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THE POLITICAL ECONOMY OF WAR

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THE POLITICAL ECONOMY OF WAR

BY

F. W. HIRST



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PREFACE TO THE FIRST AND SECOND EDITIONS

So far as I have been able to learn by personal investigation and by inquiry there is in existence no formal treatise on the Political Economy of War. This book is an attempt to fill the gap. The welcome it has received is indicated by friendly criticisms from all parts of the world and by the rapid exhaustion of the first edition. For valuable assistance and criticisms I have to thank several friends, among whom I would especially name Mr. G. P. Gooch, Mr. H. M. Williams, Mr. C. P. Sanger, Mr. J. E. Allen, Professor Edgeworth, Dr. Cannan, and my sister Miss M. E. Hirst. The second edition contains not only many corrections, additions, and modifications, but one entirely new chapter on the debts of the Balkan states and Turkey. The chapters on war debts and on the finance of the present war have been entirely revised. They contain, I believe, information not generally available, which will be of value to the City and to investors generally, as well as to those politicians and journalists who have not wholly abandoned interest in public finance.

F. W. H.

LONDON, *June*, 1916.

INTRODUCTION

ECONOMY, a Greek word signifying the management of a house—including, in those days, as Xenophon's curious treatise reminds us, the management of a wife—might be represented in English by combining our two words husbandry and housewifery. As the management of a household is an art requiring skill, the word economy has come to imply thrift, or at least a judicious and unwasteful expenditure of money. But, with the prefix "political," economy regains its original meaning, which is transferred by virtue of the adjective from the family to the larger unit of the state. Thus political economy is described in one of our earliest treatises [1] as being the domestic concern of a statesman whose business, like that of a good householder, is to supply and regulate the wants of those over whom he rules whether by elective or hereditary right. Nine years later, in the *Wealth of Nations*, Adam Smith gave a more objective definition: "Political economy, considered as a branch of the science of a statesman or legislator, proposes two distinct objects; first to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly to supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign." But, as the late

[1] *An Inquiry into the Principles of Political Economy*, by Sir James Steuart, 1767.

Professor Henry Sidgwick pointed out in an acute analysis of the term, this definition is only given at the beginning of the Fourth Book, when Adam Smith turns from the progress of opulence and the causes of that progress to the different systems of political economy which had been invented for the avowed purpose of enriching a people. Adam Smith had shown how, given external peace with a decent degree of order and security, capital accumulates and labour becomes more productive, so that increasing wealth and comfort are naturally diffused through all classes of society independently of government, whose efforts (intended to foster) have usually clogged or choked the industry and enterprise of individuals. The Fourth Book of the *Wealth of Nations* constitutes in fact, to quote Sidgwick's words, an " elaborate indictment of all endeavours of government, whether by special encouragements or special restrictions, to allot to a particular species of industry a greater or lesser share of the capital of the society than would naturally go to it."

After thus exposing for all time (to the eye of philosophy) the general futility of artificial restraints and encouragements, our great teacher grants statesmen a complete discharge " from the duty of superintending the industry of private people and of directing it towards the employments most suitable to the interests of society." Under the influence of this doctrine political economy came to be regarded not as a study of the means by which statesmen should regulate industry, but of the manner in which trade progresses when free from political meddling. Smith himself, however, wiser in this than most of his disciples, preserved the public side of political economy, not forgetting the large and

increasing duties which devolve upon central and local government even after it has been discharged of those functions which it had so improperly assumed. Consequently, while most of the leading economists since Smith have confined themselves to abstract reasoning in their economic treatises, we find in the *Wealth of Nations* a larger and more comprehensive outlook. Nor is this contrast anywhere more remarkable than in the treatment of war, and of the preparations for it. The developments of armaments and military service and of war debts are all sketched with a masterly hand by the great Glasgow professor. The advantages and disadvantages of colonial empire are coolly surveyed. But since his time—though the literature of modern war is bewilderingly vast—one may look in vain for an economist of the first rank—for the academic mind will hardly bring Bastiat or Cobden within its horizon—who has made any comprehensive inquiry into the economics of modern warfare. And yet the subject is of fascinating interest and surpassing importance. Of that no intelligent statesman, or student of politics, or taxpayer in any civilised community, can be in doubt; for it involves problems hitherto unsolved upon which the fate of civilisation depends.

In offering this volume to the public I am under no illusions as to its value. It is little more than a temporary makeshift for the ideal work which I can only imagine and leave to others. My best reason, perhaps, for publishing these chapters is that ever since the South African War I have been an eager and anxious student of war and armaments. To enclose in one small book an essay on the Political Economy of War in general, and another on the Political Economy

of the War that has been desolating Europe, is an act of boldness which claims the indulgence of critics. But my hope is by the first and second parts to induce economists to read the third, and by the third to induce business men and practical politicians to consult the first two.

In all arts and theories, but especially in those inexact and imperfectible studies which constitute the architectonic science of politics, classification is a mighty aid to progress. And in every case there are various methods of division each of which has its advantages. Sometimes you may make a vertical, sometimes a horizontal cut. But for the advancement of learning a rigid uniformity of method is to be avoided. Thus in the Political Economy of War we may divide our subject chronologically or logically or geographically. We may separate it into historical chapters; we may distinguish warfare by land, sea, and air; or we may treat of it in three grand divisions—the preparations for war, the economics of war itself, and the economic consequences.

In 1906 I wrote some dialogues, one of which turned upon the economy of war. As it covered a part of the ground, I have transferred a number of pages, with certain modifications, to the first part of this volume, on the principle that it is no use saying the same thing over again in different words.

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PART I

POLICY AND ECONOMICS OF WAR

THE POLITICAL ECONOMY OF WAR

PART I

CHAPTER I

HUMAN SOCIETY AND WAR—THE PHILOSOPHY OF MILITARY AND NAVAL HISTORY

THE natural history of society presents a panorama of contrary passions—the love of freedom, the love of power, the desire for wealth and comfort, the love of fighting either for its own sake, or for glory and plunder. In the infancy of civilisation men were governed by physical strength and brute force. The stronger got what he wanted, and the weaker went to the wall. In the city states of Greece and in Rome the rule of law was established, and civilisation was protected against barbarian inroads. But the downfall of the Roman Empire was followed by centuries of insecurity. Right through the middle ages private wars flourished; commerce by land and sea was infested by bandits and pirates. By degrees civilisation gathered strength, the seas became safe in peace time, and men began to travel without arms. But the duel lingers to remind us of days when trial by battle was the alternative to a law-suit. When two men differ, or two tribes, or two

cities, or two nations, the primitive instinct, our first instinct, as we say, is to fight, and for incredible ages this was the ordinary solution of a quarrel. How the establishment of order and law gradually freed men of the same State from this curse has been described often enough. But the part played by the commercial instinct in subduing private combats and curbing public wars is not always realised. When once the beginnings of orderly justice have been established in a given community, the people become deeply interested in its maintenance and extension. Released from the fear of being attacked by his fellows, the tribesman or citizen can give his whole energies and thought to agriculture, industry, or commerce, except in times when a public war is being undertaken by his government. Under such conditions considerable progress can usually be made in wealth. Society is already susceptible of the advantages to be derived from the division of labour. Neighbours begin to exchange their products. Instead of trying to combine, let us say, agriculture, tailoring, bootmaking, and housebuilding, one man farms, another makes clothes or boots, and another builds houses. The total product is far greater than before, because by this division of labour each man has become a specialist, and is able to perfect his particular trade.

Money is invented; waggons are fashioned; roads are constructed; and by degrees the distribution or marketing of goods gives rise to special trades. A class of merchants and shopkeepers springs up; farmers and manufacturers find that instead of exchanging their products by direct barter they can do better by selling them to retailers, who will dispose of them to home consumers or to foreign merchants. From time to time

exchange is made easier and cheaper by further inventions, such as banks and cheques, and by every improvement in communication, from wheeled vehicles and row-boats to railways and steamers.

It requires no effort of the imagination to see how the growth of industry and trade, and the discovery by experience of the benefits and comforts that come in their train, would affect the practice of war and the attractiveness of a military life. The steady rewards of farming and commercial enterprise came to be preferred to the precarious profits of warlike adventure. Honour, indeed, for a long time remained a monopoly of the soldier, though other professions, and especially that of the law, began also to acquire a certain reputation as pursuits fit for gentlemen. Moreover, as the principle of the division of labour operated, a complete revolution was brought about in the relations of society to war. War, from being a universal habit, became a profession or art—an art designed to produce not beauty or utility, but security—to ensure the State against foreign enemies by destroying them whenever necessary. Originally the methods and instruments of destruction were very simple. Victory was decided by the strength and prowess of the individual combatants. Presently brains began to count as well as muscles. Arms and armour were perfected; new weapons were invented. Bows and arrows and catapults were superseded by gunpowder. Armies were organised. Success came to depend more and more upon drill, training, engineering, mechanical skill, equipment, and strategy. Modern battles are won in foundries, machine shops, and laboratories. Unseen agencies kill or maim men by the thousand. The very minister who preached a holy war

in the autumn of 1914 was forced after ten months to describe it as a War of Munitions.

The division of labour produced the professional soldier; every advance in the military art and every invention gave a new advantage to the nations which, being the most proficient in agriculture and manufactures and commerce, were therefore the wealthiest and the best able to equip and support costly armies or navies. In Adam Smith's *Wealth of Nations* the equipment of military forces is treated at the beginning of Book V. as an expense of the sovereign or commonwealth, and one that is necessary and unavoidable, because "the first duty of the sovereign, that of protecting the society from the violence and invasion of other independent societies, can be performed only by means of a military force." But the expense, he adds, both of preparing this force in peace and of employing it in war has varied widely in different stages of society.

Thus among wandering tribes of hunters, such as were the North American Indians, every man was ready to fight for his life against other warriors with the same weapons he employed against wild beasts for his livelihood. A rude nomad society of this kind is at no expense to equip its army or to maintain it in the field.

Among more advanced but still wandering nations of shepherds like the Arabs and the old Tartar tribes there is more distinction between peace and war. But every man is still a warrior, and is prepared for war by his ordinary exercises and pastimes. They all go to war together. "Among the Tartars even the women have been frequently known to engage in battle. If they conquer, whatever belongs to the hostile tribe is the recompense of the victory. But if they are vanquished

all is lost ; and not only their herds and flocks, but their women and children, become the booty of the conqueror." Owing to the precarious subsistence of the chase an army of hunters could seldom exceed two or three hundred men. An army of shepherds might number two or three hundred thousand, and these hordes have often overwhelmed civilised communities. The terrors of a Scythian, Tartar, or Arab invasion are verified by history. In the more advanced state of a society, which cultivates the soil, besides possessing flocks and herds, there is more leisure. Moreover a nation of husbandmen, even if it be self-sufficing, is settled in a territory, and the people therefore cannot move to war together. But in tribes inured to hardship, like the old Romans and Sabines, the men of military age, say a fifth of the whole population, might take the field if the campaign falls between seed time and harvest. The direct cost of such a campaign was small. Thus in the wars waged by our Norman kings by feudal law the barons and knights with their dependants served the crown at their own expense.

But with the growth of arts and manufactures and corresponding advances in the weapons and machinery of war it became necessary to provide more and more for armaments and armies out of a common fund. Defence, in fact, became a first charge on the revenues. And as the wealth of the individuals and the revenue of a society grew, so did the warlike rivalries and jealousies and ambitions of the rulers require and demand larger and larger sums for military and naval preparations. The difference between the husbandman and the artificer, and its bearing on the art of war, is thus elaborated by Adam Smith : " Though a husband-

man should be employed in an expedition, provided it begins after seed time and ends before harvest, the interruption of his business will not always occasion any considerable diminution of his revenue. Without the intervention of his labour nature does herself the greater part of the work which remains to be done. But the moment that an artificer, a smith, a carpenter, or a weaver, for example, quits his workhouse [1] the sole source of his revenue is completely dried up. Nature does nothing for him; he does all for himself. When he takes the field therefore in defence of the public, as he has no revenue to maintain himself he must necessarily be maintained by the public." But in a country a majority of whose inhabitants are artificers and manufacturers a great part of the people who go to war must be drawn from those classes, and must therefore be maintained by the public as long as they are employed in its service. The argument is clear, and may be illustrated by the history of all civilisations—of ancient Athens from the Persian wars, of the Roman Republic after the siege of Veii, and of European kingdoms which gradually substituted payments for services and mercenary troops for retainers. In Adam Smith's time it was "commonly computed"—so rapidly had the cost of war grown—that "not more than one hundredth part of the inhabitants of any country can be employed as soldiers without ruin to the country which pays the expense of the service." Ruin, of course, is a relative term; but it is a striking proof of the growth of wealth and of scientific organisa-

[1] The first edition of Adam Smith's *Wealth of Nations* was published in 1776 before the factory system had much developed. The weaver's loom was in a room of his cottage or in a shed beside it.

tion for war that in spite of an enormous addition to the cost of munitions and arms since 1776 both France and Germany in 1914 were able so long to maintain at the front or in reserve over one tenth of their population. Compulsory service, indeed, which confiscates the adult labour of every physically capable man for one, two, or three years of his life, and disciplines him for war, obviates the necessity for pay. A pittance of from one farthing (in Russia) to twopence halfpenny a day in addition to food and clothing is all that the modern conscript is allowed by the modern state. Thus the institution of small, mercenary, standing armies by most European powers in the eighteenth century, though agreeable to the principle of the division of labour and to the freedom-loving people of Britain and the United States, has given way on the continent to a scheme the most burdensome which humanity could have imposed upon itself. The responsibility for spreading this deadly slavery, called conscription, falls on Napoleonic France and Prussianised Germany.

Another historical distinction is to be drawn between the cost of military preparation and the cost of warfare. In ancient and feudal times martial exercises were a part of education and games, involving little or no expense to the public authorities. In mediæval England knightly exercises were encouraged by jousts and tournaments, and for centuries archery was a public institution. But the simple mechanism of war was altered out of recognition by the invention of gunpowder and firearms, by the application of steam to ships, and by mechanical improvements of all kinds. The whole offensive and defensive armour of war has been carried to a pitch of costly and intricate perfection unimagin-

able, if it were not spread out in all its amazing destructiveness before our very eyes.

The qualitative superiority of a well-paid long service regular army to an equal number of conscripts, the enormously greater *real* cost of conscription, the ingrained repugnance of Englishmen to forced service, and finally the practical impossibility of maintaining a continental army in addition to a supreme navy explain why this island kingdom steadily refused until January 1916 to be tricked or cajoled into any form of compulsory service. One of the reasons advanced by Adam Smith to show why militias gradually yielded in Western Europe to standing armies is, no doubt, a reason why the continental states and Japan (when it began to cast eyes upon China) have, one after the other, accepted conscription. "When," he writes, "the expedient of a standing army had once been adopted by one civilised nation it became necessary that all its neighbours should follow the example." They soon found that a militia was altogether incapable of resisting the attack of a regular army. The praise which Adam Smith bestows upon standing armies must have surprised many of his contemporaries who thought it a novelty and a danger to the constitution. In the first place, he says, a standing army can take the field with success even after a long peace. Thus in 1756, when the Russian army marched into Poland, its soldiers, though few of them had ever seen an enemy, appeared to be as valiant as the Prussians, then "the hardiest and most experienced veterans in Europe." Again, in 1739, after twenty-eight years of peace, the English soldiers showed extraordinary valour at the outbreak of the Spanish war in the attack upon

Carthagena. The generals, he thinks, may sometimes forget their skill in a long peace; "but where a well-regulated standing army has been kept up the soldiers never seem to forget their valour." Doubtless, as is proved by the frequent conquests of civilised countries in Asia by the Tartars, a barbarous militia is superior to that of a civilised nation; but a well-regulated standing army is always superior to a militia, and as it is a costly institution it affords the means by which civilisation can defend itself against barbarism. It is also the only means by which a barbarous country can be rapidly civilised, or rather pacified. It was by this instrument that Peter the Great introduced a degree of order and internal peace into the Russian Empire. It was by this means also that after the Russo-Turkish war of 1878 the Dual Monarchy reduced to order Bosnia and Herzegovina. The Republican objection to a standing army as dangerous to liberty is founded on many classical instances, the subversion of the Roman Republic by Cæsar and of the Long Parliament by Cromwell being the most famous. But there is much to be said on the other side, provided that the army is under the command of those who are interested in the support of the civil authority. Besides the security which it gives against small tumults and revolutions, it is really favourable to liberty in countries which enjoy constitutional government.

The effect of gunpowder, firearms, and artillery is thus described in the concluding paragraphs of Adam Smith's chapter on the Expense of Defence:—"The great change introduced into the art of war by the invention of firearms has enhanced still further both the expense of exercising and disciplining any particular

number of soldiers in time of peace and that of employing them in time of war. Both their arms and their ammunition are become more expensive. A musquet is a more expensive machine than a javelin or a bow and arrows; a cannon or a mortar than a balista or a catapulta. The powder, which is spent in a modern review, is lost irrecoverably, and occasions a very considerable expense. The javelins or arrows which were thrown or shot in an ancient one, could easily be picked up again, and were besides of very little value. The cannon and the mortar are, not only much dearer, but much heavier machines than the balista or catapulta, and require a greater expense, not only to prepare them for the field, but to carry them to it. As the superiority of the modern artillery too, over that of the ancients is very great, it has become much more difficult, and consequently much more expensive, to fortify a town so as to resist even for a few weeks the attack of that superior artillery. In modern times many different causes contribute to render the defence of the society more expensive. The unavoidable effects of the natural progress of improvement have, in this respect, been a good deal enhanced by a great revolution in the art of war, to which a mere accident, the invention of gunpowder, seems to have given occasion.

"In modern war the great expense of firearms gives an evident advantage to the nation which can best afford that expense, and consequently to an opulent and civilised, over a poor and barbarous nation. In ancient times the opulent and civilised found it difficult to defend themselves against the poor and barbarous nations. In modern times the poor and barbarous find it difficult to defend themselves against the opulent and

civilised. The invention of firearms, an invention which at first sight appears to be so pernicious, is certainly favourable both to the permanency and to the extension of civilisation." Hume had said in his history, in reference to the use of cannon at the battle of Creçy, that artillery, "though it seemed contrived for the destruction of mankind and the overthrow of Empires, has in the issue rendered battles less bloody and has given greater stability to civil societies." It had, he thought, brought nations more to a level, conquests had become less frequent and rapid, and success in war had been reduced nearly to a matter of calculation.

Since Adam Smith's time the danger that civilised nations will ruin one another by applying their wealth to the machinery of destruction has become much greater than the danger of civilised wealth being annihilated by barbarous poverty. Otherwise the processes sketched by Adam Smith have expanded along the same or similar lines. The musket, the breech-loading rifle, the magazine gun, quick-firing machine guns, an immense development in the weight and range of artillery, the steam frigate, the ironclad, the torpedo, the submarine, and, lastly, the airship and aeroplane are a few of the most salient changes in the machinery and art of war, which has lost much of its romantic glamour, as success has come to depend less and less upon soldierly prowess, and more and more upon the skill of chemists and mechanics.

On the other hand, in the century which followed Waterloo the progress of International Law, of arbitration, and of conventions to regulate and mitigate the customs of warfare seemed to promise that the increasing atrocity of the weapons would be compensated by the

improved rules of the game. On land the theory that private property must not be looted was established, at least in theory. At sea it was still liable to capture, though the laws of naval warfare seemed to have made some advance.

In the fifteenth and sixteenth centuries, which saw the dawn of modern commerce, the chief sea-faring nations, the first navigators and discoverers of unknown seas, claimed exclusive rights of navigation along the trade routes which they deemed to have made their own. The Portuguese, the Genoese, the Venetians, the Norwegians, the Danes, and the English all made pretensions of this sort; but after the defeat of the Armada, England became the most formidable claimant to maritime dominion. The Portuguese, Spanish, and English claims were obstinately opposed by Dutch sailors and jurists; for Holland was the world's carrier: The *Mare Liberum* of Grotius (1608) was written primarily against the Portuguese claim to the Indian trade, but also to support a protest of the Dutch States-General against the English title to a monopoly of fishing and trading in the English Seas. But the book goes far beyond the brief. The great founder of international jurisprudence argued the high theme that the sea is in its very nature insusceptible of private ownership or monopoly, as being a grand international highway incapable of occupation, no less necessary to the life of nations than is the air to the life of individuals. John Selden, our learned patriot, penned in reply (at the command of James the First) the *Mare Clausum*, described by Charles Butler as "a noble exertion of a vigorous mind, fraught with profound and extensive jurisdiction." It is the first and best of a long line of

written fortifications by which English jurists have defended, with obstinate skill, a receding frontier of imaginary interests and untenable claims.

The first consequence of the freedom of the seas, a proposition now universally conceded in time of peace, is the right of all and each to trade and sail everywhere unmolested. The second consequence is the right of fleets at war to fight in any part of the ocean. Obviously, if the first private right of individuals to trade and navigate extends to times of war it may conflict with the second or public right of nations to fight. But, originally, the second right, the liberty of fighting in any part of the sea, was claimed by individuals at all times. In Homeric days the trader was a low fellow who existed to be despoiled by the gentleman pirate. Piracy was curbed by the might of Rome, but we know how the Vikings at last prevailed over the counts of the Saxon shore. Private war at sea outlived private war on land. The knight errant died before the pirate. And even after the decay of piracy, which began before the eighteenth century, the licensed pirate or privateer was maintained as an auxiliary to regular warfare at sea. For though civilised Powers combined to suppress the pirate as "the enemy of the human race," and to protect mutual commerce in time of peace, they issued commissions and letters of marque and encouraged privateers to prey upon the merchant shipping of those against whom they had declared war, or even those against whom they had wished to make reprisals without levying war. The calling of the privateer was an honourable one, though the acts for which he was rewarded, had they been committed on land, would have sent him to the gallows. How often

he overstepped the borderland of piracy may be discovered in the letters of Sir Leoline Jenkins, a learned naval judge who flourished in the time of Charles the Second.

At last by the Declaration of Paris of 1856, in which all the great Powers, except the United States, joined, privateering was formally abolished; but a civilised Power may still lawfully fit out cruisers for the sole purpose of preying upon the commerce of the enemy, and the prizes so captured are generally divided between the captain, officers, and crew of the captor. There was a clear distinction between the pirate and the privateer; for the pirate was like an ordinary thief who made no distinction between friend or foe, while the privateer could lawfully prey only upon ships and cargoes belonging to citizens of a country with which his own was at enmity. The issuing of letters of marque to privateers in sea war is just as if, when two nations fought on land, the Governments were to give licences to thieves to pick the pockets and rifle the houses of citizens of the enemy. The difference between a captain of a privateer and a captain in the Royal Navy whose ship is built and commissioned to prey upon merchant vessels, is a difference for the casuist rather than for the moralist or economist. To quote one of the leading authorities on British Naval prize law :—

"It is, and has been, the invariable rule of the Crown in modern times to surrender the entire proceeds (of a prize) to the officers and men engaged in the capture. The general practice of Prize Courts is to order a sale of the vessel or goods on condemnation, and the sum thus realised is divided among the captors."

True the Prize Court is a sort of tribunal, though it is more like an inquest than a Court of Law, its business

being to decide to whom the ship and cargo really belong —a question often complicated by sales and bills of mortgage—and secondly whether according to sea law as interpreted and modified by the municipal laws and administrative orders of the captors they are lawful prize.

The right to capture and make prize is accompanied by the right to destroy a prize if it is difficult or dangerous to convey it to port; for the object of harrying the enemy's commerce and injuring the enemy's citizens is even more important in theory than that of enriching your own admirals and captains. Thus merchant shipping is at once the cause of naval armaments in time of peace and their raw material in time of war. By using this second right and neglecting the duty to save the lives of crews and non-combatants the German Admiralty proclaimed early in 1915 a submarine warfare against British commerce, after their own merchant ships and cruisers had been chased from the seas.

At the close of the Crimean War the plenipotentiaries of the European Powers who prepared the Declaration of Paris besides abolishing privateering made another important change in the public maritime law of Europe. They decided that, in future, neutral property at sea, during a time of war, should be respected when in an enemy's ship, and that enemy's property should be respected when under a neutral flag. "These propositions," to quote the words of Cobden in 1862, "after being accepted by almost every country in Europe, with the exception, I believe, of Spain, were sent to America, with a request for the adhesion of the American Government. That Government gave in their adhesion

to that part of the Declaration which affirmed the rights of neutrals, claiming to have been the first to proclaim those rights; but they also stated that they preferred to carry out the resolution, which exempted private property from capture by privateers at sea, a little further; and to declare that such property should be exempted from seizure, whether by privateers or by armed Government ships. Now, if this counter proposal had never been made, I contend that, after the change had been introduced affirming the rights and privileges of neutrals, it would have been the interest of England to follow out the principle to the extent proposed by America." Mill was opposed to the Declaration of Paris; but in 1867 he favoured the further step on purely national grounds :—

"Those who approve of the Declaration of Paris mostly think that we ought to go still farther; that private property at sea (except contraband of war) should be exempt from seizure in all cases, not only in the ships of neutrals, but in those of the belligerent nations. This doctrine was maintained with ability and earnestness in this House during the last Session of Parliament, and it will probably be brought forward again; for there is great force in the arguments on which it rests. Suppose that we are at war with any power which is a party to the Declaration of Paris; if our cargoes would be safe in neutral bottoms, then if the war was of any duration our whole import and export trade would pass to the neutral flag; most of our merchant shipping would be thrown out of employment and would be sold to neutral countries, as happened to so much of the shipping of the United States from the pressure of two or three—it might be almost said of a single cruiser." [1]

These opinions and arguments were so well established in the minds of shipowners and merchants in the United States, Scandinavia, the Low Countries, the

[1] The *Alabama*.

Hanseatic towns, and even Great Britain before the present war broke out that the freedom and security of non-combatants at sea and the immunity of peaceful commerce from seizure or destruction are likely, when peace returns, to command more earnest and practical attention than ever before. The stupid barbarity of the practices and reprisals and counter-reprisals which culminated in an indiscriminate throwing of bombs from the air, in a wholesale strewing of mines at sea, and in the sinking of the *Lusitania* must have helped to disillusion the blindest worshippers of Force. Above all—even if in the course of 1916 a military decision should be reached—the forecast of de Bloch that a struggle between well-armed and organised nations will end through trench warfare in a stalemate has so far been bitterly fulfilled in Flanders and France.

CHAPTER II

THE WARS OF THE SEVENTEENTH AND EIGHTEENTH CENTURIES

A COMPREHENSIVE comparison of the actual product of wars with the declarations and promises that accompanied their outbreak would be a work of inestimable value; for the warning voice of history is too seldom heard contrasting the pretexts and occasions that provoke hostilities with their conclusions and consequences. Such a treatise would show that wars have hardly ever gone according to programme, and that the most high-flown declarations have soon been lost in smoke and blood. Peace, Trade, Freedom, Honour, Security, Defence, Justice—how many declarations of war have turned upon these words? How often have these empty symbols been employed to justify the warlike emotion of platform, press, and pulpit? Our purpose in this chapter is the humbler one of recalling the beginnings and ends of a few past wars, in order that a reader entering, it may be for the first time, the economic mazes of war may have some clue to guide him from the past to the present; for history is always repeating itself, not exactly, but with such modifications and exceptions as prove the permanence of her rules and the invincible folly of the human race. "War is a game which, were their peoples wise, kings would not play at." But their peoples are not wise. They are not wise enough to choose their rulers, or strong enough to

restrain them. To learn the economic evils of war one need not go to the professional economists. William Penn more than two centuries ago [1] put them in a nutshell. He was arguing that the only reason why God chastises us with war is to acquaint us with the blessings of peace; for there is one thing and only one better than peace, and that is the grace to use it. What do peace and war respectively bring to mankind? Here is Penn's answer: "Peace preserves our possessions; we are in no danger of invasions; our trade is free and safe, and we rise and lye down without anxiety. The rich bring out their hoards, and employ the poor manufacturers;[2] buildings and divers projections for profit and pleasure go on. Peace excites industry, which brings wealth, as wealth again provides the means of charity and hospitality, not the lowest ornaments of a kingdom or commonwealth." But what of war? "War, like the frost of '83, seizes all these comforts at once, and stops the civil channel of society. The rich draw in their stock,[3] the poor turn soldiers, or thieves, or starve: no industry, no building, no manufactory, little hospitality or charity: but what the peace gave war devours."

The Thirty Years' War, a war religious in its causes and ferocious in its conduct, was brought to a conclusion by the Peace of Westphalia in 1648. It exterminated multitudes of Catholics and Protestants without deciding the truth of any Christian doctrine. But its dreadful effects were still discernible in many parts of Germany a century and a half later. "A prodigious number of towns," wrote Pütter, in 1786,[4] "have never been able

[1] In 1695. [2] *i.e.* work-people. [3] *i.e.* their capital.

[4] See Pütter's *Historical Development of the Germanic Empire*, translated by Dorndorf (London, 1790), vol. ii., pp. 209-10.

to recover the losses they sustained through the horrors of the Thirty Years' War. If we were to compare each individual town of Germany in the state it was in before and after the war of thirty years, the picture would be dreadful beyond conception. The city of Magdeburg alone had formerly no less than 30,000 inhabitants; but after its destruction by Tilly, only 400 remained. The city itself was razed to the ground, and had scarcely one stone left upon another. In the city of Frankenthal, where there were 1800 inhabitants, who were mostly artists and manufacturers, the number was reduced to 324. In Göttingen there were 1000 houses; in the war 179 were pulled down or fell of themselves, 237 remained uninhabited, 137 inhabited only by widows, and only 460 by burghers and strangers. At Nordheim, near Göttingen, upwards of 320 houses which were uninhabited, were destroyed to procure fuel from the timber for the winter; and the number of distressed widows exceeded that of the burghers. The repairs of Minden, which was one of Tilly's garrison-towns in 1625, cost, in two years, 600,000 thalers; and a tax was fixed upon the houses of the burghers, under the name of the "Eintheilungs Capitalien," which continues even now [in 1786]. In the bailiwick and town of Leonberg, in the country of Würtemberg, 1270 burghers emigrated, 885 houses were destroyed by fire, and 11,594 acres of land went out of cultivation. In the whole dutchy of Würtemberg, no less than 57,721 families were ruined; 8 cities, 45 villages, 158 houses of the clergy and school-masters, 65 churches, and 36,086 private houses, were burned to ashes."

The Anglo-Dutch alliance did not long survive the decline of Spain. The trade jealousy which prompted

Selden's reply to the *Mare Liberum* of Grotius led to the wars for sea power between Holland and England in the days of Cromwell and Charles the Second. Then Fortune turned her wheel to seat William of Orange on the English throne, and we were speedily engaged with Holland, Austria, and Spain against France and her Grand Monarch Louis the Fourteenth.

Our intentions, as set forth in the declaration of war, were to assist the Emperor to repel the encroachments of the French upon the Newfoundland fishery, and to recover possession of Hudson's Bay, to maintain the interests of English commerce and the supremacy of the English flag, to protect the French Protestants, and to oblige Louis to withdraw his support from the Stuarts. The Dutch complained chiefly of injuries to their trade; the Emperor of the aggressions of Louis in general, and the seizure of the Palatinate in particular.

The war opened with one of the most abominable crimes ever committed by a great military power, whether we consider its deliberate and systematic wickedness, or the amount of innocent suffering which it involved. In 1688 a French army under Duras had invaded the Palatinate and some of the neighbouring German principalities. But these conquests could not be held in face of the new alliance against France. The burning words of Macaulay's narrative may serve to describe what was done :—

" An atrocious thought rose in the mind of Louvois, who, in military affairs, had the chief sway at Versailles. He was a man distinguished by zeal for what he thought the public interests, by capacity, and by knowledge of all that related to the administration of war, but of a savage and obdurate nature. If the cities of the Palatinate could

not be retained, they might be destroyed. If the soil of the Palatinate was not to furnish supplies to the French, it might be so wasted that it would at least furnish no supplies to the Germans. The iron-hearted statesman submitted his plan, probably with much management and with some disguise, to Lewis; and Lewis, in an evil hour for his fame, assented. Duras received orders to turn one of the fairest regions of Europe into a wilderness. Fifteen years had elapsed since Turenne had ravaged part of that fine country. But the ravages committed by Turenne, though they have left a deep stain on his glory, were mere sport in comparison with the horrors of this second devastation. The French commander announced to near half a million of human beings that he granted them three days of grace, and that, within that time, they must shift for themselves. Soon the roads and fields, which then lay deep in snow, were blackened by innumerable multitudes of men, women, and children flying from their homes. Many died of cold and hunger; but enough survived to fill the streets of all the cities of Europe with lean and squalid beggars, who had once been thriving farmers and shopkeepers. Meanwhile the work of destruction began. The flames went up from every market-place, every hamlet, every parish church, every country seat, within the devoted provinces. The fields where the corn had been sown were ploughed up. The orchards were hewn down. No promise of a harvest was left on the fertile plains near what had once been Frankenthal. Not a vine, not an almond tree, was to be seen on the slopes of the sunny hills round what had once been Heidelberg. No respect was shown to palaces, to temples, to monasteries, to infirmaries, to

beautiful works of art, to monuments of the illustrious dead. The far-famed castle of the Elector Palatine was turned into a heap of ruins. The adjoining hospital was sacked. The provisions, the medicines, the pallets on which the sick lay were destroyed. The very stones of which Manheim had been built were flung into the Rhine. The magnificent Cathedral of Spires perished, and with it the marble sepulchres of eight Cæsars. The coffins were broken open. The ashes were scattered to the winds. Treves, with its fair bridge, its Roman baths and amphitheatre, its venerable churches, convents, and colleges, was doomed to the same fate. But, before this last crime had been perpetrated, Lewis was recalled to a better mind by the execrations of all the neighbouring nations, by the silence and confusion of his flatterers, and by the expostulations of his wife." [1]

When "the war of the Grand Alliance" had lasted seven years — during which Italy, Germany, France, Hungary, and Spain had been deluged with blood; while England had seen her commerce sadly crippled, taxes multiplied, and a national debt contracted for the first time—a temporary suspension of hostilities was effected in 1697, amid great rejoicings in England, by the Treaty of Ryswick. To William's deep chagrin Parliament promptly reduced the standing army to 10,000 men, and his Dutch guard was sent back to Holland. By this treaty the claims of the Palatinate were left to arbitration. Louis gratified the honour of the Emperor by demolishing the fortifications on the right

[1] *History of England*, by Lord Macaulay, vol. iv. pp. 127, 128. Macaulay refers in a footnote to a contemporary broadside entitled: "A true Account of the barbarous cruelties committed by the French in the Palatinate in January and February last" [1689].

bank of the Rhine. He also restored some territory to Austria, but only on condition that the severe laws which supported the Catholic worship should remain unaltered; in consequence of which nearly two thousand churches were compelled either to abjure the reformed religion, or to suffer the penalties attached to its profession. A memorial was presented to Louis on behalf of his persecuted Protestant subjects, but upon its rejection they were abandoned to their fate. Yet zeal for the Protestant cause was one of William's ostensible motives for entering upon this war. To Spain, indeed, the King of France made some sacrifices, but only with the design, afterwards executed, of more easily ensuring the whole Kingdom to the House of Bourbon; moreover, it was evident, from the question of the Spanish Succession being left undetermined, that Europe was soon to be the theatre of a new war, derived from the very evils the old one had been intended to remove.

We meanwhile had deserted our German allies; our claim to Hudson's Bay was referred to future arbitration; and how far the remaining objects for which England and Holland had declared war were from being attained is manifested by the respective declarations of each nation when war again broke out in 1702.

England then protested against fresh infringements of her commercial rights, and against the continued countenance afforded to the Pretender. The Dutch declared that "the Republic was deprived of a barrier for which she had already maintained two bloody wars"; and that "the late treaty was no sooner ratified" than the French recommenced their encroachments on her trade. The House of Austria claimed by right of inheritance, and by virtue of the partition treaty signed in

1700, a large part of the kingdom and dependencies of Spain, which the French monarch had already succeeded in appropriating to the Bourbon family. England and Holland also thought themselves interested in preventing the growth of the power which might result from a union between these two kingdoms. The King of France, of course, in his counter-declaration, charged the allies with being the aggressors, and asserted the justice and necessity of self-defence. After all the sanguinary battles fought in pursuit of these objects, between the years 1702 and 1713, the following were the principal conditions of the Peace of Utrecht. The grand aim of the Grand Alliance, which had been to effect a permanent separation between the French and Spanish crowns, was secured only by an *unguaranteed* promise on the part of the Bourbon family that the two kingdoms should never be united; a renunciation to which they readily consented, having declared it to be null and void by the fundamental laws of France; and one so fallacious, in the words of a protest entered in the House of Lords, that no reasonable man, much less whole nations, could ever look upon it as any security. We gained Gibraltar, Minorca, Newfoundland, and the right to trade in slaves to America. But the commercial treaty procured was thought so unfavourable to the interests of trade, that the Bill for making it operative was rejected by the Commons, in consequence of the numerous petitions against it from merchants in all parts of the country. Nor was any alteration produced in Louis's conduct towards the Pretender by his recognition of Anne's title.

The Dutch were hurried into a treaty, in many respects less advantageous than the one by which their

Pensionary Heinsius had declared they would lose the fruit of all the blood and treasure hitherto expended. In regard to Austria, Marshal Villars justly remarked that "after a war of fourteen years, during which the Emperor and King of France had nearly quitted their respective capitals, Spain had seen two rival kings in Madrid, and almost all the petty states of Italy had changed their sovereigns, a war which had desolated the greater part of Europe was concluded on the very terms that might have been procured at the commencement of hostilities."

The grants of Parliament in the course of thirteen years had exceeded eighty millions, of which about fifty had been spent on war, and at the death of Queen Anne the interest on the national debt required an annual sum of nearly three millions to be raised in taxes on the labour and property of the people.

The next war in which England engaged, in 1718, had for its professed object the protection of our merchants against the Spaniards; it was also intended, by obliging the King of Spain to accede to the Quadruple Alliance, to secure to the Emperor the undisturbed possession of Sicily. Philip was indeed forced to comply with the demands of the allies; but the continued depredations upon British vessels soon became again a subject of complaint, and in 1735 Sicily was restored to Spain.

