ears of the public, and of most business men for that matter. Nor need it be emphasised that the breakdown of the speculative inflation of stocks and share prices on the New York Exchange in fact enormously accentuated the relapse owing to the sudden loss of business confidence. But the boom itself was no accident. The surplus of investable capital, as in previous slumps, found its way into share-speculation. Actually, the relapse had made its appearance in America as early as 1927 when industrialists refused to take up the expanded credit offered to them. The situation was saved by the surplus credit finding its way on to the Stock Exchange and creating a boom in share prices. No less than 86% of the enlarged volume of bank credit went into speculation. Indirectly, of course, this orgy of speculation did stimulate the market and production for a year or two. Gambling took place not only in securities, but in commodities which could be easily held and quoted. In fact most of the boom production of 1928-9 may be ascribed to the purely artificial speculative demand. When stocks were finally "unloaded" by the speculators, the surfeit of goods

was all the worse. The rapid spread of hire-purchase in 1927 was also partly responsible for the delay, and intensification, of the slump. It resulted in a sharp consumers' demand, followed by a shrinkage of the market during the years when the goods were being paid for. With the inflation of commodity prices by the easy credit policy after the middle of 1927, American industrial profits rose sharply and provided an apparent justification for the optimism in the security market. (American company profits were 28% higher in 1928 and 39% higher in 1929 than in 1927.) The significant drop of profits in the third quarter of 1929 showed their speculative origin. The investment in production arising out of the boom only aggravated the real surplus industrial capacity already existing.

In the world as a whole, there were many statistical indications, besides the accumulation of stocks, to demonstrate the artificial nature of the boom, and the inevitability of the ensuing slump. During 1928-9 prices of manufactures failed to rise, and even fell in Germany, the United States and other countries. The output of manufactures began to decline in the United States and in Germany in June; in Poland

and Canada the drop in production started in February. In most countries share-prices began to fall at the beginning of 1929 or earlier. Wholesale prices fell from March or earlier in Britain and the Empire, Germany, France and Italy; but the commodity boom upheld American prices until August. Finally, American building activity declined by 30% between May 1928 and August 1929.

The critical days in Wall Street came when the surplus commodities invading an overstocked market could not be disposed of and needed large quantities of credit to "carry" them. "Short" money was largely tied up in stock exchange speculation, and interest rates were rising at an alarming rate.¹ In such circumstances a break in prices was inevitable.

Despite the spectacular events of the stock exchange and monetary crisis, the root cause of the whole cataclysm is not to be found in human foolishness or greed, but in the basic defects of the capitalist productive relationships. The warnings of the over-production crisis long before the boom of 1929 made it impossible for even the most bigoted fanatic of pure monetary

¹ From June 1928 to November 1928, from 4 to 8½%. During 1929 rates fluctuated between 8 and 9%, at which rate the cost of "carrying" commodities was prohibitive.

theory to maintain that the great depression was due fundamentally to the speculative boom. The *Economist* is quite correct in boding ill of the similar speculative boom in commodities which began in earnest in November 1936; but it would be a mistake to imagine that we can prevent the reaction ahead by preventing the speculation. To restrain it can at best mitigate the severity of the crisis, and perhaps bring it on sooner. Furthermore the gambling itself is only a symptom that will not disappear by the bewailing of it.

One is forced to the conclusion by the economic events leading up to the 1929 slump, that only under exceptional circumstances can a capitalist economy maintain the rate of expansion necessary to avoid the periodic relapses. The British competitive capitalism of the nineteenth century accomplished this feat in the main, so long as she had the monopoly of manufacture; and only then indeed with the immense reservoir for investment in railway construction at her disposal, not to mention the gigantic new markets which the railway and steamship opened up. The British imperialistic capitalism of the thirty years before the War was able to maintain the constant flow of capital into production by

virtue of the development of backward territories. The permanent residue of unemployment in Britain since the War, and in other capitalist countries since the depression, is the measure of the failure of modern capitalism to maintain its rate of growth. Never was Marx more up-to-date than when he wrote:

