"All that is necessary for the triumph of evil is that good men do nothing . . ." — EDMUND BURKE.

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Douglas Social Credit Through the Lens of Market Failure
By M. Oliver Heydorn

Recently, perhaps as a result of some interactions on social media, it has occurred to me that the best angle for approaching the Douglas Social Credit analysis and proposals for the benefit of those on the conventional right of the economic and political spectra is to frame Douglas' stance in terms of the concept of market failure. To the question: "What is Douglas Social Credit all about?", we can respond as follows: Douglas Social Credit is an economic model that is based on a diagnosis and a set of prescriptions. The diagnosis is that the number one cause of economic failure is a specific category of market failure, and the number one cause of the market failure in question is the existing financial system. [1] The remedy is to reform the financial system, to correct its faulty design in such way that not only will it no longer interfere with the operation of the free market, but it will henceforth positively enhance the ability of the free market to maximize the general societal welfare.

The Concept of Market Failure

According to neo-classical economic theory, when free markets operate as intended they also maximize societal welfare (in economic terms). For the purpose of this paper, we will refrain from either investigating or challenging this assumption to any great degree. [2] It is based on the principle that individuals, when acting in their own rational self-interest through free market exchanges, inadvertently contribute to a socially optimal outcome where the overall well-being is well served. This alignment of individual and societal benefits is encapsulated in the concept of the "invisible hand," which asserts that the market, when left to its own devices, will efficiently allocate resources to enhance total welfare, ensuring that we reach a stage of 'optimality' in which no one can be made better off without making someone else worse off. What benefits one person (through voluntary exchange) will benefit others, so that in some significant,

though not necessarily equal or equitable sense, everyone 'rises together'. The market is thus supposed to provide us, individually and collectively, with the best possible world in terms of material benefits.

Unfortunately, for various reasons, the market mechanism sometimes fails to deliver this outcome; i.e., individuals acting in their own self-interest through voluntary exchanges do not always result in the maximization of the overall societal welfare. Instead, the market allocates goods and services in a manner that leads to a net loss in overall well-being *vis-à-vis* the outcome that could and should ensue. This phenomenon is often referred to as 'market failure'. In cases of market failure, the allocation of resources is inefficient or grossly inequitable, meaning that some individuals or groups benefit at the expense of others and hence at the expense of the collective well-being. In other words, market failure occurs when the market fails to maximize both individual and social benefits as expected.

The Causes of Market Failure

Whenever the market fails to achieve in practice what it is supposed to achieve in theory, i.e., a state of *pareto* * efficiency where no one can be made better off without making someone else worse off, it is due to some kind of *interference.* Some external or internal factor is preventing the market mechanism from delivering the socially optimal result, either by act or omission. Depending on the nature of the factor in question, we can identify different categories of market failure in terms of their differing causes. Some of the most commonly recognized forms of market failure can be adumbrated as follows:

** pareto: formula used to express the income distribution of a society*

1. **Market Failure Induced by Externalities.** In the case where the production or consumption of a good or service affects third parties (whether positively or negatively), market failure can result because there are costs or benefits that are not reflected in market prices. The decisions then made on the basis of those "inaccurate prices" are misleading as they do not take into account all of the relevant information that market players require in order to make decisions that are pareto efficient. A good example is that of companies who profit while imposing pollution and its ill-effects on the general population (the costs of which are not represented in the price of the products the company makes). Had the cost of the pollution been included, the people, especially the people affected, would have bought less of the good. Both profits and pollution would have been reduced.

2. **Market Failure Induced by the Public Nature of Certain Types of Production.** Goods and services that are of a public nature because they are non-excludable (no one can be excluded from using them or benefiting from them) and non-rivalrous (one person's use does not reduce its availability to others) can also cause market failure. Due to their non-policeable accessibility, people can make use of them without paying for them and so private providers are not sufficiently incentivized to provide them (they would lose rather than make money if they

tried). The market therefore does not provide them or tends to underprovide them. The only way to ensure that people pay for them would be through government taxation and thus the government becomes the natural provider of these public goods. National Defence is one of the most obvious examples of a public good that cannot be adequately provided for by the market.