The dreadful conflicts to which the disputed claim to the Polish throne soon after gave rise roused the greedy jealousy of the three neighbouring powers and led at last to the partition of Poland and the destruction of a national life. Charles the Sixth of Austria, by his uncontrollable love of war, reduced his once flourishing dominions to the lowest state of degradation and

weakness. In 1739, after twenty years of peaceful progress, England renewed hostilities with Spain about the Right of Search, but four years later the pretext was changed to the question of the Austrian succession, and in 1744 war was also declared against France.

In 1748, at the Peace of Aix-la-Chapelle, when a general restitution of conquests took place, nearly thirty millions had been added to our national debt; the trade of the country was encumbered with additional customs and excise; and the nation, in regard to its foreign possessions, was in exactly the same state as at the commencement of the war. "Every defeat in this war," wrote Bolingbroke, "like every triumph in the last, became a reason for continuing it." Nor had the continental powers, whose quarrels (prosecuted for seven years with the utmost animosity) were also decided at the conferences of Aix-la-Chapelle, any better ground for satisfaction. France had failed in her object of dispossessing the Austrian princess of her hereditary dominions. Maria Theresa told the British Ambassador, when he offered his congratulations on the return of peace, that a message of condolence would be more appropriate; while the robbery of Silesia by the King of Prussia, who was territorially the only gaining party, led to the outbreak in 1756 of a fresh war between Frederick and the Empress-Queen, which soon drew nearly all the states of Europe within its focus, and extended its ravages to Asia, Africa, and America.

Hoping so to gain success in the famous Seven Years' War (1756-1763), Maria Theresa relinquished the friendship of England, to whose assistance she had been largely indebted for the preservation of her crown; at the same time her alliance with France, her neglect of the

barrier towns in the Netherlands, and the family compact between the two houses of Bourbon, to which the events of the war gave rise, overthrew the whole system of continental policy, to the maintenance of which the peace of Europe had been sacrificed for more than a century. As to England, when it was proposed with English money to combine the states of the Continent against France in defence of Hanover, Pitt denounced the whole scheme of policy as "flagrantly absurd and desperate." "It was no other than to gather and combine the powers of the Continent into an alliance of magnitude sufficient to withstand the efforts of France and her adherents against the Elector of Hanover at the expense of Great Britain. The three last wars with France had cost Britain above 120 millions of money; the present exhibited a prospect of an effusion of treasure still more enormous."

"Who," he cried, "will answer for the consequences or insure us from national bankruptcy? We have suffered ourselves to be deceived by names and sounds —*The General Cause, The Balance of Power, The Liberty of Europe*—and have exhausted our wealth without any rational object." [1] But Pitt no sooner found himself in power, a popular and successful War Minister, than he fell in love with the folly he had so eloquently denounced.

In the Guildhall at the foot of Chatham's statue an inscription records what Macaulay supposes to have been the general opinion of the citizens of London, that under his administration commerce, *for the first time*, had been *united with and made to flourish by war*.

The Seven Years' War is one of the few which are

[1] See Pitt's speech in Parliament, November 1755.

still popularly supposed to have "paid." But this delusion is not shared by those who have looked facts in the face, and consulted the original and contemporary authorities. The war was ended by the Peace of Paris in 1763. In the Spring of 1761, writes Lecky, "the burden of the war was beginning to be seriously felt." [1] The arguments in favour of terminating a war "are always strong" in the opinion of that sober historian, "but in this case they had a more than common force." The debt was rapidly increasing and the estimates had risen to an alarming extent. In 1752 three per cent. consols stood at 106. In 1755, on the eve of war, they fell to 90, and continued to fall through almost the whole course of the war, though a rumour of peace in March 1761 sent them up four points. But in 1762 they dropped to 63.[2] Early in 1761, when a new ballot was about to be enforced for service in the militia, riots took place in several counties. At Hexham, where the Deputy Lieutenant and Justices met on March 9th, four companies of the Yorkshire Militia were attacked by 6000 or 7000 Northumbrians, mostly pitmen armed with spiked clubs. An officer and three soldiers were killed. The soldiers fired, killing forty-two and wounding forty-eight. A letter from Berwick recounting the tragedy was printed in the London papers. The writer looked forward with dread to some more extensive movement: "Where it will end, God knows; so variable is the multitude that a measure,[3] brought about a few years ago by their clamour, appears now to them the most oppressive that ever a free nation was subjected to."

[1] See Lecky's *History of England in the Eighteenth Century*, chap. x.

[2] See Hamilton on *The National Debt*, 3rd edition, 1818, p. 318.

[3] The Ballot Act, under which working men had to draw lots for military service.

The popular change in sentiment was reflected by Burke in the political summaries of the *Annual Register*. In 1759 there is a note of triumphant satisfaction. "Power and Patriotism unite. Liberty and Order kiss. The nation is happy and secure." [1] Six millions had been borrowed at an easy rate, and though taxation was high, voluntary subscriptions had been raised in the large towns for the patriotic purpose of enlisting soldiers, and for the philanthropic purpose of providing French prisoners with clothing. In the following year (1760) the tone is philosophic and subdued. The writer has been persuaded that victories do not decide the fate of nations. The balance of power, he complains, is the cause of infinite contention and fruitless bloodshed. France, described as "bankrupt" the year before, was now said to be "inspired with no small hope." Beaten at sea, she looked for success in Germany, relying upon (1) "the strength and perseverance of the two empresses," (2) "the wasted condition of the King of Prussia," and (3) "the enormous expense of the German War to England, which must gradually exhaust the resources of her credit, and with them, the patience of an inconstant people." The only hope of a "happy conclusion" is that England and France "wearied and exhausted by war" will "huddle up a peace," and so compel Austria and Prussia to do the same. The first overtures must be between France and England, "for they never think of peace in Germany." [2] In another passage the writer explains that the English people are now opposed to

[1] *Annual Register* for 1759, pp. 7, 56.

[2] See *Annual Register*, 1760, p. 5. About this time a great effect was produced by a peace pamphlet, *Considerations on the German War*, by one Manduit. Lecky says it had more influence than any similar publication since Swift's *Conduct of the Allies*.

the war and discontented with its conduct. France had received financial relief from the loss of her navy and of her colonies, and could now carry on a war in Germany against England more cheaply. We were now incurring "an expense which the single revenue of England is by no means able to bear." [1] The *Annual Register* for 1761 gives an account of the negotiations which terminated in the Peace of Paris, and of Pitt's dramatic resignation when his proposal for attacking Spain was rejected by the Cabinet. The attempt made to procure addresses and resolutions in Pitt's favour from the civic and municipal bodies was a failure. The movement was "slow and languid, only a few corporations took part, and some even of those few in a manner less warm than was to be expected." The truth seems to be that the war had begun to occasion much inconvenience and suffering, and Pitt only lost his power when his war lost its popularity. Burke thinks that a no less advantageous peace might have been concluded in 1758, at the close of the third campaign. But the war was then still popular in England. By 1760-1 if the animosity of the belligerent Powers was not abated, "at least a great part of the fuel of discord had been consumed."

Macaulay himself, than whom few great writers have been less insensible to glory and martial achievement, or more disposed to slur over the social and economic suffering that are involved, cannot assent to the Guildhall inscription. The price, he says, at which Chatham purchased victory, "though far smaller than that which his son, the most profuse and incapable of war ministers,

[1] *Id.*, pp. 52-3. On the other hand (p. 54) it was argued, no doubt correctly, that France was really more exhausted than England, and that the channels of colonial trade, at any rate, had been secured by the naval victories.

paid for treachery, defeat, and shame, was long and severely felt by the nation."

During Chatham's wars it was predicted that if once we became masters of Canada there would be a great importation of skins and beavers and a prodigious extension of fine hat manufactures. "Every man might afford to wear a beaver hat if he pleased, and every woman be decorated in the richest furs; in return for which our coarse woollens would find such a vent throughout those immense northern regions as would make ample satisfaction for all our expenses." Canada was taken, and after we had possessed it for several years, beavers, furs, and hats were dearer than ever. As for woollens, the Canadian consumption of English cloth was hardly as much as would have been required by the English soldiers who had been lost in taking, defending, and garrisoning Canada.[1]

It is sometimes said on behalf of war that it circulates money; the Seven Years' War certainly circulated a great deal of foreign money in Germany. Horace Walpole, after describing the severity of the winter campaign of January, 1760, expressed his amazement that with such weather, such ravages, and distress there was anything left in Germany but money: "for thither half the treasure of Europe goes: England, France, Russia, and all the Empress [Maria Theresa] can squeeze from Italy and Hungary, all is sent thither, and yet the wretched

[1] It was complained at the end of the Seven Years' War that, owing to the growth of taxes and the rise of prices in England, the sales of our manufactures in *foreign* countries had much decreased, and even our colonies, on whose behalf the war was supposed to have been undertaken, were buying goods "in Holland, in Italy, and Hamburg or any other market where they can buy them cheapest, without regarding the interest of the Mother country."

people have not subsistence. A pound of bread sells at Dresden for elevenpence."

In 1771 Junius headed the Jingoes in an effort to force Great Britain into a war with Spain over a petty dispute about the Falkland Islands. After disposing of the particular argument for war Dr. Johnson, in one of his ablest pamphlets, founded a general plea for peace on the recent experience of his own country: "As war is the last of remedies, *cuncta prius tentanda*, all lawful expedients must be used to avoid it. As war is the extremity of evil, it is surely the duty of those whose station intrusts them with the care of nations to avert it from their charge. There are diseases of animal nature, which nothing but amputation can remove; so there may, by the depravation of human passions, be sometimes a gangrene in collective life, for which fire and sword are the necessary remedies; but in what can skill or caution be better shown, than preventing such dreadful operations, while there is yet room for gentler methods?

"It is wonderful with what coolness and indifference the greatest part of mankind see war commenced. Those that hear of it at a distance, or read of it in books, but have never presented its evils to their minds, consider it as little more than a splendid game, a proclamation, an army, a battle, and a triumph. Some, indeed, must perish in the most successful field; but they die upon the bed of honour, *resign their lives amidst the joys of conquest, and, filled with England's glory, smile in death.*

"The life of a modern soldier is ill represented by heroic fiction. War has means of destruction more formidable than the cannon and the sword. Of the

thousands and ten thousands that perished in our late contests with France and Spain, a very small part ever felt the stroke of an enemy; the rest languished in tents and ships, amidst damps and putrefaction, pale, torpid, spiritless and helpless; gasping and groaning, unpitied among men, made obdurate by long continuance of hopeless misery; and were at last whelmed in pits, or heaved into the ocean, without notice and without remembrance. By incommodious encampments and unwholesome stations, where courage is useless and enterprise impracticable, fleets are silently dispeopled, and armies sluggishly melted away.

"Thus is a people gradually exhausted, for the most part, with little effect. The wars of civilised nations make very slow changes in the system of empire. The public perceive scarcely any alteration, but an increase of debt; and the few individuals who are benefited are not supposed to have the clearest right to their advantages. If he that shared the danger enjoyed the profit, and, bleeding in the battle, grew rich by the victory, he might show his gains without envy. But, at the conclusion of a ten years' war, how are we recompensed for the death of multitudes and the expense of millions, but by contemplating the sudden glories of paymasters and agents, contractors and commissaries, whose equipages shine like meteors, and whose palaces rise like exhalations?

"These are the men who, without virtue, labour, or hazard, are growing rich as their country is impoverished; they rejoice when obstinacy or ambition adds another year to slaughter and devastation; and laugh from their desks at bravery and science, while they are adding figure to figure, and cipher to cipher,

hoping for a new contract from a new armament, and computing the profits of a siege or tempest.

"Those who suffer their minds to dwell on these considerations," added Johnson, "will think it no great crime in the ministry that they have not snatched with eagerness the first opportunity of rushing into the field, when they were able to obtain by quiet negociation all the real good that victory could have brought us." [1]

To complete this picture of the misfortunes caused by the Seven Years' War, we may append the reflections of Sir Samuel Romilly, to whom it suggested the paradox that a victorious war is more calamitous to England than defeat:—

"I had the mortification, a few days ago," he wrote (June 4, 1790) to a friend in France, "of finding myself considered as a maintainer of the most extravagant paradoxes, because I asserted that a war of any kind must be to England a calamity; but that a victorious war would be the greatest of all calamities. And this is thought a paradox after the experience of the glories, as they are called, of Lord Chatham's administration—glories which procured no one solid advantage to this country; which did not add one single moment's happiness to the existence of any human being, but which were purchased by an immense debt, by infinite bloodshed, and, what was worse, which gave us false notions of our honour, and our dignity, and our superiority, of which we cannot be corrected but by the loss of much more treasure and much more blood."

This melancholy analysis came dolefully true.

[1] See *Thoughts on the Late Transactions respecting Falkland's Islands.* (1771.) Adam Smith, no admirer of the Doctor or of his politics, expressed a very high opinion of this pamphlet.

Yet, when he wrote, our notions had already been corrected by the humiliations of the American War of Independence and the loss of all our richest colonies. Romilly's remarks were provoked by the clamour for a war with Spain, which was being artificially worked up " by the barbarous prejudices of persons concerned in privateering, or in particular branches of commerce." The discovery, he says, of a grand elixir which would efface pain and disease from the list of human calamities could not have given a humane person more pleasure than some Londoners felt at the prospect of plundering foreign merchants and sinking Spanish ships. It was easy, by means of the London mobs, to make Parliament think that an unjust and impolitic war would be popular.

When George the Third came to the throne in 1760 the Seven Years' War still raged. The new King, who " gloried in the name of a Briton," told Parliament that he loved peace, but would wage war vigorously. It was recognised that the original cause of war had been altered ; for the House of Commons voted supplies, not to vindicate our Canadian claims, but " to obtain peace and secure the Protestant interest." The war, which, as Burke put it a year or two later, had been begun in America about a piece of land, " was now to be carried on for the Protestant religion ; and the Atheist King of Prussia (the Robber of Silesia) was to fight the battles of the Lord and His anointed." At last, on the fall of Pitt, Lord Bute was able to conclude a peace, the most advantageous perhaps ever negotiated by Great Britain so far as the acquisition of important dependencies is concerned. But as a matter of fact Canada is the only one of the territories then acquired that can be regarded as a source of strength to the British Empire ; and the

immense addition of 72 millions to the national debt, together with the oppressive weight of war taxation, led presently to the loss of a territory infinitely wealthier in soil, climate, and population than all the rest of our overseas Empire put together.

Whether the military glory won by Frederick and the acquisition of Silesia compensated the people of Prussia for the dead and the maimed and the ruined is a question which the official historians of the Hohenzollern dynasty answer with a loyal affirmative. But before acquiescing in their views let us read the conclusion of Macaulay's Essay on Frederick :

" The war was over. Frederick was safe. His glory was beyond the reach of envy. . . . He entered Berlin in triumph. . . . Yet even in the midst of that gay spectacle he could not but perceive everywhere the traces of destruction and decay. The city had been more than once plundered. The population had considerably diminished. Berlin, however, had suffered little when compared with most parts of the Kingdom. The ruin of private fortunes, the distress of all ranks, was such as might appal the firmest mind. Almost every province had been the seat of war, and of war conducted with merciless ferocity. Clouds of Croatians had descended on Silesia. Tens of thousands of Cossacks had been let loose on Pomerania and Brandenburg. The mere contributions levied by the invaders amounted, it was said, to more than a hundred millions of dollars ; and the value of what they extorted was probably much less than the value of what they destroyed. The fields lay uncultivated. The very seed-corn had been devoured in the madness of hunger. Famine, and contagious maladies, the effect of famine, had swept away the herds and flocks ; and there was reason to fear that a great pestilence among the human race was likely to follow in the train of that tremendous war. Near fifteen thousand houses had been burned to the ground. The population of the kingdom had in seven years decreased to the frightful extent of ten per cent. A sixth of the males capable of bearing arms had actually perished on the field of battle. In some districts no labourers, except women, were seen in the fields at harvest-time. In others, the traveller passed shuddering through a succession of silent villages, in which not a single inhabitant remained. The currency had been debased; the authority of law and magistrates had been suspended;

the whole social system was deranged; for, during that convulsive struggle, everything that was not military violence was anarchy. Even the army was disorganised. Some great generals, and a crowd of excellent officers, had fallen, and it had been impossible to supply their place. The difficulty of finding recruits had, towards the close of the war, been so great that selection and rejection were impossible. Whole battalions were composed of deserters or of prisoners. It was hardly to be hoped that thirty years of repose and industry would repair the ruin produced by seven years of havoc. One consolatory circumstance, indeed, there was. No debt had been incurred. The burdens of the war had been terrible, almost insupportable; but no arrear was left to embarrass the finances in the time of peace."

As a matter of fact Prussia had not been self-supporting; loans had been raised in England to help Frederick to pay his troops; and there had been a deliberate debasement of the Prussian coinage, an operation far more demoralising than any system of borrowing. Readers of Carlyle will remember the Jew Ephraim who coined for Frederick, and the epigram about the coins:

> "Outside noble, inside *schlimm*,
> Outside Frederick, inside Ephraim."

No sooner was peace signed (March 1763) than Frederick, infinitely to his credit, proceeded to restore the currency. For the debased coinage of Ephraim a less debased coinage was substituted in the summer, and in a year's time (March 1764) notice was issued that an honest silver coinage, "pure money of the standard of 1750," would be ready by June 1. Thus in 14 months the currency of Prussia was in order. In less than three years 8000 ruined houses had been rebuilt in Silesia and 6000 in Pomerania. How after the peace food and seed corn were distributed in the provinces devastated by the Russians is told in a deeply interesting chapter of Carlyle.[1] The work of restoration lasted

[1] Carlyle's *Frederic the Great*, Book xxi., chapter ii., "Repairing of Ruined Prussia."

until 1770; but much unpopularity was incurred by the institution of an inquisitorial excise system borrowed from France. Whatever else the Seven Years' War may have done it cured Frederick and his people of all desire for martial glory. In his old age, it is true, he was forced unwillingly into the Bavarian War of Succession, "a sort of a war," which lasted from January 1778 to March 1779. Frederick did all he knew to avoid heavy fighting. His army was employed in foraging and eating up the food. Even so it cost him £2,000,000 and 10,000 men, while the Austrians suffered similar losses. In allusion to the foraging, the Prussian soldiers dubbed it "Der Kartoffel Krieg," the Potato War; and it ended in an "As you were" settlement, which left Germany in peace until the French Revolution.

The general treaty of peace which ended the Seven Years' War was signed at Paris in 1763. This treaty, to quote Coxe, "placed the affairs of Germany in precisely the same situation as at the commencement of hostilities, and both parties [Prussia and Austria], after an immense waste of blood and treasure, derived from it no other benefit than that of experiencing each other's strength, and a dread of renewing the calamities of a destructive contest." England wrested Florida and Minorca from Spain, but restored them again by the treaty of 1783. The differences between France and England in the East and West Indies, and in Africa, were compromised by mutual concessions, though large additions were made to the British Empire. But the financial cost was immense. Our national debt had been augmented from 75 to 146 millions. It was, however, loudly asserted, that by the additional security which the acquisition of Canada had afforded to her colonies in North America, Great Britain would ultimately acquire ample in-

demnification for all her losses, in the increasing trade and prosperity of the colonies; and that the long peace which this war was supposed to have secured would result in a steady diminution of debt; in short, it was confidently predicted that the war policy, in spite of the heavy losses it had involved, would prove a fine commercial speculation.[1]

But mark the short-sightedness of politicians! It was in order to lessen the weight of the debt incurred in the pursuit of the Seven Years' War that Great Britain, after peace was re-established, tried to tax her American colonies,[2] an attempt upon their liberties which, after reviving the horrors of war on both sides of the globe, and costing the lives of a hundred thousand British soldiers, terminated in the entire loss of our American colonies, and in the addition of nearly a hundred millions to the burden of the national debt.

The American war broke out in 1775. France joined against us in 1778, Spain in 1779, and the Dutch in 1780. Peace was concluded in 1783. We recognised the independence of our revolted colonies, retained Canada, and ceded Minorca, St. Lucia, and other

[1] See *Annual Register*, 1762.

[2] Besides the question of taxation there were difficulties as to boundaries, which also grew out of our Canadian conquests. The old colonies wanted to be enlarged. I may subjoin here the judicious remarks of Robert Hamilton in his *Essay on Peace and War* (1790). "After peace was re-established, Britain attempted to levy a revenue in America, by its own authority, in order to reimburse part of the expense contracted by the war. We enter not into the argument concerning the justice or prudence of this measure; but only observe that the securities, which the cessions at the peace procured for the colonies, furnished the pretext for the demand and emboldened the colonists in their opposition. We cannot hesitate to affirm that the successes of the former (Seven Years') war were the cause of this one."

possessions to our European enemies. Our National Debt was nearly doubled, and our credit suffered severely. Sir George Trevelyan in his history of the war writes: "The Funds always fell after British defeats and never very visibly recovered themselves in consequence of a British victory. In August 1774, before the Revolution began, the Three per cent. Consols stood at 89. A month before the news of Long Island arrived in London they were at 84; a fortnight after that news they were at 82; and that was all the effect produced by a complete rout of the Americans, which was hailed by courtiers at home, and English diplomatists abroad, as a most reassuring and almost a conclusive success. By October 1777 Consols had fallen to 78. The tidings of the capture of Burgoyne brought them down to 70. They fell and fell until the capitulation of Lord Cornwallis reduced them to 54; and they could hardly have gone lower if they were to retain any value at all." [1]

But when at last Lord North made way for a ministry pledged to recognise American Independence, Consols "rose six points on the mere prospect of a peaceful settlement with our former colonies," though Lord North had always insisted that the right of taxing them and controlling their trade was indispensable to the prosperity and commerce of Great Britain.

To understand the blunders of our colonial and foreign policy in the eighteenth century one must be acquainted with the political atmosphere and social conditions as

[1] Twenty years afterwards Pitt knocked them down to 47. The last sentence reminds us of the remark Adam Smith made to Sinclair after Saratoga. "The nation is ruined," said the young man when he brought the news. "There is a great deal of ruin in a nation," was the cool reply of the philosopher.

well as with the character of our old constitution and unreformed franchise. If the Whig magnates had had more public spirit, and if the middle classes had controlled Parliament, the war with the American colonies might never have been begun, or if begun, it could never have been carried on so long merely to humour Royal obstinacy. The paradox of a sound nation and a rotten government emerges in Sir George Trevelyan's brilliant chapter [1] on Parliament and the People: "The most serious-minded and keen-sighted among foreign critics . . . could not understand how it came about that a nation, which apparently possessed an unlimited supply of sagacious and successful men, numbered so very few of them among its rulers. . . . The real people of England had very much less than a due share in the government of their native country."

The judgment of a contemporary journalist on the King's friends of 1782 might easily be paraphrased to fit the rulers of another nation in August 1914. "The wisdom of these counsellors surpasses the possibility of human estimation. They have created a war with America, another with France, a third with Spain, and now a fourth with Holland. A nation or two, more or less, does not seem to be a matter of the least consideration with them. The candle they have lighted in America may, and probably will, make a dreadful fire in Europe." Our isolation in this war was a subject of boastful pride. A minister in the House of Commons, when charged with diplomatic incompetence, declared that the glory which the nation had acquired, the jealousy entertained of her power, and the hatred of

[1] In "George III. and Charles Fox," the concluding Part of *The American Revolution*.

her insolence, had rendered it impossible to procure any allies.

It was above all else the maritime policy of England towards neutrals that reduced us to the almost desperate plight of 1781. The successes of our revolted colonists in America induced France in the spring of 1778 to join their cause, and in the naval war which followed Vergennes, the able Foreign Minister, fished skilfully in the troubled waters of Search, Capture, and Contraband, declaring that "free ships make free goods, and that no articles are contraband except arms, equipments, and munitions of war." In 1779 the Spanish fleet united with the French, and before the end of 1780 our persecution of neutral trade brought the Dutch also into the field against us. An old treaty between England and Holland granted special maritime privileges to either party in wars in which the other was engaged. Nevertheless, from the spring of 1778 onwards Dutch merchantmen were overhauled, and searched, and ransacked, and carried into Portsmouth or Plymouth with a prize crew on board, more rigorously and systematically than the trading-vessels of any other people. The feeling among the Dutch shipowners grew very bitter; and the war party in Holland (for a war party there was) were not behindhand with reprisals. Open war broke out in 1780. The proclamation was received on 'Change with long faces. It was bad news for shipowners and merchants, "whose ambition it was to live by selling their own wares, instead of by capturing the ships and confiscating the property of others. But the fashionable tone in Admiralty circles was triumphant, and even insolent. There was a scent of prize money in the air, and the cue had been given by the First

Lord himself [Sandwich], who informed all and sundry that, time out of mind, the treachery and covetousness of the Dutch had always been equalled only by their cowardice."

But our naval policy had roused anger in yet more dangerous quarters. The two ablest potentates of continental Europe—Frederick the Great and the Empress Catherine—had small sympathy with American aspirations, and a firm determination to avoid, if possible, entanglement in the war; but at the same time, as neutral States, they were interested in protecting neutral rights. In the winter of 1779 Spanish cruisers captured a Russian trader, and sold her cargo of wheat on the plea that it was meant for the English garrison at Gibraltar. Catherine, in hot indignation, prepared her fleet, but Frederick exerted all his influence at Versailles to put pressure upon the Spanish Government and at St. Petersburg to divert the Empress's indignation into another channel. " He warmly applauded the readiness shown by the Empress Catherine to defend the rights of neutrals by force of arms; but he begged her to keep in mind that England, and not Spain, was the tyrant of the seas. The King of Prussia for many months past had been exhorting the Northern Courts to resent and resist the high-handed proceedings of the British Admiralty. Every government (he said) which possessed a mercantile navy should take active measures for its protection, and should refuse to abandon the property of its subjects to the ' brigandage and cupidity ' of these domineering islanders.[1] That was violent language," writes Sir George Trevelyan,

[1] Frederick the Great to the Queen Dowager of Denmark, January 1, 1779.

but "none too strong for those to whom it was addressed." The trade of all the Baltic and North Sea States had been more than half ruined by a war in which they themselves were not engaged as principals. A Danish or Swedish merchantman, with hemp, or tar, or timber, or grain on board—the staple commodities of Northern Europe—was always liable to be stopped, and searched, by a British frigate. The question whether the goods were contraband was decided off-hand by a post-captain with no legal training, who was arbiter in a cause which nearly concerned both his own pocket and his reputation at Whitehall as a smart and zealous officer. His decision usually favoured both, and the unlucky vessel was taken by a prize crew into a British port. "Remonstrances poured in through the ordinary diplomatic channels from Copenhagen, and Stockholm, and Hamburg, and Lübeck, and Bremen; but no satisfaction could be obtained from the English Foreign Office beyond a haughty answer to the effect that His Majesty's Ministers were bound to abide by their own interpretation of the law." When Harris, our Ambassador, expounded the Foreign Office and Admiralty's theory of belligerent rights to Count Panin, the Russian Premier answered with a smile that "being accustomed to command at sea our language on maritime objects was always too positive."

Thus the subservience of British policy to prize money set all foreign countries against us, and France seized the opportunity to press Catherine to support, or, rather, to lead, the weaker States. When the British Government awoke to the situation they did not mend matters by promising the Russian Minister that henceforth Russian merchant vessels would be exempt. For

Catherine had a vein of chivalry, and her reply was a proclamation (March 1780) asserting the maritime rights of neutrals. Following this, she took an important step in conjunction with Sweden and Denmark. "The three Governments bound themselves mutually to equip and keep on foot a combined fleet in certain fixed proportions, and to exact a strict retaliation for every one of their trading vessels which was seized by the cruisers of any belligerent Power. . . . The example of the Baltic States was imitated by all the naval countries of Europe. The Netherlands acceded to the Armed Neutrality before the year was over. Prussia gave in her adhesion in May 1781, and the German Empire in the following October. Portugal, that ancient ally of England, moved in the same direction reluctantly, and by successive steps; but she was not strong enough to stand out alone, and in the summer of 1782 Portugal likewise joined the ranks of our potential enemies. Later on even the Turk left us and became an armed Protector of Neutral Rights."[1]

It must not be supposed that the naval policy of Great Britain, so disastrous to our success in these wars, was in any way favourable to British shipowners and merchants. The rewards of privateering are a very poor substitute for the profits of legitimate commerce. From the first, as Sir George Trevelyan's history shows, the City of London had viewed the policy of George III. and Lord North with distrust. Priestley and Price, two men of influence with City merchants, had shown, at the beginning of the troubles in 1776, what ruinous consequences a war with the American colonies would bring

[1] For the above statements and quotations see Chapters XII. and XIII. of Sir George Trevelyan's last volume on *The American Revolution*.

to British trade, and it fell out as they foresaw. In all parts of the world our merchant shipping became a prey to American privateers. By 1781 " no ray of hope from any quarter of the horizon lightened the gloom which enveloped the commercial world of London. Legitimate and normal business was at a standstill, but vast gains were being made at the expense of the taxpayer by people whom no respectable firm in the City would have dreamed of admitting into partnership."

Public corruption flourished. A famous admiral complained at the time of " a long train of leeches, who sucked the blood of the State, and whose interest prompts them to promote the continuance of the war, such as quartermasters and their deputies *ad infinitum*, barrack masters and their deputies *ad infinitum*, commissaries and their deputies *ad infinitum*." This " gang of depredators " supported Lord North. Not business men properly speaking, they throve on contracts for a supply of provisions and liquor and clothing and for the transport of troops, contracts which were undersold to a deputy, or executed at the expense of our soldiers and sailors. The whole corrupt system, however, received a staggering blow in March 1781, when Lord North asked the House of Commons for a sum of £12,000,000 sterling to be raised by loan, and £480,000 by lottery. Charles James Fox, who must have been well coached by some honest insider, rose to the occasion. It was to be a 3 per cent. stock at 60. It would be far better, he said, to face the situation and issue 5 per cents. at or near par. " When the country was again at peace, and the present distress had passed away, and when the Treasury was able to pay off its obligations at par, the holders of Three per Cents. who had bought below

60 would make 40 per cent. on their money." But the great scandal was, that the loan was issued much below its true price in order to fill the pockets of individual members of Parliament, to whom most of the shares had already been allotted! Already the shares had risen far above the issue price. "The profit," said Fox, "on the loan now proposed . . . is £900,000; and this large sum of money is in the hands of a minister, to be granted to members of that House as compensation for the expense of an election, or for any other corrupt influence which might suit his views." There was enough honesty, even in that degraded House, to rise up in excitement against so huge a job. Dundas admitted that friends of ministers complained of having made only £10,000 out of the loan. The fight against corruption lasted for several weeks, and "finally extinguished such popularity as the ministry still retained among the trading classes of London."

Thus the end came and after the Peace of 1783 the country was allowed rest for ten years, during which by wise and economic management Pitt contrived to resettle the national finances. But the National Debt had been doubled, the whole purpose for which the war was undertaken had failed, and many previous conquests were wrested from us at the peace.

The French, whom the hope of injuring us had drawn into the American war, acquired nothing by the treaty of 1783; the Dutch lost some commercial privileges; and the Spaniards simply regained what they had been deprived of in the preceding war. With this may close a recital, imperfect, indeed, but perhaps not uninstructive, of the conflicts that desolated Christendom between the English and the French Revolutions.

CHAPTER III

THE WARS WITH FRANCE, 1793–1815

HISTORY, as it is taught to the multitude, tells little of the causes or the consequences of the wars that began with the French Revolution and ended at Waterloo. The records and memories of many heroes and many glorious victories survive. The agonies and woes of its countless victims, the pestilences and famines—these are forgotten. Some have even persuaded themselves that Great Britain had as good a right to crush the Revolution as to resist the onset of Napoleon. Is that so? Europe at the end of the eighteenth century was still despotically governed by dynastic kings and aristocracies. An enormous majority of the people in France, Germany, Austria, and even in England had no voice in the government. The French Revolution proclaimed liberty, equality, and fraternity. It was a signal to the oppressed in all countries. The absolute rulers of Austria and Prussia, who were then busily engaged with the Czar of Russia in partitioning Poland, turned aside to attack France and to put down free institutions and free thought—"the French principles," as they were called. On April 20, 1792, the French declared war but with a manifesto renouncing all intention of conquest. Then began the invasion of France. The Duke of Brunswick, in a manifesto issued on July 6, 1792, proclaimed on behalf of Austria and Prussia that the allied sovereigns would put an end to

anarchy in France, arrest the attacks made on the altar and the throne, and restore the legitimate authority of the King. This manifesto, which also threatened to treat Frenchmen who defended their country as rebels, did more than anything else, writes Mignet, to hasten the fall of the throne and to prevent the success of the Coalition. A great volunteer army was raised in France. In October Brunswick was checked at Valmy and retreated. In the following year Louis XVI. was beheaded and the Reign of Terror began. England meanwhile was drifting into war. By the end of 1792, when the Austro-German army was beaten back, our own aristocracy, alarmed at the sympathetic movement for reform in England, began to press Pitt to join Austria and Prussia. Pitt, reluctantly consenting, sought out a pretext and found a diplomatic *casus belli* in the opening of the Scheldt. Upon this, wrote Cobden sixty years later, if the Dutch right to a monopoly of the Scheldt was really one of the objects of the war, " the twenty-two years of hostilities might have been spared ; for if there was any one thing, besides the abolition of the slave trade, which the Congress of Vienna effected at the close of the war to the satisfaction of all parties, and with the hearty concurrence of England, it was the setting free the navigation of the great rivers of Europe." There remained indeed the question of the inviolability of Dutch territory, but on this point the French Minister had offered satisfactory pledges. " Besides," added Cobden, " the Dutch Government abstained from making any demand upon England to sustain its claim to the exclusive navigation of the Scheldt, and wisely so—for it probably foresaw what happened in the war which followed, when—the French, having taken

possession of Holland (where they were welcomed by a large part of the population as friends) and having turned the Dutch fleet against us—in less than three years we seized all the principal colonies of that country, and some of them (to our cost) [1] we retain to the present day."

Fox, in his brave speech against the war (December 13, 1792), described the opening of the Scheldt as "the pretext." Our Government's real reason for war was that France was a republic and that various persons at home wanted to reform the British constitution, to widen the franchise, to abolish rotten boroughs, to tolerate Nonconformity, and even to emancipate Roman Catholics. The French Republic tried hard to stave off hostilities with England. Indeed, on February 1, 1793, the day when war broke out, Windham, one of the Whigs who joined Pitt, "agreed that in all probability the French had no wish at this moment to go to war with this country, as they were not ready to do so; their object seemed to be to take all Europe in detail, and we might be reserved to the last." Upon which Cobden observes: "If we were justified in going to war because *we predicted* that France would attack us at some future time, there never need be a want of justification for a war." As a matter of fact, even though he put Holland in the forefront, Pitt disclosed the real reason why war was undertaken in his speech of January 4, 1793: "They had seen within two or three years a revolution in France founded upon principles which were inconsistent with every regular government, which were hostile to hereditary monarchy, to nobility, to all

[1] Less than half a century later the Dutch colonies in South Africa cost us a three years' war and some 250 millions sterling.

the privileged orders, and to every sort of popular representation short of that which would give to every individual a voice in the election of representatives." It was, in short, a war of intervention in the affairs of another country directed against republicanism and representative democracy. The French were hard pressed at first; but gradually a great military leader grew up in the person of Napoleon, who converted the Republic into a military tyranny (as Consul in 1799 and Emperor in 1804), defeated the armies of every continental power, and was finally subdued by national uprisings in Germany, Russia, and Spain assisted by the small but unbeaten armies, the superior finances, and the invincible fleet of England.

Against the armies of absolutism in 1792 the French revolutionary government defended itself by voluntary levies. Then, becoming more and more aggressive, it had recourse to compulsory drafts and to the Requisition, which Burke called " a sweeping law of unprecedented despotism." As the war went on, the organisation of Republican France took shape, and it was divided into some 30 military Governments, each subject to a General of Division. There was also a civil division into departments, districts, and cantons. The law of Conscription as a substitute for Requisition was introduced in 1798, and is attributed to Carnot, who pretended to have derived his inspiration from the Roman Republic. By this law all Frenchmen were pronounced to be soldiers, and to be liable to serve whenever the country was declared by the Government to be in danger. At other times, by this law, " the wants of the Army are relieved by the Conscription," and the number of conscripts was to be determined annually by the Government, the

contingent of each department being proportioned to its population. This contingent was again divided amongst the districts, cantons, and municipalities. All Frenchmen from 20 to 25 were made liable to Conscription, and it was the duty of the civil authority in each administrative area to prepare a list, a sort of National Register, on which were inscribed the names of all the men liable to serve, with their name, their home, their height, and other details. These lists were transmitted to the prefects, who consigned them to the Minister of War. Eight days were allowed for the preparation of the lists. The conscripts were then assembled in each canton and examined. Those who pleaded infirmity and inability to attend were visited in their homes by military inspectors. These pleas being disposed of, lists were made of the physically fit, and tickets numbered in accordance with the names on the list were placed in an urn, from which the conscripts or their friends drew the lots. The lot fell on those who drew the numbers below the amount of the quota, those above being summoned later in case death or any other disablement should befall the others. Absentees who failed to present themselves within a month of the drawing of the lots were declared refractory, proclaimed throughout the Empire, and pursued as deserters. These were the conscripts of the active service. An equal number forming the reserve were organised and drilled within their own district, to march out of it only in case of emergency. A third body, numbering one-fourth of the whole contingent, were called supplemental conscripts, to fill vacancies caused by death, desertion, or other causes. If this supplement proved inadequate, the reserve was called upon. No

Frenchman under thirty was permitted to travel or to serve in any public office unless he could produce a certificate showing that he had discharged his liability under the law of Conscription. To prevent organised opposition, the hapless conscripts were marched under an escort of gendarmerie in bodies of a hundred to various depots throughout the Empire, and there supplied with arms and clothing. Curable diseases only obtained a temporary discharge. The incurables had to pay an indemnity to the Government. At first no exceptions were allowed, but eventually the eldest brother of an orphan family, and the only son of a widow, might, on soliciting the indulgence, be transferred from the active service to the reserve, and the same privilege was allowed to subdeacons in seminaries. Another dispensation exempted workmen engaged in the manufacture of war material, and by another limited *congés* were allowed to soldiers who had survived five campaigns. One of the chief advantages claimed for the conscript system is that it saves pay. The continental conscript soldier even now only receives from one farthing to twopence halfpenny a day.