“An ever larger quantity of capital is required in order to employ the same, and still more, an increased amount of labour power, to the extent that the capitalist mode of production develops. The increasing productivity of labour thus creates necessarily and permanently an apparent overpopulation of labouring people.”¹

It is difficult to foresee how, if ever, this rate of growth is to be resumed, short of the artificial markets provided by wars and re-armament. Not only has a British capitalist class to solve the problem of expansion, but the American and German and French and Italian and Japanese, and those of a host of other capitalist economies. The present curious phenomenon of a speculative commodity boom amid the substantial vestiges of the previous depression (spring 1937) is no indication that the dilemma is being any more than temporarily

¹ *Capital*, Vol. iii, p. 261.

solved. It is natural that a frantic world armaments race, together with rather scanty harvests coming at a time when the accumulated stocks of the last depression have been absorbed, should cause commodity speculation. That this will repeat the process of 1927-9 is more than probable. It may be that stock exchange speculation will be intensified, and that production will receive a certain stimulus, but of a period of prosperity, with the full use of our material and human resources, there is, short of a *deus ex machina*, no hope. What is more likely is that the phase of overproduction arising out of the financial stimulus will develop into a crisis in less time than the 1929 cycle.

And what then? *Can* the next crisis be more severe than the last? If the future crisis follows the precedent of becoming more severe than its forerunners, the industrial capitalist economies must come practically to a standstill. When we speak of the trade fluctuations of the nineteenth century we must bear in mind that they were nothing of the order of the post-war crises. For instance, the value of world trade fell by only 5% during the crisis of 1873-4 by 4% during that of 1883-4, by 7% during 1907-8. The drop between 1929 and 1933

was no less than 64%. World pig-iron production never experienced a cyclical fall of more than 10% until the 23% drop in 1907-8; in 1920-1 the fall was over 40%; between 1929 and 1932 it was 66½%. American pig-iron production in 1932 was little more than a fifth of the peak boom production (that not even up to capacity). During the black year of 1932 world industrial production reached its lowest level of 61½% of that of 1928, while the American index fell as low as 52½%.

Perhaps more than the severity, the duration of the recent depression was symptomatic of the dilemma of world capitalism. The League of Nations study observes:

“In all the earlier depressions except that of the eighteen-eighties, the lowest level of output (of pig-iron) was reached in the year after the crisis. In other words, some recovery began to take place during the second year. The recent decline in pig-iron production has not only lasted longer than in any of the previous depressions, but from the available figures for 1931 it appears that the reduction in output is greater.”

For over three years after the 1929 crash industrial production continued to decline. The

familiar question was then, "When *are* we going to touch rock-bottom?"

It is an interesting theoretical question as to whether a "rock-bottom" exists at all. It is obviously quite feasible for all manufacture of capital-goods, even for replacement, to come to a standstill. That is, pig-iron production would fall to zero. As industry as a whole becomes more highly capitalised, the drop in production can be greater. As the capacity to produce grows we may expect periods of recovery to change sooner into periods of over-production. So far as economic theory is concerned, we have seen that the consumers' section of the market could shrink to zero but for certain rigid factors, such as unemployment insurance, salaries and wages of permanent employees, etc., where loss of market does not entail dismissal of the employee. Actually, of course, long before such extremes are reached, the history of a crisis is likely to pass from the economic to the political arena: the "consumers' section of the market" may become a revolutionary class and break the vicious circle by breaking up the capitalist productive relationships.

CHAPTER XIV

PALLIATIVES

The transference of purchasing power from one country to another by protective tariffs—Government subsidies—State restriction—Germany the extreme case—Wage-cuts in times of crisis—Currency depreciation—Armament expenditure as the favourite form of deficit financing and as a possible solution.

IT IS ONLY to be expected that since 1929 world capitalism should be acutely aware of the threat to its existence. Just as during the critical 1880's, the leading capitalist groups have not failed for lack of trying. Manifestly, no regenerative expedient like the imperialist development of the latter end of the nineteenth century has come their way, but they have not been inactive in applying the best palliatives at their command.