3. **Market Failure Induced by Extreme Market Power (Monopolies and Oligopolies).** Whenever a particular market is dominated by a single firm or a small number of firms, these firms can impose self-serving conditions that distort the operation of the market. For example, if a firm has monopoly power, it might restrict output to keep prices high, leading to fewer goods being available at the higher prices than what would otherwise be the case in a competitive market. The reduction in consumer goods then reduces the overall welfare, as more people would have benefitted from increased production at the lower prices. In this way, imperfect competition can prevent markets from delivering the most efficient results possible. It is not often appreciated by free market ideologues that the only type of free market which fully delivers the benefits which we associate with the free market generally, i.e., physical efficiency in resource use, capitalist justice or a dollar paid for a dollar's worth, and consumer choice, is the perfectly competitive market … something that tends to be rarer than hen's teeth. If a nation only has two or three main supermarket chains, for example, the lack of competition can lead to collusion or price rings among the few major players to keep prices artificially high so that larger profits can be made at the expense of the consumer.

4. **Market Failure Induced by Information Asymmetry.** Whenever one party in a transaction has more or better information than the other, decisions are being made that are based on incomplete or misleading information. As a result, market failure can occur because one party is led to make adverse selections or is baited into moral hazard. An example: someone in need of air conditioning in a car could be told by a car dealer that installing such a/c units is not done by the company, while omitting the fact that private mechanics do it all the time. The end result is that the customer is induced to buy a new vehicle just to have one with a/c. A lot more money is then spent that would not have been spent otherwise.

5. **Market Failure Induced by the Misuse of Common Resources.** What is known as the 'tragedy of the commons' can occur whenever rivalrous but non-excludable resources are overused by individuals acting in their own self-interest. This can lead to market failure by eventually causing a depletion, perhaps even a permanent decline, of the resource in question. Overfishing is a good example.

An Overlooked Cause of Market Failure – Faulty Institutional Frameworks

There is, however, a sixth category of Market Failure which can be identified, one that is often underplayed or even ignored. Market failure can also occur due to institutional frameworks which are somehow faulty or inappropriate.

Rules, regulations, or operational procedures, whether public or private, may fail to facilitate efficient market operations; they may create barriers to market participation; or they may fail to provide incentives that are aligned with the general societal welfare. For example, overly restrictive zoning laws that limit housing development, can, by reducing supply, have the effect of inflating prices and preventing the market from meeting societal needs for affordable housing. In the same way, private companies can, through the use of patents on essential items, limit access by adopting high pricing strategies or restrictive licensing. This induces a market where the distribution of certain key benefits does not reflect societal demand or need. In both cases, institutional regulations mandate or permit the emergence of an artificial scarcity of particular goods, which then distorts market operations to the detriment of the wider societal welfare.

The Single Greatest Institutional Framework Failure: The Current Financial System

Now, I want to suggest that the single most significant example of this 6th type of market failure, and indeed, the single most significant form of market failure period, has to do with the faulty nature of the reigning financial system. The existing financial system involves certain institutions and a set of rules that can be likened to computer software. According to the Douglas Social Credit analysis of that software, the reigning financial system is not designed as an honest system; i.e., it does not accurately reflect the physical economic facts. Instead, it systematically underestimates our ability to produce and consume. As a result, it fails, ab initio, to respond adequately to the real demand of economic agents for money in the form of bank credit. It mandates a certain type of artificial scarcity where money is concerned.

In other words, there is a market in bank credit and that market is not at all saturated in the way that it could and should be if overall well-being is to be maximized. This type of market failure is due to poorly designed institutional rules which interfere with transactions (either by acting as barriers to transactions or increasing transaction costs), making them much less feasible or profitable for the providers to supply the bank credit at the socially optimal level and in the socially optimal forms. The interference of the institutional framework leads to market inefficiencies, or even to the outright failure to provide in the market for bank credit.

The First Level of Finance-Induced 'Market Failure'

For example, on the level of production, whenever there is, on the one hand, a legitimate need or desire for some good or service on the part of the population, and there is, on the other hand, the materials, labour, technology, know-how, etc., available to meet that need, then sufficient producer credit should be issued by the financial system to ensure that the production of the requisite goods or services will be catalyzed. Unfortunately, the existing financial system often fails to issue sufficient producer credit for this purpose and needs then go unmet (even though the

physical resources are all present). This is a failure to provide sufficient producer credit to maximize the overall societal welfare.

The Gap

Similarly, on the level of consumption, whenever there is, on the one hand, a flow of real wealth, of goods and services with remunerative prices attached, there should be, on the other hand, a corresponding flow of consumer incomes so that all goods and services can be purchased and all costs of production can be met. Unfortunately, the existing financial system fails to *automatically* provide sufficient consumer buying power in the form of income to offset the prices of the corresponding flow of goods and services. The resultant deficiency is known in Douglas Social Credit literature as the price-income gap. This is a *distribution failure* which is embedded in the very operation of the system and it prevents the maximization of the overall societal welfare.

