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THE INVESTMENT OF SURPLUS REVENUE AND THE SAVINGS BANKS FUNDS.

IN a previous article¹ dealing with the difficulties which have arisen in connection with the investment of the Savings Banks Funds and the reduction of the National Debt, I endeavoured to show that the time had come for the Government to purchase home stocks, other than their own, in order to maintain the latter at a reasonable price and so avoid the waste at present incurred in redeeming debt. There is, however, little benefit to be derived from the discussion of a principle of action if its practicability cannot be demonstrated. I shall endeavour accordingly, assuming such a Board of Investment as is referred to in the previous essay to be actually constituted, to discover the nature of the task set before it, the difficulties that would arise, and the best means of grappling with them. It will then be possible to go more fully into the wider financial aspect of the problem than could be done previously to a definite statement of the exact methods to be employed in dealing with it.

The chief impediments to the production of a satisfactory working plan are due to the existence of so immense a variety of choice of investments and the danger of admitting, if not actual corrupt practices, at least the suspicion of such into our financial system. There is a close connection between these two matters. For, if no limit is to be placed to the number of objects to be chosen from, then, since those persons on whom the task of selection devolves could not possibly know the merits of more than a small fraction of the competing stocks, and even in regard to this limited number would have no guiding principle by means of which to make comparisons, no satisfactory reason could be given for any particular choice. The assurance that each decision was made solely from considerations of the public good would be

¹ *ECONOMIC JOURNAL*, September, 1896.

wanting. No man of integrity who united therewith the necessary degree of intelligence would be anxious to join a board occupying so invidious a position. A body possessing an unlimited power of dealing in stocks and shares must eventually include amongst its members some in whom the predatory instinct is uppermost, for where the carrion is thither will the vultures flock. It would appear to follow, therefore, that, before any feasible scheme for eliminating the danger of corruption can be applied, it will be necessary to reduce the field of selection of investments to manageable proportions. It is proposed accordingly to make a primary selection of a class of stocks which, whilst of sufficient extent to allow large transactions to be carried on without prices being materially affected, will yet possess the homogeneity necessary to permit of an easy comparison between the individual stocks composing it. This means, practically, that a decision must be made between investing in corporation stocks and purchasing railway shares.

If a sufficient field can be found without having recourse to corporation loans, the encouragement to borrow which would follow from an increased competition to supply their wants should not be held out to municipalities. As it is, they are already too prone to meet their expenses by means of loans. This phase of finance is only in its infancy as yet ; and the great fascination of borrowing has ever lain in the smooth way it provides at the beginning of the journey. That this smoothness is only to be procured by depositing the obstacles in a cumulative fashion further along the route is so obvious a truth, when applied to individual borrowing, that its statement seems superfluous. But when for individuals we substitute corporations or states, and instead of hundreds of pounds millions are in question, the popular notion appears to be that the familiar maxims of experience no longer apply, and that we then enter on the domain of an occult science. Now, the only knowledge we can have of large masses of men and of the conditions affecting their material prosperity must be obtained by inference from the information we possess of the limited number that actually come within our ken. We are able to postulate the general conditions in this smaller sphere under which borrowing will be attended with good or evil to the borrower. We may observe an individual or a business firm borrowing extensively, without present inconvenience and with apparently good results, and still be in entire ignorance of the probability of a successful or a disastrous issue. When, however, we have knowledge of the main principles governing the borrow-

ing, we are in a better position to forecast the ultimate results; because we can always carry the mind back to the history of similar cases that have run their full course. But as regards municipal loans, we have not yet had sufficient experience of the system to form a safe judgment as to what its results will be in the long run.