During the first decade after the war the market problem took the shape of a desperate struggle for markets for industrial goods, in which struggle the protective tariff was widely used to assure the monopoly of the home market. With the onset of the crisis even Great Britain, the classical country of free trade, resorted to

the protective tariff in an attempt to bolster up the home economy. It is unnecessary here to examine all the complicated reactions of the protective tariff. Suffice it to illustrate by an example how it is used to transfer purchasing power from one country to another.

Suppose that Henry Ford finds his automobiles excluded from Britain, and that he decides to build a British factory in order to produce inside the "protected" market. Previously, a large number of Ford cars had been sent across the Atlantic; American citizens had been employed in their production. In return British citizens would be employed in making commodities to send to America in order to pay for the cars. When Henry Ford builds the British factory this process of international exchange ceases. The American automobile workers are thrown out of employment, and the British industrial workers do not send goods to America.

Let us study the effects in America first. There has been a net reduction in employment, and hence in purchasing power. The commodities previously imported from Britain to pay for the automobiles are no longer demanded in the U.S.A., for the fall in purchasing power is commensurate with both the lost production of

automobiles and the import of commodities from Britain. The U.S.A. suffers a net loss of purchasing power.

In Britain, on the other hand, there is increased purchasing power generated by the extra employment of automobile workers. Although Britain has lost the trade with America of general commodities (a point which free-traders are never tired of rubbing in), this is compensated by the extra spending power of the British public. For instance, if Lancashire had previously supplied shirts for the workers in the American Ford plant, it now supplies shirts for the workers in the British Ford plant. In addition, Britain has captured the purchasing power of automobile users who once bought American cars. Britain has received a net increment of purchasing power.

This process is not only applicable to a single capitalist like Ford who transfers production to within the protected area. The transfer can come about by rendering the price of the imported article so prohibitive in Britain that the Americans cannot find buyers. Consequently British capitalists supply the market instead.

Besides laying its hands on a supply of purchasing power by a permanent transfer of

production, the protecting country benefits by a stimulation to investment in production. The transference of industry from one locality to another must always necessitate some capital investment, and in some cases a great deal. Capital equipment in one country is scrapped, and built anew in another. Just like the mutual destruction of capitals in a competitive capitalism, the change of the location of industry alleviates market difficulties by increased investment in production.

Another blessing of Protection, not always recognised as such, is its capacity for rendering the production of commodities *less efficient*. It is quite true, as ardent free-traders point out, that you cannot transfer industry from a locality where it has grown up because of natural advantages, or where production costs are cheaper for other reasons, without a loss of real wealth to humanity. What the free-traders overlook is that humanity, tied hand and foot by the capitalist market, does not want real wealth; it hates it. The very fact that a greater expenditure of human labour is required to produce a commodity in the protected country means that the dangers of heightened productivity are, by so much, avoided. It is one of those instances of

waste which are such a boon to the capitalist economy. Nevertheless, every application of the palliative of Protection entails a reduction of living standards for the masses of humanity. The economic absurdities which the restriction of international trade has imposed upon humanity have already reached the stage of hay suits and wooden pants.

That Protection must always be a palliative, and no permanent solution for the market difficulty, is seen when one reviews the general spectacle of all the capitalist powers raising tariff barriers against each other, and stealing each other's purchasing power. Thieves cannot take in each other's washing. It is easily seen that the chief gain from Protection, the transference of purchasing power, is only a gain from the point of view of the individual protecting country. Once the most important capitalist economies engage in competitive and retaliatory counter-Protection, even this gain is lost. The only net gain of purchasing power results from the expense of re-equipping plant to produce in the new localities. Nevertheless, any economy which imposes a protective tariff still reaps certain direct benefits which are easily seen, especially by the home manufacturing interests,

and any country abolishing tariffs, on manufactured goods at any rate, suffers certain direct losses. Consequently Protection will always afford an attractive temporary palliative in difficult circumstances, even if the ultimate effects are deleterious.