Now, what I have briefly described here is the first level, or the first layer, of market failure involving the financial system. The banking system, because of its institutional design, fails to automatically issue sufficient and appropriately structured bank credit so as to meet the need, the real demand, of economic agents for bank credit in such a way that the societal welfare is maximized to greatest extent that is physically possible.

If the recurring price-income gap which the system generates is not filled or to the extent that is not filled, a certain percentage of production will be wasted and producers will not be able to meet all of their costs, leading to bankruptcies and increased unemployment. Sometimes, when austerity policies are in place, the system does deal with the gap in this way, but it comes at a heavy cost. This is a kind of non-response or negative response, a non-solution to the problem of the gap.

The Second Layer of Financed Induced 'Market Failure'

There is, however, a second layer, a second level, of market failure involving the market in bank credit which emerges when the financial system attempts to respond to the existence of the gap in a more positive or proactive manner instead of doing nothing, i.e., by filling it with additional debt-money. Because of its design as a debt-only system with monopoly control on credit creation exercised by the banks, the financial system can compensate for the lack of endogenous consumer buying power by issuing additional debt-money to governments, businesses, and/or consumers. These loans will, directly or indirectly, augment the level of consumer purchasing power. Naturally, the system only does this on terms which disproportionately benefit the credit monopolists (in whose hands wealth, power, and privilege are centralized) at the expense of the common individual and the wider society as a whole. Thus, while this type of action can alleviate some of the deleterious effects of the first type or layer of market failure, it simultaneously induces or exacerbates other manifestations of market failure and market inefficiencies. In both cases, whether a general policy of austerity or stimulus is being followed, there is a long

train of negative consequences that ensue.

For example, both the gap and the filling of it with debt-money (to the extent it is thus filled) can cause or exacerbate 1) poverty in the midst of plenty, 2) servility in place of freedom, 3) economic instability (including demand-pull inflation and deflation), 4) exponentially and ever-increasing total societal debt, 5) periodic financial crises, 6) cost-push inflation, 7) forced economic growth, 8) economic inefficiency, waste, and sabotage, 9) unnecessary conflict, 10) social problems, 11) mass migration, 12) environmental degradation, 13) international conflict, and 14) the centralization of wealth, power, and privilege in the hands of those who own and operate the financial system.

All of these deleterious consequences of the gap and the attempt to fill it with more and more debt-money (or the failure to fill it fully) can, in turn, be understood and classified in terms of different categories of market failure.

For example, things such as economic instability (sometimes too much debt-money is issued to fill the gap, sometimes too little), cost-push inflation (caused by forever increasing debt-servicing burdens which then result in demands for wage increases and wage-price spiralling), unnecessary conflicts between producers and consumers and between workers (as people fight over an insufficient flow of consumer buying power), social problems (that are caused or exacerbated by artificial financial pressures), environmental degradation (caused by cutting corners to keep prices low because consumers can't afford the environmentally friendly alternatives) might all be regarded as negative externalities. They inflict harm on the whole society to be sure, but these costs are not borne by all equally. Those who benefit the most by the creation of debt-money under the existing system do not pay for these costs in any special way or manner that is proportionate to their benefit, while those who benefit the least from the existing system pay as much or even more (proportionately) in terms of the fallout.

Similarly, the undue centralization of wealth, power, and privilege in the hands of a few who then exercise tremendous social, cultural, and political power (above all), is a direct consequence of the market power afforded to the credit monopolists. Only the banks can, for all intents and purposes, fill the gap under the existing system by issuing additional debt-money to governments, businesses, and/or consumers. This means they can hold the wider economy at ransom, as it were, by only agreeing to alleviate the deficiency on terms which serve their own narrow interests (i.e., they can impose policy) at the expense of the general interest. This has a negative impact on the social welfare, preventing markets from maximizing that *desideratum.* The banking system's monopoly on credit-creation within the context of an accounting system that generates a recurring price-income gap is what gives rise to this specific manifestation of market failure.

Finally, consequences such as: forced economic growth and economic inefficiency, waste, and sabotage arise because the economy is driven by the need to

fill the gap and/or service existing debts rather than to respond first to human needs and demands. This qualifies as an inefficiency in resource allocation which likewise weakens the general societal welfare.

The 3rd Layer of Finance-Induced 'Market Failure'

Now, since the market in bank credit affects every other monetized market (since everyone else's business is dependent on the operation of the banking system), the 1st layer and 2nd layer market failures that arise from the current financial system's faulty design also contaminate all the other markets in existence. In general, we can observe that the lack of credit for production and for consumption artificially limits market outcomes, while the need to fill the gap with more debt-money misdirects economic activity in a thousand and one different ways. As a result of these interferences, the economy cannot, through the mechanism of the market, fire on all cylinders in an effective, efficient, and fair service to the common consumer. This 3rd layer of market failure that is induced by the financial system can manifest itself in very particular ways, causing or exacerbating additional market failures depending on the specific markets in question.