This military enslavement of the nation was fortified by a penal code of searching rigour. Any public functionary who gave a false certificate of infirmity suffered five years' imprisonment in irons. Conscripts who mutilated themselves or shammed infirmity were placed at the disposition of the Government for five years to labour as prisoners. Absentees or refractories underwent corporal punishment, and paid a fine of 1500 francs, which, together with the expenses incurred in the pursuit, was levied either on their own property, or on that of the father or mother. In 1807 a man who used

a false document to save his son from Conscription was condemned by a decree of the Criminal Court "to eight years' labour in irons, to be branded with a hot iron on the left shoulder, to an exposure of six hours, besides paying the cost of the prosecutions, and of 400 copies of the Decree." Refractory conscripts were imprisoned in the citadels of nine garrison towns, where they had to work under the most severe discipline in the arsenals, or on the roads in prison dress, with their heads closely shaved. When they gave "tokens of docility and reformation" they were to be drafted into the Army. A conscript who absented himself for twenty-four hours was punished as a deserter, either (1) by death, or (2) by the punishment of the ball (*peine du boulet*), or (3) by hard labour. Death was inflicted on those who deserted to the enemy, or who, fleeing from the punishment of the ball, carried off arms with them. The punishment of the ball was inflicted on deserters who got away in uniform but without arms. A mere deserter received hard labour for three years. The punishment by the ball was as follows:—An iron ball weighing eight pounds was fastened by an iron chain seven feet long to the deserter's legs. The deserter, after hearing the sentence read on his knees, was condemned to hard labour for ten hours daily, and to be chained for the remainder of the day in solitary confinement. This punishment was for ten years, but was prolonged with an additional ball fettered to the knee in cases of contumacy or serious disobedience.

Such is a brief outline of the law which has been so much admired by military writers in all countries. The praises of Napoleon, who perfected and improved it with such assiduous and loving care until France, bled

almost to death, at last deserted him, have been sung not only by great Prussian generals, but by Liberal Imperialists in France and in Great Britain. The sacred duty of obedience to the Conscription was inculcated by the ecclesiastical parasites of the Napoleonic *régime*, and the modern European police state has borrowed this fundamental institution from the First Empire. It is the pride of the German professor, and the glory of writers and rulers who mistake patriotism for the subjection of the individual to the state. A contemporary English writer, who surveyed the system in 1809, observed: "The grand characteristic of the present administration of France is relentless inflexibility. A host of informers secures the fidelity of the executive officers. Cases of the most signal and barbarous rigour crowd all the daily gazettes of the Empire and even the journals of Paris, into which they are compulsively and awkwardly thrust, in order that the quickening impulse of fear may be propagated through the entire mass of servitude." One of the advantages attributed to Conscription, as to other forms of slavery, is its cheapness. This fallacy needs no refutation. Slavery is the least prosperous form of industrial organisation. Unpaid labour is notoriously dear. Nations burdened by Conscription are forced to accumulate debt even in times of peace. In France it was enormously costly, but the estates of the great landowners were confiscated, and so the poor peasants, who formed the vast majority of the French nation, receiving land for blood, endured it patiently for a time. Those who had any money were allowed to pay for a substitute if they could find one. As to the confiscation of the estates, an English critic could not help contemplating with strong sympathy

the ruined emigrants, the impoverished families, and the decayed gentlemen of the old *régime* who had fallen victims to a Revolution which speedily resolved itself into a military Empire. Our own pressgang for seamen was revolting enough, but the sight of an impressment could not be compared with the distressing scenes at a Conscription ballot, when piercing shrieks accompanied the drawing of the fatal ticket from the urn. Nor in England, at the worst times of the Napoleonic War, did the traveller meet along the high roads "twenty or thirty miserable beings called refractory conscripts, guarded by gendarmes, and tied together with a rope attached to a horse's tail as a badge of disgrace." [1]

Napoleon maintained his huge armies by quartering them on defeated nations and by all the methods of systematic extortion of which military power is capable. Thus after the battle of Jena in October 1806 he refused to hear of an armistice. "He intended so to abase the Prussians that never again should they be able to contest his authority. He besieged and took all their fortresses, made his headquarters in their capital, and levied a crushing war-contribution upon people already exhausted by extraordinary charges. Having thus in a most signal way 'avenged the defeat of Rosbach,' he issued (November 21, 1806) from Berlin the famous series of Decrees which proclaimed the British Isles to be in a state of blockade."[2] The consequences of the commercial war between Great Britain and Napoleon are so little understood and so frequently mis-stated, or ignored, by fashionable writers that it may be well to

[1] See article in the *Edinburgh Review*, January 1809, on *Code de la Conscription* (Paris, 1806).

[2] *Napoleon*, by Herbert Fisher, p. 148.

show what was the policy adopted by our government, how it brought on a disastrous war with America, and how injurious it was to our industry and commerce.

In the Berlin Decree, issued "from our Imperial Camp at Berlin," Napoleon represented himself as retaliating upon the naval policy of England; for he started with the following propositions :—

1. England has ceased to observe the law of nations, recognised by all civilised states.

2. She considers every individual as an enemy who belongs to a hostile state, and consequently makes prisoners, not merely the crews of ships of war, but also the crews of merchant vessels, and even the members of commercial factories, and persons connected with commerce, where employed in their mercantile affairs.

3. She extends the right of conquest to the cargo and commodities, and to the property of individuals; which right of conquest, however, ought only to be applicable to property belonging to the hostile state.

4. She extends her right of blockade to places not fortified, and to commercial ports, in bays, and the mouths of navigable rivers; which blockade, according to the principles and practice of all civilised nations, is applicable only to fortified places. She considers a place in a state of blockade before which she has not even a single ship of war, although a place can only be considered as blockaded when its communications are so circumscribed that it cannot be approached without visible danger. She even declares places blockaded which with her whole united strength she would be unable effectually to blockade; for instance, whole coasts and whole kingdoms.

5. This monstrous abuse of the right of blockade

has no other object but to impede the communication between nations, and to aggrandise the commerce and industry of England by the ruins of the commerce and industry of the continent.

6. As this is the object of England, all those who carry on traffic in English commodities upon the continent, by doing so, second her views and render themselves her accomplices.

7. This conduct of England, which is altogether worthy of the age of barbarism, has become advantageous to that power to the prejudice of every other.

8. It is a right conferred by nature to oppose to an enemy the weapons he employs against you, and to fight against him in the same manner in which he attacks, and this principle is recognised by all those ideas of justice and liberal sentiments which distinguish civilised societies.

"We therefore determine to employ against England those principles which she has adopted in her maritime code, so long as England refuses to acknowledge one and the same law as applicable to sea and land, till she ceases to consider private property, be it what it may, a good prize, and until she shall apply the rights of blockade only to places which her force is adequate to cut off from communication."

Then follow the Articles declaring the British Isles to be in a state of blockade, and all commerce and correspondence with them prohibited; all English subjects in countries occupied by the troops of France or its allies to be prisoners of war; all commodities belonging to English subjects and all the produce of England and her colonies to be good prize; no neutral ship which came direct from England or the English

colonies to be admitted into the harbours of France and her allies.

Napoleon's reprisals were soon followed by counter-reprisals, retaliation in each case, be it observed, being inflicted by the armed forces of one state upon non-combatant merchants and innocent neutrals. A few weeks after the Berlin Decree an Order in Council was issued from the Court of St. James reciting that "whereas the French Government has issued certain orders, which in violation of the usages of war, purport to prohibit the commerce of neutral countries with his majesty's dominions; . . . and whereas his majesty, though unwilling to follow the example of his enemies by proceeding to an extremity so distressing to all nations not engaged in the war, and carrying on their accustomed trade, yet feels himself bound by a due regard to the just defence of the rights and interests of his people, not to suffer such measures to be taken by the enemy without taking some steps on his part to restrain this violence and to retort upon them the evils of their own injustice; his majesty is therefore pleased," etc., etc. The Order which followed and those of November 11, 1807,[1] are far too long for reproduction here; but a brief analysis made at the time by the Board of Trade for the use of the American merchants may be cited. It ran as follows:—

"All trade directly from America to every port and country of Europe at war with Great Britain, or from which the British flag is excluded, is totally prohibited. The trade from America to the colonies of all nations remains unaltered by the present orders. America may export the produce of her own country, but that

[1] One of these prohibited the sale of enemy merchant-ships to neutral countries.

of no other, directly to Sweden. With the above exception, all articles, whether of domestic or colonial produce, exported by America to Europe, must be landed in England, and can be only re-exported on payment of certain duties to the British Government—with an exception in favour of such articles as are actually the produce of the United States (cotton excepted). Any vessel, the cargo whereof shall be accompanied with certificates of French Consuls abroad of its origin (called certificates of origin) shall, together with the cargo, be liable to seizure and condemnation."

These Orders in Council exasperated a controversy with the United States, which was already acute owing to the naval policy of Great Britain and the practices of our cruisers and privateers. The motives which eventually led us into war were analysed about this time by an Edinburgh Reviewer (probably Brougham) who, after a learned discussion on the maritime rights of neutrals and belligerents, came to the conclusion that the claims put forward by Great Britain to search and visit American ships for deserters and for contraband were rather the pretences than the true reasons for a rupture with America: "In consequence of the long and successful war carried on by England against almost all the other maritime powers, a great portion of their commerce, and a share also of our own, has passed into the hands of the Americans. A certain class of politicians, therefore, regard them at once as rivals in trade, and as interfering with the course of our hostilities, and are anxious, not only to deprive them of all the benefit which they derive from our constant wars, but to injure them nearly as much as the enemy. The principle of these reasoners is that the enemy shall trade with nobody, and the neutrals only with ourselves." The progress of the demands made by

the assertors of belligerent rights as against neutral commerce was instructive enough. The first demand was to stop the transport of produce in neutral vessels from the French colonies to France. When this was done neutral traders carried French colonial produce to their own ports and thence to the ports of France. British naval jurists held this to be one voyage and an evasion of the first prohibition. A second prohibition was then demanded: the colonial produce must be landed and pay duties, and it must not be re-exported in the same vessel. Even under these restrictions the trade continued, and the produce still found its way to France though at higher prices.

The next demand was to revive the rule of the war of 1756, and to prevent French colonial produce entering enemies' ports at all in neutral bottoms, because in time of peace the French government only allowed French ships to carry French colonial produce to France. But if neutrals yielded to this British rule, they could still carry French colonial produce to a neutral port of Europe, whence it could find its way into the enemy's market. Hence a further demand that all traffic in the enemy's produce should be absolutely prohibited. But even this, it was argued, could be evaded, because the colonial produce of France could not be distinguished from that of British or other colonial produce, and therefore it would be necessary to interdict absolutely the carriage of colonial produce in any non-British vessels. But even this, adds the Edinburgh Reviewer, "though sufficient to outrage all public law, would still be inadequate to prevent smuggling, so long as any traffic remained between our enemies and the neutrals. There is but one other step to take, therefore. We must

go to war with the neutrals, and put their ships upon the same footing with those of our enemy, whose places in trade they are now filling. By this chain it is that we are driven on from prohibition to prohibition, till we find that the prohibition of neutrality itself is our only remedy; and that we can only trust to the vigilance of our cruisers for the security of our colonial monopoly, and the interruption of our enemy's trade. The case is therefore short and plain. If all nations will not go to war with France when we choose to do so, we must go to war with them also. There is no other way of vexing our enemy, and protecting our mercantile profits."[1]

The author of *War in Disguise* and other advocates of British naval policy declared that the outcry in America came from French houses established there, and that our triumphant navy was being rendered useless by the traffic of neutral ships with France and her allies. And besides our decrees were merely retaliatory, provoked by those of the enemy. But as the London and Liverpool petitioners in evidence laid before Parliament showed, our measures of retaliation were neither just towards neutrals nor expedient as regards our own commercial and shipping interests. They protested that the inevitable result of the Orders in Council would be to reduce our American trade from ten to four millions annually. Many thousands of hands and much machinery would be thrown out of employment, and there was the danger of losing our great American market through a war with the United States.[2]

[1] *Edinburgh Review*, October 1807.

[2] The years 1807 and 1808 are the low-water mark of British statesmanship, for they include a deplorable attack on Danish neutrality as well as the Orders in Council.

These melancholy prognostications were more than justified. The distress of Lancashire in the winter of 1807-8 was shown in a petition presented to the House of Commons by Colonel Stanley, one of the county members, complaining "that thousands of the petitioners were reduced to great distress by the stagnation of trade and the cessation of the customary demand for labour" as a result of the war. During 1808 the woollen industry of Yorkshire recovered somewhat, but the depression in Lancashire became worse. A bill to fix minimum wages for weavers failed to pass the House of Commons, and disturbances broke out in Manchester and Stockport. The rioters, however, were treated with unusual leniency, and shortly afterwards the Manchester trade improved. The recovery, however, was short-lived. In 1811, owing to low wages, bad employment, and high prices, the industrial population of the north became desperate, and a spirit of disaffection to the government spread through Leicestershire, Nottinghamshire, Derbyshire, Cheshire, Lancashire, and Yorkshire. The immediate object of the insurgents, who called themselves Ludds, Ludders, or Luddites,[1] was to destroy new labour-saving machinery and began at Nottingham, where the rioters were mostly men thrown out of employment by the new stocking frames. Those employers were chiefly attacked who had discharged men or employed them at starvation wages. Although large armed forces of local militia, volunteer yeomanry, and special constables were employed, the rioters got the upper hand in many districts, and in January 1812, a force of regulars had to be dispatched to Nottingham,

[1] The leader in each district was for some reason called General Ludd. See Preface to the *Official Report of the Trials at York*, Jan. 1813.

while Parliament passed special Acts for the disturbed districts, establishing the ancient system of watch and ward, and making the destruction of stocking frames a crime punishable by death. Early in 1812 the movement culminated in Cheshire, Lancashire, and the West Riding of Yorkshire. A good many mills and steam looms were destroyed, some particularly obnoxious inventions to the handworkers being wide weaving frames, gig-mills, and the machinery used in shearing woollen cloth. The attacks on the mills took place at night. In one of these affairs Mr. Cartwright, a Cleckheaton employer, contrived, with the help of two soldiers and four workpeople, to drive off from his shearing mill a mob of armed Luddites, who left two of their number mortally wounded on the ground. At Sheffield the armoury of the local militia was seized and plundered. Great severity was now exhibited. Seventeen of these rioters were executed at York alone in January 1813, eight having been previously executed at Lancaster and two at Chester. In Parliament a few radicals like Whitbread and Burdett pointed out that most of the distress was caused by the government, by excessive taxation, profligate expenditure, and the folly of a hopeless and objectless war upon commerce. An inquiry instituted by Parliament at this time, early in 1812, into the policy and consequences of Orders in Council proved that in all the manufacturing districts of the kingdom there prevailed among the labouring classes an unusual degree of misery and poverty; that in many places wages had been nearly halved, that employment even at starvation wages was scarce, and that the price of all necessaries was very high. Of the smaller master manufacturers many had sunk into the

rank of labourers, many were insolvent, and others had been forced to sell their stocks at a loss in order to keep themselves and their families from the parish. As the evidence taken at the inquiry plainly showed the depression was mainly due to the loss of the American market, which had taken a large portion of the cotton goods, woollens, and hosiery. That market was now closed, but the evil suggested the remedy; for it was clear from public documents that if the British Orders in Council were rescinded, the ports and markets of the United States would be reopened to British ships and British merchandise. But at a time when practically all the ports of Europe except those of Sweden were closed to British commerce, the Perceval Ministry remained obstinate. After the assassination of Perceval, however, the British Government at last gave way, and on June 23, 1812, issued a Declaration in the *London Gazette* revoking these Orders so far as American vessels were concerned. But it was too late. Five days before (on June 18) the United States of America had declared war against Great Britain.

This costly and futile war was terminated by the treaty of peace at Ghent on December 24, 1814. By a British contemporary historian the peace was attributed, on the side of Great Britain, to the want of success which had attended her armies, even after reinforcements had been despatched from the Peninsula; to the enormous expense of sending troops to Canada, and keeping them there; to the critical state of the public finances; and to the apprehension that, if the war were not speedily terminated, some of the European powers might make common cause with America on the point of maritime rights. "On the side of the United States,

the government was disposed to peace from the deranged situation of their commerce; from the alarming augmentation of their national expenditure, and the consequent embarrassment of their finances; from the imperfect organisation of their military system; and, above all, from the devastations to which their coasts and frontiers had become exposed." In both countries, added this competent writer, "the termination of the war was hailed with unfeigned satisfaction; but the force of this feeling was considerably diminished by the reflection that all the blood and treasure expended in the prosecution of the contest had been lavished in vain."[1]

While Great Britain was brought to the verge of starvation and ruin by an anti-commercial naval policy, founded upon the pursuit of prize money, France was being gradually drained of its finest men by conscription, the most elaborate and cruel instrument hitherto perfected by military ambition for the ruin of mankind.

From 1798 to 1814 the flower of the French youth was falling in wars of conquest, supported partly by levies and requisitions and indemnities, partly by the industry of the peasant, who found, as we have seen, a substantial set off in the possession of his land. Thus Napoleon preserved his power by maintaining peasant proprietorship and sustaining the confiscation of the great feudal estates. The British aristocracy kept itself in power and retained its property by avoiding the institution of conscription. If it had introduced compulsory service and attempted to rival the armies of Napoleon we too might have had a bloody Revolution and a general confiscation of the great landed estates.

[1] *The Wars of the French Revolution*, by Edward Baines, vol. ii. p. 406.

In France the drain of life was felt more than the drain of money. In Great Britain it was the other way.

The finance of the war belongs to other chapters, but we may add here some remarks on its economic and social consequences. All over the continent, from Spain to Russia, from Holland to Italy, the losses by battle and disease had been enormous, and for long years afterwards veterans maimed or blinded in the wars were to be seen begging their bread in every European city. Those who were able to work found employment irregular and wages very low. There was hardly a civilised country in the world which had not been crippled by the war. Even in England, Scotland, and Ireland, which had escaped actual devastation, visitations of famine and pestilence continued into "the hungry 'forties." Until the Reform Bill was passed in 1832 the country remained in a state of incipient revolution. Once in the navy a mutiny threatened the overthrow of government. During the war itself there were times when Buonaparte would have been welcomed by large classes of the population. Secret drillings to prepare for a rising were held in many counties. After the war rick burnings, destruction of machinery, bread riots, were frequent events. "Lord Stanhope warned the Lords last winter," wrote Cobbett on November 1, 1830,[1] "of the danger with which they were menaced by the *open war* that had begun between the poor and the rich. I have for sixteen years been warning them of the dangers of this war."

According to Arthur Young, to whose researches we are indebted for much valuable information about

[1] See Cobbett's *Two-penny Trash* for November 1830—one of the most painful and telling descriptions of those desperate times.

the rate of wages at different periods and in different countries, the average wage paid to agricultural labourers in England in 1767, 1768, and 1770 was nearly 1s. 3d. a day; in 1801 and 1811, when money wages rose to the highest points they attained during the French War, the average was about 2s. 5d., being a rise of nearly 100 per cent. But the average price of wheat, according to the account kept at Eton College during the first-mentioned years, was £2 11s. a quarter: during 1810 and 1811 its price was £5 10s., being a rise of 115 per cent.; and Young estimates that butcher's meat had, during the same period, risen 146, butter 140, and cheese 153 per cent. So that four principal articles of consumption showed an average rise of 138½ per cent. In other words real wages, as compared with these articles, had declined in the interval 38½ per cent. or considerably more than one third; and if the increased cost of beer, leather, and some other items of a labourer's expenditure had been taken into account, the fall in the rate of real wages would have appeared still more striking. In 1790, writes Porter, the weekly wage of skilled artisans and farm labourers respectively would buy 169 and 82 pints of corn; in 1800 they would buy 83 and 53. During the war, thanks to the rise in food prices, the rents of the landlords, who then governed the country, doubled. Many manufacturers, merchants, and bankers were ruined; but the burden of misery fell most heavily upon the working classes. Even as late as 1834—this is an estimate of Arnold Toynbee—half the labourers' wages went in taxes. It is true that the price of most articles of clothing, particularly cotton, which Young left out of account, fell in money price (despite the paper currency) during the period in

question. But these reductions did not by any means compensate for the extraordinary upward movement in the prices of the principal articles consumed by the working classes; so that, notwithstanding what they gained by cheaper clothing, "it is abundantly certain," to follow the words of McCulloch, "that real wages sank considerably during the latter years of the war."

The Napoleonic wars seemed to have ended in 1814, and that year was marked by wild speculation in commodities, partly as a result of the reopening of the colonial markets. Then came the return from Elba. In 1815, Waterloo was fought and won. Forthwith, the hugely inflated prices of commodities gave way. The speculators fell into panic. Within two years, 240 banks stopped payment in Great Britain.

The gold standard was soon resumed; but it took many years to restore the national credit. The 600 millions added to the debt was capital withdrawn from employment and a perpetual mortgage on the industry of the nation. "The burden," writes Spencer Walpole, "was the more intolerable from the circumstance that every class of society was experiencing unforeseen embarrassments. The farmer suddenly discovered that the conclusion of the war had reduced the demand for agricultural produce. The manufacturer unexpectedly learned that the ruin of his foreign customers was destroying the market for his products. The shipowner found that the return of peace was terminating the monopoly of the carrying trade of the world which war had given him. The embarrassments to which these classes were suddenly exposed reacted on every grade of society. The landlord had to submit to lower rents, the capitalist to lower interest, the labourer to lower

wages." The Poor Law broke down under a load of pauperism. Parishes went bankrupt, and for more than twenty years the misery of the working classes both in town and country passes description. Mr. Drummond, a Surrey magistrate, told the Commission on Labourers' Wages in 1824 that he remembered cottages with good gardens letting for 30s. before the war, which then (in 1824) were fetching £5, £7, or £10 a year. Twenty years after the war seven or eight shillings a week was an ordinary wage in the south of England. In the towns there were periodical famines through want of employment. In the country in the winter months the best paid agricultural labourer could not hope to provide his family with enough to eat, yet we had a protectionist and preferential tariff, and all the other blessings for which modern tariff reformers work and pray. In the year 1842 one in every eleven inhabitants of England and Wales was a pauper. In 1914 the proportion was about one in sixty. The compulsory privation of " the Hungry Forties " was a long-retained and bitter memory, against which the clever protectionist speeches even of a Joseph Chamberlain contended in vain sixty years later.

CHAPTER IV

PREPARATIONS FOR WAR—THE BURDEN AND FINANCE OF ARMAMENTS

It were a tempting task, after discussing the wars with Napoleon, to describe the long respite during which the exhausted exchequers of Europe were gradually replenished for fresh struggles; how Greece and Servia were freed; how national revolutions on the Continent broke out in 1848; how we fought the Crimean War (1854-6) for the integrity of Turkey and the Balance of Power against Russia with France as our ally; how Napoleon helped the Italians against Austria in 1859, taking Nice and Savoy as his prize; how Prussia in 1866 extruded Austria from Germany and gave Venetia to Italy; how the Unity of Italy was followed by the Unity of Germany and the defeat of Napoleon the Third in 1870-1; how the Concert of Europe watched over the Sick Man at Constantinople and partitioned Africa; how the United States, after a desperate Civil War, abolished slavery, forwarded the cause of arbitration, and then, turning to conquest, drove Spain out of Cuba and the Philippines; how Japan, adopting the German system, defeated first China and then Russia; how Great Britain fought a costly colonial war against the two Boer Republics in South Africa, and afterwards gave them a full measure of autonomy; and finally how Italy by attacking Tripoli set the Balkans ablaze until at last after two bloody wars Europe mobilised for another giant conflict. But

these topics are too vast, and we turn from war to armaments.

The political economy of war falls naturally into two parts or divisions, the one comprising war itself, its economic causes, concomitants, and consequences, while the other is concerned with the preparations for war; that is to say, with what we in this country call peace establishments (*i.e.* standing armies and navies), with armaments and armament companies, and generally with the military burdens which rivalry, hatred, fear, or necessity throws upon all powers. To trace the growing cost of these preparations, their main causes and the attempts which have been made to control them, is the principal purpose of this and the following chapter. It is only by a very complete survey of the public and private interests concerned that we can hope to attain a true perspective of this gigantic problem. Whether it can be solved, and if so how, is the most pressing of all political questions. For if the disease grows and spreads this generation must witness a general decline in the standards of civilised life.

If we look back over the past century we shall find that it is only in the last quarter of it that the burden of armaments in time of peace has begun in many countries to grow much faster than the general wealth. In 1895 the average inhabitant of Europe and America was far better off than in 1855, and in 1855 he was far better off than in 1815. In the history of the political economy of war, the year 1815 seemed to be a sort of temporal boundary between an old world, in which war was the normal condition, and a new world, in which peace was the normal condition. There were, in the opinion of close observers who marked an unusual

cessation of wars in Europe from 1815 to 1848, two principal causes to account for a tranquillity so unexpected and so gratifying. The first was the exhaustion of Europe, whose nations, worn out by invasions, and conscriptions, and taxes, staggering for the most part under an unprecedented load of debt, had no heart for fighting. "For years," as Channing finely said in 1829, "poverty kept the peace in Europe." But no one would wish that perpetual peace should be founded on perpetual poverty. Besides, peace makes wealth; so that if poverty were the only preventive of war, governments, after resting their subjects, might be expected to renew their pernicious activity. Yet the increasing expensiveness of war and the increasing apprehensiveness of commerce gave a certain permanence and force to pacific feeling. To quote Channing again: "When the voice of humanity cannot be heard, the hollow sound of an empty treasury is a warning that cannot be slighted." And the sharp contrast between the deterioration of 1794–1815 and the gradual amelioration of 1815–1854 was an object-lesson to the whole civilised world. Peoples began to be accustomed to regard peace as a permanent right and war as an occasional wrong—a thing to be prevented, if possible, and, if not, to be re-converted into peace at the earliest opportunity. Peace associations sprang up, and socialism, which recognised no national barriers, struck root.

A second cause, which also impressed contemporary observers, was the extension of profitable relations between all countries. "Since the pacification of Europe in 1816," wrote Channing in the discourse above referred to,[1] "a new impulse has been given to

[1] Lecture on War.

industry. The discoveries of science have been applied with wonderful success to the useful arts. Nations have begun in earnest to develop their resources. Labour has been discovered to be the grand conqueror, enriching and building up nations more surely than the proudest battles." Commerce, indeed, was miraculously enlarged. Its first great expansion followed the adoption of Free Trade by Great Britain; but soon the development of railways and steamships so quickened and cheapened intercourse that the surplus products of every nation found their way everywhere, over every tariff wall, and ridiculed the utmost efforts of Protectionist policy. Nations began to compete against one another with food and raw material and machinery and manufactures instead of with fleets and armies. A wonderful interchange of products enriched the whole face of the earth, and gave every part a new, lively, and absorbing interest in the maintenance of peace and order and security.

Happily for our forefathers the recovery, at first slow, then rapid, during the thirty-nine years of peace following Waterloo was used by British governments mainly for the reduction of taxes and debt. Only a small proportion of the revenues released went to the augmentation of armaments. The naval rivalry with France was mitigated by the influence of Cobden,[1] and after his death in 1863 the attention of Napoleon the Third was diverted to the growing military power of Prussia. The view of British statesmen and of the House of Commons as a whole in the years between 1815 and 1870, perhaps

[1] Whose treatise on *The Three Panics* of 1847, 1851, and 1859 is a masterly survey of the subject. Cf. also Bagehot's pamphlet, "Count your Enemies and Economise your Expenditure," 1862.

even till 1890, were well expressed by Sir Robert Peel:—"We should best consult the true interests of the country by husbanding our resources in time of peace and—instead of a lavish expenditure on all the means of defence—by placing some trust in the latent and dormant energies of the nation, and acting upon the confidence that a just cause would rally a great and glorious people round the national standard and enable us to defy the menaces of any foreign power." It was in this speech, delivered in the House of Commons on March 12, 1850, that Sir Robert Peel suggested a limitation of armaments on the continent;[1] and although the proposal went no further, a certain diplomatic understanding grew up between France and England by which, for many years, our fleet and our naval expenditure were maintained at a proportion of three to two as against those of our French rival. There was, it is true, an increase in the 'thirties and 'forties, large, if considered in percentages, but still small in proportion to the growth of private incomes. Thus the cost of the British fleet rose from £4,200,000 in 1831 to £8,000,000 in 1847, and that of the French fleet in the same period from £3,000,000 to £5,000,000. After the Crimean War

[1] See Hansard CIX., p. 765.—"No greater benefit could be conferred on the human race than if the great Continental Powers were to consent to maintain their relative position towards each other, while each reduced its army to an amount of force the maintenance of which would not exhaust its strength and undermine the foundations of its prosperity. If the time for a severe struggle should ever recur the financial trial would be as severe as the physical one. If the Governments of Russia, Prussia, France, and Austria would have the good sense, without any disturbance of the balance of their relative strength, each to forego a portion of the enormous expense incurred by maintaining vast armies, they would not diminish their national security, and would greatly contribute to the happiness of their people."

statesmen of all parties—Lord John Russell, Gladstone, and Disraeli—joined with the Manchester School in calling for a return to the old peace footing. "It is by moderate establishments," said Russell, "by rendering such establishments good and efficient, by attending to everything which cannot easily be originated or replaced; it is by such a system, and by relying on the greatness of the country and on the spirit of our people that you will be most formidable in war, and not by any new-fangled system of increased Estimates during a time of peace."

Some light may be thrown upon the burden of armaments and of war debts by considering it in relation to the financial history of the United Kingdom, one of the few countries which has always maintained faith with private investors.

Archbishop Whately, who held the Chair of Political Economy at Oxford, in 1830–1, pointed out, in one of his lessons on money matters, that more than three-fifths of the taxes raised annually went in paying interest on the national debt, and nearly all the rest of the revenue was swallowed up by the army and navy. Every pound paid in taxes was disposed of in about the following proportions :—

	s.	d.
On the army and navy, etc. . . .	7	2
On the civil services	0	10
Interest on national debt . . .	12	0

A generation later Judge Longford made a similar calculation, which worked out as follows. The proportion allocated to the civil services had been multiplied, it will be seen, by five—from 10d. to 4s. 2d. :—

	s.	d.
On the army, navy, etc.	7	9
On civil services	4	2
Interest and sinking fund on debt . .	8	1

In 1898, before the Boer War, a similar calculation would have given the following result—showing another gain for the civil service, but also a threatening increase in the naval and military share :—

	s.	d.
On the army and navy	9	10
On the civil services	5	0
Interest and sinking fund on debt . .	5	2

In 1903–4, another year of peace, but after the Boer War, the expenditure under all three heads had greatly increased ; but this time the proportion spent on the civil services had slightly diminished :—

	s.	d.
On the army and navy . . .	10	9
On civil services	4	9
Interest on debt	4	6

But if rates are included in taxes, and the expenditure of local authorities added to the item of civil services, a real improvement appears in the relative proportion of civil to military expenditure. To illustrate this we may compare the year 1870–1 with the year 1903–4, in each case adding the produce of the rates to the produce of the taxes, and the local expenditure out of rates to the expenditure on civil services :—

In the year ending March 31, 1871, the public revenue from taxes amounted to just over 68 millions ; the public expenditure was just under 68 millions ; the local revenues, including rates, tolls, and profits, but excluding government contributions, came to 25 millions. The expenditure for the year 1870–1 (excluding the cost of collecting revenue) then works out as follows in round figures :—

Civil services :	
(*a*) national	13 millions.
(*b*) local	25 millions.
Total civil services . . .	38 millions.
Army and navy	24 millions.
Service of debt	26 millions.

Thus, out of a total of 88 millions of expenditure defrayed from taxes and rates, 24 went to the army and navy, 26 to the debt, and 38 to what may be called by contrast productive and beneficial expenditure—the civil departments and local government. Out of every pound taken from the pockets of British ratepayers and taxpayers in 1870

s.	d.	
5	5	were spent on the army and navy.
5	11	were spent on the national debt (interest and sinking fund).
8	8	were spent on poor relief, police, education, roads, public health, and other civil or local services.[1]

In 1903–4 the national expenditure (excluding expenditure from loans) had risen to 130 millions, and the local expenditure from rates, tolls, rents, etc. (excluding expenditure from loans and government contributions), to about 90 millions. The total expenditure to be considered (after deducting the cost of collecting customs and inland revenues) was about 216 millions, divided as follows :—

Civil services :	
National	27 millions.
Local	90 millions.
Total civil services . . .	117 millions.
Army and navy	71 millions.
Service of debt	28 millions.

[1] See Statistical Abstract, 1873, Table 1.

Thus, out of every sovereign taken by the Government from the pockets of British ratepayers and taxpayers in 1903

s.	d.	
6	8	were spent on army and navy.
3	0	were spent on the national debt.
10	4	were spent on civil and local services.

It is only within the last twenty-five years that civilisation has begun to tremble at what was called "the armed peace of Europe." At the birth of Christ the standing army which defended the Roman Empire in Europe, Asia, and Africa numbered only about 300,000 men;[1] and probably the standing armies of the principal European powers in the reign of George the First were together no larger. Yet the evil was growing, and it arrested the attention of the clear-sighted Montesquieu, who protested most vigorously against the ruinous competition of his day. "Each monarch," he wrote, "keeps as many armies on foot as if his people were in danger of being exterminated; and they give the name of peace to this general effort of all against all." The consequence, he added, is "a perpetual augmentation of taxes." For this there might have been a natural remedy; but another mischief had supervened. Kings were no longer content to spend their revenues. They went to war with their whole capital, and staked the future as well as the present earnings of their people with the utmost levity. Indeed they had already begun to mortgage their funds in time of peace for purposes of war.

But if the evil was already manifest to Montesquieu,

[1] In 1897 less than 30,000 soldiers sufficed to guard the United States of America.

the whole scheme and proportion of things altered with the system of conscription, a system fully developed by Napoleon and afterwards perfected by the Continental powers in the second half of the nineteenth century. To comprehend the magnitude of the movement and to measure the rate of acceleration we may usefully take two dates, 1858 and 1898, and compare the state of armaments. The first year is an interesting one, because it immediately preceded the first of the two sharp but decisive struggles which terminated in the establishment of the modern Kingdom of Italy and the modern Empire of Germany. According to a computation made by a careful writer of that day from the best sources the peace establishment of Europe consisted of over 2½ millions of men. This barrack population was made up as follows :—

(1) Russia	600,000	(14 Lesser Italian) States	36,000
(2) Austria	380,000	(15) Belgium	73,000
(3) France	366,000	(16) Switzerland	72,000
(4) Prussia	161,000	(17) Holland	58,000
(5) Lesser German States	124,000	(18) Sweden and Norway	42,000
(6) Bavaria	87,000	(19) Principalities	34,000
(7) Hanover	26,000	(20) Portugal	26,000
(8) Saxony	25,000	(21) Denmark	21,000
(9) Turkey	143,000	(22) Greece	9,000
(10) England	140,000		
(11) Spain	112,000		
(12) Naples	92,000	Total,	2,675,000
(13) Sardinia	48,000		

The reflections made by the compiler of these statistics are worth recalling, for they apply with greater force to the far more appalling conditions which will confront us upon the restoration of armed peace.

Why, he asked, should Europe require eight or nine

times as many soldiers to protect her after nineteen centuries of Christian preaching as she needed under the pagan empire of Augustus? All external danger had disappeared. The Sultan was powerless except to murder his own subjects. The foreign risks of Europe were measured by her own aggressions in Africa and Asia. Each of the Christian powers of Europe maintained, at vast expense and sacrifice, a huge and costly military establishment in order to protect itself against attack from its neighbours or to support its own schemes of aggrandisement. For nearly two centuries Europe had been free from the fear of a horde of invading barbarians. Her rich and flourishing cities were not liable to be sacked by Goths and Visigoths, Franks and Huns, Picts, Saxons, and Danes, or the rest of the unnumbered and unnamed hordes which the populous north "poured from her frozen loins to pass Rhene or the Danau." All this was very true. But in 1858 all Hungary and a large part of Italy were still under Austrian tyranny. Germany was still distracted. Bulgaria and Bosnia were still Turkish. The French were under a corrupt despotism.

And yet forty years later a more democratic Europe was groaning under a still heavier weight of military servitude. In 1898 the standing armies of Europe had increased by nearly a million, at a greater rate than the population, if not at a greater rate than the wealth. Let us place them in their new order :—

EUROPEAN ARMIES ON A PEACE FOOTING IN 1898

Russia [1]	860,000	France [3]	576,000
Germany [2]	585,000	Austria and Hungary [4]	397,000

[1] War footing, about 3,400,000.
[2] War footing, about 3,900,000.
[3] War footing, about 3,975,000.
[4] War footing, about 2,749,000.

Italy [1] . . .	185,000	Belgium . . .	47,000
Great Britain,[2] at home and in the colonies . .	171,000	Bulgaria . . .	42,000
		Sweden . . .	40,000
		Roumania . .	46,000
In India . .	73,000	Montenegro . .	35,000
Turkey . . .	180,000	Portugal . . .	30,000
Spain . . .	120,000	Greece . . .	26,000
Holland . . .	78,000	Norway . . .	18,000
Denmark . .	50,000	Servia . . .	13,000
Total peace footing .	3,562,000.		

Luxemburg, a neutralised State with a population of 217,000, had in 1898 an army of 325 men.

Switzerland had no standing army; but the whole population received a short military training. Nearly 500,000 men could be called upon to resist invasion. The above figures, drawn from English sources, do not give an adequate notion of the burden of armaments for they exclude "reserves" and the ever-growing naval forces. In the same year another representation of European armaments in 1898 was prepared for the Czar and his ministers in that year in order to pave the way for the Hague Conference. It appeared in the *Official Messenger* of St. Petersburg by way of supplement to Count Mouravieff's Note. According to this Russia's peace establishment numbered about a million men, and 280,000 conscripts were annually enrolled. On a mobilisation the Russian forces were supposed to rise to 2½ millions, exclusive of about 6,950,000 militia and reserve; so that Russia, with a population of 120,000,000, had on paper a force of over 9,000,000 trained soldiers. France had, including reserves, 4,370,000. Her standing army numbered 589,000,

[1] War footing, about 2,220,000.