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The effects of Government subsidies are of a similar nature. Less efficient methods of production are kept extant just because they can be performed in the home country. There is a lower labour productivity than otherwise would be, so that the capitalist economy attains a certain measure of stabilisation. This time the taxpayer pays the price in a reduced standard of living. If the subsidy is of the fashionable variety of a levy on imported foodstuffs, the tax falls directly on the consumers of these foodstuffs. Thus, when the British Government levies imported wheat and beef to subsidise the British farmer, those who spend a considerable portion of their income on bread and foreign beef suffer a lowered standard of living. If the subsidy is financed out of income-tax, this is tantamount, as regards its effects on purchasing power, to expenditure on useless public works, such as digging holes and filling them up again.

Nevertheless, the volume of British purchasing power is increased in so far as the production of these commodities is transferred to Britain.

Similarly, the dumping of exports upon another country, that is, selling them below their market price, is just another method of retaining the production and the purchasing power of the employees in the home country, at the same time reducing purchasing power in the country of destination. This is why capitalist States object, at first sight paradoxically, to receiving presents of commodities from abroad (for this is what dumping amounts to). Needless to say, no Socialist State would object to having goods forced upon it at less than their cost of production, and more cheaply than it could make them itself.

All the devices by the governments of advanced capitalist powers to maintain purchases at the price of efficiency, whether tariffs, dumping, levies, exchange restrictions and manipulations, limitation of investment, may be termed *State restriction*. The fashion, and its effects, are characterised by the *Economist*:

“Entrepreneurs (i.e. capitalists), both in the industrialised and primary producing countries, have contrived to exert sufficient pressure, either

on their Governments or on markets, to maintain and even raise prices by restricting production and by roping off their markets. Thus, the profitability of enterprise—and to a lesser extent of agriculture—re-emerges at lower levels of production; but the communal well-being is scarcely benefited.”¹

In some countries, and notably in Germany since the coming into power of the Nazi Government, State restriction has come completely to dominate their economic structure. In the words of the *Economist*:

“Time alone will show whether the rest of Germany can support an agricultural community which can only produce at prices which are at present roughly three to five times the world market prices, or alternatively, what will happen to Germany in the event of a really bad harvest.”² The long tale of shortage of fats, meat, bread and raw materials has been the answer to date. The German Government has been equally consistent in its capitalist rôle by its use of the power of the State in order formally to prohibit the growth in efficiency. In the same periodical we read:³ “Private investment in plant is pre-

¹ *Economist*, Sept. 21st, 1935.

² Sept. 23rd, 1933.

³ Nov. 3rd, 1934.

vented by prohibitions in numerous branches not only against the formation of new undertakings, but even against reopening of works closed during the depression." Here we see capitalism played out to its logical absurdity, forbidding itself to use the productive resources at its command lest it be not able to control them. The state of the German economy to-day is fulfilling Marx's prophecy:

"Since the aim of capital is not to minister to certain wants, but to produce profits . . . conflict must continually ensue between the limited conditions of consumption on a capitalist basis and a production which for ever tends to exceed its immanent barriers."¹

Dr. Ley, leader of the Nazi Labour Front, put it somewhat differently when speaking to Neunkirchen miners: "The main issue with the workman is not his ridiculous wage-pennies but the dignity of his position; and ultimately wage-questions settle themselves if the worker respects himself."² While the productive resources are lying unused, the worker must be proud to tighten his belt.

The ideal of State restriction is the crystallisation of the capitalist economy into a vast

¹ *Capital*, vol. iii, p. 301.

² Sept., 1935.

institutional structure, in which the population is graded into economic castes of the ancient Indian pattern, or "Stände" to use the modern German term borrowed from her medieval history. Ancient Hindu feudalism and the Germany of the Middle Ages were only able to maintain this crystallisation in the absence of any technical progress. But to ban all improvements in a modern capitalist economy is in the long run impossible. Not only would it entail the practical abolition of heavy industry, but an elimination of commodities from the world market by the more efficient production of other countries. No nation who needs to import industrial raw materials and foodstuffs could envisage this prospect. The failure of the German State to prevent the operation of the natural law of rising productivity is shown by their own official figures; between 1932 and 1935, the production of commodities increased by 40%, but employment by only 29%.