Expenditure is provided for by these means for purposes which are not only strongly objected to by a minority at present, but may be altogether contrary to the desires of a majority of future rate-payers, to whom part of the burden is being transferred without the possibility of their being consulted. Even then it might be justified if the intention were in all cases to exact a fair price for benefits conveyed to the future. But it is not in human nature for the seller to refrain from endeavouring to obtain the best of a bargain where he makes his own price, acceptance of which is compulsory on the part of the buyer. There is not only the general tendency of any body of ratepayers to shirk present payment; but there is also the desire of the sect holding power for the time being to gain as much credit as possible for work performed, whilst leaving the expense as a future burden to be distributed on an average equally between itself and its rival. This is the main cause of unnecessary resort to loans, and we are not without the means of estimating its future power for evil. For from the self-same root springs the reluctance to liquidate liabilities already incurred; and the history of our National Debt during times of peace furnishes a remarkable object-lesson of the strength of this sentiment. It should also be borne in mind that Acts of Parliament establishing compulsory sinking funds are somewhat delusive checks to the increase of municipal debts, so long as they do not prevent the raising of progressively larger loans; and this they cannot do.

Apart from the danger of increasing debt generally, it is too readily assumed, by those who support this method of municipal finance, that the present rate of industrial progress will be maintained in the future, and that there will be no great dislocations of trade and prosperity, such as have so frequently occurred in past times and such as are not unlikely to be occasioned in the future by the increased cost of living in towns which have overborrowed.

Attention is not drawn to these considerations from any desire to disparage such stocks, but in order to show that a participation by the Government in lending to corporations might be harmful rather than beneficial to the community. It is the

more important that these points should be carefully considered in that the evils, from their nature, would not become manifest perhaps for many years, and it would then have become exceedingly difficult to retrace our steps. The local debt of the country forms a more threatening phenomenon than does the imperial; and it is open to grave doubt whether a convenience gained in dealing with the latter can justify encouragement of the former.

Railways, on the other hand, besides being free from any of the above objections, possess many advantages which we should look for in vain in any other class of stocks. The enormous amount of capital they represent, the extent to which they are already interfered with by Parliament, their quasi-national character and the desirability of having the public interests represented on their boards, point them out as the fittest undertakings for our purpose. The question whether the Government should purchase and control the railway system of the country has been much debated in times past. The principal objects which those who have argued for their purchase have had in view would be attained were the Government to become an important shareholder; whilst the objection, fatal in the absence of extreme urgency, of making so heavy an addition to the functions of Government as the control of the railways would entail, would be obviated. But let it be understood that there is no intention of ultimately purchasing the railways right out, or even of acquiring a majority of votes in their management. That is an altogether different matter, in regard to which the prudent course would appear to be to await the result of the numerous experiments of the kind at present in progress in other countries—experiments, the results of which have so far been far from encouraging.

There is a prevalent opinion that the money of the Savings Bank depositor is safer when invested as at present than it would be were the Government to use it in the purchase of any other securities. It is, indeed, true that for individuals or private bodies no better security than consols can be obtained. The reason is, however, that their money is lent to Government; and this is the only reason. Practically they hold a mortgage on the taxation of the country; and their position remains unchanged, no matter to what purpose the money is devoted by the Government, so long as the credit of the latter is not endangered. There would appear to be a sort of magic to many minds in the word "consols." But what does their possession mean? Simply that the holder's name is inscribed in the books of the Bank of

England as creditor for a certain sum in respect of an advance made to the Government ; and beyond this he does not look and does not require to look. The sum may represent part of what has been destroyed by war, or it may be considered as a portion of the Suez Canal. This does not concern the lender ; and neither would it concern him if it represented part of our railway system.

It cannot be too clearly pointed out that a board appointed by, and empowered to pledge the credit of, the Government occupies an essentially different position from that of ordinary trustees. The latter are placed under certain limitations by the Trust Investment Act ; an Act which assumes that the trustee's personal security is not to be relied upon, and accordingly points out the various stocks in which trust money must be invested. In the case before us, however, the security lies in the trustees, that is to say, the nation ; and this circumstance of itself constitutes a higher form of guarantee than any restrictions as to the manner of dealing with trust funds can furnish. Given, then, the promise of the Government to repay in full, it may be left to a great extent free to choose its own methods of laying out the money lent to the best possible advantage. The sole interest of the savings bank depositor would then be to see that the Government did not act in the matter so as to endanger its power of prompt repayment ; and this is a contingency so remote that we may consider the depositor, as such, entirely unaffected by the proposition.