In other words, the financial system, because it is improperly designed, because it is not "fit-for-purpose" (which would require it to reflect or mirror the physical economic facts in the virtual world of monetary figures and to change these figures as the facts change), artificially limits and distorts market operations in all other sectors. When a specific free market fails, to the extent that it fails, to maximize societal welfare, it often does so because (amongst possible other causes) the current financial system is actively interfering with its activity. The structurally dishonest, monopolistic, and dysfunctional financial system is a hitherto unrecognized cause of market failure on a general or macro-economic level, a general market failure that nevertheless admits of many different permutations. Indeed, the institutional market failure which the financial system generates may be regarded as "the mother of all market failures" in the sense that it is the primary factor that is interfering with the operation of the free market and preventing it from maximizing the social welfare in practice as it is supposed to do in theory.

Douglas Social Credit as the Remedy for Financial Market Failure and hence for Financially-Induced Market Failures in Other Sectors.

To correct this situation of market failure in bank credit, and the cascading market failures which stem from it, no form of communism, socialism, social democracy, *dirigisme,* or market socialism is necessary. All that is necessary is for the state to regulate the private financial system sufficiently in line with reality and the natural law in order to ensure that the financial system will function as a structurally honest financial system should. Once the financial system is designed to provide us with accurate information in the virtual world of numbers to correspond to the physical facts of the economy, the invisible hand of the market will be much freer to work its magic. It will then be in a much better position to deliver the kind of results that are

optimal for individuals and for societal as a whole.

This is what Douglas Social Credit proposes to do: let us introduce monetary reform based on reality and natural law in order to free the invisible hand of the artificially limiting and distorting effects of conventional finance. By bringing finance into alignment with reality, the financial system will cease interfering and instead empower the free market to function much more efficiently. This will allow the overall societal welfare to be maximized and the specific market failures which have been identified in connection with the financial system would no longer exist.

Thus, as an economic model, Douglas Social Credit is simply free enterprise plus an honest financial system. [3] It corrects the structural, technical defects in the financial system without curtailing or in any way controlling the freedom and dynamics of market participants. In fact, it serves a facilitative or supportive role where free markets are concerned, supplementing the private sector's credit system when necessary via the issuance of debt-free credit (the National Dividend and Discounts). DSC may thus be described as a partially state-managed credit system in which the state acts only like an umpire or referee. The task of this referee is to ensure that the monetary system remains in balance and in alignment with the productive capacity of the economy, but without overriding in any way the autonomy of the private sector. This type of state intervention in the money market is governed by reality (the facts of the physical economy) and the rule of law and is therefore limited and non-intrusive. Instead, it is a market-enhancing state stewardship, just as a refereeing is a game-enhancing stewardship.

More concretely, what does DSC as a reality-based monetary reform involve? Well, there is the need for a National Monetary Policy which would have to be imposed on the private banking system. The institution that would administer this policy could be designated as a National Credit Office or a National Credit Commission. This entity would be tasked with drawing up a National Set of Books, a National Balance Sheet, and a National Profit & Loss Account. The purpose of the National Balance Sheet is to establish a physical foundation (the nation's net worth) to justify the creation of additional producer credit up to the level that is required to actualize the whole of the nation's useful productive capacity.

Similarly, the purpose of the National Profit & Loss account is to measure the size of the price-income gap in any given economic period. Once the gap – which can also be conceptualized as the nation's profit – has been measured (remunerative prices of goods and services produced minus incomes distributed), the gap can be monetized *via* the creation of a sufficient flow of debt-free credit and distributed to or on behalf of consumers so as to balance the financial system in a self-liquidating equilibrium. The dividend would provide every citizen with a share of the national wealth or productivity, ensuring an income independently of employment status that would help to close the price-income gap directly on the consumers' end. The discount mechanism would lower prices at the point of sale, reflecting the real

cost of production, rather than the artificially inflated prices that arise from the financial system's failure to reflect physical reality. The steady injection of debt-free compensatory consumer credits would correct the price-income imbalance without the negative effects of debt, thus removing artificial limits on consumption without imposing debt-based trade-offs.