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During the recent crisis of 1929 and the prolonged depression which ensued, the solution of their difficulties the most universally attempted by the capitalists was the reduction of

costs by direct wage cuts. Unable to sell its products at remunerative prices, and often faced with imminent bankruptcy, a firm would reduce labour costs as the only means of keeping itself in business, or at least of maintaining the level of profits. This procedure has been justified in that it tended to restore profitability, and so encourage investment. Of course, to reduce wages does raise profits and under certain conditions will stimulate investment in new production. The fact which economic experts of this way of thinking overlook is that the community suffers an immediate reduction of purchasing power, unless the recipients of the increased profits immediately re-invest them in production. In times of economic crisis, when the policy of wage cuts is most energetically prosecuted, we know that these profits will tend to be hoarded. To cut wages, therefore, may be a temporary alleviation for the individual enterprise, but from the point of view of the economy as a whole it will tend to deepen the depression. At the same time that production is driven to lower levels, the capitalist class will have done something to maintain its income. In other words, the burden of the reduction of purchasing power will be borne by the class

of employees, and more especially the wage-earners, whose incomes are the most fluid. During the recent crisis the workers of Central Europe suffered terribly from the driving down of their living standards.

While the British bourgeoisie did not shrink from the device of direct wage cuts, it did not consider the lowering of living standards by such crude means to be politically the most advisable. It resorted to the cleverer tactic of currency depreciation. When the money of one State loses in exchange value compared with other currencies, all imported commodities must be paid for by larger amounts of the home currency if the foreign vendors are to receive the same price in their own currency. Thus the consumers of foodstuffs in Britain, a great part of which are imported, were forced to pay a higher price than if the original exchange-rate had been maintained. Actually, Britain was in the fortunate position of being the sole large purchaser of these foodstuffs, so that the producing countries found themselves in a very bad bargaining position and had to accept lower prices in their own money. Either because home consumers could not buy at the enhanced home prices, or because foreign producers would not find production on

the old scale profitable in view of their diminished receipts, the volume of imports into the currency-depreciating countries would tend to be cut down. The effects as regards purchasing power would be the same as a protective tariff. In so far as it was possible and profitable, a certain amount of the production would be transferred, the depreciating country would gain, and the other countries would lose somewhat in purchasing power.

The second effect of depreciation arises from the fact that foreign currencies have a higher money value when converted into the home currency. Exporters selling in the U.S.A. at the same dollar prices would find that these dollars gave them a larger quantity of the depreciated £ sterling, the currency in which their accounts were kept, wages paid, and profits calculated. Exports yield higher profits and their volume is relatively enlarged. The effect is that of an export subsidy; production is transferred to the home market at the expense of other nations engaged in international trade. Britain's panacea of depreciation has made a significant contribution to her recovery from the throes of the crisis. Other capitalist powers were not long in following suit, and were

able in turn to direct the stimulus to themselves.¹

It is obvious, however, that once all the currencies have been depreciated, the advantages of mutual spoliation will have cancelled each other out. The stimulus can only be regained by a renewed outburst of depreciation. At best the great capitalistic powers can only gain a lasting advantage at the expense of the more backward, raw material producing economies. Since the impoverishment of these destroys their ability to buy the products of the manufacturing economies, the spoliation will rebound upon the robber.

It can be stated in conclusion that exchange depreciation may provide a temporary alleviation to the market problem of the individual countries, but its main effects on the world capitalistic economy are, firstly, a certain ephemeral investment expansion due to the

¹ The vital rôle played by currency depreciation in lifting the world out of the crisis is shown by the following summary by the *Economist* (Aug. 15th, 1936) of the findings of *Money and Banking*, a review published by the League of Nations:

"The most obvious and significant fact which emerges from the Review is that no single major country has overcome the great depression without undertaking a policy or monetary expansion of some kind or another.