The more general interest in the soundness and profitability of the investments would not extend to each individual act of the board, but only to the probable and actual outcome of its policy in its entirety. There would, accordingly, appear to be no valid objection to investing in any particular variety of railway shares ; and less disturbance of the market would be involved if " Ordinary " stocks were taken up in their due proportion. We are not under the obligation to avoid occasional losses against which an at least equally probable series of gains may be set, when we have so strong a presumption, from a long experience, that the railways as a whole form a safe and profitable investment. The investments should as far as possible represent an actual share of the railways if the scheme is to work without friction ; and difficulties must inevitably arise if, by Government action, stocks having certain preferential conditions attaching to them are unduly raised in price. Whilst the effect of investments covering every variety of railway stock could, from the greater simplicity of action involved, be approximately gauged, it would be impossible

to estimate the results of acting on a section only. In particular, an element of confusion would be thereby introduced into the problem of fixing the terms under which fresh capital should be sought by a company. On the score of safety, the wider field secured and the higher average rate of interest would compensate for the absence of exceptional guarantees on a portion of the purchases.

However desirable it may be that we should take the railway system as a definite entity, it is obvious that a certain amount of weeding is absolutely necessary. There is no reason why Government should participate in the results of foolish and extravagant ventures and faulty management. Certain conditions must be fulfilled before the stock of a company can be considered an eligible object of investment. It must have paid a regular dividend over a sufficiently long period to justify confidence in its future profitability; and it must represent a sufficiently large capital to allow of purchases being made on such a scale as will make investment worth the trouble entailed. For example, it might be decided that the stocks of such companies only should be utilised as had a total paid-up capital of five millions and upwards at a date ten years back, and had in the interim paid a dividend at least once a year on their ordinary shares.

In whatever degree the effect might follow of raising the prices of the stocks of the larger systems, the displacement of purchases occasioned thereby would find an outlet in the funds of the lesser companies; and this would tend to produce an equilibrium. In like manner other industrial enterprises would not suffer; but a fresh level for all would be found, differing only from the previous level, since there is no creation of fresh capital but a transference only, in that consols would fall to their real value and other funds be slightly appreciated.

Having fixed the limits of our sphere of action we come to the question of selection. It would appear, however, that this problem is dealt with by the money market in a manner and with a certainty that no individual or body of persons can equal, much less improve upon. If a £10 share in one concern is quoted in the market at £18, and a £10 share in another is quoted at £9, although the former is the superior stock, the meaning of the price is that by paying £18 for one and £9 for the other the investments are made equally good, provided the concerns are of like character. It would not follow that what are considered steady businesses can be compared in this way with speculative

undertakings. But, in the case of long-established railway companies differing in no material circumstances, the value of their shares will be fixed by a keen and active market following the purchases and sales of those who are supposed to be in the best position to know and to be well able to judge the prospects of profit; and, to those who are not in a position to watch the movements closely, there can be no question of superiority as investments once the prices are so fixed. Besides being superfluous, it would be an impossibility for the board to make the necessary investigations, in regard to any considerable number of stocks, to justify them in deciding, in spite of the prices agreed upon by the market, that such and such stocks would prove better investments than certain others. Consequently, the best plan would be to make no distinction in this respect between the various companies, nor yet between the various classes of stock of any particular company. And, in order that the play of forces in the market may remain undisturbed, the investments should be made in exact proportion to the share of each company in a total of the paid-up capital of the eligible systems. For instance, it might be made compulsory on the part of the board to deal with each £100,000 to be invested, according to the following suggestions, viz. :—

(1) The railway companies to be divided into two classes according as they represent more or less than a given amount of capital.

(2) An amount in strict proportion to its share of the total capital to be carried to each class.