[2] Total force in 1898, including army reserves, militia, yeomanry, and volunteers, 742,000.

which could be raised by mobilisation to a war footing of 2½ millions. Germany, with a peace effective of 585,000, boasted that she could mobilise 2¼ million men in ten days. There were supposed to be 4,300,000 trained soldiers in Germany. The standing army of Austria-Hungary consisted of 365,000 men, 15,000 less than in 1858, but rising to 2½ millions on mobilisation, and to 4 millions including reserves. Italy had a peace establishment of 174,000, which could be raised to nearly 1½ millions by mobilisation, with a reserve in addition of 720,000. The standing army of Great Britain was larger than that of Italy by 50,000 men (220,000 in all), but our total force, including militia and volunteers, only numbered 720,000. This, however, excluded over 100,000 sailors and marines in the Royal Navy. To give an idea of the numbers of these gigantic hosts, it was calculated that the French army in line formation would extend a distance of about 325 miles; while the 34,000,000 men who composed, on paper, the available trained forces of the Continent in 1898 would have stretched, had they been called out and drawn up in line, from Paris to St. Petersburg. Compulsory service had also been adopted by Japan, and by several of the South American Republics.

Then as to cost. The permanent standing armies of the world were computed by the *Official Messenger* at 5¼ millions always under arms, which, at an average cost of £40 per man per year [1] (a very moderate estimate), would mean an annual sum raised by tax and debt of

[1] In 1898, it was computed, the annual cost to the taxpayers of every soldier in the standing armies of the six great European powers varied from £30 in Russia to £81 in Great Britain. A German soldier cost £46, and a French soldier £65.

£210,000,000, representing at 4 per cent. a capital sum devoted to militarism, and withdrawn from industry, of £5,250,000,000. But the 210 millions ought to be doubled in order to allow for the product of the men's work, if they had been allowed to remain in industry. What comfort and happiness might have been diffused among the labouring poor of the world if half this gigantic sum had been restored after the First Hague Conference to the fruitful and fertilising channels of industry, and if, at the same time, 2½ millions of labouring men, instead of drilling two years for mutual destruction, had been dismissed from the ranks to join in producing works of utility or beauty.

From a series of articles published in *La Revue Statistique* about the same time (September 1898), it appeared that the ordinary cost of European armies in time of peace, per head of the population, varied from 2s. 7d. in Finland to 13s. 10d. in France. The average for a Dane was 5s. 3d., for a Dutchman 8s. 3½d., for an Englishman 9s. 6½d., and for a German 11s. 8d. An English family of four persons would pay on an average at that time nearly £2 per annum for the army and rather more for the navy. In 1914 the contribution had risen from £4 to £7 for the two services.

As a result of the Boer War our military expenditure increased 50 per cent., so that a family of the same size had to pay nearly £3 a year for the army where previously it had paid £2. The cost of the navy at that time in Europe varied from 10d. a head in Austria-Hungary to 11s. 7d. a head in Great Britain. In France it was 6s. 2½d., in Germany 2s. 11d., in Russia 1s. 2d., in Holland 5s. 5½d., and in Denmark 3s. 5½d. The total military budget of Europe was, in 1897-8, about

£156,000,000, and the total naval budget, £61,000,000, of which the British share was more than a third. The economic result was summarised by the *Official Messenger* of St. Petersburg :

" By no possibility can expenditure on this colossal scale be reproductive. It exhausts the sources of national revenues, increases taxation, paralyses the action of national finance and commerce, and arrests the general well-being. The best minds of all countries and all ages have therefore sought to assure peace without recourse to constantly increasing armaments by principles of justice and equity operating through the channel of arbitration." The Hague Conference of 1898 established a Court of Arbitration, but no Court of Disarmament. The game of " Beggar my neighbour " could not be ended in the Oranje Zaal. Still a first attempt was made by the Czar's government.

On August 24, 1898, a Note was handed, by order of the Czar, to the representative of every Power accredited to the Court of St. Petersburg. It opened with these resounding words :—" A universal peace, and a reduction of the intolerable burdens imposed on all nations by the excessive armaments of to-day is the ideal towards which every Government should strive."

The Imperial Government, the Note went on, believed the moment to be a very favourable one for an international inquiry into the most effective means of securing a real and durable peace for all nations, and in particular of arresting the progressive increase of armaments. For the past twenty-five years the maintenance of peace between the Powers had been a main object of European policy. Great alliances had been concluded and undoubtedly they had conduced

to the maintenance of peace. Nevertheless, in the emphatic words of this remarkable document, "the unceasing increase in financial burdens is threatening the very roots of public prosperity." Labour and capital, enterprise and invention, were being diverted from the service of man into unnatural channels of destruction. Millions were being spent on engines of warfare which might be deemed irresistible at the time but might on the morrow be rendered valueless by a single new discovery. Economic crises were justly attributed to this system of armed peace, and a prediction was made that if the system were indefinitely prolonged it would inevitably end in the cataclysm which it was designed to prevent. "To set a final term, therefore, to these armaments and to discover a means of preventing calamities that threaten the entire world is the supreme duty of every modern State."

The courteous and generally favourable reception given to the Russian Note led, as we all know, to the Hague Conference. On January 13, 1899, Count Mouravieff addressed an invitation to all the Powers; after referring to his previous Note he pointed out that the latest estimates of military and naval expenditure showed a continued growth of armaments. He therefore renewed his proposal that "an inquiry should be initiated without delay into the means of limiting the present augmentation of military and naval armaments, a question evidently becoming more and more urgent," and also that the way should be prepared for "a discussion of questions touching the possibility of substituting the pacific action of international diplomacy for the arbitrament of force."

England and the United States were comparatively

prosperous, and their governments sadly indifferent. That of Germany was hostile. Speaking on the Russian proposal for an international agreement not to increase the size of armies a German representative said :— " The German people is not crushed under the weight of charges and taxes. . . . Quite the contrary, public and private wealth is increasing. . . . So far as compulsory military service is concerned, which is so closely connected with these questions, the German does not regard this as a heavy burden, but as a sacred and patriotic duty to which he owes his country's existence, its prosperity, and its future." [1]

After the failure of the Czar's proposals in 1898 the expansion of armies and navies and armaments went ahead faster than ever. But in order to show the rate of development it will be well to trace the expenditure of the four leading Powers which acted as pacemakers in the great race.

Our first year shall be 1890 ; our second 1897, before the Spanish-American and Boer Wars ; our third 1906, after the Boer War ; and our fourth 1913, or the last year available. To begin with Great Britain :—

GREAT BRITAIN

Year Commencing April 1.	Army. £	Navy. £
1890	17,560,000	15,553,000
1897	19,330,000	20,850,000
1906	27,765,000	31,434,000
1913	28,346,000	48,833,000

Since 1890, it will be seen, we have added ten millions to the annual cost of our army and thirty-three millions to the annual cost of our navy. Of this last increase

[1] Speech by General von Schwarzhoff before the First Committee of the Hague Convention, June 27, 1899.

more than sixteen millions has occurred in the last five years, and is directly responsible for the severity of recent taxation, more especially in the budgets of 1909 and 1914.

GERMANY.

Year Commencing April 1.	Army. £	Navy. £
1890	35,976,000	3,586,000
1897	30,741,000	5,701,000
1906	37,660,000	12,958,000
1912	47,260,000	23,522,000

These figures are from the *Statistical Abstract*. The increases tally as closely as would be expected with those of Great Britain. The army increases are a little more and the naval increases a good deal less. The strain was too much for German finance, and in 1913 a capital levy of fifty millions for the army and for fortifications was proposed, and put into execution as regards the first instalment. This showed that the financial reform and the new taxes then imposed had proved inadequate. Thus in 1909, although the whole cost of new ships for the navy was paid out of borrowed money, another deficit of 12½ millions sterling was anticipated.

UNITED STATES

Year Ended June 30.	Army. £	Navy. £	Pensions. £
1890	8,916,000	4,120,000	21,387,000
1897	9,790,000	6,912,000	28,210,000
1906	23,589,000	22,095,000	28,207,000
1912	29,759,000	27,118,000	30,718,000

In the case of the United States our figures are again taken from the *Statistical Abstract*. In 1909 and 1910 they went ahead rapidly. Clearly Presidents Roosevelt and Taft led the United States into a foremost place

among the great Powers as pacemaker in both military and naval expenditure.

FRANCE

Year.	Army. £	Navy. £
1890	23,209,000	8,055,000
1897	27,345,000	10,431,000
1906	34,382,000	12,236,000
1912	39,753,000	18,675,000

Thus between 1890 and 1913 France would appear to have added more than sixteen millions to the cost of her army, and above ten millions to the cost of her navy. Considering that her population has been stationary, it is not surprising that these additions, coupled with the Morocco war, caused large deficits, which raised the interest on the debt to over fifty-one millions sterling.

One may sum up with a tabular comparison of military and naval expenditure at the time of the Czar's proposal and on the eve of the great war, which includes all the principal combatants:—

	Naval Expenditure in 1898.	Naval Estimates in 1914.
Great Britain	£25,674,000	£51,550,000
France	11,716,000	25,387,000
Germany	5,972,000	23,285,000
Russia	7,089,000	26,149,000
Austria	1,300,000	7,408,000
Italy	4,709,000	10,313,000
Japan	1,100,000	10,024,000

	Army Expenditure in 1898.	Army Estimates in 1914.
Great Britain	£20,800,000	£28,845,000
France	26,343,000	57,460,000
Germany	31,635,000	71,000,000
Russia	30,327,000	79,704,000
Austria	10,000,000	31,231,000
Italy	12,683,000	18,756,000
Japan	3,200,000	9,997,000

It should be added that in most of these cases, notably Japan, there was a heavy " extraordinary " expenditure out of money borrowed, which is not included in these figures.

Some years ago a calculation was made by M. de Molinari that the European working man of the present day has to work a whole month in the year to defray the cost of war and armaments ; and in most countries he has to work a week or two longer to pay interest on national debt, that is for the wars which his predecessors could not pay for. In 1910 the writer of this book, after surveying recent additions to military and naval expenditure by the principal Powers, concluded :—

" If Europe had accepted the original proposal of the Czar at the first Hague Conference to discuss and seek a remedy for the increasing burden of armaments, and if that proposal had been successful in bringing about, at any rate, an arrest of military and naval expenditure, all the European Powers would now be enjoying overflowing treasuries, with ample funds both for the reduction of taxation and for the improvement of social and economic conditions. Has not the time come for British statesmen to revive this proposal, and to endeavour to bring about an international agreement? Every Prime Minister, every Foreign Secretary, who folds his hands and does nothing while the machinery of warfare and the cost of armaments grow at this unheard-of rate runs the risk of being held responsible for a ghastly and avoidable calamity."

CHAPTER V

THE TRADE IN ARMAMENTS

SUPERIORITY of weapons has given the victory almost as often as superiority of strategy where mere courage or numbers would have decided otherwise. Hence the attention that has been bestowed upon the manufacture and supply of arms and armour. Hence also the gradual development of a great trade with centres which shift as changes and revolutions are brought about in warfare by invention, and as new military or naval powers emerge. The blades of Damascus, Toledo, and Sheffield were famous in their turn and were sold freely to all comers. Swords, like guns, torpedoes, or battleships, were made for profit. Turks, Spaniards, and Englishmen have fallen often enough by home-made weapons. The armament tree has now grown until its leafy ramifications throw shadows over all the world. There is a market in the most barbarous countries for the most refined machinery of destruction. Thus, though the preparations for war are national, the trade is international. The most fashionable firms, Krupp, Creusot, Vickers, Armstrong, etc., sell very largely to foreign governments. They also co-operate from time to time for the purpose of stimulating the demand or raising prices. Their directors form syndicates and enter into agreements for exploiting virgin markets. But as the only customers of such firms are governments, whose ministers and subordinate officials have no interest in economy, and have even been known to yield to bribery, the ordinary theory

of supply and demand cannot be applied rigorously to the armament trade. Moreover, in most countries the government is itself a manufacturer of arms, ammunition, warships; and there are probably but few instances of a government establishment being allowed in peace time to manufacture for a foreign power. It is, however, natural that a great private firm should form close connections with its government. If public money is not actually invested in its shares, highly paid directorships may be offered to influential officials, possibly with a view to attracting government orders.[1] As modern armaments require large capital and expensive plant the tendency of great rival companies to co-operate, which is universal in high-tariff countries, is particularly marked in this trade. But since a formal combination between manufacturers of armaments in different countries might conceivably arouse patriotic criticism, and so positively endanger the volume of business by making war itself look ridiculous, the evils of competition and price-cutting are as a rule avoided by secret agreements, which are either national or international in scope. A liberal expenditure on advertisements or subsidies is another precautionary measure which guarantees under ordinary circumstances a favourable press.

When armament firms fall out over the exploitation of countries like the South American Republics, China, Turkey, or Russia, which have not the technical resources for supplying themselves, diplomatic difficulties often arise, but are usually—though not always—adjusted without open scandal. To push the armament trade in

[1] A superior person reviewing my book in the *Spectator* described this sentence as a "low insinuation," and tempted me to substitute "usually" for "possibly" in this edition.

such regions is one of the functions of modern diplomacy. It follows that none of the economic theories that have been fashioned for the industries of peace really fits. The nearest case, perhaps, is that of a monopoly like a water company which supplies several local authorities. But this parallel is obviously far from adequate. The demand for armaments has so many peculiar characteristics that armament firms have to seek success by peculiar methods. Some of these are due to the monopoly element, some to the government contractor element, some to the special causes and motives that determine the demand for armaments.

Since the demand for armaments is greatest during war, war is the ultimate aim of private armament firms; or, if not the actual aim, it is their *raison d'être*, the end and purpose for which they exist. And as the leading armament manufacturers are companies many investors and speculators in Great Britain, Germany, the United States, and France (the countries which produce most war material) have shares in armament firms. Hence there is a large class—apart from the actual war professions and apart from directors, salaried officials, and employees—which has a direct pecuniary interest in war. It is natural enough that many of these investors should be influential; for who should be better informed as to the prospects of armament firms than ministers, high officials, and their private friends? Moreover, in various ways the press finds an interest in the business; so that philanthropic efforts to promote goodwill or a friendly understanding between nations constitutes an attack upon economic interests resembling the menace of temperance movements to the liquor interest. From this point of view there is a very close parallel between

a great beer or whisky company and a great armament concern. Thus although it is clearly to the interests of mankind to make proportional reductions of armaments, the groups that manage mankind have preferred to arrange a competitive race, which was bound to end in general disaster.

During the last half-century a system known as representative democracy has given most of the civilised nations some small share in the government, or rather some small control over their rulers. As a result partly of this and of the spread of education, but still more of the enormous growth in the cost of war material, the old practice of almost perpetual war has been abandoned; but in relation to the demand for armaments the continual apprehension of war is a serviceable substitute; and the only difficulty lies in reconciling the peoples to an ever-growing tribute.

To persuade the taxpayer that he requires armaments he must be shown that other nations are a menace. If one enemy flags in the race another can usually be found, and if there is a temporary lull in the trade a panic can be worked up with marvellous rapidity. Diplomacy working behind the scenes with the directors of this trade and of the allied press is an invaluable aid at times when economic exhaustion or peace movements threaten business.

Here again the ordinary economic theories are not applicable. Human beings have wants—they fear hunger and cold; they require food, clothes, and houses. As they get more of these, their demand slackens. Sometimes, especially in society, one person wants something —jewellery, furs, a motor car, or the like—because another has it. But Jones, as a rule, wants a thing for

himself and not solely or mainly because Brown has it. A hungry man wants food whether or not others have enough to eat. But the basis of armaments is that they are used by one state *against* another state. The more battleships Argentina buys the more are ordered by Brazil, and so on. Hence, if one government can be persuaded to increase its armaments more orders can be secured for others. The supply, instead of checking the demand, increases it. Nay more, it is found by experience that a large addition to the navy vote in one year leads to an automatic increase in the following year whatever may be done in other countries. Take a concrete case. During the years 1906 to 1914, when the Triple Entente was pitted against the Triple Alliance, a British firm, which by establishing a branch in Austria or Italy could get orders for warships from either of those governments, was not only doing a good piece of business, but was creating a certain prospect of further business at home by supplying a cogent argument for at least a double increase in the British Navy. But if an English firm sold boots to Austrian or Italian merchants this would have no tendency to increase the demand for boots in England.

If armaments are made by private firms, it is inevitable that such firms will use all available methods to get orders from foreign powers—even though they are potential enemies. If not they are neglecting their business. The first duty of directors is to their own shareholders, and as there is no law prohibiting exports of armaments the objections sometimes advanced by sensitive moralists are usually overruled. The practice, moreover, is supported on patriotic grounds by naval and military experts in the press, who point out that in

case of war uncompleted battleships can be commandeered by the home government. This was actually done in the autumn of 1914 in the case of the Turkish battleships—with disastrous consequences.

A demand for increased armaments may come from public opinion, *i.e.*, the newspaper press, or from the government, which informs parliament on the advice of its experts that an increase in the estimates is necessary for the security of the country. If a controversy arises, true — or false — statements are circulated as to the military or naval preparations of other countries. It is by an appeal to fear that modern governments overcome the reluctance of parliaments to impose new taxes or to borrow for armaments in time of peace.

If all rulers, ministers, and newspaper proprietors were genuine lovers of peace and concord, the menace of armaments would be removed by international agreement and immense annual sums would be set free for the social service of mankind. Slums could be abolished, and the world would progress as it has never progressed before. Unfortunately but few of those who rule have visions of that sort. The glories of war and the splendours of armaments, the popularity of military and naval spectacles, the fine uniforms and decorations, the enormous influence of the military and naval professions—all these considerations must be weighed and balanced before we can understand why the manifest interests of society are neglected, and are likely to be neglected, by its trustees not only in tyrannies and aristocracies, but also in modern democracies. In corrupt countries, moreover, government contracts cannot be got for nothing—commissions have to be paid, often to a very large number of persons. A story

is told of an Englishman who went out to execute a contract for a cruiser which a branch establishment of his firm had procured from the government of a European power. On his arrival he began to pay commissions to the various folk, great and small, who were interested in the contract. At last to an official who came with an exorbitant demand the Englishman cried: "How am I to build the cruiser?" The reply was: "What does that matter so long as you get paid and we get paid?"

But the classical illustration of commercial travelling in armaments is taken from the records of a case in the Chancery Division heard on December 14 and 15, 1904, by Mr. Justice Warrington. It was an action brought by a Mr. R. L. Thompson, formerly a special correspondent of the *Times*, against the armament firm of Armstrong, Whitworth & Co., claiming various sums due on orders for warships from the governments of Chili, China, and Japan during the years 1892 to 1898. Mr. Thompson was acting for Armstrong's from 1886 to 1897, and for the *Times* up to 1894. He claimed to be specially well acquainted with Spain and Portugal, and some of the South American Republics, where he seems to have had influential friends. His position was not that of an ordinary commission agent, but (to use the language of his counsel) "a position somewhat analogous to that of a private diplomatic agent, or a sort of a private ambassador." Counsel went on to explain that his client's business was "to find out what was happening in various countries, to let his employers know what was likely to be required, and generally to prepare the way for the receipt of orders for warships

and armaments." From 1886 to 1890 Mr. Thompson acted for the British firm in Spain and Portugal, but was unable to do much business. In 1890 he went to Argentina and acted as the firm's representative there and in Chili—a highly promising arrangement as hostile relations then subsisted between the two Republics. The private ambassador, being impartial in his sympathies, was just as eager to supply one rival as the other. The commission varied. By a bargain made in 1892 he received 5 per cent. on orders for artillery and armaments, and 2½ per cent. on hulls and machinery. In 1893 he went to China. He was there during the Chino-Japanese War, and stayed in the Far East for four years with one short interval. In the first instance he received £1000 for expenses and 1 per cent. on all orders. In February 1894—to quote one of the reports—" there was a slight misunderstanding between the plaintiff and the managing director, in consequence of which the plaintiff gave a six months' notice to the firm, determining his agreement with them; but this misunderstanding was subsequently cleared up, and the plaintiff continued to act as the agent of the defendants." In September 1894, the plaintiff ceased to act as a special correspondent owing to a difference of opinion between himself and the editor as to the political situation in the East. But he was able according to his own account to conclude much better terms with Armstrong's after a visit to England in 1895. By this arrangement (so the plaintiff alleged) he was to receive £3000 a year for expenses in addition to the 1 per cent. commission on orders. " Not a penny of that has been paid," Mr. Thompson complained, " and although he obtained

orders worth millions of pounds for armaments and vessels for Chili, China, and Japan, he said he had only received £5000 in 1895 and 1896, and £1000 on account of expenses in 1892." He had received £3695 in 1893 and £8711 in 1895 on sales of warships to Argentina and Chili; but these were for sales effected before the arrangement of 1892. In August 1895, the plaintiff returned to the East, remaining out there till May 1897. The greater part of the moneys he claimed to have earned while in China and Japan still remained outstanding and owing to him by the defendants, who, so the plaintiff alleged, declined to render any accounts. Hence arose the action. Nearly the whole of the first day was occupied in reading the voluminous correspondence which had passed between the plaintiff, Sir Andrew Noble, and other members of the defendant firm from 1887 to 1895.

In the year 1893 Mr. Thompson was the first to get news that France might attack Siam. He at once hurried off to Siam where he was received by the King, and very soon his name "rang throughout Siam," whence he wrote and telegraphed to the firm about getting orders for warships and other armaments from the Siamese Government. In the course of the action (which was settled satisfactorily on the second day) a great deal of interesting correspondence was read. Some portions, extracted from the London press reports of the time, may be reproduced here as illustrations of some of the theories advanced in this chapter. All were from Mr. Thompson to the managing director of Armstrong's. We take three selections from letters written in 1892 during a brief stay in London when Mr. Thompson was preparing to start for the Far East:—

1. "I have taken large offices in Bouverie Street, where I shall receive ambassadors, ministers, and attaches."

2. "I shall try and see the Mikado with regard to the model of your new battleship. In spite of all difficulties I shall also try and show the model to the Emperor of China."

3. "I intend, with De B——'s help, to make this [the increase of the American naval force in 1892] very clear to the Japanese; and I think they will go ahead in their naval preparations. Lord Salisbury knows Admiral H——m's views, and I intended before leaving discussing the matter with the former, as I have been in communication with him through his secretary on our policy in the Pacific. I am sorry Lord Salisbury is likely to go out of office, but I have already arranged to carry on the matter with Lord Rosebery if he becomes Minister of Foreign Affairs."

Four more extracts may be quoted from letters which Mr. Thompson wrote to his principal from the Far East between the years 1893 and 1897:—

1. "As regards China——. It may surprise you; but it doesn't surprise me, that the Chinese authorities are on good terms with America and Japan. It is quite as well that I am also on very friendly terms with Japan. That may be very useful to Armstrong's.

2. "I get on very well with Satow. Ministers differ so very much in character, that one can never be always sure of striking the right chord in a man you don't know—although I have generally been pretty fortunate in this respect.

3. "Russia and France have stolen a march on our Government with regard to lending money to China. The sum is fifteen millions. Thus China practically becomes the debtor of Russia. The Chilian loan is a very great success."

4. "I cautioned the Japanese not to make armour plates for their own ships. I am all right in Japan."

It would be unfair to this zealous ambassador to leave out a letter from London shortly before his missions and commissions terminated. It was written at a moment when a war between Chili and Argentina appeared to be imminent, and ran as follows:—

"I am going over to Paris to see Mattei [the Chilian Minister], and push him to order another ship. I am really alarmed at the reckless preparations of the Argentines, and I proposed to him that if Chili is going to do anything to meet these preparations no time must be lost."

Some of the most remarkable events in the history of the armaments trade occurred a few months before the Great War, and one of these certainly contributed to bring it about. This was the division of Turkey between Krupp and an English group of armament firms, Krupp (supported by a German military mission) taking over the military control of the Turkish army and the fortifications, while the British group (with a naval mission) took over the naval reorganisation. It has been frequently stated in Russia that this German move made war between Germany and Russia inevitable, as Russia could not allow the control and exploitation of Turkey to fall into the hands of German officers and capitalists. The British share nearly led to ludicrous consequences; for another naval mission was dispatched to Athens to take over the Greek navy, and British armament firms began to build for both powers. A war seemed to be inevitable, in which case the two navies would have been largely built and officered by Great Britain. The struggle, however, was postponed, as Turkey was waiting for a super-Dreadnought from the Tyne while Greece was purchasing smaller battleships from the United States and torpedo boats from Great Britain. Before the Turkish battleship could be got away the Great War broke out. The Turkish battleships, one of which had been paid for by voluntary subscriptions in Constantinople, were seized by the

British Admiralty, and the Turks greatly incensed joined Germany in the war against the Allies.[1]

Another event was the exposure of naval corruption in Japan in connection with British and German contracts for the Japanese navy. These scandals caused the fall of the Japanese cabinet and the disgrace and imprisonment of various Japanese admirals, captains, and officials. The judgments in the Siemens-Schuckert case and in the Mitsui-Vickers case were reported in the Japanese newspapers of June and July 1914. Only a few brief reports appeared in the London press. Reuter's agent was also involved. It is to the credit of the Japanese courts that the system of bribery and corruption carried on by powerful armament firms was ruthlessly exposed, and that so many high officers and placemen suffered condign punishment.

At the same time in England an old-established system of corruption was brought to light by the Canteen Scandals of which the Government was at last induced to take notice in May 1914. The evidence and the judgment of Mr. Justice Darling showed Sir Thomas Lipton's company in a very bad light; but Sir Thomas was not even called. One or two subordinates were punished. Most of the culprits were let off.

[1] See *Times* telegram from Constantinople, December 3, 1913:—"A contract was signed to-day with the Armstrong-Vickers group for the reorganisation of the Turkish naval dockyards. The Government hands over to the Armstrong-Vickers group the arsenal and docks on the Golden Horn, with all the existing machinery and buildings. It likewise provides for a site for a naval base at Ismid. The English group finds the capital for the exploitation of the works and supplies the technical knowledge and control essential to the success of the undertaking." See also for our diplomacy in Turkey the later chapters of Sir Edwin Pears' *Forty Years in Constantinople.*

Some light was thrown upon the armament business in Germany by Dr. Liebknecht, the Socialist deputy for Spandau, in the Reichstag debates of 1913 and 1914 on the Army Estimates. In the spring of 1913 Dr. Liebknecht accused the firm of Krupp's of bribing Government officials. The trial which followed in the summer led to a series of convictions. It was not a Panama. The actual sums spent in bribery had been small. But the case revealed a widespread system of corruption, in which the directors of the firm themselves were involved, and it left behind an uncomfortable impression that, despite the efforts of the court, all had not been revealed. In May 1914 Dr. Liebknecht returned to the charge, and in an unexpected speech during the second reading of the Army Estimates brought forward more exposures and accusations. The value of the speech rests upon the general survey it gives of the German armament industry, of its international tentacles, and of practices which, if not directly contrary to the written law, are highly reprehensible, and form a serious danger both to public welfare and to international peace. Whatever may be said of certain details of the speech, its main elements were uncontroverted. Dr. Liebknecht was roundly abused. The armament press experts complained that the speech was damaging to Germany's good name, and to the business prospects of the industries concerned.

According to Dr. Liebknecht, the German armament industry was then working with a nominal capital of £12,750,000, or, when certain increases already agreed upon were reckoned in, of £13,500,000. The market value was something over £25,000,000. The three chief elements of the industry were Krupp's, the Loewe

Concern, and the Powder Trust. Krupp's, said the speaker, are the matador of the international armament industry, pre-eminent in every department, and they are gradually extending their influence over all their German rivals. Formerly there was a strong competition between Krupp's and the Dillinger Hütte; now the two are combined in a cartell relationship. Even the Ehrhardt Concern, the Rheinische Metallwaren und Maschinenfabrik, with a board of directors containing such powerful members as Dr. Paasche, the Vice-President of the Reichstag, Herr von Loebell, Prussian Minister of the Interior, and Lieutenant-General von Reichenau, could not hold out, and now Krupp's and the Ehrhardt Concern are one. There is no branch of the German armament industry, however remotely connected with it, over which, if Herr Liebknecht is to be believed, the hand of Krupp does not reach. Its international connections are almost equally widespread. The old connection with the Austrian Skoda Works had already developed into a close cartell, going so far as an interchange of all patents. Since 1904 the Krupp-Skoda Concern had been in intimate relations with Russian and French concerns, especially with Schneider-Creusot. Through them came the connection with the Putiloff Works, and through the Putiloff Works with various English armament firms. Dr. Liebknecht drew serious attention to the close relations between Krupp's and certain German newspapers, and declared that the great firm had influence over the official Wolff Telegraph Bureau. He said further that the *Etoile Belge* and a certain Italian newspaper had been bought up by Krupp's. Moreover, in 1910 they were implicated in a case of corruption in the Argentine, and in

1911 there was an unpleasant affair between the firm and the Swedish Government.

The influence of the Loewe Concern, according to Dr. Liebknecht, was almost equally extensive and perilous. The original company had given up the manufacture of weapons, but this was now carried on by the Deutsche Waffen- und Munitionsfabrik, which had earned an unenviable notoriety through the famous *Figaro* letter, whereby an attempt was made to get false news of French armaments published in the French Press, in order to create a demand for more armaments in Germany. The Concern controlled a factory in Belgium, the " Fabrique Nationale d'Armes de Guerre " ; another in Paris, the " Comp. Anonyme Française pour la Fabrication des Roulements à Billes " ; and a third in Italy, the " Società Metallurgica Bresciana." Through its hold over the firm of Köhler, it also had connections with Austria, Italy, China, Japan, etc. It was also intertwined with the Nobel Trust, and in this way with the English dynamite trade.[1] Close relations had, moreover, been established with the famous Austrian firm of Steyer, and Loewe and Steyer were the chief participants in the new Russian armament company, " Parabellum." All the processes and patents of these two German and Austrian concerns were expected to be placed at the service of the Russian Army !

The German powder industry, said Herr Liebknecht, is now completely cartellised, even the one or two

[1] The annual report of the directors of the Nobel Dynamite Trust Co. was presented to the shareholders on June 4, 1915. The chairman described how the German directors had resigned, and how with the consent of the British government negotiations were being carried through neutral sources for a severance of the assets between the British and German shareholders.

independent concerns that remain having underground connections with the main group. The powder group, again, is closely bound up with the dynamite trust abroad, so that the whole industry has become internationalised, and the various boards of directors contain members representing every nationality. The largest German factory, the Köln-Rottweiler, was the chief holder in Russian powder works; the Deutsche Dynamitgesellschaft was bound up with many foreign concerns.

As to connections between the members of these firms and the authorities, the speaker offered various particulars. Thus, he said, the president of the Krupp directorium was formerly a departmental chief in the Treasury; the director Eccius, who was convicted of complicity in last year's bribery case, was formerly in the Foreign Office. Another Krupp official was brother of General Wandel. Vice-Admiral Sack, who was formerly employed in the Admiralty, sat at the same time on the board of directors of Krupp's, of the Waffen- und Munitionsfabrik (Loewe Concern), and of the Köln-Rottweiler Powder Factory (Powder Group), with all of whom he formerly had dealings as a Government official. The manager of the Köln-Rottweiler Powder Factory had been until recently the manager of the State Powder Works in Spandau. But these connections extended beyond the boundaries of Germany itself. The director of the Diesel Motor Company was also a General Consul for France. An English Consul-General sat on the directorate of the Loewe Concern and of the A.E.G. The well-known director Guggenheim himself was General-Consul for France.

Customers, added Dr. Liebknecht, are welcome to the armament industry whencesoever they come. German arms, he asserted, had been exported to Ulster, and it was with German (not Birmingham) arms that the Abyssinians were worrying the British forces in Somaliland. The German Diesel Company had invented a submarine. Its Augsburg branch had built submarines for France on this model. Is it not true, asked Herr Liebknecht, that the new French gun came from Germany by way of Italy?[1]

One other example of the international character of the armaments trade may be taken from an English writer.[2] As the Trust is deceased there can be no indelicacy in repeating the facts.

The Harvey United Steel Company, Limited, which was formed in 1901 and wound up in 1913, after having done its work, "was the first combination," we are told, "to illustrate the international character of the armament business and the way in which the different armament firms have become consolidated." The company[3] was formed to acquire the undertaking and assets of the Harvey Continental Steel Company, Limited, and the Harvey Steel Company of Great Britain, Limited, and the whole or a controlling majority of the shares in the Société des Procédes Harvey and the Harvey Steel Company of New Jersey. These

[1] The above summary is from a letter in *The Economist* of May 16, 1914, by a Berlin correspondent. With Dr. Liebknecht's speech may be compared that of Mr. Philip Snowden in the House of Commons on the Navy Estimates of 1914.

[2] The well-informed author of a recent pamphlet on *The International Industry of War.*

[3] The statements in this paragraph are taken from the *Stock Exchange Official Intelligence.*

companies held patents for the manufacture of steel and armour plates. They were of the ordinary business kind, and were formed to exploit these patents in every advantageous country in the world. The parent company was formed in New Jersey. In 1893 it formed a company in Great Britain; next year the Harvey Continental Steel Company was formed, and in 1896 this company acquired the sole right to use Krupp armour patents except when worked in Germany for the German Government. This company dealt with the whole world except in so far as it had been covered by the American parent company, the British company, and the French company.

There the matter stood in 1901, when the armament firms—the clients of the Harvey companies—made their move. From a purely business point of view amalgamation of the companies and the firms offered many inducements. These firms must have been almost the sole users of those patents. But the moment when this international combination was promoted by the great armament firms, the tremendous step had been definitely taken of converting national defence into a huge international profit-making concern, taking full advantage of all the special opportunities which the nature of its market gave it, and bridled by none of the sentimental checks which ought to operate on that market.

How was the new combination — which was called the Harvey United Steel Company — constituted? Here is a transcript (except the words in brackets indicating the nationality of the person) of the directors of the combination as filed in Somerset House on May 27, 1902:—

Names.	*Armament firms they represented.*
Bettini, Raffaele,	Director-General, Terni Steel Works. (Italian.)
Clark, John Alfred,	Director, Charles Cammell & Co., Ltd. (British.)
Ellis, Charles Edward,	Managing Director, John Brown & Co., Ltd. (British.)
Falkner, John Meade,	Director, Sir W. J. Armstrong, Whitworth, and Co., Ltd. (British.)
Fox, Edwin Marshall,	Gentleman. (British.)
Gathmann, Auguste,	Director, Dillingen Steel Co. (German.)
Geny, Maurice,	Director, Schneider & Cie. (French.)
Hughes, John William,	Metal Merchant. (British.)
Hunsiker, Millard,	Representative in England of the Carnegie Steel Company. (American.)
Klüpfel, Ludwig,	Director of the firm of Fried. Krupp. (German.)
Lévy, Léon,	Director of the Chatillon Steel Company. (French.)
Montgolfier, Joseph de,	Director of the St. Chamond Steel Company. (French.)
Richards, Edward Windsor,	Gentleman, and late President of the Iron and Steel Institute. (British.)
Vickers, Albert,	Managing Director of Vickers, Sons, & Maxim, Ltd. (British.)

There were some changes in subsequent years. Between 1905 and 1908 several vacancies occurred which were filled by two French, two German, and one British director. The Trust was dissolved in 1913, most of the patents having run out; and other combinations came forward.

It would be easy, of course, to multiply examples of the fraternal unity in which the great cosmopolitan manufacturers of man-destroying machinery lived and wrought right up to the awful moment in August 1914, when the diplomats and rulers of Europe touched the war buttons and set in motion all the international patents which chemical and mechanical invention had been patiently accumulating for the destruction of mankind.

CHAPTER VI

INDEMNITIES—THEIR POLICY AND UTILITY

In undisciplined armies pillage and booty are the soldier's reward—" the tokens of the wanton, the plunder of the poor." The capture of private property at sea and its distribution in the form of prize money still survive in many navies, and is defended as a stimulus to officers and crews. Discipline on land has in theory, and under favourable conditions in practice, substituted public requisition, tributes, and pecuniary indemnities for private looting. But at sea merchant ships and merchandise are still lawful prey; and in land warfare—as recent experience in Macedonia, Belgium, France, East Prussia, and Poland abundantly show—a civil population had best flee before the invader.

When two men go to law and one of them wins a clear verdict or judgment the loser is ordered to pay the costs of the action, and these " costs " are an addition to any damages or compensation which the court may have awarded to the plaintiff; or if the defendant wins they are intended to serve as a reimbursement of expenses which the plaintiff has unjustifiably caused him to incur. Sometimes the rights and wrongs of the case so nearly balance that the plaintiff secures only nominal damages, and both sides have to pay their own costs. Upon this analogy of legal " costs " the modern theory of a war indemnity might be based. Nor, if the victor in a trial by battle were usually in the right, could justice

complain. If a government makes an unprovoked war on its neighbour, and is defeated, it should be called on, as one of the conditions of peace, to repay all the expenses which the other nation has had to incur as the result of the attack; and perhaps it ought to pay "moral and intellectual damages" for the assault as well. But even in this, the most favourable case that can be supposed, an objection arises. In a private lawsuit judge and jury hear the case and decide between the parties. But in the case of a dispute between sovereign States ending in war, the victor imposes terms. There is no impartial assessor to ascertain and measure the damages. Nor of course is there any guarantee that the best cause will win. Rather is victory apt to side with the big battalions. Sometimes, indeed, a righteous cause may give strength and success to the weaker party. But the fact that one party consents to pay an indemnity does not in the least prove that the victor has any moral claim to it. Only when nations agree to submit a dispute (as Great Britain and the United States submitted the *Alabama* claims) to arbitration is the analogy between international and private justice nearly perfect, though even then there is as yet no international police to enforce the award.

At the outset, therefore, the analogy between costs at the end of a lawsuit and indemnities at the end of a war breaks down. But as the want of moral justification will no more prevent a government from exacting an indemnity than from going to war, we may pass to a much more difficult question, namely, "Will the indemnity do any good to the victor?" or better perhaps, "Is an indemnity worth fighting for?" And it has become a very practical question in modern times, since

the cost of war has become almost prohibitive and the power of raising vast sums by credit, *i.e.* by mortgaging the future, has enormously increased.

The classic instance of an indemnity is the five milliards of francs (£200,000,000) exacted by Bismarck from France in 1871. It would be a difficult matter duly to apportion the blame for the war of 1870 between France and Prussia; but as the French Emperor was at least technically the aggressor, the French people, even after they had proclaimed a republic, were generally held to have deserved a severe penalty. Nor did the question of Alsace-Lorraine induce the other Great Powers to interfere with the Treaty of Frankfort, and to save France from the disastrous consequences of Napoleon's last blunder. As to the intentions and expectations of the victor there was not much doubt or concealment; having defeated the forces of France in the field Bismarck meant, by exacting this unheard-of sum, to impoverish the nation and so to avert for many years the danger of a war of revenge.[1] Since the war had only cost the budget of Prussia and her allies about £115,000,000, and since France had to pay various extra sums amounting to twelve millions, the German States apparently made a net profit of a hundred millions sterling out of the war. This estimate, however, does not allow for the direct loss to Germany through the deaths of 26,000 able-bodied young men, or for the indirect loss of trade through the calling up of her conscript forces from their labour on the land or in the workshop.