"It is also true that in every one of the countries which have overcome the depression, recovery did not begin, if we discard the hardly discernible 'false starts' of early 1931 and late 1932, until expansionist policies had already been undertaken."

transference of industry from one locality to another; secondly, to the extent that production is displaced from its favourable location, labour becomes less efficient, and standards of living fall; thirdly, in so far as the workers are unable to demand higher money-wages to compensate for the increased prices—the purchasing power of the world is reduced. The first two effects enumerated tend to alleviate the dilemma of the market, the third to aggravate it.

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The list of the palliatives which have hauled world capitalism out of the 1929 economic crisis would be incomplete without a mention of the activity of the war industries. At the time of deepest depression the *Economist* published a satire on the contradictions of the market problem. Mr. Ramsay MacDonald, the then Prime Minister, recalled that in war-time there had been no difficulty in disposing of the output of industry. Quite the reverse, the insatiable demand could hardly be met. Accordingly he launched an imaginary war. On the basis of the demand for supplies of all kinds, the previously stagnant production rocketed to new heights, and not only in the war industries; the

increased purchasing power of the people stimulated all industries, and the standard of life soared in company with the enormous productive forces released. The munitions were surreptitiously dumped in the North Sea. The present armaments race is fulfilling this prophecy in certain respects. It is providing an increment to purchases which is not subject to the disadvantage of capital investment—it does not generate increased labour productivity. It provides a perfect illustration of the previous conclusion, that if only enough values are wasted, i.e. put to unproductive uses, the market problem is solved.

The armaments remedy has the limitation of deficit financing, yet for a complex of political-economic reasons it seems to be the form which a capitalist society is the most willing to tolerate. The enlarged Government expenditure finds its way in the first place to the iron and steel and armament firms which constitute the most powerful sections of capitalist industry. That the last-named section is not above using whatever means are in its power in order to promote expenditure on armaments has been revealed by recent enquiries into the activities of the munition makers. It would be naïve to suggest that

twentieth century capitalism is run by the armaments groups, but these capitalists put themselves to much greater pains than other sections of industry to gain political influence and to have a say in the Press. In consequence, the mouthpieces of capitalist opinion are much more indulgent to deficit financing when devoted to armaments than when it is devoted to any other and more useful object. An expenditure of £1,500,000,000 on the building of working-class houses, providing new schools, or a badly needed network of State hospitals would be met by the outcry of "unsound finance", "driving the State to bankruptcy", or even "Bolshevism run mad". Despite the proved facts of the impossibility of bringing up a healthy family on the present scale of unemployment allowances, any suggestion to increase these would be howled out of existence. But the prospect of spending £1,500,000,000 on an expenditure such as rearmament, which does nothing to increase the health of the people or the amenities of life, is met with a smug approval by the most respected Press organs without a hint or suggestion of unsound finance.

During the first nine months of 1937 the German State raised 2,200,000,000 marks by

three rearmament loans, apart from other borrowing. The loan was floated at a little less than par at $4\frac{1}{2}\%$, and one-sixth of the principal is due to be repaid in each of the years 1947-52. The very method of redemption illustrates the hand-to-mouth nature of the expedient. This promise of repayment in a few years' time is a regular feature of Nazi borrowing. The colossal burden on the German economic structure of a decade hence if it attempts to repay the loans hardly bears calculation. Quite apart from the consideration that the State of those days will be unable to bolster up the economic structure as the German Government is now doing, the process of repayment must cause an enormous shrinkage of purchasing power (unless the holders of the redeemed bonds can be persuaded immediately to spend the funds on personal income or invest them in production, which is unlikely, owing to the glut of capital caused by the repayments). The amount of deficit financing indulged in this year by these three loans is equivalent to about £110,000,000 (at twenty marks to the £). How much this falls short of the total German borrowing for the year it is impossible to say. The German economy is approaching a position of no great volume of

unemployment with a labour shortage in some trades (according to official figures at any rate). It has required the pumping into circulation of an amount of purchasing power of something over £110,000,000 in order to achieve this position. It may be enquired what would be the state of employment without these liberal doses of extraneous purchasing power.