(3) The sum devoted to a class to be divided amongst the companies composing it on the same proportional system; and

(4) Each company's share to be distributed in like manner between the various kinds of stock of which its capital is made up.

At the end of each financial year a statement of the purchases made might be published and an estimate of the proposed rate of investment for the ensuing year furnished. The publicity of the transactions, the forewarning of investors of their probable extent, and the automatic character of the operations would leave little room for genuine complaint. Prices would be affected at the outset only, and that as the result of a necessary effort to remedy the position of Government stocks.

In order to counteract any excessive rise in the price of any class of shares involved, whether as a direct result of Government purchases or through the action of speculators, and to avoid loss

arising therefrom, an actuarial estimate would be requisite showing the price in each case, as compared with a tabulated set of prices of consols, at which the difference of profit in favour of any particular stock might not be considered sufficient to make further investment advisable. Any funds apportioned to such a stock would then be redistributed amongst the remaining railway stocks when consols were much above par, and, in the alternative case, would be applied to the purchase of consols, either for cancellation or for the savings banks funds as the circumstances required. Since the values of shares on which the dividends fluctuate are affected by time, such an estimate would require annual revision; and, as the respective capitals of the railway companies are also variable quantities, a fresh statement of the proportion of investment would likewise be required annually, including therein such further companies as had qualified in the meantime, and excluding such as had failed to maintain the necessary status.

Whilst railway stocks lend themselves to the easy classification necessary to make an automatic system practicable, corporation stocks, on the other hand, do not exhibit sufficiently strong and permanent lines of demarcation to permit of the adoption of similar treatment. Furthermore, a constant succession of fresh loans is raised by local bodies, and the instability is increased by the action of sinking funds. Adding these practical difficulties to the economic objections that have been adduced, there can be little hesitation in giving judgment in favour of railways.

It must be admitted that, at the outset, the effect of Government purchases would be to raise the prices of railway shares. Part of this appreciation would be due to the actual investments and part to the moral effect of the change of policy. The latter factor might cause a sharp rise at first, but would ultimately resolve itself into nothing more harmful than is already to be found in the mention of particular securities in the list of the Trust Investment Act. Any objection on the ground that some sort of guarantee would be given to railway stocks may, I think, be met with a reference to the fact that the above-mentioned Act already goes much further in this direction, since it actually specifies certain stocks as being trustworthy; whilst the present scheme only asserts the safety of railway investment when spread equally over the entire system, and gives no ground of opinion whatever for regarding any particular stock as being secure. Any material increase caused by the actual purchases must in the long run be dissipated, as has been already shown, as the wave

of disturbance widens throughout the general range of investments. Prices could never through Government action reach the same level in the market as consols; since such action would cease as soon as a certain fixed margin of profit is touched. Nor could they be appreciated to any serious extent. For, in whatever way the action, or the expectation of action, of the Government could force up the prices of railway shares there must be a corresponding downward pressure on consols. As the former rise towards the limit of profitable investment, this limit is itself falling; and not solely from this cause. It will also have been deprived of the support furnished by the idea that the Government must perforce continue to purchase consols so long as there are any in existence.

In the endeavour to pay off its debt and in investing the savings banks funds, the Government is obliged to enter into competition with the market. In so doing its action differs from that of the general body of buyers and sellers in that it purchases its own stocks, that those stocks are of great value to the commercial world from the peculiar functions they perform, and that, its policy of continuing to purchase until the National Debt is entirely cancelled being well-known, the possessors of consols can, if they choose, hold out for exorbitant terms. To escape from so manifestly unfair a position it becomes necessary for the Government to cease to cancel debt, and to employ in the purchase of other stocks such funds as are not required to meet its necessary expenses. However undesirable such action may appear to competing investors, it is purely defensive in character. The Government is seriously hampered in paying off its debt by the rivalry of the general investor, and it is forced to carry the war, so to speak, into the territory of the latter the better to defend its own. A disturbance of the equilibrium of the money market is not a thing to be wantonly produced; but the price of Government stocks has been forced up to a false level, and the pressure cannot be relieved without distributing it elsewhere.