[1] Cf. p. 57 for Napoleon's action against Prussia after Jena. After the victories of 1866 (as we shall see) Bismarck was content to exact from Austria and her allies about half Prussia's war costs.

Sir Robert Giffen, writing in 1872,[1] reckoned the public profit at £174,000,000, though he had some doubt whether Germany would really gain; and he had, of course, no knowledge of what was to happen after 1872. Still at the time the Franco-German War seemed to have resulted in a handsome profit to the new Empire, and it might be inferred both that Germany would use this new capital to good effect, and that France, hampered by the loss of the five milliards, would have to undergo a long period of penury and recuperation, with her foreign trade destroyed or crippled.

As a matter of history what really followed was something quite different. A recent writer[2] on the subject comes to the conclusion that "In spite of the loss of two manufacturing provinces the foreign trade of France continued to increase in the years succeeding the war, not merely per head of the population, but absolutely. An increase in trade was by no means the general experience; on the contrary, other countries, and especially Germany, found this period one of depression. The actual payment proved a much easier task than M. Thiers and his colleagues anticipated: indeed they were able to pay the final instalment in September 1873, six months before it was due. Payment was not of course made entirely or even mainly in coin and bank notes, but in commercial bills. But this large and sudden influx of French money sent up prices in Germany and so checked exports; and then the coin began to flow back to France."

Mr. O'Farrell takes the view that the indemnity was in some ways an injury and in other ways a gain to Germany.

[1] *Essays in Finance:* first series.

[2] Mr. H. H. O'Farrell, *The Franco-German War.*

On the one hand it disturbed the exchanges, checked exports, and was undoubtedly accompanied by commercial depression; on the other hand it enabled the German government to reform and unify the national currency, as well as to strengthen its military defences against a "guerre de revanche." To the question whether a nation can conceivably make a profit by the exaction of a pecuniary indemnity from another nation, Mr. O'Farrell replies that it is not impossible in certain circumstances. It is reassuring to note, he adds, that "such circumstances must always be very exceptional. The nation from whom the indemnity is exacted must be very wealthy, or the operation will not be worth while, and at the same time it must be immeasurably weaker in a military point of view than the victor." And further, the war "must be of short duration." A less balanced and qualified opinion—that the indemnity did nothing but harm to Germany—was professed by many Frenchmen in the 'seventies. M. Lavisse, indeed, declared that the German government thought seriously of returning the indemnity, while France would refuse to take back "les milliards empoisonnés." This is an absurdity; but the disadvantage of an indemnity to the victorious state has been argued recently with much ingenuity by Mr. Norman Angell. In the sixth chapter of his *Great Illusion* Mr. Angell originally discussed, and believed himself to have demolished, the theory that a country might make an actual profit out of a war, and went near to advancing the counter theory that it is more blessed to give than to receive. In the 1914 edition he omits much of his general argument and concentrates upon the effects of the 1871 indemnity. French and German writers are quoted to prove that

the excessive supply of money in Germany sent up prices, increased the cost of living for the poor, diminished their purchasing power, and caused the German market to be flooded with French goods. At the same time this extra supply of capital encouraged speculation and the starting of ill-considered enterprises all over the country, which soon came to grief. Bismarck himself declared in 1879 that Germany was "slowly bleeding to death," and two years later he said: "It was towards 1877 that I was first struck with the general and growing distress in Germany as compared with France." Mr. Angell sums up the net result of the indemnity thus: "Germany was, ten years after the war, a good deal worse off, financially, than her vanquished rival, and was at that date trying, as she is trying to-day (1910), to borrow money from her victim." Although he claims (too boldly I think) to have proved, by examining the economic consequences of the indemnity, that the war of 1870–71 did not pay Germany, Mr. Angell does not rest his general objection to war indemnities on this particular case. If it were granted that all the money exacted by an indemnity could be received by the victorious country without any economic disturbance, nevertheless "the direct cost of preparing for a war and of guarding against a subsequent war of retribution must, from the nature of the case, exceed the value of the indemnity which can be exacted."

The 1871 indemnity was not the first exacted by Prussia, though the other two were comparatively insignificant in amount. One of them is chiefly remarkable as showing the statesmanship of Bismarck in acting with moderation towards Austria after Sadowa. By the Treaty of Prague, 1866, the Austrian Emperor

undertook to pay to the King of Prussia 40,000,000 Prussian thalers, from which sum he was to deduct fifteen millions as his share of the Schleswig-Holstein indemnity and five millions for the maintenance of the Prussian army in Austria. Smaller sums were paid by Austria's German allies. But the war did not show a budget profit; for 63,000,000 thalers—over nine millions sterling—were added to the Prussian debt as a result of the famous six weeks' war. The total cost of the war was about halved by the indemnities.

The Treaty of Vienna, October 1st, 1864, had not only stripped Denmark of the three duchies—Schleswig, Holstein, and Lauenburg—but had also burdened these newly annexed territories with the war expenses of the two big States. No clearer case of the wolf and the lamb could be imagined, or one which destroys more completely the analogy with "costs" after a lawsuit; for no impartial court can be imagined which would have awarded costs to Austria and Prussia against the little peoples of the Duchies. The Boxer indemnity exacted by the Great Powers from China in 1900, the unfulfilled promise during the Boer War of a contribution from the gold mines of the Rand, and above all the fruitless efforts of Japan to exact a pecuniary indemnity from Russia in 1905 after the capture of Port Arthur show that modern statesmen and rulers are still anxious for costs when the trial by battle results in their favour. It is, however, to be observed that the Japanese plenipotentiaries at Portsmouth abandoned their demands for an indemnity because the Japanese government could not afford to go on with the war. It was increasingly difficult to borrow more money either at home or in London, and it was felt

better to cut the financial losses without an indemnity rather than continue them in hope of an indemnity. When the terms of peace were published there was intense disappointment in Japan. But Marshal Yamagata in an interview with the Japanese press declared that in deciding to conclude peace the Government carefully investigated the present financial capacity of the Empire. " After full consideration the Government came to the conclusion that if the hostilities were continued longer, it would hardly be possible to obtain compensation for the vast expenditure involved, and no better result could be secured than was to be obtained by concluding peace at the present moment. The continuation of the war would require a further heavy sacrifice of money, and the only result would be to exhaust the funds necessary for the promotion of works in Korea and Manchuria. Thereupon the members of the Government agreed without a dissenting voice to conclude peace without delay."

CHAPTER VII

HOW WAR IMPOVERISHES—THREE FALLACIES REFUTED—THE PARALLEL OF 1870

THE simple truth that war impoverishes is still obscured by the artistic representatives of special interests who seek to paint it as a mine of gold or a fountain of plenty. A Roman poet ends his stirring description of its social and commercial corruptions with three words, Multis Utile Bellum,[1] as if to explain how it is that peace can be broken in a world where reason is allowed a hearing. But after all it is only at rare intervals in the most civilised and best governed communities that the rulers or ruling classes truly accept as a first principle of their administration the greatest happiness of the greatest number. For the representative system of government it may indeed be claimed that it professes to make the offices and emoluments of the governors dependent upon their directing the public administration with a single eye to the advantage of the governed. It is far better that ministers should always pretend to be acting as trustees than that their love of office and lust for power should be uncontrolled by public votes and public criticisms. The superiority, therefore,

[1] "War advantageous to many." Lucan's *Pharsalia*, I. 182. The whole noble passage commencing at line 158, "Hæ ducibus causæ suberant; sed publica belli semina, quæ populos semper mersere potentes," deserves attention as a trenchant analysis of the economic and social causes of the war which overthrew the liberties of Rome.

of representative and responsible over personal and irresponsible governments, at any rate for civilised communities, may be conceded. Its advantages are manifold. But until fidelity to pledges and veracity in public statements can be enforced on ministers, and until you have independence and incorruptibility in parliament and the press, no near approach can be expected to a perfect system of self-government. As in a public company so in a democracy good and honest management is largely an accident. It rests with the character of the men who have climbed to the top, though, of course, the citizens or shareholders may by incessant vigilance secure faithful and competent directors.

(Thus we dispose of the argument sometimes urged, that war must be an economic advantage to a nation because the enlightened governments of modern times have so frequently adopted it as a remedy for small evils, or for the purpose of obtaining comparatively small advantages.) Some modern military writers, it is true, looking at the examples of Napoleon and his Prussian imitators, have put forward the view that a nation of high military efficiency may expect by the imposition of tributes and indemnities to wage war at a profit, or at least without actual loss. But this notion, examined in the preceding chapter, was found unconvincing, even after the long and costly slavery of preparations for a war, which after all might prove unsuccessful, had been excluded from the account. In truth there is only one important modern instance, the Franco-German War of 1870, in which the successful government has been able to extract from the vanquished its out-of-pocket expenses, let alone a pecuniary com-

pensation for loss of men, loss of trade, and the commercial depression that almost inevitably follows.

Against the main proposition that war is a destructive and therefore an impoverishing agency, from which a general decline of comfort and prosperity must result, three fallacies have been invented to misdirect the Pilgrim on his quest for Truth. The first is that war increases wealth by circulating money; the second, that it increases wealth by creating a demand for the things it has destroyed; the third is, that it increases wealth by reducing unemployment.

The idea that war increases wealth by circulating money is based upon a confusion between money and wealth. It is quite true that war multiplies and debases the currency, because the issue of new currency is the most obvious and the easiest method by which a government can pay for troops and supplies. The poorer the government, and the greater the expense of a war, the more paper and token money will it seek to circulate. Thus good money will be driven out, and prices will rise. Rising prices often create an appearance of fictitious prosperity by stimulating speculation and production. But the impossibility of raising all wages and salaries in proportion soon leads to general suffering and discontent.[1] Moreover, a depreciation of the currency soon causes grave embarrassments to the government and to the external trade of the country. The publication of gold premiums at Frankfurt was prohibited by the

[1] In Great Britain alone among all the belligerent nations during the Great War have we heard of any general attempt to pay a 'War Bonus' on wages to meet the rapid rise in prices which began to be felt during the winter of 1914-15. But it may be doubted if all our war bonuses put together represented 20 per cent. of the total loss of purchasing power suffered by the working classes through the rise of prices.

German Government in November 1914. But things do not cease to exist because information is not printed; you cannot prevent bad weather by falsifying or suppressing weather reports. And although a gold premium may be concealed at home it peeps out in the foreign exchanges. If the identification of wealth with money meant the identification of wealth with gold, the doctrine that war increases wealth by circulating money would plainly be absurd. For in the Great War which broke out in the autumn of 1914 all the belligerents except Great Britain immediately abandoned the gold standard, and even the British Government issued a considerable quantity of paper money which took the place of a proportionate amount of gold sovereigns and half-sovereigns.

The second fallacy starts from the undoubted fact that some of the things which war destroys are bound to be replaced. We say *some*, because the work of replacement either during or after the war depends upon the power to replace. If in a modern war a village or small town, with all its churches, farmhouses, factories, villas, and cottages, is totally annihilated by shells, and all the inhabitants are killed, there is no probability of replacement. If the inhabitants all escape, some of them are sure to return to the ruins after the war, and those who have independent means may sell or borrow on securities in order to rebuild and restore what has been destroyed. It is obvious then that only a fraction of the visible property destroyed by war can be restored. What that fraction is will depend upon the wealth of those who remain and upon the credit of the government. Thus when a country has been devastated, as Poland, Serbia, Belgium, and East Prussia have been devastated, an effort

will undoubtedly be made after the war by public and private credit to restore with all possible speed such primary necessities as railways and railway equipment, farms, cottages, factories, and the like. If by indemnity or otherwise a large quantity of money can be raised for these purposes, a certain temporary stimulus will be given to the iron and steel trades and to the manufacture of machinery and implements in countries where the means of producing steel rails, girders, machinery, furniture, and implements of all kinds are still intact. But to argue that this sort of *post bellum* stimulus to industry proves the economic desirability of war is exactly like arguing that drunken undergraduates, when they break windows in a university town, are creators of wealth merely because the owners of the houses, or the insurance companies, or the parents of the undergraduates are well enough off to pay the glaziers of the town for replacing the broken windows. Still just as town and gown rows may find favour with the worthy glaziers of Oxford and Cambridge, so districts which benefit, as the West Riding of Yorkshire did in 1871 and 1872 by French and German replacement orders, may easily think while the boom lasts that there is something to be said for war.

The third fallacy that war is good for trade because it reduces unemployment or increases employment is nearly related to that which we have just been considering. As a matter of fact war diverts employment from productive to destructive arts. It enormously reduces employment in peace industries and enormously increases it in war industries. Thus at the beginning of the Great War of 1914 vast numbers of able-bodied men were thrown out of employment in Great Britain by the

curtailment of foreign trade and domestic consumption. But all and more than all these were quickly absorbed in the army, or in the work of producing supplies, armaments, and ammunition of all kinds for the fighting services, with the result that in a few months' time the trade union returns showed an unusually low rate of unemployment. The explanation is simple enough. The government was borrowing about two millions sterling a day, which sum (to be defrayed by posterity) was supplying the means of employing in the army and the armament factories men and women for whose products after the outbreak of war there would have been little or no peace demand. When orders poured in from the governments of France and Russia a positive congestion arose, with overtime, shortage of hands, and transport difficulties of all kinds.

It must be clearly understood that in refuting the three fallacies we are in no way concerned to deny that many individual traders, shipowners, and financiers may and do make fortunes out of war. Ministers and public servants are surrounded by men who know how to pick up the crumbs that fall from the table of a vast and ill-controlled public expenditure. In time of war able and respectable men of business may become bankrupts while worthless favourites and corrupt contractors make money very quickly. In the management of war finance at its best incompetence is too often matched against roguery. And there may be not merely incompetence but negligence or something worse in the public offices. It was so in the war with the American colonies, in the war with Napoleon, in the Crimean War, and in the South African War. You may eliminate waste and corruption in one form, but they will reappear ere long in another.

In computing the real cost of war to a nation allowance should perhaps be made for these war fortunes, which resemble the sums won by a gambler. But a more important extenuation of national losses is to be found in the diminution of private luxury which a great war entails, especially in countries like Great Britain where it is accompanied by the screwing up of a stiffly graduated income tax and death duties, and by an increase of taxation on articles of luxury. Suppose for example that a millionaire has ten valets and chauffeurs and that each costs £100 a year. If the Chancellor of the Exchequer imposes a tax of £100 a year per head the millionaire may perhaps reduce his staff to five. He still pays £1000 a year for his bodyguard; but of this £500 flows into the Treasury and will go some way to support the five unemployed valets if they join the army. Here is a case in which a public luxury is substituted for a private one; and in opulent countries like Great Britain an augmentation of the burdens upon large properties or incomes and upon the luxuries of all classes will undoubtedly reduce substantially the economic evils of war, though it will of course play havoc with the capital invested in luxury trades.

Another plea in extenuation of war needs consideration, though it does not quite deserve a place beside the three fallacies. It is this—that the pressure of war taxation and the withdrawal of so much labour from field and factory drive many people to work who never worked before and induce many more to work harder. Women and children and old men are forced into employment so that national production is stimulated. Indeed, economic professors have been heard to declare in all seriousness that the total income of a country after a

great war may through this cause be greater than ever, so that a nation may in an economic sense be more than compensated for its losses by its losses! Even during the long years of distress that followed the Napoleonic wars one or two writers tried to console the public for the severity of taxation by the thought that it forced people to work harder than they would have done.

And so we return to the proposition that war while it enriches a few impoverishes the many. In his Glasgow lectures (p. 207) Adam Smith put it in a few sentences which deserve repetition: "The poverty of a nation proceeds from much the same causes with those which render an individual poor. When a man consumes more than he gains by his industry, he must impoverish himself unless he has some other way of subsistence. In the same manner, if a nation consume more than it produces, poverty is inevitable; if its annual produce be ninety millions and its annual consumption an hundred, then it spends, eats and drinks, tears, wears ten millions more than it produces, and its stock of opulence must gradually go to nothing."

Then in reply to the objection, advanced perhaps by some youthful heckler, that there is no harm in spending money on war so long as you spend it at home and employ home manufacturers, the philosopher continued: "Suppose my father leaves a thousand pounds' worth of the necessaries and conveniences of life. I get a number of idle folk about me, and eat, drink, tear and wear till the whole is consumed. By this I not only reduce myself to want, but certainly rob the public stock of a thousand pounds, as it is spent and nothing produced for it." In the same way money spent on war is wasted wherever the war is waged and wherever the money

employed in preparations is laid out. These propositions should be translated into every language and written up in gold over the door of every spending authority in the world; for there is no more insidious fallacy than the fallacy that waste is profitable if it provides employment at home. The taxpayer suffers equally whether a superfluous battleship, or fort, or barrack is built at home or abroad, by British or foreign labour. Nor does it in the long run make any difference whether money borrowed for unproductive purposes is raised by a foreign or a domestic loan. In either case the home taxpayer has to pay the interest; which, unless the capital be paid off or repudiated, constitutes a perpetual charge on the trade and industry of the country. Another consideration often lost sight of relates to the enlisting and disbanding of troops. Every man who is tempted or driven from the ranks of productive labour into the army or navy constitutes a double loss. There is first the direct payment of £75, or so, which is added to the army or navy estimates, and second, there is the loss of all the wealth he produces in the year, part of which goes into his own pocket as wages (say £50), and part of it into his employer's pockets as profit (say £25); so that by the enlistment of a young man the nation stands to lose £150 a year as long as he remains in the service. If it be objected that the man is a consumer whether he labours at agriculture or war, the criticism may be met by deducting from the total the cost of his maintenance.

The above considerations, supported by the teachings of experience and history, will probably satisfy any jury of good men that war, however advantageous to the few, must impoverish the peoples engaged, although in

exceptional cases the victorious government may recoup itself from the proceeds of an indemnity. But just as a few speculators and contractors may gain at the expense of the general body of taxpayers, so one or two neutral nations may prosper at the expense of the belligerents. If a neutral country is a great manufacturer its boot and clothing and ammunition trades may thrive on war orders from the governments of nations whose factories are half closed by mobilisation or are in the occupation of the enemy. And during the demobilisation and dislocation following a war this same neutral country, with its factories in full efficiency, may get the cream of the restoration orders for iron girders, rails, ships, machinery, and the like, by which the exhausted peoples, with such credit as may be available, will endeavour to prepare themselves for a fresh start in the race of industry and commerce. By way of illustration let us glance at the course of British trade during and after the Franco-German War of 1870-1.

War was declared by Napoleon on July 14, 1870; Paris capitulated on January 28, 1871, under an armistice; on February 26 the Peace preliminaries were signed, and two days later the Treaty of Peace was ratified by the National Assembly at Bordeaux. On the news that war was declared there was a brief panic in the City of London, and the foreign market in the Stock Exchange fell to pieces. But there was no collapse of credit or trade. The German victories at Gravelotte (August 18) and Sedan (September 1) and the investment of Paris (September 19) removed the possibility that Britain might be drawn into the war on either side in defence of Belgium's neutrality, and British trade began

to thrive, partly through war orders, partly with the American and other neutral customers of French and German manufacturers who were unable to execute their contracts.

The general level of prices rose fast from 1870 to 1873; but at first the working classes in Great Britain were fortunate. The harvests of 1870 happened to be good, there was no fear of our food supplies being cut off, and the average wheat prices, at 46s. 11d. per quarter, for the year were the lowest since 1865. In 1871 the harvest was poor and wheat rose to 56s. 8d. per quarter, but employment was very good, and wages went on rising. For most of the staples of the country, notably the cotton, wool, and iron trades, these two years of disaster on the Continent were years of a rapidly growing prosperity which culminated in 1872. The depression of the years preceding disappeared soon after the outbreak of war. For 1870 the value of our cotton exports went up by three million pounds. In the next year progress was still more rapid. According to the contemporary cotton report of Messrs. Ellison, the year 1871 was "one of the most prosperous periods in the history of British commerce and manufacture." Every branch of trade, added Messrs. Ellison, showed extraordinary expansion. It was, in fact, an *annus mirabilis*. Although the price of raw cotton fell to 8d., the total value of raw cotton imports rose from £51,000,000 in 1870 to £55,900,000 in the following year. The movement in export of cotton piece goods can be seen from the following table :—

COTTON PIECE GOODS IN YARD

1869	1870	1871
2,776,000	3,267,000	3,410,000

To Germany during these three years the exports of cotton piece goods were, in 1869, 102,000 yards, in 1870, 70,000 yards, in 1871, 107,000 yards. So far, the years 1870 and 1871 have alone been considered. Our export trade in textiles as a whole and the extent of the boom in the two following years may be judged from the next table :—

EXPORTS OF TEXTILE MANUFACTURES

	1869	1870	1871	1872	1873
	£	£	£	£	£
Cotton	53,022,000	56,745,000	57,760,000	63,467,000	61,468,000
Linen	6,800,000	7,248,000	7,504,000	8,226,000	7,306,000
Woollen	22,669,000	21,665,000	27,182,000	32,383,000	25,350,000
Woollen yarns	5,538,000	4,994,000	6,101,000	6,110,000	5,393,000

The beginning of the decrease that followed in the middle 'seventies is already seen in the last year of the table.

There was a good deal of irregularity in the iron and steel trade at the outbreak of the war, and some fear that a restriction in production would follow. These fears proved ungrounded. By the end of the year an all-round increase in prosperity could be recorded, and the total make of Cleveland pig-iron for the year reached 1,690,000 tons, as compared with 1,459,000 tons in 1869 and 1,233,000 tons the year before. In the following year the iron and steel trade, engineering, shipbuilding, and cutlery trades were all employed to their utmost capacity very largely in answering the demands of the Continent. Prices for the best iron bars rose from £7 2s. 6d. on January 7, 1871, to £8 17s. 6d. on December 30. For the same five years as before

the value of exports in the chief branches of the iron trade was as follows :—

IRON AND STEEL EXPORTS

	1869	1870	1871	1872	1873
	£	£	£	£	£
Pig-iron	2,055,000	2,229,000	3,229,000	6,713,000	7,118,000
Iron bars, etc.	2,699,000	2,615,000	2,922,000	3,633,000	3,756,000
Steel rails	7,238,000	8,757,000	8,085,000	10,225,000	10,419,000
Total iron and steel	22,342,000	24,038,000	26,124,000	35,997,000	37,731,000

After making proper deductions for the rise of prices the years 1870 to 1872 must be marked as years of great prosperity for the industries of Great Britain, though they had to pay afterwards for the boom in a prolonged period of depression. Owing partly to the blockade of German ports by the French navy our trade with Germany suffered during the second half of 1870. The table on page 133 gives a view of our general commerce and of our trade with France and Germany from 1869 to 1873.

The French people paid for the war largely by privation and also by the conversion of the peasantry's gold and silver hoards into rentes, or interest-bearing debt. This, as well as the indemnity, may help to explain why in the later 'seventies the economic depression was more acute in Germany than in France. An extract from the contemporary *Volkszeitung* given in the *Economist* of July 1, 1871, indicates some economic implications of a military system which in time of war withdraws the strength of the nation from industrial pursuits :—

"The war has not only interrupted work, but has destroyed thousands of places of work. The four million thalers, which are

British Imports

	1869	1870	1871	1872	1873
From—	£	£	£	£	£
Germany . . .	18,354,000	15,404,000	19,263,000	19,232,000	19,926,000
France . . .	33,527,000	37,607,500	29,848,500	41,803,500	43,339,000
Total (including other countries) . .	225,044,000	238,425,000	258,071,000	275,321,000	290,277,000

British Exports

	1869	1870	1871	1872	1873
To—	£	£	£	£	£
Germany . . .	32,072,000	28,066,000	38,494,000	43,150,000	36,709,000
France . . .	23,277,000	21,983,000	33,388,000	28,292,000	30,196,000
Total . . .	185,123,000	188,689,000	228,013,000	248,980,000	239,857,000

to be spent for the assistance of those who have suffered loss, are as a drop on a hot stone, which, hissing, drops on to it, and in an instant disappears in smoke. Thousands of men of the Landwehr and Reserve return to their homes crowned with victory and covered with wreaths, but they find their dwellings destitute, their wives in want, their children neglected, their workshops destroyed, their customers dispersed, their credit shaken, and the want of their manufacture lessened. Their rent is still due, which has accumulated for a year. New tools have to be bought, which their wives in time of distress have either pawned or sold. Materials have to be laid in stock, to enable them, in case of an order being given, to begin work. Repairs and clothes are necessary. The bakers, butchers, and retailers have to be paid. If work is not begun at once, the cry of distress will soon be distinctly heard as the echo of rejoicing. . . . All our small trades are founded on the credit allowed them by the great dealers. They never pay ready money, but by a bill of exchange, which delays the payment until their goods are sold. The diminished supplies of the war year have increased the small bills to enormous sums. As long as the owner of the business was in the field, the bills were prolonged. When they return home, the bills have to be taken up, if they wish to begin work again, and their distress becomes greater as they are obliged to begin again with renewed vigour."

The same journal, added the *Economist*, " points out that the French indemnity will not compensate the private losses of Germany. The payment of it will impoverish the customers of Germany, the German industry will gain nothing directly, because the money will be largely used in replacing munitions of war, and otherwise assisting warlike operations. The German triumph is thus far from unalloyed, and as France has suffered far more, it would be difficult, indeed, to measure the net suffering of the two belligerents."

In the *Commercial History of the Year*, published by the *Economist* in March 1871, when the fate of the war

had already been decided, occurs a passage of strange significance. "The great disturber, France," it runs, "is thoroughly humbled. Germany has no longer any aggression to fear. Her most serious peril lies in the rising spirit of militarism. . . . The most threatening quarter is still the South-East of Europe—Turkey and the Danubian Principalities—and these two and Russia are involved in intrigues and harbour designs which at any time may produce mischief."

The economic lessons of the war of 1870—the last great war in Western Europe—may be used in constructing forecasts of what may happen when the present, far more devastating, calamity reaches its end. But the parallel must be employed with extreme caution. Even if this war lasted only one year the exhaustion of credit would probably be twenty times, and the destruction of property fifty times, greater than in the Franco-German conflict. In 1871, though Paris had lost much of its financial power to London, France was solvent. But who can guarantee the solvency of Europe when the post-bellum liquidation takes place? In 1871 the credit of London was unimpaired, and it was able to finance the indemnity. In this war all the great financial centres of Europe are being exhausted. Most of our liquid capital has been employed in the manufacture of floating war debt; permanent assets are everywhere being mortgaged for forced loans; and even the resources of New York have been heavily drawn upon by the belligerent governments.

CHAPTER VIII

WHETHER THE COST OF WAR SHOULD BE MET FROM LOANS OR TAXES OR BY CONFISCATION OR BY ISSUES OF PAPER CURRENCY

THERE are four methods of paying for a war, all of which are being employed (as I write this chapter) by the four continental powers engaged in this greatest of all European contests—loans, taxes, confiscation of labour or property, and the issue of paper currency. All have their drawbacks and limitations. The first is limited by the credit of a nation, the second by its taxable capacity. The third sets the doctrine of state omnipotence on its highest pinnacle and reduces citizenship to servitude. The continental soldier-slave under this system is fed and clothed by the state and receives a pittance of at most twopence halfpenny a day, which means in effect that the state saves on an army of two millions about one shilling per day per man, *i.e.* £100,000, or £36,500,000 a year. This contribution is more substantial in appearance than reality; for in the first place many of the soldiers leave dependants who have to be supported, and secondly the total saved in soldiers' wages only represents from one-tenth to one-twentieth of the total war expenditure if we take the war of 1914–15 as our standard. Forced labour indeed is neither economical nor efficient, and it would not be surprising if conscription were abandoned by general consent after the present war, though it is undoubtedly a powerful engine for suppressing insubordination among munition workers. With conscription of labour may be

associated confiscation of property—a favourite device of revolutionary governments on the Continent. In a modern state, where the working classes have a good deal of influence, war is very dangerous to property; for a war ministry may often find it convenient to raise taxation of the rich to a point bordering on confiscation. So in Japan during the war with Russia the income tax was graduated up to about five shillings in the pound on high incomes, at which point it has remained. A similar figure has already been reached in Great Britain as against the eightpenny rate which was levied prior to the Boer War. The last method—that of issuing paper currency—is the most convenient and probably in an economic sense the most disastrous. It is highly convenient for a government to print paper for the payment of contractors at home and abroad, and to issue token money for the payment of its soldiers and sailors. But this policy involves the relinquishment of the gold standard, the debasement and depreciation of the currency, and consequently a general rise in prices. Accordingly this device should not be employed by a solvent government for the purpose of meeting more than a small part of the cost of a great war. The chief question, therefore, is that already touched upon—whether a state in this emergency should resort to loans or to taxes for the extraordinary expenses of war.

In his chapter on Public Debts, Adam Smith drew attention to what was then a comparative novelty—the dependence of war makers on loan mongers. Unless a government has accumulated treasure by parsimony in time of peace it is compelled to contract debt the moment war begins, "or rather at the moment it appears likely to begin." The army must be augmented, the

fleet fitted out, the garrisoned towns put into a posture of defence; arms, ammunition, and provisions must be served out and concentrated at proper depots. A great and immediate expense must be incurred at the moment of danger; and as there is seldom a large surplus in the Treasury beyond what is necessary for defraying the ordinary expenses of government, recourse must be had to borrowing. To the objection that in lieu of loans new taxes might be imposed, Smith replies that in war the revenue required is three or four times greater than the revenue required in time of peace; and even if a government had (as it hardly ever has) the power of quadrupling the revenue by increased taxation "yet still the produce of the taxes, from which this increase of revenue must be drawn, will not begin to come into the Treasury till perhaps ten or twelve months after they are imposed." In this exigency, therefore, borrowing is the obvious resource, unless the government prefers to rely upon forced issues of paper currency. In the second half of the eighteenth century it was already fatally easy for the government of an opulent commercial kingdom to obtain accommodation —at a price; and, moreover, war loans were very popular with influential persons who obtained stock at a figure well below the market price. Smith's general remark, however, deserves to be repeated, as it is now being illustrated by a very bitter experience:—

"The progress of the enormous debts, which at present oppress and will in the long run probably ruin all the great nations of Europe, has been pretty uniform. Nations, like private men, have generally begun to borrow upon what may be called personal credit; without assigning or mortgaging any particular fund

for the payment of the debt; and when this resource has failed them they have gone on to borrow upon assignments or mortgages of particular funds."

In Smith's day the land and malt taxes were the only considerable branches of British revenue that remained unmortgaged and even these were regularly anticipated, *i.e.* spent before they came in. The philosopher compared the governments of his time to improvident spendthrifts, whose pressing occasions would not allow them to wait for their income. The evils that attended the new method of financing war were obvious; but statesmen gave little thought to them. "To relieve the present exigency is always the object which principally interests those immediately concerned in the administration of public affairs. The future liberation of the public revenue they leave to the care of posterity." Twenty-three years later, after five years of disastrous borrowing, Pitt adopted his master's advice and appealed to the House of Commons to raise the necessary supplies by taxation.[1]

It may then be asked: granted that a loan is the only means of raising the money required at the outbreak of hostilities, why should not taxes be laid on at the commencement of a war sufficient to cover its whole annual cost, after, say, the first six months, and be continued for six months after its cessation, so as to leave the country with no larger debt than it laboured under at the outset? The answer to this question seems to be that the simple *ought* is applied to public finance even less commonly than to other branches of politics. But it can nevertheless be inferred from the object-lessons of our own history that the extraordinary

[1] On Dec. 3, 1798; Pitt's *Speeches*, vol. ii. pp. 454-5.

expenses of war should be raised and paid for *as far as possible* by additions to taxation. That there are strong moral and political reasons for this course is obvious. An economic argument may be derived from the practice and experience of the country under Pitt and Gladstone. The fearful burden laid (and too long left) by the Napoleonic War upon the nation's back is due to the fatal error of Pitt at its beginning, to the feeble incompetence of Addington in 1804, and to the base action of Lord Liverpool's government in abolishing the income tax to please a selfish parliament of rich men immediately after the peace.[1]

Mr. Gladstone in one of his famous budget speeches classified the Napoleonic War into three periods according to the mode in which its financial burdens were discharged. During the first period, from 1793 to 1798, borrowing was the principal resort. In 1792 British three per cents. had touched 97. In 1797 they touched 47. This was the result of relying upon loans, and of making no grand effort to enlarge the revenue. The land tax was left untouched. In 1798 Pitt made and carried a proposal for an income or property tax. In the second period, from 1799 to 1802, there was an income tax; but owing to serious flaws in its legal frame-work, general evasions were practised, and it was far from effective. Finally, in the third period from 1806 to 1815, the income tax was in full force and efficiency. The whole war, it is estimated, added a sum of no less than 613 millions to the National Debt. But

[1] March 18, 1816, Vansittart, then Chancellor of the Exchequer, moved that the income tax be continued. He met with sharp opposition, and was beaten by 238—201. The government accepted the decision, continued in office, and met the year's deficit by borrowing.

the extraordinary thing is that, as Mr. Gladstone said in 1853, "our debt need not at this moment have existed if there had been resolution enough to submit to the income tax at an earlier period." [1]

This appears from a comparison — in which I follow Mr. Gladstone closely—of the financial results achieved during the first, second, and third periods of the French War—results all the more impressive when we remember how, as that unprecedentedly costly war dragged on, the financial exhaustion of the country steadily increased. In the first period, 1793-8, the charge for government and war together, with the interest on debt incurred before 1793 (9½ millions), amounted on an average to 36 millions a year, and the average revenue was about 20½ millions, including all the additional war taxes. The annual excess of charge over revenue, excluding interest on debt contracted after 1793, averaged £15,400,000. In 1798, as we have seen, the income tax was introduced, and the new policy of endeavouring to pay for the war out of current revenue began. In the second period, 1799-1802, the charge for government, war, and war debt, *plus* interest on the old debt, rose to an annual average of £47,400,000; but the average annual revenue rose concurrently from £20,500,000 to over £33,500,000, so that the excess of charge over tax revenue was reduced by nearly 2 millions a year.

But the most remarkable results are seen when we come to the third period of the French wars, the ten years from 1806 to 1815, a period of desperate difficulty and danger, which called for the utmost exertions and entailed the heaviest charges. The average annual

[1] See *Gladstone's Financial Speeches*, p. 16.

expenses of war and government during this decade, together with the interest on the debt contracted before 1793, were nearly 66 millions; but the average annual revenue from taxes reached nearly 64 millions, so that the annual deficiency, which had fallen from 15½ millions to 13½ millions in the second period, had now sunk to the almost insignificant sum of 2 millions a year. Now the annual interest on the old debt contracted before 1793 amounted to 9½ millions, so that in the last decade, with the aid of Pitt's income tax, Great Britain for ten years actually raised 7 millions a year more than the combined cost of administration and war. Such was the result of supplementing a bad fiscal system by a ten per cent. income tax, and that result justified Mr. Gladstone in drawing what may be called an economic moral :—

"Much as may be said of the importance of an army reserve and a navy reserve, and of having your armouries and your arsenals well stored, this fiscal reserve is not one whit less important; for if it be used aright it is an engine to which you may again resort; and with this engine judiciously employed, if unhappily this necessity should arise—which may God in His mercy avert—with it, judiciously employed, you may again, if need be, defy the world."

By fiscal reserve Mr. Gladstone meant generally low taxation, but especially an income tax, which is either at a low rate, or better still, disused but in readiness for use; and in this connection I recall an opinion expressed in conversation by Sir William Harcourt a few months before his death. He said that in his judgment the income tax in time of peace ought not to be higher than sixpence in the pound. Another fiscal reserve is, of course, good national credit, *i.e.* the power of borrowing money cheaply; and this again can only be secured by due economy, systematic repayment of

debt, and a fiscal system which does not oppress industry or labour in time of peace.

Mr. Lloyd George in his last financial statement painted in glowing words the financial courage of the British oligarchy in its struggle with Napoleon. The taxes imposed on wealth, however, were less than half the taxes imposed now. Moreover, as the French wars caused scarcity of food, and as some of the protective taxes imposed were favourable to agricultural rents, the landed aristocracy did not suffer, and even the income tax seems to have been frequently evaded by the governing classes. The finance of the Crimean War was much fairer. But in both cases the burden of war taxation fell most heavily on the masses, and the income tax was not graduated.

At the time of the Crimean War, which broke out in February 1854, Mr. Gladstone was Chancellor of the Exchequer, and he has therefore the main credit for what must be called the best financed of our great wars. The proposition he started with was that the cost of a war should be defrayed out of current revenue, *i.e.* by war taxes, and that those taxes should be in the main direct, so that trade should suffer as little interference, and posterity as little injustice, as possible. Accordingly he took the strong step of asking the House to consent to double the income tax—from sevenpence to fourteenpence in the pound for the first half year. To begin the war by a loan would, he urged, be a confession of financial cowardice and economic weakness unworthy of the character of the country. But in spite of the courageous promptitude with which war taxes were imposed there was enough borrowing in the first year to depress the public credit. At the beginning of 1853

consols yielding £3 per cent. stood at par. In September of the next year, after only six months of war, stock yielding £3 3s. 10d. per cent. was at 94.

The following table is of interest: it represents the highest and lowest points touched by three per cent. consols from the year before to the year after the Crimean War:

	HIGHEST.	LOWEST.		HIGHEST.	LOWEST.
1853,	101	90¾	1856,	95⅞	85⅛
1854,	95⅞	85⅛	1857,	94¼	86½
1855,	93¾	86¼	1858,	98¾	93⅞

Mr. Gladstone presented to the House of Commons a moral and even a religious argument against leaving posterity to pay the Crimean War bill:—

"The expenses of a war are the moral check which it has pleased the Almighty to impose upon the ambition and the lust of conquest that are inherent in so many nations. There is pomp and circumstance, there is glory and excitement, about war, which, notwithstanding the miseries it entails, invests it with charms in the eyes of the community, and tends to blind men to those evils to a fearful and dangerous degree. The necessity of meeting from year to year the expenditure which it entails is a salutary and wholesome check, making them feel what they are about, and making them measure the cost of the benefit upon which they may calculate. It is by these means that they may be led and brought to address themselves to a war policy as rational and intelligent beings, and may be induced to keep their eye well fixed both upon the necessity of the war into which they are about to enter, and their determination of availing themselves of the first and earliest prospects of concluding an honourable peace."