To what extent the capitalist powers will be prepared to pile up State debt to maintain the present armament boom lends itself to no categorical answer. This is not so much an economic question, as a matter of the struggle for power and the manœuvrings of the various capitalist groups. Just as the munitions makers are not in the habit of sneezing at orders, so it can be imagined that the banks will have little objection to creating money out of nothing and lending it to the Government at a rate of interest. As shown in the discussion on deficit financing (Chapter IV), the interest payments for which the State renders itself liable very soon assume proportions big enough to upset any budget. Such payments can only be maintained by a rigorous curtailment of expenditure on social services or other useful public expenditure, or by a drastic rise in the level of taxation. The

difficulty could be solved from time to time by a repudiation of the State debt by such devices as inflating the currency until it becomes valueless, as Germany got rid of her war debt in 1923. But such tactics can never become the recognised policy of a capitalist State, because the very knowledge that the State intended to repudiate its obligations after a few years would prevent it from borrowing at all. During war-time, paradoxically enough, the difficulty of raising vast State loans offers few difficulties. Few people, in such a situation, are disposed to enquire how the money is raised. In time of peace, the creation of thousands of millions of pounds by the privately-owned joint-stock banks, and the profitable lending of this money to the Government, would provoke adverse comment. But in time of war the banks would be praised for their patriotism. Only after the war is over do the limitations of deficit financing become a pressing embarrassment.

By way of conclusion of these remarks on the rearmament programmes, we can see no grounds for complacency in a world capitalism which relies for an adequate flow of purchasing power upon such expenditure. A halt must be called before many years are out. The proposed

capital outlay by the British Government in the next five years will necessitate £45,000,000 a year of additional taxation to meet the interest alone. But Britain, even with the enormous scale of her present National Debt, will probably be able to stand an orgy of deficit financing for longer than Germany. There is a real danger that a State, finding itself financially embarrassed, and unable to attract further loans, may resort to war rather than face the certain catastrophe of another slump.

CHAPTER XV

CONCLUDING REMARKS

The capitalist social relationships are at the base of the problem—No solution to the dilemma in sight—Capitalism will not simply “collapse”—Living on make-shifts and destruction—The attitude of the social classes—A solution demands the abolition of the employer-employee relationship.

“Revolutionaries sometimes try to prove that there is no way out of the crisis. That is a mistake. There is no such thing as absolutely hopeless positions.”—Lenin, speech at the Second Congress of the Communist International, 1920.

AS THE ANALYSIS of this essay was completed, and its conclusions tested by an examination of some of the characteristic disturbances of the capitalist economy, the reader must often have pondered over the unknown which lies ahead. Our analysis has followed capitalism through its various phases, each phase being ushered in by some major qualitative development. Yet the primary dynamic force, the rising productivity of human effort, was observed to transcend these changes of quality, since it is the corollary to

those social relationships of the classes which *are* capitalism. That "the bourgeoisie cannot exist without constantly revolutionising the instruments of production"¹ is just as much now a law of monopoly imperialist-capitalism, as it was of the competitive capitalism of 1848. Each qualitative development within the limits of the capitalistic social form appeared as a response to the dilemma of the limited market and its external manifestations of over-production, unemployment, and low profits. As each barrier was approached, means seemed to be evolved of surmounting it.

As we survey the world capitalist economy of the post-war period, we observe convulsions far more destructive, the barrier of the market far more formidable, than in any previous period. Any new qualitative change capable of giving the vast productive forces of the twentieth century a new lease of life will have to be unthinkable enormous. It is not a question of providing expanding markets for one capitalist economy, but for fifty. A new imperialism capable of fulfilling the need would have to establish trade relations with and political domination over Mars. Nor do the governing classes

¹ The Manifesto of the Communist Party, Marx and Engels, 1848.

show any inclination to raise the consumption standards of the world's hundreds of millions of poverty-stricken toilers. Now, as always, the necessary effort to discipline their own predatory and exploiting motive of profit cannot be expected of the dominant economic class. They cannot even resist the temptation to depress living standards and so aggravate the general crisis of their economy. Certainly the requisite qualitative development is not at hand, and it is hard to envisage whence it can come. It is significant, moreover, that for the first time in capitalism's history has the required adaptation failed; the partial recovery from the recent depression has been shown to be due to a series of palliatives, such as deficit financing, rearmament, the housing boom, currency depreciation, which merely delay the day of reckoning. Ironically enough, the most important qualitative change now being operated, namely the rapid transference of the remainder of production to a monopolistic form, allows the dynamic of productivity to work itself out, uninterrupted and uncompensated, in a more purely destructive manner.