Such a dislocation would as surely take place were a policy of rapidly reducing the debt to be entered upon and consols cancelled in large quantities, and would be held to be perfectly justifiable. The crux of the problem lies not in this initial disturbance but in the question of non-interference thereafter with the functions of the market. Once the general direction and strength of Government purchases become clear and a fresh equilibrium is attained, the relative prices, if they are to be at all accurately fixed, must be determined as before by business men;

and this would be impossible if power were given to a particular body to select first one stock and then another on its own collective judgment when dealing with investments on the large scale that would be necessary for our purpose. It would be an undeniable grievance to an insurance company, let us say, which had instructed its broker to buy Birmingham $3\frac{1}{2}$ per cents. to find that they had risen several pounds in a day through a large Government purchase. Such purchases would be suspected in every case of an unexpected inflation of price, and the introduction of so important a fresh element of uncertainty would give rise to much discontent. The perfect ideal of a stock market requires that the value of each separate concern which solicits capital shall be determined, with reference to the current rates of profit in business generally, by the competition of experts, in order that an as nearly as possible exact knowledge may be obtained of the comparative values of different investments. The prices quoted in such a market thus become a source of trustworthy information to the general investor, by means of which, with an average amount of care and judgment, he will be able to transfer his capital with safety from one object to another without the expense and delay of making a thorough personal investigation (often an impossibility) into the financial soundness of the exchange. Laying aside the moral and intellectual shortcomings and the physical difficulties which prevent the full attainment of this ideal, it can only be even approximately reached when the operators are acting for their own personal interests and when no overbalancing power is wielded by a few hands. But both of these disturbing factors are introduced when Government purchases largely on its own judgment.

There remains to be considered the manner in which the credit of the country would be affected by the proposed change. Although few will be found to deny that the present high price of consols places us at a disadvantage so far as redemption of debt is concerned, an impression exists that were this country to become engaged in a serious war, a corresponding advantage would be ours, since we should then become borrowers. This would be true were the high price occasioned solely by considerations of credit. As a matter of fact consols are at a false price; and, on the outbreak of war, the pressure which had raised them—the Government policy of purchasing—would be withdrawn. A fall would thereby be occasioned to what I shall call the real credit level; and it would be from this point, as though consols had never been higher, that the war depression would act. These

causes acting simultaneously, the first sudden drop would be much greater than need be and the subsequent panic intensified accordingly.

In order to compare the two policies, let us assume that a certain period of time has elapsed sufficient to accomplish the objects of the scheme here detailed; that is to say, that we have arrived at a point where the Government holdings constitute a considerable proportion of the railway stocks, consols are at or about par, and transactions are taking place in a normal fashion. This is the stage at which the question of credit would be most thoroughly tested and the faults or merits of the policy be most easily demonstrable. And at this stage let us further assume that war, the sole eventuality for which a high governmental credit is requisite, breaks out. Since, instead of paying off debt on exorbitant terms, the money which would otherwise have been devoted to that purpose has been invested at its full market value, it follows that the net liabilities of the nation must have become considerably less than they would under the present policy. This result is independent of the assumption that the scheme would permit of a continued, although slower reduction of debt on better terms. So far as net indebtedness is concerned then, we are in a better position to incur further burdens and will consequently obtain a correspondingly greater loan on given terms. Let us now deduct the net liabilities from both systems. We have then to consider the effect on national credit of the retention of a portion of debt, combined with the possession of as much railway stock as the money necessary to accomplish the redemption of this debt has been able to purchase. Apart from the minor fluctuations of the market, which are as likely to be favourable as unfavourable, the force which has been applied to purchases of railway stocks can still be translated by their sale into a power of raising a war fund, just as though it had been used in redemption of debt. The fall that must ensue in the price of railway stocks, offered by the Government for sale or as collateral security, would be produced by the same causes, neither stronger nor weaker, as would, under the alternative policy of a lower debt and no assets, make the terms of a loan onerous. The extent and urgency of the Government wants and the caution engendered in the minds of the lending class by the prospective financial dangers of the war would be the factors at work in either case; and on their strength the issue would depend, whether the force upon which they operated were exhibited in an absence of debt or the possession of tangible assets. So