Northcote in his *Twenty Years of Financial Policy* objects that this argument, however sound in itself, and however weighty it would have been in the mouth of an independent member resisting an official proposal to carry on a questionable war by means of loans, came

unfortunately from a minister who, with his colleagues, had just drifted into a war (as they thought), not *of*, but *against*, aggression—a war, writes Northcote with gentle satire, the speedy close of which was to be hoped for rather from a display of energetic determination than from a deliberate and public adoption of the policy of so adjusting the burdens of the people as to impose a "moral check" upon their ardour. Bright could have used that argument. Gladstone might well have been content to point out that, by paying its way as he recommended, the nation would display to the world its resolution. Nor, as we have pointed out, could borrowing be wholly avoided; for a few weeks later Treasury Bonds had to be issued in anticipation of taxes; and in the following year, the Aberdeen Ministry having fallen, Sir George Cornewall Lewis, Mr. Gladstone's successor, found it necessary to float a loan of sixteen millions.

Nevertheless no one can say that Mr. Gladstone's practice in war finance, in the first year, lagged far behind his preaching. By the 8th of May it was evident that the country was in for a big war; new estimates were framed, and Mr. Gladstone had to provide for a further sum of £6,850,000. To cover this he augmented the duties on spirits, malt, and sugar, and not only extended the double income tax over the whole year, but provided for its continuance over the year following the conclusion of peace, with a view to prevent what had happened in 1816, when the income tax was repealed, and the country deprived of any chance of dealing effectively with either debt or customs duties until the advent of Peel.[1]

[1] In 1822, however, the criticisms of Ricardo and Hamilton produced some effect, and in 1823 Vansittart induced Parliament to pass an Act

The adoption of this bold and resolute policy at the outset of the Crimean War not only arrested the fall of national credit that invariably attends war, but also enabled the country to recover its prosperity after the war so rapidly that in 1861, after the emancipating budget of 1860, the taxes on its trade and consumption were less burdensome than in 1854, after the emancipating budget of 1853. Further, the depreciation in consols was only slight; and in the year after they were almost as high as in the year before the war. The net financial result of the Crimean War was to add 42 millions, a little more than half its cost, to the National Debt, along with a substantial legacy of additional taxes.

The Boer War, the next very costly conflict in which Great Britain engaged itself, was financed in a much less satisfactory way. In the 'eighties and early 'nineties large reductions had been effected in the National Debt, and in 1897-8 2½ per cent. consols rose as high as 110. On March 31, 1899, six months before the war broke out, the National Debt had been reduced to 635 millions. Unfortunately, when Parliament assembled in October 1899, Sir Michael Hicks-Beach, the Chancellor of the Exchequer, saw no necessity for taxation. The South African War was expected to be a cheap promenade. The House of Commons was told, first, that it would not cost more than 10 or at most 11 millions; second, that its cost would be defrayed by the gold mines of the Transvaal; and accordingly it was persuaded

providing that a real surplus of five millions should be set aside every year for the reduction of debt; and the National Debt was reduced from 885 millions in 1823 to 841 in 1833. It was 851 millions when Peel took the helm in 1841. The effect of the 1823 policy on the price of consols and on conversion is worthy of notice.

to sanction a loan without providing a farthing out of taxation. Some of the waste of public money[1] during the war, the huge addition to the debt, and the severe depreciation of consols must be attributed to the easy optimism of the Chancellor of the Exchequer at the outset. Trade was then booming. Employment was very good and wages were rising. The income tax stood at eightpence. It should have been doubled in October for the second half of the financial year. The ground then lost was never recovered. The budget of 1900 was quite inadequate and was not redeemed by its successors. Although Great Britain in 1899 was perhaps better able to pay 240 than it was in 1854 to pay 70 millions, the ratio of war borrowing to war taxes was much worse. The precise cost of a modern war cannot be easily ascertained — so much depends upon book-keeping. But we shall probably be not far from the mark if we put the total cost of the Boer War—which commenced in October 1899 and ended with the Peace of Vereeniging in April 1902 — at 250 millions, of which sum 76 millions were raised by new and additional duties,[2] 14 by an increase in the ordinary revenue, while 160 millions were added to the National Debt. The market value of consols fell about 20 per cent., railway and other home securities suffering in many cases still greater declines.

The period from the end of the Boer War to the

[1] Estimated by General Sir William Butler, President of the War Office Committee which examined the War Stores Scandals in 1905, at one hundred millions sterling.

[2] Fourpence was added to the income tax in 1900, twopence in 1901, and a penny in 1902. New import duties were imposed on sugar and corn, and an export duty was laid upon coal. Additions were also made to the taxes on tea, beer, spirits, and tobacco.

commencement of the Great War was a remarkable chapter in public finance. After the Peace of Vereeniging Mr. Balfour's administration restored the sinking fund; but it reduced the war taxation, while it fixed the army at 10 and the navy at 13 millions above the expenditure preceding the war. It also continued and enlarged the system of borrowing money for military and naval works. Consequently in the three years following the war no reductions were made in the debt. As a result partly of the distress following the war, partly of Mr. Chamberlain's tariff reform agitation, a sweeping Liberal and free-trade majority was yielded by the general election of 1906. With Mr. Asquith as Chancellor of the Exchequer borrowing for works was stopped and large surpluses were applied partly to the reduction of taxes, partly to debt. After Sir H. Campbell-Bannerman's death Mr. Asquith became Prime Minister and Mr. Lloyd George Chancellor of the Exchequer. An expansion of armaments began and was accompanied by a general growth of expenditure in all public departments. Mr. Lloyd George, however, took care that new taxation should keep pace with the new expenditure mainly by additions to income tax and death duties; the revenue was rapidly enlarged, and substantial reductions were effected year after year in the debt. Of the 160 millions added by the three years of the Boer War over 100 were cancelled between 1905 and 1914—by far the best performance in the peace history of the National Debt.

The secrecy in which the diplomatic and financial transactions of our government have been enveloped since the summer of 1914 makes a scientific and objective criticism almost impossible. It is more than likely that

this halo of mystery has promoted extravagance; in the worship of Cotytto:

> "'Tis only daylight that makes sin,
> Which these dun shades will ne'er report."

Enough, however, has been published to show that ornamental expenditure still figures in the public accounts and that economy up to midsummer 1915 had made no contributions to the prodigious appetite of War. Which reminds me that to the four methods of paying for war a fifth should be added—Privation. It is being practised across the Channel and North Sea; and it may soon be domiciled here; for even British credit is not inexhaustible.

CHAPTER IX

THE EFFECT OF WAR ON CAPITAL AND LABOUR

In our last chapter we examined various methods of meeting the cost of a war. Shall the state seek to cover its requirements by credit, by new taxes, by debasing the currency, by forced labour, or by economy and privation? The main question whether resort should be had to loans or to taxes, and the further questions whether aid should be obtained by compulsory unpaid services, by reducing civil expenditure, and by issuing paper money, are all to be considered with an eye partly to the present and partly to the future. Statesmen, if they are worth the name, will measure the internal as well as the external dangers to the society which they control. A prolonged war may result in social chaos, ruin, and revolution at home. Indeed, wars are frequently ended because the governments concerned relinquish their desire to fight on for conquest or prestige through fear that their own subjects, unable to endure more misery and want, will rise up in revolt against them. There is a limit to human endurance and to the economic misery which a state can inflict on its people. This topic, then, the most deeply interesting perhaps of all, arises naturally out of the problems discussed in our previous chapter, and was so treated in the course of a correspondence between Sir Stafford Northcote and Mr. Gladstone some time after the Crimean War. Mr. Gladstone, as we learn from Lord

Morley's *Life*, thought that Northcote, in comparing the effect of taxes and loans, had looked too much to the effect on labour at the moment. Capital and labour are in permanent competition for the division of the fruits of production. When war comes and large sums are borrowed, two consequences follow:

1. An immense factitious stimulus is given to labour at the time—and thus much more labour is brought into the market.

2. When that stimulus is withdrawn an augmented quantity of labour is left to compete in the market with a greatly diminished quantity of capital.

Here, wrote Mr. Gladstone, is the story of the misery of great masses of the English people after 1815, or at least a material part of that story.

As to the relative advantages to labour and capital of relying upon taxation or borrowing in war time, Mr. Gladstone's considered judgment is of high importance, and the following sentences from his letter to Northcote may be regarded as the *locus classicus* upon this strangely neglected topic:

"Assuming as *data* the established principles of our financial system and by no means denying the necessity of loans, I have not the least doubt that it is for the interest of labour, as opposed to capital, that as large a share as possible of war expenditure should be defrayed from taxes. When war breaks out the wages of labour on the whole have a tendency to rise, and the labour of the country is well able to bear some augmentation of taxes. The sums added to the public expenditure are likely at the outset, and for some time, to be larger than the sums withdrawn from commerce. When war ends, on the contrary, a great mass of persons are dismissed from public employment, and, flooding the labour market, reduce the rate of wages. But again, when war comes it is quite certain that a large share of the war taxes will be laid upon property; and that in war, property will bear a larger

share of our total taxation than in peace. From this it seems to follow at once that, up to the point at which endurance is practicable, payment by war taxes rather than by taxes in peace is for the interest of the people at large." [1]

If this view be correct, as I believe it to be in the main, it is to the interest of the labouring classes that a large proportion of the extraordinary expenses of war should be defrayed out of taxation, *i.e.*, out of the current national income. The best instrument for this purpose yet discovered is the British income tax backed by severe revenue duties (customs and excise) upon widely consumed luxuries such as beer, spirits, tobacco, and possibly also tea. But this course, with all respect to Mr. Gladstone, is not adverse to capital. Capital and labour are the two essential parts of the machinery of production. If a state goes on borrowing until it becomes bankrupt, those who have put their savings into state loans are like the shareholders of a limited liability company which has gone into receiver's hands. If the public credit collapses, as it well may do under a load of debt, then private capital and credit stand to suffer at least as much as labour.

The problem was approached but left unsolved by Mr. Lloyd George in his last war budget statement [2] made at a time when his proposals for following up the war taxes on beer with war taxes on spirits had failed owing to the power of the Trade in Ireland and Scotland. Mr. Lloyd George argued that the nation was unusually prosperous and could far better afford to find the war money out of its current income than to let the exchanges, the currency, and the commercial credit of the country

[1] See Morley's *Life of Gladstone*, vol. i. pp. 517, 518.
[2] See Hansard's *Parliamentary Debates*, May 4, 1915.

go to the bad. It is quite true that when he spoke the only people unemployed were the incurably lazy, the infirm, and the unemployables. On this point the trade union returns afforded cogent proof. But when Mr. Lloyd George proceeded to infer that the income of the country was higher than usual and that the savings of an ordinary year might be doubled and pocketed by the state, he entered upon doubtful and disputable ground. For to begin with, above two million men had been drafted from the mines, workshops, agriculture, and fisheries, and general business of the country into the army and navy. Agricultural labourers, instead of ploughing, had been learning to shoot; fishermen were trawling for mines; coal miners were digging trenches in Flanders. Above all, there was an immense rise in prices, which really meant a general reduction in wages and salaries. Mr. Lloyd George seemed to be preparing the House of Commons for a general tax upon wages as well as for further additions to the income tax. Against this Mr. Philip Snowden argued that no further taxation ought to be imposed on the wage-earning classes, because the purchasing power of wages had fallen till a sovereign was only worth 17 or 18 shillings. The increased duties on beer, whiskey, and tea he held to be a comparatively small item in comparison with the general rise of 20 or 30 per cent. in food prices. He put the reduction in spending power of the working classes at about 180 millions, their total spending power before the war having been 800 millions. Over two million men had been withdrawn from wage-earning employment, and only one million a year, he believed, had so far been added to wages in the shape of war bonuses. But Mr. Snowden saw no insuperable

obstacle to raising by taxes the whole of the deficit which the Chancellor of the Exchequer would have to meet. "If he were as courageous as the Chancellors of the Exchequer towards the end of the Napoleonic wars, and took two-sevenths of the present national income, which he himself stated to be £2,400,000,000, that would give him about the sum he wants—say, £800,000,000 a year." Mr. Snowden did not propose a multiplication of taxes. Income tax and death duties would suffice. A small tax upon wages would only bring in three millions a year, but he proposed, in view of their prosperity, that farmers should be subjected to the same income tax as other men, and that the income tax should be regraduated up to 15s. in the pound on very large incomes, seeing that by such a tax "not one of these persons would be reduced to a condition of starvation." According to Mr. Snowden, the Chancellor of the Exchequer should look not at what he is taking, but at what he is leaving, and should say, "No man shall be left with more than a certain amount; we are going to take all the rest." This is a new doctrine, an extension of the so-called People's Budget, by which in 1909 Mr. Lloyd George threw the main cost of armaments and old age pensions upon the rich and the well-to-do classes. Confiscation of wealth is the socialist's answer to the conscriptionist's call for confiscation of labour.

If the working classes can be taxed during war time with substantial results to the revenue, Mr. Snowden's argument will not hold; for, as we have seen, the hardships of the working classes after the war will be much greater if the cost of the war is raised by loans than if it is raised by taxes. Moreover, it is morally right that the

anguish of the soldiers at the front should be associated with privations at home; and no nation, least of all a democracy, should be allowed to enjoy an illusory prosperity during war. Moral and political considerations like these should always be present in the minds of those who control national finance in a moment of crisis.

One other problem deserves attention in connection with the labour market at the beginning and end of a great war. The disturbance and dislocation are great in proportion to the size of the army, and to the trade which has been lost. In August 1914 business in France and Austria—to a less extent in Germany, thanks to its wonderful organisation—was paralysed for a time. In Great Britain several hundred thousand men were thrown out of work or received notice owing to the suspension of commercial intercourse with our largest customer in Europe and to the cancellation of orders from all parts of the world. A large proportion of those who had lost their work joined the army. In a few weeks' time employment became normal; and in a few more weeks the shortage of labour became acute.

Then it became gradually evident that Great Britain would have to supply not only its own army and navy with clothes, boots, equipment, and munitions of all kinds, but that it would also have to do a great deal of manufacturing for the allied governments. Moreover, if it ceased to export goods to the United States, India, Argentina, etc., it would have much difficulty in paying for the necessary imports of food and raw material. Besides this, our colonies required to be financed, and so did our Allies. Thus the policy of raising a continental army ran counter to the commercial and financial calls upon the country. The recruitment of miners,

railwaymen, and transport workers proved especially mischievous; the rise of food and coal prices led to strikes and other embarrassments. In fact, by the spring of 1915, the government had begun to say that munitions, and especially explosives, rather than men were the chief need, and that the idea of running the war on principles of unlimited liability could no longer be entertained. If Pitt had introduced continental service and had endeavoured to maintain an army as large as Napoleon, Great Britain would have been unable to maintain itself, let alone sustaining and inspiring a continental combination. This mood, however, did not last. A succession of failures in the Dardanelles forced Mr. Asquith to a choice between facing a critical opposition and admitting its leaders to office. There resulted a coalition government, a disastrous development of the expeditionary policy, and finally a resort to compulsory service at the end of the year 1915.

The problem of disbanding a huge army at the end of a war is always difficult; but if the stocks of merchandise all over the world have run very low, and if there are sufficient credit resources to provide new money for rebuilding factories and restoring broken machinery in the devastated areas, there may be a short boom in many trades, which will absorb a large proportion of the disbanded soldiers. Bastiat, in one of his most brilliant essays, examines the argument against disbanding 100,000 troops after a war. "You tell me," he writes, "there will be a surplus of 100,000 workers, that competition will be stimulated and the rate of wages reduced. And this is what you see. But what you do not see is this. You do not see that to

dismiss a hundred thousand soldiers is not to do away with a million of money, but to return it to the taxpayers. You do not see that to throw a hundred thousand workers on the market is to throw into it, at the same moment, the hundred millions of money needed to pay for their labour; that, consequently, the same act which increases the supply of hands, increases also the demand; from which it follows that your fear of a reduction of wages is unfounded. You do not see that before the disbanding, as well as after it, there are in the country a hundred millions of money corresponding with the hundred thousand men. That the whole difference consists in this: before the disbanding, the country gave the hundred millions to the hundred thousand men for doing nothing; and that after it, it pays them the same sum for working. You do not see, in short, that when a taxpayer gives his money either to a soldier in exchange for nothing, or to a worker in exchange for something, all the ultimate consequences of the circulation of this money are the same in the two cases; only, in the second case, the taxpayer receives something, in the former he receives nothing. The result is a dead loss to the nation.

"The sophism which I am here combating will not stand the test of progression, which is the touchstone of principles. If, when every compensation is made, and all interests satisfied, there is a *national profit* in increasing the army, why not enrol under its banners the entire male population of the country?"

PART II

ON WAR DEBTS

PART II

ON WAR DEBTS

CHAPTER I

ON WAR DEBT AND WAR FINANCE IN GENERAL

"Yet reason frowns on war's unequal game,
Where wasted nations raise a single name,
And mortgaged states their grandsires' wreaths regret
From age to age in everlasting debt."

Dr. Johnson.

In Great Britain during the eighteenth century much apprehension was caused among economists and statesmen by the rapid increase of the War Debt. Time after time predictions of ruin or national bankruptcy were made by eminent writers, and the most fantastic remedies were proposed. Finally at the end of the Napoleonic wars the limit of taxation appeared to have been very nearly reached, and so heavy was the burden of interest that a serious discussion arose as to whether some measure of repudiation or composition with the public creditors would not have to be introduced. Towards the end of the war Robert Hamilton, professor of mathematics in the University of Aberdeen, published his *Inquiry Concerning the Rise and Progress, the Redemption and Present State and Management of the National Debt of Great Britain and Ireland,* a work which still deserves our attention and admiration. After showing that under any system of government the general

wealth is insufficient to supply the expense of wars, he explains how the irregular system of borrowing by pledging the jewels, or mortgaging the lands of the crown, proved inadequate, and how the more systematic method, adopted after the expulsion of the Stuarts, had been carried during the wars with France "to an extent far beyond what was ever known in any other age or nation; far beyond what any person at its commencement, or even after its considerable advancement, believed to be practicable." This system at the end of the Napoleonic wars seemed to be still expanding. "The public debt, which was inconsiderable at the Revolution, has increased, in little more than a century, to its present magnitude. The increase during every reign, except the pacific reign of George I., has been greater than during the preceding. The increase during every war has been greater than during the preceding. The increase during the latter period of every war, except the late one, has been greater than in the earlier period. The increase, by every national exertion, has been greater than administration held forth when the measure was undertaken. The part of the National Debt paid off, in intervals of peace, has borne a small proportion to that contracted by the preceding war. No man can foresee how far this system can be carried, or in what manner it will terminate."

To discredit deceptive schemes for discharging national encumbrances was even more necessary then than now; for Mr. Pitt had adopted the Sinking Fund of Dr. Price, partly, no doubt, because, like the author, he was a victim to the imposture, but mainly because he was anxious to ease the alarm and check the decline of public credit which the magnitude of his borrowings

had caused. Hamilton began by establishing a series of principles and "general conclusions concerning our financial system," and so avoided the necessity of examining a multitude of illusory projects. Thereafter he proceeded to describe the systems adopted by successive British governments in the creation and management of the National Debt, including the payment of interest and Sinking Fund. It will be convenient to follow Hamilton's plan, commencing with general principles and proceeding in successive chapters to particulars of the methods adopted by the governments of Great Britain and other Powers in raising money for war purposes, and in the management and discharge of debts so accumulated.[1]

The twelve "general principles" formulated by Hamilton may be resolved into nine as follows:

1. "*The annual income of a nation consists of the united produce of its agriculture, manufactures, and commerce. This income is the source from which the inhabitants derive the necessaries and comforts of life; distributed, according to their stations, in various proportions; and from which the public revenue, necessary for internal administration, or for war, is raised.*"

The national income is a favourite but misleading expression; for it is sometimes used to signify the aggregate incomes earned or received by all the inhabitants of the kingdom. In this sense the national income of the United Kingdom is variously estimated at from 2000 to 3000 millions. Or again, the national income may be a synonym for the public income or the national

[1] I have used the third edition (1818) of Hamilton's *Inquiry*. A valuable article on the second edition will be found in the *Edinburgh Review*, vol. 24, p. 294.

revenue, consisting in normal times mainly of the produce of taxes and the nett profits of public monopolies like the Post Office. The public expenditure in time of peace is partly productive, *e.g.*, for the building and maintenance of roads, partly unproductive. This unproductive expenditure may be unnecessary, or it may be required for defence and security. In time of war this unproductive expenditure may grow to an amount which is only limited by the national credit. Public expenditure, however reasonable and necessary, is defrayed, as Hamilton observes, from the funds which supply our wants, and so tends to lessen our enjoyments. "Taxation therefore, though necessary, is not desirable. It may arise to a magnitude which will press severely on the comforts, and even encroach on the necessaries, of the middling and lower ranks. Unnecessary public expenditure, whether occasioned by engaging in wars which might be avoided, or conducting necessary ones with improper prodigality, or by extravagance in internal administration, is a serious evil to the public."

It has indeed sometimes been affirmed, as for example by Southey, in his *Colloquies of Society*, that taxes are in themselves harmless or even useful, first as a spur to industry, and secondly, because, it is said, the money collected returns, through channels selected by rulers wiser than the people, to the community from which it has been extracted. But the first argument only applies to idlers, or to very rich people who waste a large proportion of their income on luxuries. The second argument is founded upon the ever green fallacy that money constitutes wealth, and that public expenditure on whatever object is good because it circulates money

and so spreads prosperity. The dogma that rulers are wiser than their subjects, in the sense that a minister, for example, can spend the money of his constituents to better advantage than they can spend it for themselves, is refuted by experience and is contrary to reason. As to public expenditure in time of war it may further be observed that even on the theory that money constitutes wealth, a large part of British expenditure on war is altogether lost and wasted since it is sent abroad to pay for munitions or to support troops, or in subsidies to allied Powers. In this respect the finance of our wars with Napoleon has been reproduced.

2. *"The portion of national income which can be appropriated to public purposes, and the possible amount of taxation, are limited."*

The truth of the above proposition will not be disputed though it may be said at any time that in any particular country there is still a large margin of taxation left upon which a finance minister may draw. But clearly the whole annual income of a nation cannot be appropriated unless the whole people can be put upon rations or converted into government employees; otherwise the tax-gatherer must leave the taxpayers enough to live upon—what sociologists call a subsistence minimum. In Japan during the war with Russia the income tax on high incomes was raised to about five shillings in the pound, and this example was followed by Mr. Lloyd George when he doubled the income tax in the late autumn of 1914. In May 1915, during the Budget debates, Mr. Philip Snowden, a Socialist member, suggested that the tax on high incomes should be raised from five to fifteen shillings in the pound. Such a tax, he argued, would cause less suffering to the

rich than would a very small income tax of, say, one penny or twopence in the pound to the poor.

From this it is fairly obvious that war under a socialist *régime* would mean an almost unlimited confiscation of private wealth by the State. Indirect taxation upon articles of luxury and comfort is limited by the consideration that at a certain point the consumption is so much reduced that the raising of the tax, instead of increasing, will actually diminish the revenue. This limit would seem to have been nearly reached in Great Britain before the war of 1914, as regards tobacco, and after the first war budget, as regards beer. Similar considerations apply to most other indirect taxes; and with added force in the case of protective duties on articles imported from abroad; for these stimulate home production, until a point is reached at which the imports, and consequently the customs duties, cease.

3. *"The amount of the revenue raised in time of peace ought to be greater than the expense of a peace establishment, and the overplus applied for the discharge of debts contracted in former wars, or reserved as a resource for the expense of future wars."*

This rule will not be gainsaid in the abstract, though in the concrete it is seldom observed; for rulers bent on avoiding unpopularity have been only too eager to find plausible arguments for ignoring it. In almost every country the ministers and officials who constitute the bureaucracy, though nominally the servants, are really the masters, of the nation. They are quartered upon the taxpayer,[1] and a reduction of public salaries

[1] The growth of bureaucracy is one of the plagues of modern society, which is in danger of being controlled, bullied, regulated, and impoverished by its own salaried servants. Even in England the rapid

or of public functionaries in order to ease public burdens or to provide a sinking fund for the public debt is a desperate resort of which history provides few examples. Indeed, over and over again, as the records of Spain, Portugal, Greece, and the Southern Republics of America abundantly show, governments have preferred in a financial emergency to suspend payment of interest to their creditors, in other words, to repudiate their obligations, rather than to economise.

4. "*In time of war, taxes may be raised to a greater height than in peaceable times; and the amount of the additional taxes, together with surpluses of the peace establishment, should be applied for defraying the expenses of the war.*"

Upon this proposition Hamilton remarks:—"It is not intended to affirm that the power of a nation to bear taxes is increased in consequence of its being engaged in war. The contrary is always the case." The learned author's last dictum is too sweeping. Wars carried on as they have been carried on by British governments in modern times may actually increase for a short time the aggregate money incomes of the individuals who compose the nation. During the first year of the Boer War, 1899-1900, and again in the Great War of 1914-15, extraordinary activity was imparted to most branches of trade. Wages rose and unemployment decreased as a natural result of the withdrawal of men into the army, and of the enormous government contracts which gave employment to factories in all

expansion of the Civil Service is making it a favourite refuge for young men of promise at the universities. They pass an examination, and thenceforth (entrenched in the Consolidated Fund) look forward with equanimity to rising salaries and an eventual pension.

parts of the country. But these modern exceptions only strengthen the argument for increased taxation during war. And in any case, increased taxation can be justified by Hamilton's reflection that "necessity, real or supposed, has a powerful influence on the public mind, and reconciles the community to submit to privations which in peaceable times would be accounted insupportable." It must be admitted, however, that the privations of a great war between continental powers with enormous conscript armies may be so great that additional taxes are impossible, and this view was taken by the governments of France, Germany, and Austria in 1914. Indeed, in the face of a heavy decline in customs revenue, they actually abandoned many of their protective duties on food in order to stave off the danger of famine and of a shortage of supplies. The Russian government having suppressed its lucrative traffic in vodka also lost a large revenue; but additional taxation which made up a fraction of this loss and of the decline in customs was introduced in the autumn of 1914. Further arguments for increasing taxation in time of war in order to sustain the national credit have been set forth in a previous chapter.[1]

5. "*The expense of modern wars has been generally so great that the revenue raised within the year is insufficient to defray it. Hence the necessity of having recourse to the system of funding or anticipation. The sum required to complete the public expenditure is borrowed on such terms as it can be procured for; and taxes are imposed for the payment of the interest; or perhaps, to a greater extent, with a view to the gradual extinction of the principal.*"

We have shown in earlier chapters the causes of the

[1] Part I., Chapter VIII.

rapid rise in modern war expenditure, owing partly to the increased cost of armaments, partly to the system of conscription by which rival nations place almost the whole of their adult male population between the ages of eighteen and forty in the field. Moreover, where nations with colonial empires are fighting one another the ravages of war extend to every corner of the globe. And further, after abandoning it for a time, our Foreign Office has returned to the Balance of Power, a system under which, as Hamilton remarked, large sums are granted by the more opulent states "as subsidies to others supposed to be interested in the same common cause."

Whether this function of maintaining the Balance of Power in Europe is really better than a pretext for meddling in other peoples' affairs may be doubted; for when a war for the Balance of Power has once begun the original object speedily disappears. One object after another is proclaimed, until finally it becomes clear that a decisive victory will incidentally upset that balance which it was our purpose to trim. Thus if the Balance of Power is really our policy Great Britain ought always to join the weaker side and to desert its allies as soon as they are too successful. The progress of the public debt mainly as a result of the continental and colonial policy pursued by British governments in the eighteenth century is described in our next chapter.

6. "*In every year of war, where this system is adopted the amount of the public debt is increased, and the total increase of debt during a war depends upon its duration, and the annual excess of the expenditure above the revenue.*

"*In every year of peace, where the excess of the revenue above the expenditure is properly applied, the national*

debt is diminished; and the amount discharged during any period of peace depends upon the length of its continuance and the amount of the annual surplus.

"*If the periods of war compared with those of peace, and the annual excess of the war expenditure compared with the annual savings during the peace establishment, be so related that more debt is contracted in every war than is discharged in the succeeding peace, the consequence is a perpetual increase of the debt; and the ultimate consequence of a perseverance in this system must be its amount to a magnitude which the nation is unable to bear.*"

The above proposition consists of two incontrovertible premises and of a conclusion which Professor Hamilton (writing at the close of the Napoleonic war) held to be "a necessary consequence." Fortunately for the nation its statesmen began to realise after Waterloo that perpetual wars could not be sustained without danger of bankruptcy, revolution, and repudiation. Consequently a more peaceful policy was pursued. The debt was gradually reduced; oppressive taxation was diminished, and for thirty-nine years no great war was undertaken. After the Crimean War a policy of non-intervention was adopted, and the new spectacle was witnessed of Great Britain remaining at peace during the sharp struggles on the continent which ended in the establishment of a Dual Monarchy, a United Italy, and a United Germany.

As to whether the limit of the taxable capacity of Great Britain was reached in the last years of the war with Napoleon, Hamilton believed that the taxation of the middle classes was not much less than half their incomes, "and therefore," he adds, "we are already advanced to the utmost limit which taxation can ever

reach"; a statement which he afterwards modified by conceding that it might be possible "with great difficulty and danger" to increase the taxation by one half. A real increase of revenue would, of course, follow an increase of national wealth, which, however, is not likely to occur in a perpetual state of war. Moreover, a long interval is required after the termination of a great war before a return of the military and naval establishments to anything like the old peace level can be hoped for. According to Hamilton, "if we add a year of war expenditure to the duration of each war on this account we shall not go beyond the fact."

7. "*The only effectual remedies of this danger are the extension of the relative length of the periods of peace; frugality in the peace establishments; lessening of the war expenses; and increase of taxes, whether permanent or levied during war.*"

From the Revolution to 1816, a period of 128 years, there were 66 years of war and 62 years of peace. The whole debt contracted during the 66 years of war is computed at £802,819,000. The whole debt discharged during the 62 years of peace is computed at £44,837,000. Thus more than 16 times the debt discharged in a year of peace was annually contracted in a year of war. It was argued that the magnitude of the national debt in 1816 need cause no alarm because most of the national creditors were British taxpayers, "and a debt owing by one part of the community to another is in effect no debt at all." This resembles the defence of a housebreaker, who, being convicted of carrying off a shopkeeper's money, replied that it had caused no loss, for he had used the money to buy goods from his victim's shop. Some writers even maintained that the

national debt was a part of the national capital, though the objects on which it had been expended yielded no revenue. To which it must be answered that nearly all the national debt of Great Britain can properly be described as dead-weight debt. It represents unprofitable if not unnecessary wars. The interest on the debt is largely drawn from industry and paid to idleness. " It is drawn from the merchant, the manufacturer, the farmer, and paid to the stockholder. The amount so drawn may be augmented till it occasion the ruin of those who pay it " and so lead to national bankruptcy. The only remedy then is for statesmen to practise a pacific in place of a warlike diplomacy; to pay off debt as steadily and rapidly as possible, and to study public economy.

8. " *If the three former of these remedies be impracticable, the last affords our only recourse. By increasing the war taxes, the sum required to be raised by loan is lessened. By increasing the taxes in time of peace, the sum applicable to the discharge of debt is increased. These measures may be followed to such an extent that the savings in time of peace may be brought to an equality with the surplus expenditure in time of war, even on the supposition that the periods of their relative duration shall be the same for centuries to come that they have been for a century past.*"

As the British Empire is world-wide, and our navy very great, and our wealth enormous, a British government is tempted to wage war on the principle of unlimited liability. But in the prosecution of war exertions should be concentrated at points where the contest is likely to be decisive. Operations should be prompt and vigorous. The health of soldiers, the care of the sick and wounded, the maintenance of the disabled and of

dependants must be liberally provided for. But the following questions pointing from past experience to economies in the conduct of future wars are suggested by Hamilton :—

> Have no unnecessary and ineffectual expeditions been undertaken ?
> Have not considerable armies been kept in places where they could be of little or no use ?
> Has not the acquisition of colonies and consequently the number of foreign garrisons and establishments been overdone, thereby weakening our exertions at vital points ?
> Have our finances in war time been managed with prudent frugality ?
> Have not enormous fortunes been amassed by public contractors, and large sums lost by the mismanagement of the public accounts ?
> Have not large sums been granted to foreign powers, whose fidelity we had just cause from experience to distrust ?
> Are not motions for inquiry into public waste usually discouraged ; and even when granted are not ministers dilatory and their remedies ineffectual ?

If these questions are answered in the affirmative there is obviously a good substitute for taxing to the hilt or borrowing to the limit. But if all the machinery of representative government fail through laxity, incompetence, or want of good will in the representatives and trustees of the nation, then " if we cannot or will not adopt more frugal or more pacific measures " there is no alternative but an increase in taxation under

the circumstances of the above hypothesis. Moreover, the moral advantages of raising most of the expense of war during the war are very great. The burden of a war is the natural and proper restraint upon the propensity for war. Besides every generation has its own struggles, and it has no right to throw them forward upon posterity.

9. "*The excess of revenue above expenditure is the only real sinking fund by which the public debt can be discharged. The increase of the revenue, or the diminution of expense, are the only means by which this sinking fund can be enlarged, and its operations rendered more effectual; and all schemes for discharging the national debt, by sinking funds, operating by compound interest, or in any other manner unless so far as they are founded upon this principle, are illusory.*"

The idea that a small sinking fund will atone for a large deficit is fostered by governments all over the world, and the illusion is still cherished by jobbers and brokers who admire the state for financial jugglery which they would deem dishonest in individuals. If we bear in mind the simple truth elaborately established by Hamilton, but really requiring no demonstration, that a debt can only be discharged by a surplus, we shall understand the futility of maintaining a sinking fund when we are borrowing five, ten, or a hundred times its amount for war purposes. And yet in all parts of the world governments still borrow for sinking funds.

CHAPTER II

THE HISTORY OF THE WAR DEBT OF GREAT BRITAIN [1]

OUR National Debt has been described appropriately enough as Dead Weight Debt; for it represents liabilities contracted in a long succession of wars, and against it there are practically no revenue-producing assets. Before the Revolution of 1689 there was no National Debt in the modern sense. The Stuart kings used to raise small sums by pledging crown jewels, or mortgaging temporary revenues, or by extracting loans from the Jews and the goldsmiths. But with the settlement of 1689 the financial control of the House of Commons was established, and Parliament was ready to pledge public revenues for the wars against the King of France and the ejected dynasty which he supported. And it was the more ready to borrow as an attempt to pay for the war by taxation might easily have aroused popular discontent and strengthened the factions which still favoured the Stuarts. In 1689 the so-called "Bankers' Debt" constituted the only public liability of importance. It had originated in 1672, and for some years afterwards interest had been duly paid at the rate of 6 per cent. Before the death of Charles II. payment was dropped, but the claims of the creditors were constantly pressed until in the last year of King William's

[1] This and the four following chapters are based on a memorandum which I drew up for the National Monetary Commission of the United States in the year 1909.

reign a composition was made by which Parliament agreed to discharge the whole "Bankers' Debt" by a payment of £664,263, half the principal, or to pay in perpetuity half the originally agreed interest, *i.e.* 3 per cent. The failure to pay interest on this debt was a serious difficulty in 1690, when Parliament decided to borrow for the war expenses; for the credit and integrity of the administration were naturally regarded by the moneyed and money-lending classes with suspicion. This explains the high rate which had to be paid for even small sums. Thus the loans varying from £250,000 to £1,200,000, raised before the Peace of Ryswick in 1697, were all issued at 7 or 8 per cent., and were charged mainly on customs and excise duties.

In Burnet's *History of His Own Time* we read how Charles Montague (afterwards Lord Halifax) began to make a figure in the House of Commons, how he was advanced to be a Commissioner of the Treasury, and soon after to be Chancellor of the Exchequer. Undoubtedly he was the first of our few great Chancellors of the Exchequer, and as such his opinion on the proper means of raising money for William the Third's wars deserves to be put on record. In the words of Burnet "he came to have great notions with relation to all the concerns of the Treasury and of the public funds, and brought those matters into new and better methods: he showed the error of giving money upon remote funds at a vast discount, and with great premiums to raise loans upon them; which occasioned a great outcry at the sums that were given, at the same time that they were much shrunk before they produced the money that was expected from them. So he pressed the king to insist on this as a maxim, to have all the money for

the service of a year to be raised within that year." The Bishop's language is rather obscure, as though he were puzzled by the mysteries of finance; but the last sentence is clear enough, and later on he tells how by 1698 "public credit was restored and the payment of public debts was put on sure and good funds."

At the Peace of Ryswick in 1697 many of the revenues upon which the various loans had been secured seemed likely to prove deficient, and the exchequer tallies in the hands of the public began to be sold at a heavy discount. The Bank of England was authorised to enlarge its capital, and provision was made by "the first general mortgage" to discharge the debts before 1706 by continuing certain war duties till that time, interest at 8 per cent. being paid meanwhile. Several further loans, however, necessitating additional duties on malt, coal, etc., were contracted before the accession of Anne in 1701. But in addition to the loans above described large amounts were also raised by annuities, and toward the end of the reign, when, owing to the cost of the war, money was becoming very difficult to raise, recourse was had to a vicious method which added to the capital of the public debt a much larger sum than the exchequer received. By means of six lotteries, including one granted after the Peace of Utrecht, £9,000,000 of money were obtained. Each ticket was entitled to a capital equivalent to the sum advanced bearing interest at 6 per cent. with repayment in thirty-two years. But in addition the prize drawers were entitled to large additional sums amounting in all to £2,723,000 repayable in the same year and bearing the same interest. So that the Government borrowed £9,000,000 but created £11,723,000 of debt. The

Government also raised money through the South Sea Company; and so became involved in the South Sea Bubble.