A general realisation of the difficulties of modern capitalism have led many people to talk

glibly of its "collapse". During the recent crisis it was often speculated whether the system would "collapse" or not. The metaphor was presumably that of a house, or bridge, whose structure was rotten, and which could quite literally collapse. But transfer the notion to an economic system, and it is hard to envisage what actual process these people have in mind, if any. Obviously it cannot fall down like a house or a pack of cards, because it is not subject to the laws of gravitation. Nor is it imagined that the factories will fall down, the ships sink, and the trains run off the railway lines. The capitalist economic structure is a complex of social relationships—employer and employee, buyer and seller, landlord and tenant, rentier, pauper. The only way to pose the question as to the survival ability of capitalism, is to ask whether these relationships will be dissolved and supplanted by new ones.

Although we have been able to formulate a series of laws, or methods of behaviour of the capitalist economy as a whole, this does not mean that it is a mechanism such as a clock or internal combustion engine. This analysis has revealed a constant tendency for purchasing power to fail; but it cannot be deduced there-

from that the capitalist system will run itself down to a standstill. The component parts of the system are social classes, composed of living human beings with wants and aspirations, with a certain freedom of action, and an ability to decide their attitude to the social relationships. One may expect those who have the most to gain by the conservation of the capitalist system to work actively with this objective, and those on whom it bears most hardly to examine the possibility of substituting another social system, such as a Socialist society, which is free from the inherent weaknesses of capitalism. We have seen how the governing classes have obeyed this law by "bolstering up" capitalism with a series of make-shifts. These have mainly taken the form of a plundering of the non-capitalist sections of the community, of a mutual stealing of markets by the national capitalist groups, and the artificial inducement of destruction. Each make-shift is only applied at the cost of reducing the living standards of the masses of humanity, the toilers. So long as these masses are prepared to tolerate renewed applications of this medicine, the capitalist social relationships will remain intact, even though this entails a reversion to a more primitive

economy. At this stage the survival of capitalism becomes a political question involving the effectiveness of the resistance of the oppressed, and the clarity of their perspective of the new order of society. It has been shown that war offers a capitalist society the most perfect of palliatives. It not only solves the market problem completely during its actual duration, but generates a post-war boom such as that of 1919-20, when articles of consumption and capital goods were demanded to replace those worn out or destroyed. Whether capitalism is able to give itself repeated new leases of life by a resort to war, depends upon the acquiescence of humanity in the ghastly process.

In the analysis of this book, a claim has been made, to explain exactly why the capitalist system bears within itself the strange contradiction of being able to produce wealth and yet not distribute it to a needy world. The paradox, all too apparent, and yet not so obviously explicable, has caused economist and layman alike to ask, "What is choking the flow of goods to the consumer? What social adaptations must take place before the contradiction is resolved? Does this entail the abolition of capitalism, and will Socialism solve the

problem?" The analysis has centred round the strict limitation of the flow of purchasing power accruing to employees, and the tendency to reduce this purchasing power relatively to the growth of productive forces. The limitation of incomes arises from the employer-employee relationship. The main lever of production and of investment is not consumption but profit. The capitalist does not aim to produce, but to secure the largest possible margin between the costs and his receipts in his trading operations. Since the incomes of employees arise in the first place as cost items on the balance sheet, this origin entails their being kept as low as possible. The essential pre-requisite for the removal of the barrier between production and consumption is the abolition of the profit-incentive and the employer-employee relationship. No man must be permitted to control means of production, and control and limit the incomes of other human beings, in such a way that the more he limits their incomes, and the lower he drives their standard of life, the greater become his wealth and power, and the more privileged and honoured his position in society.