much of the force of debt redemption, which is implied in a surplus revenue, as has not been actually wasted will give a power of borrowing that remains unchanged in strength in whatever form it is embodied. Criticism of methods of dealing with such surpluses in relation to the question of national credit, to be valid, must, accordingly, confine itself to an examination into their efficacy in preventing leakage—an examination which must result in the condemnation of the system at present pursued.

A leading feature of our times is the great struggle that is being carried on amongst the nations for commercial supremacy. Now, although we do not in this contest depend like our chief rivals on a system of customs charges and subsidies, it is a very narrow view that shuts out the important part political action has taken in the advancement of our foreign trade. It would, indeed, be difficult to point out a beneficial Act of Parliament, of any great importance, in which the tendency to promote commercial efficiency could not be traced; and this is true in an especial degree in regard to enactments concerning money matters. The excellence of our financial system, by economising the national wealth producing power, leaves a greater proportion of energy free for purposes of foreign trade than is the case with any of our competitors. To maintain this high standard, however, we must be prepared to make amendments whenever they are called for by altered circumstances. Under such conditions an obstinate clinging to use and wont is not conservatism, it is simply drifting; and in the present case means a considerable lessening of the advantage we now hold. For the injurious effects on our finances are not to be judged solely by considering how much of the money devoted to the reduction of debt is spent unnecessarily. The whole system is liable to be affected, as the following considerations will show.

Increased expenditure which entails the levying of fresh taxes has always to reckon on a formidable opposition and criticism; but, when the revenue is in excess, it is comparatively easy to resist the clamour for remission of taxes. Moreover, if a useful purpose can be found for the surplus, to remit a tax is to throw away a provision against the future and to narrow the basis of revenue. Formerly such a surplus could always be profitably employed in reducing debt; but now, in the minds of both those who have the spending of the money and those whose function it is to criticise expenditure, there is the ever-present idea that this outlet is wasteful. The consequences are that there is less reluctance to engage in new projects of expenditure and that the

voice of criticism falters because it has no alternative advice to utter. Extravagance under such circumstances must of necessity follow; making itself felt, not only in the amount of money spent, but likewise in a less careful scrutiny of the return value.

It is customary to blame a ministry for all the financial aberrations originating during its term of office. This condemnation is seldom just. A democratic nation, having imperfectly ascertained and agreed to the line along which its leaders desire to advance, possesses the power, and invariably avails itself thereof, to drive them further than they would willingly have led. It then censures them for bad leadership, and, having chosen fresh guides, attempts once more to strike the proper route. Thus, instead of moving along a straight line, we have a zigzag motion intersecting the straight from the right and from the left alternately; and the most that statesmanship can do is to maintain the general direction and reduce as much as possible the limits of deviation. Let us take as an example the revolution in public finance accomplished mainly by the great statesman who has lately passed from us. A long series of reforms was carried out and an improved revenue system firmly established, admirable alike for its simplicity, its justness, and its efficacy in extracting the greatest possible sum at the least injury to the taxpayer. Averse as the general mind is to the study of such subjects, it is highly improbable that the enthusiasm requisite to carry out these projects would have been evoked by the consideration of their permanent results solely. But a subsidiary effect of these reforms, proper only to the transitional period, captivated the public imagination. This was the astonishing succession of surpluses that arose from the impossibility of accurately forecasting the immediate effect of the changes. A cult of surplus-worship took possession of the people; and the parsimonious policy which ensued, by refusing to pay a fair price for national defence, eventually led the country into grave danger. It is obvious that, once the people had become imbued with this fallacy of surpluses, it was quite beyond the power of the Government to restrain them; and the point to be noted is this powerlessness of even the greatest genius to avert the evil consequences of a departure in either way from that first maxim of finance—To give value for value and nothing for nothing.