The reign of George I. marked an important recovery of national credit, thanks to the operation of peace and economy. Although the nominal capital of the debt was but slightly diminished, the charge for interest, and consequently the real burden on taxpayers, was very greatly decreased. Several important improvements in the management of the debt were introduced. In the first place the plan of mortgaging branches of the revenue was replaced in 1715 by a loan raised in perpetual annuities redeemable by Parliament on repayment of principal, but with funds assigned only for payment of interest. This system was thenceforth generally adopted, though the old plan of specific mortgage was also occasionally resorted to. Under the old system separate accounts of each loan with the assigned taxes had been kept. This had led to confusion, as there emerged a multiplicity of funds, some showing deficiencies and others surpluses. Accordingly, soon after the Peace of Utrecht, most branches of the revenue were united in three funds—the aggregate fund, the general fund, and the South Sea fund—each fund being charged with the payment of certain annuities. The united surplus of these three funds formed the basis of the first sinking fund (1716), usually called after Sir Robert Walpole, though its real author was Lord Stanhope. In 1717, after negotiation with the Bank of England and the South Sea Company, a general reduction of interest on the public debt was agreed upon to 5 per cent.—the debt in King William's reign having been contracted mainly at 8 per cent. and that of Queen

Anne's reign mainly at 6 per cent. Almost all the public creditors agreed to the reduction, and very few had to be paid off. Ten years later, in 1727, the Government arranged to reduce from 5 to 4 per cent. the interest on its debt to the Bank and the South Sea Company, and in 1732 a similar arrangement was made with the East India Company. The irredeemable annuities were also converted into redeemable debt, and a reduction of interest to 4 per cent. upon this new capital was agreed upon in 1727. At the end of George the First's reign the total debt funded and unfunded was estimated at about £52,000,000 sterling and the charge for interest at £1,217,551.

During the first part of the reign of George II. (1727-1760), under the wise administration of Walpole, peace and financial progress continued. Although the fallacious principle of contracting new debts while applying a sinking fund to the reduction of old debts was still occasionally observed, the debt was substantially diminished. Unfortunately in 1739 a long war began, at first with Spain and afterwards with France and Spain together, which eventually added some £30,000,000 to the National Debt. But thanks to the growing wealth of the nation, and the growing confidence in public credit, the Government easily raised the large amounts required at from 3 to 4 per cent., though the rate went a little higher in 1745 owing to the alarm caused by the invasion of the Young Pretender, when the 3 per cents. fell to 75. After the Peace of Aix-la-Chapelle the Threes soon rose to par, and actually touched 106 in 1752. Advantage was taken of this rise in public credit to effect an important conversion of the debt. It was enacted in 1749 that all

the public creditors at 4 per cent. who should signify their readiness to accept 3 per cent. after December 25, 1757, should have their existing rate of interest continued till December 25, 1750, and should then receive 3½ per cent. till December 1757, after which the interest should be 3 per cent. The total amount of the debts involved in this important scheme, which was to serve as a model for future financiers, was £57,000,000 sterling. Most of the creditors accepted the offer; but as some declined it was repeated in 1753, though on less favourable conditions, as the offer of 3½ per cent. interest was only till December 25, 1755. Most of the remaining creditors then accepted, and those who persisted in declining were paid off. The debts thus dealt with were united in a fund afterwards called "the 3 per cent. reduced annuities," while the debts originally contracted at 3 per cent. were united in another fund called "the 3 per cent. *consolidated* annuities." Thus practically the whole debt was converted in the middle of the eighteenth century into the "sweet simplicity of 3 per cent.," and the two parts of it were known into our own time as "*reduced threes*" and "*consols*." British credit (measured by interest) in fact stood much higher in 1755 than it does in 1915.

While this great reduction in the debt charge was being effected the nominal amount of the funded debt was but little reduced, but the unfunded debt was nearly all paid off in 1756. Then the Seven Years' War broke out, adding nearly £60,000,000 to the debt, and 3 per cents. fell far below par. Various devices were resorted to, such as (in 1756) a 3½ per cent. loan redeemable in fifteen years; lottery loans; 4 per cents. (1760), reducible to 3 per cent. after twenty-one years, allowing

£103 for every £100 borrowed; and a 4 per cent. loan for £12,000,000 (1762), to be reduced to 3 per cent. after nineteen years, with an annuity of £1 for ninety-eight years. A large floating debt in navy bills, exchequer bills, etc., incurred during this war was paid off during the peace which ensued. The following conspectus shows the progress of the National Debt from 1689 to the war of the American Revolution :—

	Principal.	Interest and annuities.
Debt at the revolution, 1689	£664,000	£39,000
Debt contracted during the succeeding wars of King William	20,851,000	1,681,000
Debt at Peace of Ryswick, 1697	21,515,000	1,721,000
Debt paid off during peace	5,121,000	410,000
Debt in 1702 at commencement of Queen Anne's war	16,394,000	1,310,000
Debt contracted during the war	35,750,000	2,040,000
Debt at Peace of Utrecht, 1713	52,145,000	3,351,000
Debt paid during the peace	4,190,000	1,338,000
Debt in 1739, at beginning of war	47,954,000	2,012,000
Debt added during the war	31,339,000	1,078,000
Debt at Peace of Aix-la-Chapelle, in 1748	79,293,000	3,091,000
Debt paid off during peace	4,961,000	480,000
Debt in 1756, at beginning of Seven Years' War	74,332,000	2,610,000
Debt added by Seven Years' War	64,533,000	2,241,000
Debt in 1763, at Peace of Paris	138,865,000	4,852,000
Debt paid off during peace	10,281,000	380,000
Debt in 1775, at commencement of American war	128,583,000	4,471,000

We have seen[1] how the public credit was shaken during the war with the American colonies, which proved far more costly than any of its predecessors. The first loan of 1776 was £2,000,000 in 3 per cents. at £107 10s. funded for every £100 borrowed. In 1777 £5,000,000 were raised in 4 per cents. at par with an annuity of 10s. for ten years. In the two following years the Govern-

[1] Part I., Chapter II.

ment reverted to 3 per cent. issues with large annuities to tempt the public. In 1780 £12,000,000 were borrowed in 4 per cents. at par with an annuity of £1 16s. 3d. for eighty years. In 1781 3 per cents. were funded at £150 with £25 added in the 4 per cents., so that by this transaction £21,000,000 were added to the capital of the debt, though only £12,000,000 reached the exchequer. The credit of the country went from bad to worse, the lowest point being reached in 1782 when the 3 per cents. fell to 54. After the Peace of Versailles in 1783 consols remained low for about two years, and then rose gradually until in March 1792 they reached 96, their highest point for many years.

We may now continue our history, following the figures of Robert Hamilton, the learned and accurate author of the *Inquiry Concerning the National Debt*.[1]

	Principal of funded debt.	Interest and annuities.
Debt in 1775, at commencement of American war	£128,583,000	£4,471,000
Debt added by American war . .	121,267,000	4,980,000
Debt in 1783, at Peace of Versailles .	249,851,000	9,451,000
Debt paid off during the peace . .	5,732,000	149,000
Debt in 1793, at commencement of French war	244,118,000	9,302,000
Debt in 1802, at Peace of Amiens .	520,207,000	18,643,000
Debt in 1814, after Napoleon's retirement to Elba	742,615,000	26,647,000

These figures only relate to the funded debt. There was also an enormous amount of floating or unfunded debt. Thus according to Porter in the *Progress of the Nation*[2] the whole capital of the debt funded and unfunded amounted to £637,000,000 in 1802 and had risen

[1] Third edition, 1818. It will be observed that while the American war did not quite double the debt it more than doubled the debt charge.

[2] Edition of 1847, p. 482.

to £885,000,000[1] in 1816, involving a charge for interest in that year of £32,938,000—more than half of the whole public revenue from taxes. The national credit was, of course, much impaired. During the French wars the price of 3 per cent. consols fluctuated between a maximum of 73 and a minimum of 47. This lowest point was reached in January 1797. In 1798 the Fours fell to 59¼ and the Fives to 68⅜. These last had stood at 122 in August 1791.

After the war the financial recovery was very slow. Until 1822 little was done. In fact Joseph Hume declared in that year that the debt had been increasing rather than diminishing since 1816. But in 1822 Vansittart introduced a scheme which led to the conversion of the 5 per cents. with a large saving of interest, and also provided for the establishment of a true sinking fund. Some substantial retrenchments were effected in expenditure, and in the following year Robinson, Vansittart's successor at the exchequer, found himself with a surplus of £5,000,000, which he applied to the reduction of the National Debt. A number of taxes were repealed or reduced, a net surplus of £3,000,000 was recommended as a real sinking fund for the reduction of debt in the future, and the sham device of Price and Pitt, which had proved worse than futile, was definitely abandoned. From this time until 1833 there were annual reductions of the National Debt, which fell in ten years from £885,000,000 to £841,000,000. The result was immediately visible. In 1824, when over £6,000,000 of debt were cancelled, 3 per cent. consols rose to 96, the highest point touched since 1792. After

[1] Professor Bastable estimates the unfunded debt after Waterloo at £60,000,000, and the funded at £826,000,000.

1833 the reduction of debt was suspended, but in 1837-38 there were small reductions and consols rose in the latter year to 95. Then came the Whig deficits, and consols drooped until Peel took the helm. In 1841 this great financier found that the whole debt, *i.e.*, "the aggregate gross liabilities of the State,"[1] stood at £838,000,000 and that consols were below 90. By 1845, in spite of sweeping reductions of taxation, he had got 3 per cent. consols to par, and there they stood in 1852-53. The debt was reduced by March 31, 1854, to £803,000,000.

By the Crimean War £33,000,000 were added to the debt, which amounted to £836,000,000 in 1857. In the early months of the war a marked depreciation occurred in consols and in many other gilt-edged securities.[2]

In the next twenty years nearly £70,000,000 of debt were extinguished—it was £768,000,000 in 1877—and consols varied from 84 to 97. In the following twenty years the reduction amounted to no less than £123,000,000. After 1880 3 per cents. were ordinarily above par. In 1884 a small quantity of $2\frac{1}{2}$ and $2\frac{3}{4}$ per cents. were created by Mr. Childers, and in 1888 Mr. Goschen converted £549,000,000 worth of consols into $2\frac{3}{4}$ per cents. From £736,000,000 in 1887 the debt was reduced to £635,000,000 in 1899. This

[1] The Return "National Debt" issued year by year gives "the aggregate gross liabilities of the State" at the end of each financial year from 1836, defining them as the sum of (1) the nominal funded debt, (2) the estimated capital liability in respect of terminable annuities, (3) the unfunded debt, and (4) other capital liabilities.

[2] "The funds have recently gone down to 10 per cent. I do not say that the fall is all on account of this danger of war, but a great proportion of it undoubtedly is. A fall of 10 per cent. in the funds is nearly £80,000,000 sterling of value, and railway stock having gone down 20 per cent. makes a difference of £60,000,000 in the value of the railway property of this country."—JOHN BRIGHT, at Edinburgh, October 13, 1853.

was our best performance in debt reduction during the nineteenth century, and it is not surprising that during a glut of cheap money it should have led to a record rise in consols. In three consecutive years, 1896, 1897, and 1898, the 2¾ per cents. (with a prospect of reduction to 2½ in 1902), touched 113. The 2½ per cents., of which there was a small quantity, touched 110.

In the budget of 1899 (April 13), in order to provide for the growing costs of armaments—there had been an increase in four years of £2,500,000 on the army estimates and of £7,000,000 on the navy estimates—Sir Michael Hicks-Beach, who was then Chancellor of the Exchequer, raised certain taxes and took £2,000,000 off the sinking fund. But the £2,000,000 lopped off the sinking fund did not represent the whole or net shrinkage in the reduction of the National Debt in that year of widespreading prosperity and abounding revenue. Since 1889 (the date of the Imperial Defence Act) a new source of danger to credit had been introduced. While with one hand the Chancellor of the Exchequer was extinguishing consols, with the other he was creating terminable annuities for naval works. In the year 1897-98 the expenditure out of borrowed money on works was over £3,000,000. For the year 1898-99 it was £7,000,000. Before the budget of 1899 the Secretary for War had announced that the army would follow suit. A military works bill for barracks, etc., was to be introduced on the pattern of the Naval Works Act. No wonder that when the public supply of stock was increased and the public demand diminished the private investor began to anticipate a decline in British credit. From 110 in March, April, May, 1899, the price of consols fell to 108 in June, 106 in July, and 105 in

August. By the beginning of September the danger of war with the Transvaal had become apparent; but consols only fell to 104 in September; and 103 was the average for October, though war broke out in the second week of that month. These figures are very significant. More immediate injury was done to British credit by the financial policy which preceded the war than by the actual outbreak of the war. Even after the dimensions of the war came to be more accurately understood, consols for a long time maintained themselves at about par. The monthly average from January to June 1900 was above par, the price for June being 101$\frac{5}{16}$. Let us look at it in a slightly different way. In the nine months preceding the Boer War, January to September 1899, the main considerations operating on the minds of investors were the increasing expenditure, the reduction of the sinking fund, and the apprehension of trouble in South Africa. The first operated from January to April, and caused a fall of 1 point; the second operated from May to August, and caused a fall of 5 points; the third operated in September, and caused a fall of 1 point. Then we take the nine months following, during which the war was in progress. In October 1899 the average price of consols was 103$\frac{5}{8}$. In June 1900 the average price of consols was 101$\frac{5}{16}$. Such was the strength of British credit and such the public confidence that nine months of unprecedentedly costly war only lowered consols by 2 points.

From this moment (June 1900) there was a pretty steady depreciation of British credit down to November 1901, when consols reached the lowest average monthly point touched during the war, namely, 91$\frac{3}{4}$. It may be seen now why this depreciation took place and how

it could have been prevented. The occupation of Bloemfontein (March 13) was followed by the annexation of the Orange Free State (May 28); and the occupation of Pretoria (June 5) was followed by the annexation of the Transvaal Republic (September 1). If the military successes had been followed by a treaty of peace with guarantees and indemnity, the longest and most costly period of the war would have been avoided.

From £635,000,000 in 1899, the lowest point since the Napoleonic wars, the National Debt rose in consequence of the Boer War to £703,000,000 in 1901 and to £798,000,000 in 1903. This was the highest point since 1867, so that the national savings of thirty-six years of peace were swept away by national borrowings during three years of war. The average price of consols (2½ per cents. after 1902) was 106 in 1899, 99 in 1900, 94 in the next two years, 90 in 1904, and 88 in 1905.

On March 31, 1906, though the Sinking Fund had been restored immediately after the war, the National Debt still stood at £796,000,000. Then, however, Mr. Asquith becoming Chancellor of the Exchequer, an heroic effort was made to retrieve the situation, and the national liabilities were reduced by March 31, 1909, to £754,000,000, a reduction in four years of no less than £42,000,000. Under Mr. Lloyd George the reductions of debt went on at a diminished but still rapid rate. In spite of the state purchase of telephones the National Debt had been reduced on March 31, 1914, to £706,000,000. It may cause some surprise that no recovery should have taken place in the price of consols, which in fact were lower in 1909 than in 1905, and in 1913 than in 1909. The average price of 2½ per cent. consols was 89$\frac{13}{16}$ in 1905, 83$\frac{7}{8}$ in 1909, and 73$\frac{2}{3}$ in 1913.

The state of the international money market, the Russo-Japanese War, the alarming growth of armaments, the Balkan wars, the heavy issues of colonial government securities and municipal stocks, which of course compete with consols, Mr. Lloyd George's additions to income tax and death duties, and the annual emission of some five millions of Irish land stock all contributed to the result. Many are of opinion that the inclusion, at Mr. Chamberlain's suggestion, of colonial government securities among trustee stocks also exerted a very depressing effect upon our premier security. Had not the market been supported by a large Sinking Fund it is probable that 2½ per cent. consols would have fallen below 70 before the war panic of July 1914. The London Stock Exchange closed on July 31, 1914, and when it reopened on January 4, 1915, a minimum price of 65 was fixed for consols. At this price there were practically no buyers, and on November 24, 1915, when the Treasury minimum was removed, consols fell to 57. By that time over £1,400,000,000 had been added to the National Debt, which was therefore twice as large as when the war commenced. According to a recent calculation (made in March 1916) the National Debt, including loans to Allies, will have risen to about £2,900,000,000 by August 1, 1916, if the war continues.

CHAPTER III

BRITISH SCHEMES OF DEBT CONVERSION

THE history of the British debt includes several successful schemes of conversion by which the debt charge for interest has been from time to time reduced, much to the relief of taxpayers. The need and occasion for schemes of conversion have been in the periods of peace following upon great and expensive wars. During such wars debt accumulates, and rates of interest rise. When a war is over the relation between income and expenditure gradually becomes normal; and fortunately for this nation, considering its warlike propensities and history, our statesmen have usually maintained the principle that in time of peace surpluses ought to be provided for the diminution of debt. A modern war leaves behind it an awkward legacy of floating debt, consisting as a rule of treasury bills and exchequer bonds, which it is the first business of the Chancellor of the Exchequer to diminish when a period of peace recommences. When this task is accomplished and the floating debt has been reduced to comfortable proportions, the sinking fund can be utilised for the purchase of funded debt. Then, if market conditions are favourable, consols and other national securities will begin to recover from the depression into which they were sunk by war and borrowing. This is the opportunity for a conversion. In the preceding history we have already recorded the first important and highly success-

ful scheme of conversion, which was carried through in 1749 by Pelham, then Chancellor of the Exchequer. Under his scheme over £57,000,000 of 4 per cent. stock were dealt with. The offers to holders were accepted with regard to £54,000,000, and the outstanding balance of £3,290,000 was paid off at par. The next important conversion was undertaken by Vansittart in 1818, three years after the conclusion of the Napoleonic wars. But this was a conversion from a lower to a higher denomination, as the Government wanted to raise £3,000,000 sterling of money without increasing the nominal amount of the debt. The object was effected by converting £27,272,000 of 3 per cents., standing then at 79, into 3½ per cent. stock at par, irredeemable for eleven years, the holders paying £11 in cash to the Government for every £100 in stock converted. In 1822 Vansittart carried through a scheme of conversion on the ordinary lines. There existed at the time over £150,000,000 of 5 per cent. stock consisting partly of "navy fives," representing the old victualling and transport bills, which had been funded in 1784, and partly of exchequer bills, subsequently funded. At the time of the operation the 5 per cents. were quoted at 100⅞. Under the statute by which the conversion was effected (3 Geo. IV., c. 9), holders who did not signify dissent within a fortnight were to have every £100 of this stock converted to £105 of new stock, on which interest at the rate of 4 per cent. was guaranteed for seven years. Holders of only £2,794,000 of stock dissented, and were paid off at par. The old fives, to the amount of £149,627,000, were converted into the new 4 per cents. to the amount of £157,109,000. Two years later, in 1824, when Robinson was Chancellor of the Exchequer, the whole of the old

4 per cents., then amounting to £76,248,000 and standing at 101¾ ex. dividend, was converted by the Act of 5 George IV., chapter 11, into 3½ per cent. stock irredeemable for five years. The new 4 per cents., created as we have seen by Vansittart in 1822, became redeemable in 1829; and in 1830, when the new fours stood at 102½ ex. dividend, and 3½ per cents. at 98¾ ex. dividend, Goulburn as Chancellor of the Exchequer offered holders an alternative. They might either take in exchange for their stock £100 of new 3½ per cents., guaranteed for ten years, or £70 of new 5 per cents., guaranteed for forty-two years. The proposal was made on March 26, 1830, and the assent of holders was assumed unless they dissented by April 24. Holders of only £2,880,000 dissented, and were paid off at par. The rest, with holdings of £150,790,000, accepted the proposal and nearly all of them chose 3½ per cents. Another small quantity of fours was converted in 1834 by Lord Althorp.

In 1844, when Goulburn was again Chancellor of the Exchequer, under Sir Robert Peel, a very large and highly successful scheme of conversion was carried through. The 3½ per cents. to the amount of £248,000,000 sterling stood, in March 1844, at 101¾ ex. dividend. In exchange for these, new stock bearing interest at 3¼ per cent. for ten years and at 3 per cent. for twenty years was offered, and with the exception of £103,352 the whole of the 3½ per cents., amounting to no less than £248,757,000, were successfully converted. In 1853 the ingenious mind of Gladstone, who had lately become Chancellor of the Exchequer for the first time, set itself upon another effort to diminish interest on the National Debt. Unfortunately his scheme

was too clever or too complicated, and the times were unpropitious; for troubles began to arise in Eastern Europe and the price of securities drooped in intelligent anticipation of the Crimean War. Another conversion was tried in 1884 under Mr. Gladstone's second administration by Mr. Childers, who offered holders of 3 per cents. either £102 of 2¾ per cent. stock, or £108 of 2½ per cent. stock, both to be irredeemable until 1905. "Notwithstanding that the terms of the offer were favourable," wrote the late Sir Edward Hamilton, "and that notices of it were sent to every stockholder, it took the fancy of comparatively few. The total amount of stocks converted under this scheme was only £23,362,000, of which £11,950,000 represented holdings of government departments." The Childers's scheme, however, served several useful purposes, as Sir Edward Hamilton pointed out, for it supplied Mr. Goschen four years later with a valuable gauge of the national credit, and familiarised the public with stocks of lower denomination and of less "sweet simplicity" than 3 per cents. It also brought home to many holders the fact that, though they had not been disturbed for thirty years, they were still exposed to invasion by the Chancellor of the Exchequer.

This brings us to the last, the most important, the most difficult, and the most successful of all the schemes of redemption—that, namely, which was effected by the late Lord Goschen, when, as Mr. Goschen, he was Chancellor of the Exchequer in 1888. At that time the existing 3 per cent. stocks were distinguished as consols, reduced threes, and new threes. The new threes were redeemable at any time after January 5, 1873; but under the National Debt Act of 1870, which was a consolidation

act, consols and reduced threes, though "redeemable at any time after the passing of this act," were only redeemable subject to certain regulations, including a year's notice. The result was that the fortress of consols and reduced threes was a more difficult one to assault than that of the new threes. After consultation with his advisers at the Treasury and at the Bank of England, as well as with the government broker and various other authorities in the city, Mr. Goschen came to the conclusion that, while he was in a position to make a compulsory conversion of the new threes, he could not apply the same method to the other two classes. The stocks in existence at this time stood as follows:

Consols	£322,681,000
Reduced threes	68,912,000
New threes	166,399,000

To mark the magnitude of the task, it may be mentioned that at the time of the conversion the books of the Bank of England in which the stocks were inscribed showed 96,265 accounts under the head of consols, 19,975 accounts under the head of reduced threes, and 52,995 accounts under the head of new threes; making a total number of 169,235 holdings varying in amount from a penny to £5,760,000. Mr. Goschen propounded his scheme of conversion on March 9, 1888, and after some debate the resolutions were reported and agreed to on the 12th, when the bill was introduced into the House of Commons and read a first time. It was read a second time on March 16, passed through its committee stages on the 20th and 21st, and received the royal assent on March 27 in an Act entitled "The National Debt Conversion Act, 1888" (51 Vict., c. 2). The main feature of the scheme

was the creation of new stock which was to be offered to all holders of 3 per cents. This new stock was to pay quarterly dividends at the rate of 3 per cent. per annum for the year ending April 5, 1889, at the rate of $2\frac{3}{4}$ per cent. for the next fourteen years ending April 5, 1903, and at $2\frac{1}{2}$ per cent. for the next twenty years ending April 5, 1923, and thenceforward until the stock should be redeemed. To the holders of new threes the Chancellor of the Exchequer only gave three weeks, *i.e.*, until March 29, in which they could exercise the choice of taking new stock or of being paid off. Silence meant consent to conversion. If they preferred redemption, they were required to signify their dissent either to the Bank of England or to the Bank of Ireland within the three weeks prescribed, but holders who happened to be on the Continent were given to May 1, and those who were out of Europe until September 1. This financial *coup de main* was completely successful; for the new threes remained at a premium after the notice of compulsory conversion had been served, so that holders who did not want new stock could sell to the market on terms more favourable than those offered by the Chancellor of the Exchequer. The holders of new threes who signified dissent before March 29 represented less than £500,000 of stock. For the holders of consols and reduced threes Mr. Goschen inverted the procedure. They received the same offer of conversion, but silence was taken to mean dissent. If they wished to exchange their stock for an equal nominal amount of new stock, they must signify assent on or before April 12, or at later dates if they were on the Continent or out of Europe. To encourage them to surrender their privilege of a year's notice, holders of consols or reduced threes

who assented were offered a bonus of 5 per cent. on the stock surrendered. This bait proved attractive, and in the following autumn it appeared in a parliamentary return [1] that out of a total amount of about £592,000,000 of 3 per cents. dealt with under the Conversion Act about £550,000,000 had, in six months, been converted into $2\frac{3}{4}$ per cent. stock, the old stock, which remained unconverted at the end of the operations, being less than £42,500,000. Had it been necessary to raise much money for the purpose of paying off dissenting holders of new threes, ample powers were given to the treasury—it might create or sell new stock; it might issue exchequer bills or treasury bills; or again it might borrow temporarily under the Conversion Act. The treasury plans for this great scheme were laid with the utmost skill, and Mr. Goschen's masterly speech of March 9, 1888, already mentioned, secured it a favourable reception in the City of London.

[1] House of Commons Papers, c. 5584, sess. 1888.

CHAPTER IV

SINKING FUNDS

DURING the eighteenth century, as we have already shown, the reduction of the public debt in time of peace never bore any proportion to its accumulation in time of war. Yet the danger of a large public debt and the fear of impending bankruptcy were constantly impressed on the public mind by writers and statesmen. Sinking funds were devised by which the debt should gradually be extinguished. Unfortunately the management of the debt, both in its theory and in its practice, left much to be desired. A true sinking fund postulates an excess of revenue over expenditure, a margin over and above what is required for the public services and for defraying interest on the public debt.

But during the most profound peace, as Adam Smith observed, there is often a demand for extraordinary expenditure, and the Government finds it more convenient to provide the money by dipping into the sinking fund than by imposing a new tax :

" Every new tax is immediately felt more or less by the people. It occasions always some murmur and meets with some opposition. The more taxes may have to be multiplied, the higher they may have been raised upon every different subject of taxation, the more loudly the people complain of every new tax, the more difficult it becomes either to find out new subjects of taxation or to raise much higher the taxes already imposed upon the old. A momentary suspension of the payment of debt is not immediately felt by the people and occasions neither murmur nor complaint.

To borrow of the sinking fund is always an obvious and easy expedient for getting out of the present difficulty. The more the public debts may have been accumulated, the more necessary it may have become to study to reduce them, the more dangerous, the more ominous it may be to misapply any part of the sinking fund, the less likely is the public debt to be reduced to any considerable degree, and the more likely, the more certainly is the sinking fund to be misapplied toward defraying all the extraordinary expenses which occur in time of peace. When a nation is already overburdened with taxes, nothing but the necessities of a new war, nothing but either the animosity of national vengeance or the anxiety for national security can induce the people to submit with tolerable patience to a new tax. Hence the usual misapplication of the sinking fund." [1]

The first regular and systematic plan for the discharge of the National Debt was devised by Lord Stanhope and adopted by Sir Robert Walpole's government in 1716. The public debts were then being discharged by the South Sea, aggregate and general funds, which funds were fed by the produce of certain taxes; and as the revenues thus mortgaged were greater than the interest on the debts, surpluses existed. Accordingly these surpluses, and any further surpluses which might accrue, were united and appropriated by law for the discharge of the National Debt and for that purpose alone. The fund thus created by Walpole was called the sinking fund. At the same time interest on the debt was reduced from 6 to 5 per cent., and the savings thus made went to swell the sinking fund, which again benefited to the extent of £400,000 per annum in 1727, when the interest on the National Debt was further reduced from 5 to 4 per cent. Further reductions in 1749 and 1750 added another £600,000 to the sinking fund. In the peaceful years 1710 to 1732 the sinking fund was

[1] See *Wealth of Nations*, Book V., Chapter III.

preserved intact even when fresh debt was being contracted. But in 1733, rather than raise the land tax (which then stood at the low and popular rate of one shilling in the pound), a sum of £500,000 was subtracted from the sinking fund; in 1734 £1,200,000 was taken, and in 1735 the sinking fund itself was anticipated and mortgaged.

After 1718, when the sinking fund was established, it was made a collateral security for any new loan in this way. If the particular tax or duty upon which a new loan was charged proved deficient, the deficiency was made up by the sinking fund, whereas when the tax yielded more than was required for the service of the loan, the surplus, instead of swelling the sinking fund, was used for the expenditure of the year. But this was altered by a statute of 1752, by which the sinking fund received the new taxes and discharged the interests on the new loans. The produce of this sinking fund rose pretty steadily from £323,000 at its commencement in 1717 to £3,166,100 (its highest point) in 1776.

But if the proper purpose of Walpole's sinking fund was to sink—*i.e.*, to extinguish or diminish debt—this fund certainly failed of its purpose after 1733; for out of its annual produce after that date, until the termination of the fund in 1786, only 8½ millions sterling went to paying off debt. "On the whole, therefore," to quote the summing up of Robert Hamilton, "this fund did little in time of peace and nothing in time of war to the discharge of the National Debt. The purpose of its inviolable application was abandoned, and the hopes entertained of its powerful efficacy entirely disappointed."

In 1786, when Pitt united the existing branches

of revenue in the consolidated fund, he took from this fund the sum of £1,000,000 annually and entrusted it to commissioners for the redemption of the National Debt who were to employ it in purchasing such stock as they deemed expedient at market prices. To this million was to be added interest on debt redeemed and expiring annuities until the fund amounted to £4,000,000. In 1792 another and separate sinking fund was established, consisting of 1 per cent. on the nominal capital of every loan [1] to which the dividends on the capital redeemed by the fund were to be added. A similar provision was applied to annuities. In 1802 the two sinking funds were united and modifications made. In 1807 Lord Henry Petty introduced a new plan, which lasted for one year, and in 1813 Vansittart again modified Pitt's sinking funds with a view to re-establish as far as possible the original design. The sinking funds of 1780 and 1792, which were afterwards maintained with remarkable persistency during the wars with France, were originally established by Pitt, under the influence and inspiration of Doctor Price. Price's theories first appeared in a Treatise on Reversionary Annuities in 1771, and were finally exploded by Robert Hamilton in his *Inquiry Concerning the National Debt*. Price's plan for redeeming the National Debt was to apply a fixed sum, separated from the rest of the revenue, to the purchase of stock in the market, the interest on the debt so redeemed being always added to the original sum, in order continually to enlarge the operation of the fund. Price put his faith in the operation of compound interest. Money, he said, bearing com-

[1] As a matter of fact this provision was frequently departed from during the French wars.

pound interest increases at first slowly, but the rate continually accelerating becomes in course of time so rapid as to mock all the powers of the imagination. Sinking fund prodigies are derived from calculations based upon what would happen if money were allowed to accumulate for long periods at compound interest. Thus a penny put out at the Christian era, at 5 per cent. compound interest, would, before this time, have increased to a greater sum than could be contained in *five hundred millions of Earths*, all of solid gold. This is one of Robert Hamilton's derisive calculations, and to the same author we are indebted for an account of M. Ricard's bequests.

This philanthropic Frenchman left a sum of 500 livres to be divided into five portions. The first, at the end of a hundred years, amounting to 13,100 livres, was to be laid out in prizes for dissertations proving the lawfulness of putting out money to interest. The second, at the end of two centuries, amounting to 1,700,000 livres, was to serve as a perpetual fund for prizes in literature and arts, and for virtuous actions. From the third, which at the end of three centuries would amount to more than 226 millions of livres, were to be founded banks and museums for the assistance and instruction of the public. The fourth portion, after accumulating for four centuries, would amount to 30,000 millions of livres, and was then to be employed in building a hundred towns in France, containing each 150,000 inhabitants. The fifth, which at the end of five centuries would reach a grand total of four millions of millions of livres, was to be appropriated for the payment of the national debts of Britain and France; and the surplus revenue was to be divided among all the powers

of Europe—to buy up useless offices, to purchase royal domains, to increase the income of the clergy and abolish fees for masses—to maintain all children born in France till they reached the age of three years—to improve waste lands for the formation of peasant proprietorships—to purchase manors and exempt the vassals from all servitude—to endow houses of education, workhouses, houses of health, and asylums for females—to portion young women and provide rewards for merit; while the large surplus which would remain was to be appropriated at the discretion of his executors.

Dr. Franklin was rather more moderate in his views. He left £1000 to the city of Boston, and a like sum to Philadelphia, to be lent out at interest to young artificers, upon proper security, in sums not less than £15, nor more than £60. This plan, he said, if executed without interruption for a hundred years, would raise the capital to £131,000 for each place, of which £100,000 was to be applied to public works, such as fortifications, bridges, aqueducts, public buildings, baths, pavements, etc. The remaining £31,000 was to be lent out at interest for another hundred years, when, if no unfortunate accident had intervened, it would amount to £4,061,000. Of this, £1,061,000 was to be given to the towns for various purposes, and the remaining £3,000,000 to the Government of the State—"not presuming," so wrote the Doctor, "to carry my views any farther." Hamilton's brief comment on these prodigies of the imagination may be quoted:

"It is theoretically true that compound interest may accomplish all these things; but such extravagancies rather tend to throw ridicule on the subject, than increase our confidence in its operations."

Price, accepting these imaginary calculations, argued that a sinking fund should be based on compound interest, that it should be maintained in war time, and that the money required for it should be raised by new loans if necessary. Indeed, he contended that war would actually increase the efficacy of his sinking fund, and that a suspension of its operations during war would be " the madness of giving it a mortal blow " at the very time when it was making progress most rapidly. That a man of high character and liberal talents, an expert calculator to boot, could have imposed upon himself to such a degree is hard to believe, and it seems still more incredible that this piece of charlatanry deceived Pitt and governed British finance for a generation. Of the influence of Price's plan Hamilton wrote in 1818 :

" It has not shared the common fate of the projects of private individuals and vanished in neglect and oblivion. It is the basis of Mr. Pitt's sinking fund, adopted fifteen years after its first publication, and now followed out for upward of thirty years, and although with some deviations, yet on the whole with a steadiness seldom experienced in public measures for so great a length of time and under a succession of different administrations."

Price had argued further that in time of war his sinking fund would support the price of consols. But, as Hamilton points out in his severe and, as Professor Cannan holds,[1] sometimes unfair analysis, the price of stocks as of other commodities depends on supply and demand. In years when the Government borrows as much as, or more than, it spends on cancelling debt, whatever sums are brought into the market by the commissioners for the purchase of stock, equal or greater sums must evidently be withdrawn from the market by the additional loans required to replace the

[1] *e.g.* Price's *Appeal on the National Debt*, 2nd ed. p. 60, may go to show that the author did intend to provide a real surplus for his sinking fund.

amounts given to the commissioners. If, then, and so far as purchases on behalf of the sinking fund are only made possible by borrowing, the national credit cannot receive support from a sinking fund maintained under such conditions. Price proposed that £10,000,000 should be borrowed in time of war, when £9,000,000 only are required to balance income and outgo, in order that a surplus million may be given to the commissioners of the sinking fund, and urged that this device would keep up the public credit and enable the Government to borrow at, say, 4½ instead of 5 per cent. and so save £50,000 of interest. What he overlooked was that in order to pay the lenders back £1,000,000 the Government was borrowing from them previously the same sum. The only people who benefit by the double transaction are the financiers who profit by the loan issues. The taxpayer loses just what they gain, and public credit cannot gain, but must suffer, from the unnecessary expense. In practice the Pitt sinking funds proved even worse than in theory. It was calculated by a parliamentary inquiry in 1828 that the loans raised during the French war yielded on an average £5 os. 6d. in interest, while previous loans to which a sinking fund was applied averaged only £4 10s. In fact the Price and Pitt plan of "selling new stock cheap and buying old stock dear" merely to keep up a sinking fund during war, is computed to have cost the nation more than £1,500,000 a year for a long period.

This fallacy and its exposure deserve attention not so much on account of the important part it played during the wars with France, as because it is constantly cropping up. Governments all over the world still attach sinking funds to loans, though their debts are year by year

increasing. They forget or ignore the simple truth that an excess of revenue over expenditure is the only real sinking fund by which public debt can be discharged, that an increase of revenue or diminution of expenditure is the only means by which such a sinking fund can be enlarged, and that all schemes for reducing the aggregate liabilities of a nation not founded upon this principle are fictitious, illusory, and mischievous.

In 1819 the force of Hamilton's criticisms was recognised, and a real surplus of four millions was set aside for repayment of debt. But financial embarrassments intervened, though another attempt was made in 1823. Finally, in 1828, a finance committee of the House of Commons (presided over by Sir H. Parnell), after inquiry "found" what Hamilton had proved, that the only real and useful sinking fund is a surplus, and suggested that a surplus of three millions a year should be provided. In his budget speech of July 11, 1828, Goulburn made some recommendations on these lines, and in the following year an Act (10 Geo. IV., c. 27) was passed providing that one-fourth of the whole surplus (if any) in each year should be issued to the National Debt Commissioners and applied by them to the extinction of debt. The commissioners were also authorised to use the surplus for paying off exchequer or deficiency bills as well as funded debt. In 1866 Mr. Gladstone assigned a small annual sum to the extinction of debt and reconstituted the old sinking fund by providing that the whole realised surplus of the year, if any, should be applied to the reduction of debt, a very wise provision, under which, in years of expanding trade and abnormal prosperity, unexpected windfalls and overflows of revenue are employed of necessity to reduce the national

encumbrances. Thus debt is diminished just when the nation can best afford to do something for posterity. But Mr. Gladstone's legislation of 1866 still left British finance open to the objection that in years of peace there was no substantial permanent provision for reducing debt, and that if an incautious Chancellor of the Exchequer overestimated his revenue there would be an actual addition to the debt. This defect was happily remedied by Sir Stafford Northcote, who established what is called the new sinking fund in 1875, by the Act of 38 and 39 Vict., c. 45. This Act provided that the annual charge for the debt should exceed by a substantial and increasing sum the actual interest required, and that this excess of charge over interest should be employed by the Commissioners of the National Debt in reducing national liabilities. This new sinking fund has always been temporarily suspended by statute during war in obedience to the principles above established, and it has been from time to time modified and reduced when the interest charge fell. The principle, however, that a permanent sinking fund of a substantial amount should be provided for in every peace budget, in addition to realised surpluses, has been on the whole well maintained, and in fact the largest reductions ever brought about in the National Debt were effected by Mr. Asquith as Chancellor of the Exchequer in the years 1906, 1907, and 1908, through the operations of the old and new sinking funds, the latter having been raised to some ten millions sterling annually. It was reduced to seven in the budget of 1909 by Mr. Lloyd George who also proposed to divert the old sinking fund, *i.e.*, the annual surplus, if any, of each year, to the purposes of developing the agriculture, forests,

and other natural resources of the country. But this proposal was fortunately dropped, and the old sinking fund remained untouched as it was fixed by section 5 of Sir Stafford Northcote's Act (38 and 39 Vict., c. 45). By this section the Treasury is directed to ascertain within fifteen days after the expiration of each financial year any surplus of income over expenditure and to issue the same out of the consolidated fund in the course of the year. Within six months of the date of such issue the National Debt Commissioners are required to apply the sinking fund in purchasing, redeeming, or paying off any one or more of the following descriptions of debt, namely, annuities, perpetual or terminable, charged on the consolidated fund, exchequer bonds, exchequer bills, and advances made by the Banks of England or Ireland under section 12 of the Exchequer Audit Act, 1866. By an Act of 1877 (40 Vict., c. 2) these powers of cancellation were extended to Treasury Bills, which have now become one of the principal devices for financing war. The Treasury Bill is an imitation of the ordinary commercial bill. Its form was suggested to Lord Welby, then an official at the Treasury, by the late Mr. Walter Bagehot in the year 1877.