By ensuring that the financial system enables all useful production to be catalyzed and the flow of real wealth to be automatically fully distributable and all costs of production to be covered without necessitating any further increase in debt, the Douglas Social Credit monetary reform transforms a dishonest financial system into an honest system. It thereby neutralizes: a) the first layer in finance-induced market failure: the artificial scarcity of bank credit for production and consumption, b) the second layer in finance-induced market failure: the attempt to compensate for these scarcities via the provision of additional debt-money (which compounds the problem by misdirecting economic activity and impeding stable functioning in a thousand and one ways), and c) the third layer in finance-induced market failure: the interference of dysfunctional finance in the market operations of every other sector of the economy. Far from acting as an obstacle, an honest financial system would act as a good servant that actively assists the free market in delivering the maximization of societal welfare as the inadvertent consequence of its normal activity. ***

References:

[1] Economic failure should be defined as the failure to deliver the goods and services people need to survive and flourish with the least amount of labour and resource consumption to the extent that this ideal is physically realizable.

[2] On this point, Arindam Basu has shared with me the following important critical remarks with respect to neo-classical theory and its concepts of markets and market failure in private correspondence: "I consider the term 'market failure' to be a misleading euphemism for serious economic dysfunction - especially since by adopting the term, one is essentially assuming that if 'markets' (the term market has half-a-dozen definitions incidentally) didn't 'fail', all would be well. Of course, historically, the emergence of central planning (first by corporations, then by governments) was not because 'markets failed', but because the market mechanism was too slow, cumbersome and inefficient to meet the needs of a complex industrial economy. Alfred Chandler's *The Visible Hand* is the classic on this subject. William Lazonick's *Business Enterprise* and the *Myth of the Market Economy* and J. K. Galbraith's *The New Industrial State* are also most instructive on this point."

[3] Free enterprise is not to be confused with laissez-faire capitalism. They are closely related but not identical concepts. Free enterprise generally refers to an economic system where private individuals or businesses, rather than the state, own the means of production and are free to compete with minimal government intervention. Laissez-faire, by contrast, is a more extreme version of this idea, advocating for virtually no government interference in the market at all, including no regulations, subsidies, or taxes beyond what is necessary for maintaining basic functions like defence and law enforcement, etc. While both systems promote economic freedom, free enterprise can still accommodate some level of government involvement for public goods, safety, market failures, or maintaining/promoting fair and genuinely free market conditions, whereas laissez-faire strictly opposes any such interventions. As Arindam Basu has put in recent private correspondence: "free enterprise means that enterprises are at liberty to wholeheartedly serve the customer - free of interference by third parties, be they governments, other enterprises, or even shareholders. (We conventionally assume that shareholders will not hinder their firms from serving customers - but this is not always the case)."

Vale Doug Holmes

Doug and wife Jean Holmes first made contact with ALOR in the mid 80's through the Adelaide Conservative Speakers Club and Heritage Bookshop.

They both quickly became close friends with Betty Luks, (former ALOR National Director). The three became almost inseparable with their support and involvement in ALOR activities, many National Weekend trips interstate, several trips to Inverell, NSW to attend the Inverell Forum.

Doug and Jean would regularly take a fortnightly day-trip to spend with Betty Luks, and then dropping in to the nearby Head Office for an afternoon cup of tea.

Doug, with Jean's continuous support, went on to become the Heritage Bookshop Manager, Conservative Speakers Club Convener, and ALOR SA State Director.

Doug and Jean, with Betty twice went to Victoria to place the ED Butler Library into safe storage for transportation across to its new home in Adelaide.

Doug traveled (accompanied by Louis Cook) to Toowoomba, Queensland to rescue another Bookshop back to Adelaide. Eventually the Adelaide Heritage Bookshop was integrated into the online Veritas Books.

In his later days Doug handled all the online DVD orders.

Doug reliably performed his civic duty across many, many years.

Well done thou good and faithful servant. ***

BASIC FUND

The Basic Fund for this financial years is open. I am making a special call to all those who have planned to make a donation but maybe have over-looked doing so. The fund did not fill this past year so it will be wonderful if we can make a special effort with new donations. As always, we appreciate your contributions no matter how large or small. Each donation is really a vote of thanks for the work of the League and acknowledgment of the dedicated effort of those in the 'engine room'.

EXPANSION FUND

There are plans afoot to considerably expand the number of League Speakers going into the field. They will require logistical and some financial support in advance, ready to respond to events as they occur. These forces of freedom offer leadership to a misguided public looking to restore their ancient rights and freedoms.

BEQUESTS

Apart from the Basic Fund, the League is also a recipient of bequests from supporters who remember us in their Will. These dollars are the backstop and while we are grateful, it is unfortunate that on those occasions we are unable to personally express our thanks. Best details for establishing a bequest are available from HO.

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