On the other hand, we are now experiencing the natural revulsion from extreme retrenchment, and the equally dangerous fallacy, that economy must be thrown aside in order to secure

efficiency, is rapidly becoming too strong to be checked. There is a general call upon the nation's purse, and hence it is particularly necessary that the above maxim should be kept in view. In order to avoid any question of the desirability of the object of expenditure let us select by way of illustration one of the most reasonable of these demands, viz: the cry for a stronger Navy. Its realisation is not made a whit more easily attainable by thrusting economy aside. Recent events have conclusively shown that the naval power of a nation is not to be reckoned according to the amount of money spent upon it,—not even in the number and quality of its ships. The factor, whose absence renders such calculations nugatory, is one which cannot be stated in precise numerical terms; it is the degree in which the country approaches a sound economy in its general expenditure. It is impossible to isolate the various branches of a nation's expense, so that extravagant methods may be pursued in some whilst a correct system is maintained in the rest. Lavishness may, and generally does, prevail in some departments whilst others are starved; but healthy conditions must exist universally or not at all. If this be so, a question which will be dealt with presently, a state which does not adhere closely to the strict principle of value for value will devote too great or too small a sum to a given object. In the detailed application of the money the same laxity will be exhibited. It will be apportioned unequally; and, as there will always be an effort to provide fully whatever is easily visible, all that is wasted must be balanced by the omission or incompleteness of hidden but equally essential items. The final results are altogether untrustworthy.

There is an erroneous idea current that such consequences must be due to an under-estimate in the first place of the money required, and can be averted by an increased expenditure. In reality, they follow as certainly however much the money supplied is in excess of the requirements. The starvation of individual items would still be possible and would only cease if the entire personnel concerned were imbued with the above stated maxim—a condition, however, which is in direct contradiction to the supposition of a faulty estimate of either description. The mischief already accomplished is not in its nature remediable by subsequent additional outlay; nor is it mitigated, but exaggerated, when this supplementary charge is anticipated and included in the original estimate.

To show that the assumption on which the above argument is based is justifiable, it becomes necessary to inquire into the

effects of Government finance on the character of the people generally, observing that whatever conclusions we may arrive at apply in a stronger measure to State employees.

As the Government is naturally expected to be an example of wisdom and probity in all its actions, every payment it makes has an influence, great or small, on the financial spirit of the times. It is not necessary that this influence should be exerted directly on every individual in order to produce its full effects. It is sufficient if it modifies, consciously or unconsciously, the manner of thinking of that section who understand and note its action. They will in turn affect those with whom they come in contact ; and, in this way, no part of the commercial community is untouched.

Nor can the line be drawn at commerce, for every department of social ethics is susceptible to a like modification. That the social mind is eminently sensible to financial influences can be clearly seen if we regard the interchange of duties between social units as receipts and expenditure on the part of each. In so doing, we are not merely drawing an analogy, for, whilst the subject is the same, the objects differ only in that, whereas in one case we have to deal with things capable of accurate measurement, in the other exactitude is unattainable. But the ethical process is identical, and the mind follows the same reasoning bias in the one as in the other ; just or unjust, careful or careless, in both cases alike. With healthy surroundings the healthy mind will be prompted to give a liberal return, whether in actual exchange of industry and wealth or in social and public activities, for benefits received, and will be content if the other side of the account is fairly just.

If this same mind is thrown into the midst of a corrupt society, the result is not necessarily to share in the corruption, but to give a greater and greater proportion of energy to the income to the neglect of the expenditure side of the account. Hence, without going so far as to hold that man for man the citizens of such a state are not morally inferior to the inhabitants of our own islands, it may be pointed out that the existence of extensive corruption in certain countries does not warrant the common opinion that the inhabitants are radically incapable of reaching to our standard of public morality. Nor is there any sound basis for the equally popular notion that we must undergo a long course of racial degeneration before corruption can obtain a firm foothold in our midst.

These ideas are formed by looking solely at the grosser

manifestations of the disease. In reality the loss to a state through actual dishonesty in the governing class is insignificant when compared to the more general and constant, though less obvious, action of the malady ; which may be described as the exclusive attention, of each individual to his own profit, grasping all he cannot be prevented from taking, and paying only what the law compels. When such is the general condition of a society, can we wonder that the magistrate fails to administer justice amongst an unjust people ; that the politician aims no higher than his own and his friends' aggrandisement ; that the capitalist grinds down his employees who in turn scamp their work ; and that the soldier, furnished with power to defend his brother citizens against their enemies, and finding not brothers behind him but a struggling horde as ready to jostle him as one another, turns round and crushes all ? And, seeing what the ultimate results of financial looseness are, can we attach too much importance to the discontinuance of a system under which it takes £112 to pay off each £100 of debt ?

How closely the general condition of the people is bound up with the question of public finance can be judged by a comparison with any of the more civilised nations. It will be found that, due allowance being made for natural advantages, the higher the place a nation occupies in respect of general well-being the better are its finances administered ; that is to say, the closer it follows the principle of wasting nothing. It will further be found that the improvement or deterioration in financial policy is antecedent to or contemporary with the corresponding social change, but never subsequent. Italy and Germany form strikingly contrasted examples of the truth of this law. In the one case the people have been taxed to the last penny—nothing that could be squeezed out of the nation has been spared in the endeavour to maintain the dignity of a Great Power. And yet, unharmed by enemies, it has brought about its own collapse. On the other hand we have a people, spending only when convinced that a distinct advantage is to be gained, attaining the highest position as a military power and yearly becoming more formidable in their commercial rivalry with this country, and that despite their disadvantages in regard to mineral wealth, sea-board, and immunity from foreign menace. Could anything show more clearly than do these two examples the paramount necessity for good reason to be shown for every act of public expenditure, and how fraught with danger is the policy that attempts to

counterbalance such an omission by increasing the total outlay?

To recapitulate :—A sound system of finance connotes soundness in respect of every item of expense. For, if the strict rule is violated in respect of any one item, a like course will be pursued with any other so soon as expediency suggests it. Since it is natural to avoid unnecessary trouble, the standard of all transactions will be set by whatever approved example satisfies the fewest and most easily fulfilled conditions. The financial tone of the governing powers is consequently lowered ; and their laxity is multiplied throughout the whole range of administrative officials. The efficiency of the public service depends entirely upon the strength of the sentiment that urges towards a full return for value received. The same principle is the foundation of commercial morality, and, though the fact is somewhat disguised, is the guiding rule of all social intercourse. Consequently, the pernicious effects of the violation of this principle are not confined to the loss of a million or two annually through the operations of reducing the national debt and investing the money of the savings banks depositors.

One of the great impediments to progress in financial method is the impossibility of fully tracing the effects of error except in very rare and very gross cases. No matter how serious may be the blunders which a financier is driven to commit, there comes a time when his supporters are able to turn upon his critics and confidently demand to be shown the evils the latter have prophesied. Yet it will be seen from the above that incalculable mischief may have been done without its being possible to lay one's finger upon any particular result, whose direct connection with the original cause can be demonstrated. This is owing to the great complexity of social life and also because, in order to reach the worst effects, we must pierce the medium of a metaphysical stratum, in passing through which the causal line that we are following becomes blended with others and its individuality is lost. But on this very account its action becomes more widespread and irresistible. Bad finance is capable of making its influence felt in almost every phase of human life ; whilst its agency is generally unrecognisable. This knowledge of its insidious character strengthens the already sufficient reasons for combating it on every occasion where its existence can be detected. But, when it can be shown that it is part of our permanent policy, in dealing with a considerable proportion of

the money entrusted to Government, to disregard the first principles of sound finance; then, though it may appear to be sounding too alarmist a note to suggest the fate of Italy or Spain as likely to become our own, it must be admitted that we have no means of resisting pressure in that direction until we revert to the common-sense system of giving measure for measure.

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