CHAPTER V

THE WAR DEBTS OF THE UNITED STATES

Most of the governments of the Old World have contributed to the science of war finance by providing examples to be avoided, and the history of the United States is also fertile in vicious expedients, more especially in the debasement of the currency. At the outbreak of the War of Independence, the Continental Congress, inheriting the bad financial traditions of the British colonies in North America, sought to pay for the war by issues of paper currency. Between 1775 and 1779 Congress issued paper to the amount of 241 million dollars and the States also made issues of 209 million dollars. In November 1779 this paper currency was worth $\frac{1}{38}$ of its face value. By that time business in Boston was being done by barter. In the following year paper became practically worthless. After March 1782 the interest on 11 millions of domestic loans could not be met, and certificates of value given to the lenders in lieu of interest were received by the Government in payment of taxes. Receipts for forced supplies ran up to over 16 million dollars. Loans and subsidies to the value of nearly 8 million dollars were received from the Governments of France and Spain, and from Dutch bankers [1] who lent at 5 per cent. The French Govern-

[1] Between 1784 and 1789 loans of $2,296,000 were raised in Holland at 4 per cent., nominally at par, though various bonuses and "gratifications" raised the rate to nearly 6¾ per cent.

ment subsidies were mainly spent in France on supplies, but one instalment reached America in specie, and helped to pay interest on the domestic loans. The Federal Constitution of 1787 by Article I. gave the new Federal Congress "power to borrow money on the credit of the United States," and deprived the individual states of the right to coin money or emit bills of credit. In 1789 the United States Treasury was organised, and on January 9, 1790, Alexander Hamilton, its first secretary, issued a report on Public Credit, which summarised the amount of debt as follows :—

Foreign debt, with arrears of interest	$11,710,000
Estimated domestic debt	27,383,000
Accrued interest on the domestic debt	13,030,000
Unliquidated debt	2,000,000
Total	54,123,000

The question of funding was complicated by the depreciation that had occurred. Were the holders of continental certificates to be paid at their face value, or at their face value plus the accrued interest, or at the sum they had actually given? This was hotly debated, and a wild speculation in certificates ensued. But Hamilton prevailed, and it was agreed that all holders should receive the face value of their certificates plus the accrued interest. The only exception was in the case of the outstanding continental bills of credit, which were funded into 6 per cent. bonds at the rate of $100 of bills to $1 of specie. But of these bills comparatively few were ever presented.

Out of the $21,500,000 of state debts the Federal Government took over the larger part, $18,000,000, on the ground that they had been incurred for war purposes.

The Southern States during the war had composed their embarrassments either by taxation or repudiation, and, as their existing debts per head of population were much less than those of the Northern States, they opposed the measure. Hamilton, whose aim was political—to consolidate the interests of the States and to procure national unity—pacified them by a bargain through which the Federal Capital was to be in the South, and Washington accordingly stands on territory taken from Virginia and Maryland.

By the funding act of 1790 three loans were authorised:

1. A loan of not more than $12,000,000 for the payment of the foreign debt.

2. A loan to the full amount of the domestic debt, which could be subscribed in any of the old certificates of indebtedness issued by the Continental Congress. In return subscribers received two certificates, one for an amount equal to two-thirds of the subscription with 6 per cent. interest, the other for one-third not bearing interest till 1801. As the old debt bore 6 per cent. interest, this practically meant a reduction for ten years to 4 per cent.

Conversion was not compulsory; but as the old debt was redeemable at pleasure and there was a general expectation that it would soon be extinguished, it was to the interest of holders to make the exchange. A 3 per cent. loan was also issued to clear off the arrears of interest.

3. The third loan, to take up the state debts, could be received in the certificates issued by the States for war purposes. The interest provisions in this case were also complicated. The Government agreed to limit the amount of the new debt redeemed in any one year,

and offered quarterly instead of annual payments of interest at 13 different places. The national revenue, subject to the prior claim of the foreign debt, was pledged to the payment of interest.

Six per cent. loans were raised in Holland and Antwerp to pay off part of the foreign debt to France and Spain and to extend the remainder. Allowing for commission and expenses these were floated at from 96½ to 94½. The act was complicated, and created too many varieties of stock, but on the whole it proved successful, and the old floating obligations disappeared, as these figures show :

	1791.	1801.
Old debt :		
Funded	$1,500,000	$57,000,000
Unfunded	61,000,000	2,800,000
Foreign	12,800,000	12,400,000
New debt	—	10,600,000
Total	75,300,000	82,800,000

In 1791, through Hamilton's exertions, the first bank of the United States was chartered (the Government subscribing $2,000,000 to its capital of $10,000,000) and proved a financial success. During the subsequent ten years the expenditure of the Government forced it to borrow many small loans from the bank. In all, these mounted up to about $10,000,000, of which one-third was outstanding in 1801. In 1798 a loan of $5,000,000 and in 1800 another of $1,500,000 for appropriations and military purposes were authorised. These were limited to fifteen years, and the fear of invasion forced the Treasury to pay 8 per cent. In 1792 a sinking fund

had been created, but its operation did not prevent the growth of the debt.

Jefferson's administration in 1801 adopted the policy of public retrenchment with a view to the reduction of debt and taxation, and Gallatin went to the Treasury as its director. "He had been unceasing in his demand for economy, for specific instead of general appropriations, for the extinction of the debt in preference to military and naval expenditures, and for a change in the form of the sinking fund."[1] The result was a remarkable reduction of debt between 1801 and 1812. The net amount paid off was $38,000,000, but the real reduction was larger; for the Louisiana purchase accounted for an addition of nearly $15,000,000. At the same time some unpopular excise duties and the salt tax were repealed. The foreign debt with the costly loans of 1798 and 1800 was wiped out, and no further recourse was had to temporary loans. In 1803 Gallatin to meet the $15,000,000 incurred by the Louisiana purchase issued a loan of $11,500,000 at 6 per cent., redeemable after fifteen years in four annual instalments. The balance was met from the revenue chiefly from customs, as it was a period of expanding trade. The loan was very successful.

Gallatin had long foreseen the approach of war with Great Britain, and on several occasions had declared that he should propose to raise the necessary money by loans; taxes would only be increased in so far as might be needed to pay interest on new debt. Congress was very ready to agree to a loan policy, and in March 1811 it authorised a loan of $5,000,000 at 6 per cent. not to be sold under par. In December 1811, however,

[1] Dewey, *Financial History of the U.S.*, p. 119.

Gallatin proposed the revival of the unpopular excise taxes, declaring that Congress, by its destruction of the United States Bank, had deprived him of an important credit instrument. It was, however, too late to resort to a strong policy of taxation; the proposals were rejected, and loans continued. An increase of customs duties produced little revenue; for commerce with Europe was almost destroyed by the war of 1812-14. The following is, in outline, the financial history of the war period:[1]

1812.
Mar. 14. Loan of $11,000,000, at 6 per cent.
June 12. War declared.
June 30. Issue of $5,000,000 of Treasury notes.
July 1. Customs duties doubled.

1813.
Feb. 8. Loan of $16,000,000, at 6 per cent.
Feb. 25. $5,000,000 of Treasury notes.
July 22. / Aug. 2. } Internal-revenue duties and some direct taxation imposed.
Aug. 2. Loan of $7,500,000, at 6 per cent.

1814.
Mar. 4. $10,000,000 of Treasury notes.
Mar. 24. Loan of $25,000,000.
August. Specie payment suspended.
Dec. 15. Internal-revenue taxes increased.
Dec. 24. Treaty of peace.
Dec. 26. $10,500,000 of Treasury notes.

1815.
Jan. 18. New internal taxes.
Feb. 24. $25,000,000 of Treasury notes.
Feb. 24. Loan, at 7 per cent.

The ordinary rule of policy was not to issue government stock below par; but public credit began to fall. It was difficult to get subscribers in the Eastern States, where the commercial interest had been antagonised by

[1] Dewey, *Financial History*, p. 132.

Jefferson's policy of embargo, non-intercourse, and war. In New England only $3,000,000 were subscribed out of the $41,000,000 raised to the end of 1814.

For the loan of August 2, 1813, special terms had to be made; it was not to be sold under 88 and was actually placed at 88¼. In the case of the loan of March 24, 1814, the Government agreed that if more favourable terms were offered to later subscribers they would be extended to earlier purchasers. Thus it became the interest of the earlier holders to depress the price. From 88 the loan dropped to 80, and later on to 65. Public credit rose with the conclusion of peace, and the average price received for the loan of March 3, 1815, was 95.

During the war period Treasury notes were issued to the amount of $36,500,000 (part to replace earlier issues), and all except $3,392,994 were payable to order at a definite time and bore interest at 5⅖ per cent. Two-thirds were in denominations over $100. They did not become, and were not intended to become, part of the circulating medium, though they were receivable in payment of taxes. A proposal to issue Treasury notes as legal tender was decisively rejected by the House of Representatives in 1814. The notes remained generally at par until the suspension of specie payments.

In 1816, when Dallas was Secretary to the Treasury, and Madison, President, the second bank of the United States was founded to reorganise the currency. Between 1811—the refusal of the charter to the first bank—and 1816 the number of state banks rose from 88 to 246. After the suspension of specie payments their notes fell to a discount of 10 to 30 per cent., yet they were accepted by the Government in payment of taxes. This naturally led to increased issues. The

circulation — $45,000,000 in 1812 — had risen to $100,000,000 in 1817. "The monetary derangement was so acute that the Treasury Department was obliged to keep four accounts with its depositories, in four standards of value—cash, or local currency; Treasury notes bearing interest; Treasury notes not bearing interest; and special deposits." [1]

In January 1816 the debt stood at $127,000,000; the following March Congress ordered an annual appropriation of $10,000,000 to the sinking fund and in 1817 $9,000,000 more were added. The succeeding years, however, were marked by deficits, and in 1819 there was a severe crisis throughout the country—a reaction after the forced growth of manufactures during the war and the speculation and bad banking that followed it. In May 1820 a small loan of $3,000,000 was issued, two-thirds at 6 per cent., redeemable at pleasure, which sold at 102, the remainder for twelve years at 5 per cent. at par. After 1821 trade and revenue recovered. The debt was rapidly reduced until in 1835 it was actually extinguished.

The Mexican War lasted from 1846 to 1848 and involved the creation of $49,000,000 of war debt. Six per cent. loans were floated at, or above, par. As they ran for ten or twelve years and remained at a premium, redemption proved costly. Treasury notes were also issued to the amount of $26,000,000, bearing interest at $5\frac{2}{3}$ and 6 per cent. Like the notes of 1837 to 1843, they were "merely government loans of which the securities were in small denominations and had only short periods to run." [2]

[1] Dewey, *Financial History*, p. 145.
[2] White, *Money and Banking*, p. 107.

In 1851 the debt stood at $68,000,000, but it was steadily reduced until it reached $28,700,000 in 1857. In that year a sharp commercial and banking panic ensued upon feverish railroad construction and the gold discoveries, though protectionists blamed the low tariff of 1846 and the further reductions which took place in 1857. The bank-note circulation, which was $58,000,000 in 1843, was $214,000,000 in 1857. In 1860 the debt was $65,000,000, or $2 per head of the population. During the period 1836-1860 its capital amount rarely exceeded and was sometimes much below the annual receipts of the Federal Government. After the establishment of the Constitution it stood as follows:

1791	$75,400,000
1801	83,000,000
1804	86,400,000
1812	45,200,000
1816	127,300,000
1819	95,500,000
1835	Nil
1851	68,300,000
1860	64,800,000

Abraham Lincoln's election to the United States Presidency in November 1860, foreshadowing a rupture with the Slave States, gave a shock to credit, and in December, in order to float a treasury note issue at par, 10 to 12 per cent. interest had to be offered. On February 8, 1861, a 6 per cent. loan for $18,000,000 was issued with no restrictions as to price, and sold at an average price of 89.

In March Lincoln appointed Chase Secretary of the Treasury, and in April war broke out. The debt in July stood at $74,985,000, about $18,000,000 of which

had been incurred since the secession movement began. Chase estimated that during the next year about $320,000,000 would be required, of which he proposed to raise $80,000,000 by taxes and $240,000,000 by loans. In August he negotiated $50,000,000 in three loans from the banks of New York, Boston, and Philadelphia, at par, with interest at 7.3 per cent. Chase did not believe that he had the power to leave the money in the banks till actually required, and then draw it by cheque. Consequently he ordered the banks, in spite of their protests, to pay the gold by weekly instalments into the subtreasury at New York. As the government creditors in their turn paid it back to the banks, the effect at first was not great. But in December the Trent affair caused a fear of war with England and Chase asked for another loan of $200,000,000.

The government credit declined, so that the banks could not sell government securities except at a loss, and people stopped depositing or even withdrew money. The reserve dwindled rapidly, and on December 30 the banks suspended specie payment and were, of course, followed by the Treasury. Before these loans $60,000,000 of non-interest-bearing treasury notes had been issued, of which $33,000,000 were outstanding. These were payable on demand and receivable for taxes, but were not legal tender.

In January 1862 the Committee on Ways and Means, by a majority of one vote, proposed a legal-tender system and the bill passed Congress by narrow majorities. It provided (1) for the issue of $150,000,000 of notes ($50,000,000 to take up the outstanding demand notes). They were payable to bearer, for denominations of not less than $5 and non-interest bearing. They were legal

tender and exchangeable for bonds. (2) Of these bonds $500,000,000 were authorised at 6 per cent., redeemable in five years, payable in twenty years—the well-known "five-twenties." These sold at a fractional premium when reckoned in the depreciated paper currency. (3) Certificates of deposit bearing 5 per cent. interest in exchange for United States notes left on deposit for not less than thirty days, payable at ten days' notice.

A sinking fund was established in defiance of the principles established by Dr. Hamilton.

The Senate added amendments: (1) The interest should be payable in coin. (2) The Secretary of the Treasury should have power to sell the 6 per cent. bonds at any time at their market value for notes or coin. (3) All import duties should be payable in coin.

Chase was in fact opposed to legal-tender notes, but he had not the courage of his convictions and yielded, partly out of hostility to the bankers. "A delegation of bankers from New York, Boston, and Philadelphia came to Washington to remonstrate against the bill. . . . Mr. James Gallatin presented a plan of national finance which would, in the opinion of these gentlemen, procure the means for carrying on the war without recourse to legal-tender notes. One of the proposals was to 'issue 6 per cent. twenty-year bonds, to be negotiated by the Secretary of the Treasury without any limitation as to price he may obtain for them in the market.' Mr. Spaulding (the proposer of the bill) . . . objected 'to any and every form of "shining" by the Government through Wall or State street to begin with; objected to the knocking down of government stocks to 75 or 60 cents on the dollar, the inevitable result of throwing a new and large loan on the market without limitation as

to price.' In order to avoid selling government stocks at 75 or 60 cents on the dollar in an honest way Mr. Spaulding initiated a policy which ended in selling those stocks at 40 cents on the dollar in a roundabout way, and cheating creditors, soldiers, and labouring men out of more than half their dues in an incidental way." [1]

On January 17, 1863, $100,000,000 notes, later increased to $150,000,000, were issued. The price of gold at this time was 142; by the end of the month it was 159. The former issues had been fundable within five years at the option of the holder into the 6 per cent. gold bonds, which was a method of indirect redemption. Chase hoped that if this provision were repealed he could issue 5 per cent. bonds, and he persuaded Congress to pass the law of March 3, 1863, which repealed the conversion clauses of the legal-tender act by fixing July 1 as the date when the right of redemption would cease. This was a breach of contract which destroyed the previous standards of value, injured government credit, and hindered the conversion of the currency at the end of the war.

At the same date treasury notes (as distinguished from the non-interest-bearing "greenbacks") were authorised, the act providing for $400,000,000 in denominations of not less than $10 to run for not more than three years and bear interest in "lawful money" at not more than 6 per cent. They were legal tender for their face value, minus interest. Thus it was hoped the holder would have an inducement to keep the note, and if he used it as money the recipient would have an inducement to keep it. Under these provisions $44,520,000 of one-year and $166,480,000 of two-year notes at 5 per cent.

[1] White, *Money and Banking*, p. 110.

were issued, besides $266,595,440 compound-interest notes for three years at 6 per cent. These latter were semi-annually compounded, and the interest was payable with the principal at maturity. Thus $10 were worth $10.30 at the end of the first half year and $11.94 at the end of three years. They were the most scientific form of legal-tender notes issued, since the owner had an increasing inducement to hold them as an investment.

In 1862 silver coins grew scarce and about $27,000,000 of fractional currency notes were issued. On March 3, 1863, there was an issue of bonds at 6 per cent., "ten-forties," of which both the principal and interest were payable in coin. Of these $75,000,000 were issued at about 104½. On March 3, 1864, another issue of ten-forties, at 6 per cent., was authorised, $196,000,000 in all, at prices ranging from par to 107. In June 1864 an act limited the amount of greenbacks issued or to be issued to $450,000,000. During the same month Chase insisted upon prohibiting the sale of gold on "futures." He believed the price of gold had been advanced by brokers' gambling, and declared "it must and shall come down." On the day of the bill's passage the price of the gold dollar was 198 cents in legal tender, the next day 208, the next 230, and soon 250. Never before had there been so rapid an advance, and after two weeks' operation the law was repealed without debate. On June 30 Chase resigned and was succeeded by Fessenden. During this year taxation was resorted to with more effect.

Various estimates have been formed of the loss incurred through this debasement of the currency. In 1865 Professor Simon Newcomb estimated the loss up to the end of 1864 at $180,000,000 and

the loss still to be incurred at $300,000,000, a total of $480,000,000. Professor Adams's (*Public Debts*) estimate is $850,000,000, reckoning the difference between the debt created and the gold value of the currency which the Government received in return. Mr. Wesley Mitchell (*Journal of Political Economy*, March 1897) put the loss at $528,400,000, on the supposition that the Government receipts were increased $228,700,000 by the use of the greenbacks. He assumed that the receipts from internal revenue were increased to the full extent of the greenbacks, but admitted this to be doubtful.

The main features of Chase's loan policy were: (1) He aimed at low rates of interest, and evinced a great aversion to the terms of the money market. Early issues were at 7.30 per cent., later at 7, 6, and 5 per cent. Over-eagerness for low interest led to the blunder of substituting 5 per cent. for 6 per cent. bonds in 1863. This raised the price of gold 20 per cent., and led to further legal-tender issues, and so to a further rise in the price of gold. (2) His wish for a general distribution of the loans led him to favour popular subscription, *e.g.*, through Jay Cooke's agencies. This again arose partly from his hostility to the banks. (3) Another object was future controllability, and hence his opposition to long loans. This has been criticised on the ground that it made foreigners distrust the debt and also because "the country was flooded . . . with short-time paper, which served in many instances the purposes of currency, expanded prices, and increased the speculation and extravagance always incidental to war. Temporary obligations falling due in the midst of civil conflict were a source of double vexation to the

Treasury Department, which was obliged to conduct a series of refunding operations and at the same time to go into the money market to borrow ever-increasing sums."[1]

The proportion of long to short term indebtedness during each year of the Civil War may be seen from the following table:

	Long term.	Short term.
	Per cent.	*Per cent.*
1861-62	15	85
1862-63	29	71
1863-64	67	33
1864-65	39	61
1861-1865	40	60

Another table presented by Professor Bastable in his *Public Finance* (p. 653) gives the relation of loan to tax revenue:

[In millions of dollars.]

Year.	Revenue.	Loans.	Total.	Percentage of loans to total receipts.
1861	41.5	23.7	65.2	35.0
1862	51.9	433.6	485.5	89.5
1863	112.6	595.6	708.2	85.0
1864	264.6	696.0	960.6	72.5
1865	333.7	864.8	1,198.5	74.0
1866	538.0	92.6	650.6	14.0

The growth of the debt (including notes and treasury bills) was as follows:

June 30—	
1861	$90,600,000
1862	524,200,000
1863	1,119,800,000
1864	1,815,800,000
1865	2,680,600,000
1866	2,773,200,000

[1] Dewey, *Financial History*, p. 317.

In 1866 the interest charge was $133,000,000, and the interest-bearing debt was thus divided on August 31, 1865:

5 per cent. bonds . . .	$269,100,000
6 per cent. bonds . . .	1,281,000,000
7.3 per cent. bonds . . .	830,000,000

Several of the loans issued in 1864 and 1865 were sold at from 102 to 104, and others at par, interest being 6 per cent.

The Confederate or Slave States met their expenses almost wholly by issuing treasury notes, which served as the currency of the people. "Those notes were not made legal tender by legislative authority, but were made practically so by public opinion and by the repeal of state laws for the collection of debts. Their course was similar to that of the Revolutionary bills of credit. They became nearly worthless before the close of the war and were repudiated in part by the Confederate Government and were superseded by another batch, a sort of 'new tenor,' which pursued the same downward career. Secretary Memminger said that it was impossible to carry on war by means of taxes alone." In the case of the South it would really seem that this was a mistake. "Except money borrowed abroad, every country pays the cost of a war at the time of the war. The Southern Confederacy presents an easy illustration of this maxim, because it was for the most part isolated, having little communication with the outer world, and because all of its debts were obliterated at the end of the war. . . . There being nobody else to pay it, the people of the Confederacy must have paid it, and must have paid it during the time of the war, and not a moment later." [1]

[1] White, *Money and Banking*, pp. 148, 149. The broad statement is obviously wrong. Posterity nearly always pays the bulk of the cost of a

The following were the issues under the Confederacy:

March 1861, $2,000,000 treasury notes at 3.65 per cent. payable to order. These were not currency; $15,000,000 borrowed in gold on the security of 8 per cent. bonds.

May 16, 1861, $20,000,000 treasury notes for $5 and $10, non-interest bearing. These were redeemable in specie in two years and convertible into 8 per cent. bonds. They acted as currency. The issue of bonds was increased to $150,000,000. This loan was in part based on cotton and other produce.

August 19, 1861, $100,000,000 treasury notes, later raised to $150,000,000. They were convertible into 8 per cent. bonds or 6 per cent. call certificates. At the end of 1861, $105,000,000 treasury notes were outstanding and the premium on gold was 15 to 20 per cent.

April 1862, $165,000,000 8 per cent. bonds; $50,000,000 treasury notes; also a new kind of notes for $100, bearing 7.3 per cent. interest and payable for taxes. These also passed into circulation, owing to the rapid rise in prices. Up to this time 9 per cent. of the expenses of the war had been met by bonds, 85 per cent. by notes, and 6 per cent. by taxes, donations, and the confiscation of Federal property. In September 1862 an act was passed authorising note issues limited only by the public expenses. In December 1862 the outstanding notes, including state issues, amounted to $500,000,000. Gold in relation to notes was worth 3 : 1.

In March 1863 a loan for £3,000,000 was raised abroad (by Erlanger & Co., of Paris). It was secured by the cotton in the Confederate States at a valuation of

great war. But the Southerners do seem to have lost it all at the time, except for what they borrowed abroad.

6d. per pound (the selling price in England being 21d.). The issue price was 90, and it is said to have been five times oversubscribed in England alone. Yet after deducting brokers' commissions, interest on the bonds, repurchases to sustain the market, and other expenses the net amount realised (on $15,000,000) was $6,500,000. This paid for the Confederate cruisers. Various attempts at compulsory funding were made in 1863-64.

In January 1864 outstanding notes amounted to $700,000,000. The gold quotation was 20 : 1. "Old notes and the new notes circulated side by side, were equally discredited, and continued to depreciate together." In January 1865 gold quotation was 53 : 1. In March 1865 a bill for $80,000,000 notes passed over the President's veto; and a forced specie loan of $3,000,000 was authorised, or failing this a tax of 25 per cent. on all the specie in the Confederacy. This was just before the end of the war.

The United States Federal debt reached its summit on September 1, 1865, when it stood at $2,846,000,000 against a cash reserve in the Treasury of $88,000,000, the net liabilities thus being $2,758,000,000. Its composition was as follows :[1]

Funded debt	$1,110,000,000
Inconvertible paper (of which $26,000,000 was fractional currency)	460,000,000
Floating debt (mostly immediately repayable) .	1,276,000,000
Total	2,846,000,000

According to Adams (*Public Debts*, p. 248) the interest-bearing obligations stood then at $2,381,000,000. On June 30, 1866, the interest-bearing debt consisted of

[1] Bolles, *Financial History*, p. 306.

loans at 5 different rates of interest maturing at 19 different periods, there were 12 different 6 per cent. bonds and notes, 5 different 5 per cent., and 5 different 7·3 per cent. Part of the interest was payable in coin and part in currency. Only one-ninth of the debt ran for longer than two years; the remainder was in transient forms, expressing in the aggregate nearly a hundred contingencies of duration, option, conversion, extension, renewal, etc.

The problems which faced McCulloch, the new Secretary to the Treasury, were: (1) How to pay off or fund the floating debt; (2) how to provide a permanent scheme of debt reduction. In just over two years the floating debt was brought down to $408,000,000 (a decrease of over $900,000,000), and the inconvertible paper was reduced by $20,000,000. The act of April 12, 1866, authorised the conversion of temporary into long-term obligations. In accordance with this, new funded debt to the amount of $686,000,000 at 6 per cent. was issued at a slight premium. The temporary obligations were cleared off in 1868. A sinking-fund law had been enacted in 1862; but as there was no real surplus until 1866 it had been inoperative, nor was later debt reduction carried out in conformity with it. In 1870 and 1871 refunding acts were passed authorising the creation of $500,000,000 bonds redeemable in ten years, $300,000,000 at 4½ per cent. redeemable in fifteen years, and $1,000,000,000 at 4 per cent. redeemable in thirty years. None of these issues was to be sold at less than par in gold. Both interest and principal were to be paid in "coin," and later the question arose whether gold alone was meant, or gold and silver. These stocks unexpectedly went to a high premium, and so were

difficult to redeem. Before thirty years were over the Government could borrow at 2½ per cent. By 1876 the five-twenties of 1862 were converted to 5 per cent. due in 1881, and by 1879 the five-twenties of 1865-1868 were converted into the same denomination. The 4 per cent. thirty-year bonds were not placed till 1877, and were therefore not redeemable till 1907, and the 4½ per cent. fifteen-year bonds were not placed till 1876, and were therefore not redeemable till 1891.

The surplus of 1882 was used to cancel temporary and outstanding debt; but by 1886 all bonds subject to optional redemption had been cancelled, so that in 1887 the question was whether the Treasury had power to buy bonds in excess of the amount apportioned by the sinking fund. Great haggling with the bondholders ensued. In the summer of 1887 the Secretary to the Treasury called for offers toward redemption. The 4½ per cents. at once ran up from 109 to 111, and most offers were above 110. The Treasury refused all above 109½, and the offers dropped to between 106½ and 109.

Between 1880 and 1890 the old war loans disappeared. The 5 per cents., which fell due in 1881, were continued at 3½ and 3 per cent., but extinguished in 1890. The following table [1] shows the progress of reduction of the interest-bearing debt:

Year.	Rate of Interest.	Interest Charge.	Capital.
	Per cent.		
September 1865	6.34	$151,000,000	$2,756,400,000
November 1868	5.8	126,400,000	2,484,900,000
November 1884	3.92	47,300,000	1,408,500,000
December 1889	3.7	41,000,000	1,056,100,000
June 1892	3.9	22,900,000	585,000,000

[1] Bastable, *Public Finance*, p. 654.

Thus, in twenty-seven years $2,100,000,000 were removed from the capital liability, and the annual charge was reduced by nearly $130,000,000. The reasons for this success were the rapid rise of the United States credit by which the 6 per cent. and 5 per cent. bonds as they fell due were reduced to 4½ per cent., and even 3 per cent.; also, the large annual surpluses which resulted from the high duties on imports. Professor Bastable writes: "The protective system was in this way the cause of the repayment of the war loans. From the financial point of view it is plain that a like result could have been reached at much less real cost and sacrifice if moderate duties had been used; but then it is doubtful whether in that case the policy of repayment would have been so firmly adhered to. The result was that the federal debt became unimportant except in connection with the management of the Treasury and the banking system." As a rule governments have used protective duties to buy support from a section for expenditure which would otherwise be unpopular. In the United States they are associated also with the policy of extinguishing debt after the war.

If the practical extinction of the Civil War debt was a fine achievement the failure to establish a sound currency deserves severe criticism. Suspension of specie payments lasted for fourteen years, during which time the policy of Congress underwent many fluctuations.

From the price quotations of the 4 per cent. bonds after 1878 we find that their yield in the first year was rather under French rentes, in 1879 and 1880 it was above them, but from 1880 to 1889 considerably below, partly owing to the currency law, which made them the basis for bank notes.

Year.	Highest.	Lowest.	Average Price.	Yield.
1878	102¾	99¾	100.672	3.966
1879	104¼	99	100.609	3.963
1880	113⅝	103	106.322	3.631
1881	118⅝	112⅜	115.375	3.134
1882	121¾	117¼	119.2690	2.912
1883	125⅛	118½	119.8446	2.912
1884	124⅝	118½	121.5529	2.758
1885	124⅜	121⅜	122.2833	2.680
1886	129⅜	123	126.2147	2.427
1887	129⅝	124½	127.1751	2.317
1888	130	123¾	126.7252	2.266
1889	129⅞	126¼	127.8331	2.134
1890	126½	121½	122.7499	2.372

The twenty years of peace finance from 1878 to 1898 were taken up with silver and tariff controversies.

To meet the expenses of the Spanish War internal revenue taxes were promptly increased and Congress also authorised the issue of not more than $100,000,000 of treasury certificates, and not more than $400,000,000 of 10-20 bonds at 3 per cent. In fact, the Treasury raised $200,000,000 by the sale of 10-20 bonds, while the additions from the new internal taxes were more than $100,000,000 per annum. In July 1898 the interest-bearing debt amounted to about $847,000,000—$100,000,000 at 5 per cent. and the remainder at 4 per cent. The 4 per cents. payable in 1925 were quoted at 125.34, the average for the month (or a yield of 2.704 per cent.), and it was accordingly argued that it was foolish to place the new loan at 3 per cent. The bonds were subscribed seven times over, and rose to a premium of 111.79 in May 1901. These were far better terms than had ever before been secured by the United States Government in war time. The main reasons for the success were that the bonds were offered for popular subscription in small amounts, and they formed a better

basis for the national-bank note circulation than the old bonds at 125.34, and a much better basis than those bonds at 128½, a point reached before the end of the war. Of course the international market for gilt-edged stocks was then highly favourable. It was in this year that British consols touched the high-water mark of 113. As Congress had decided for a popular loan the offers of banking houses to take it at a slight premium were refused. It was issued in denominations as low as $20; subscriptions were received through the post office, and every *bona fide* offer under $500 was accepted. More than half the issue was taken by 230,000 of these small subscriptions, and no subscription of more than $4500 was accepted. In all, 320,000 persons offered subscriptions and an amount of $1,400,000,000 was tendered. The bonds soon advanced to 102 and 105⅛, and the subscribers made from 3 to 5 per cent. in a few days. The Government certainly lost an original premium by refusing the offers of the bankers, and owing to the small size of the bonds and the number of the holders incurred greater cost and trouble in handling the loan and paying interest. But the success gave financial prestige to the Government.

The funded debt, which was $585,000,000 in 1892, had advanced to $1,046,000,000 in 1899, an increase of $461,000,000, or 78 per cent. The interest charge, in spite of low rates, had risen from $23,000,000 to $40,000,000, *i.e.*, about £8,000,000.

In 1864, at the instance of Secretary Chase, Congress had passed a bill to set up a national banking system, by which the bank-note circulation of the country was used to promote the sale of government bonds. The sole merit of the plan was that it helped public credit in

time of need. By the act each bank on commencing business was bound to deposit in the United States Treasury bonds of the United States bearing a certain proportion to its capital. In return the bank was entitled to circulate notes equal to the par value of the bonds deposited, but not exceeding the market value. Thus the note circulation of the country was made to depend largely on the amount of the national debt. After the Spanish War, instead of providing a new basis for note circulation, the Government extended a large part of the maturing debt for thirty years. In 1900 by an act of Congress the 3, 4, and 5 per cent. loans were converted into 2 per cent. bonds at par, to run thirty years. Up to this time, says Mr. White :

"It had always been the policy of the Government to pay its interest-bearing debts as soon as possible in order to avoid unnecessary burdens upon the taxpayers. Thus the 5-20 bonds issued during the war were made redeemable at any time after five years, but payable at the end of twenty years. Under this system the Treasury could use its surplus revenues to pay bonds at par instead of buying them in the market at a premium. . . . Now nearly $550,000,000 of the public debt was put beyond the chance of extinction for nearly a quarter of a century, except by purchase in the open market. The Government paid a bonus of nearly $50,000,000 on the old bonds, of which it recovered less than $2,000,000 as premium on the new ones." [1]

Mr. White adds that the loss was enormous. For example, a surplus of $240,000,000 in 1907 might (but for the refunding) have been applied to the extinction of debt, and thus annulled the interest on that amount. "The excuse for this kind of financiering was that if the Government's interest-bearing debt were paid, there would be a shortage of bonds to be held as security for national-bank notes."

[1] White, *Money and Banking*, p. 405.

A law of 1902 provided for the issue of $130,000,000 2 per cent. bonds, interest payable quarterly in gold, the bonds redeemable in 1916 and payable in 1936 in gold. These were for the Panama Canal expenditure, and a first issue in 1906 of $30,000,000 took place.

After the Stock Exchange boom of 1906 came a disastrous slump and panic in the autumn of 1907, followed by a general bank suspension for two months, which demonstrated the dangers of an inelastic and artificial currency. A monetary commission was appointed and at last in 1913 the currency and banking system of the United States was radically reformed on scientific lines.

The opening of the Panama Canal in 1914 marked a great military and commercial achievement. It was financed mainly by additions to the debt, the total cost being estimated at about 300,000,000 dollars.

The interest-bearing debt of the United States in 1908 was thus divided:

At 4 per cent.	$118,490,000
At 3 per cent.	78,132,000
At 2 per cent.	700,882,000
Total	897,504,000

The variations in the funded debt since 1870 have been as follows:

	Funded Debt.	Interest.
1870	$2,386,000,000	$129,000,000
1875	2,128,000,000	103,000,000
1880	1,942,000,000	95,000,000
1885	1,386,000,000	51,000,000
1890	934,000,000	36,000,000
1895	901,000,000	30,000,000
1900	1,107,000,000	40,000,000
1905	989,000,000	24,000,000
1912	1,027,000,000	22,000,000

In 1889 the yield of the 4 per cent. bonds was 3.13, it then rose till it was 3.58 in 1893, and between 1892 and 1895 was occasionally higher than the German and Dutch 4 per cent. From 1896 the 4 per cent. 1925 bonds fell constantly until the yield in 1901 was 2.90 and American paper was the highest valued in the world. The yield has risen since then, and has been generally about equal to French rentes and higher than consols. In 1907 it was 3.17—the lowest yield of Government stock next to consols. In that year the highest price was 131. By 1914 it had sunk to 112, in sympathy with the general fall in gilt-edged securities.

The value of the 2 per cent. United States bonds has been artificially high, because the national banks had to hold them. They have always been higher than 3 per cent. rentes or 2½ per cent. consols, sometimes even than 3 and 4 per cent. United States bonds.

In November 1909 the 2 per cents. for the first time fell below par. The prospect of fresh issues for the Panama Canal, the lessened demand for currency, and the expectation of banking reform were factors in this decline. When the price was below par the national banks had to make good the deficiency in their guarantee deposit by buying fresh bonds, and thus lose their profit.

The history of the American debt would be incomplete without a note on its sinking funds. The systematic reduction of debt began in 1790 with the application of all surplus revenue from the tonnage fees and imports to the purchase of public bonds. In 1792 the bonds purchased were made the basis of a definite sinking fund, the interest on them to continue and to be paid to a commission for the future purchase of bonds. In

1795 the commissioners were allotted certain revenues to be applied to the purchase of definite portions of the debt. Alexander Hamilton has been accused of following Price's compound interest fallacy in his plan for debt reduction; but Professor Dunbar believes that Hamilton's scheme was based on the expectation of a surplus, and that its failure resulted from an unanticipated growth of expenditure.

Gallatin formulated the true principles of debt reduction in 1800 in a debate upon the sinking fund, when he observed (with a side reference to his famous predecessor):

"I know but one way that a nation has of paying her debts, and that is precisely the same that individuals practise, 'spend less than you receive,' and you may then apply the surplus of your receipts to the discharge of your debts. But if you spend more than you receive, you may have recourse to sinking funds, you may modify them as you please, you may render your accounts extremely complex, you may give a scientific appearance to additions and subtractions, you must still necessarily increase your debt."

Still he did not abolish the old sinking fund, but increased the annual appropriations. In 1791 the debt had been $75,400,000. This old debt was reduced by Hamilton to $72,700,000 by 1801, but in the same period new loans had been made, mostly at 8 per cent., so that Jefferson's Government inherited $83,000,000. Gallatin's sinking fund extinguished $46,022,810 between 1801 and 1811, while the purchase of Louisiana added 11¼ millions of new debt. On January 1, 1812, the debt was $45,154,189, or 31 millions less than the original revolutionary debt. It seems that Hamilton's sinking fund enabled some conversions to be made, which reduced the charge.

During the war of 1812 the operation of the sinking fund was suspended. At its close (in 1817) the arrangement of the sinking fund and debt account was much simplified by an enactment that all certificates of the public debt when redeemed should be destroyed. At that time there were 14 types of stock, bearing 7 different rates of interest. In the years following the war a series of large surpluses favoured debt reduction, although the fixed periods for which loans had been contracted proved an inconvenience. In 1824 $9,500,000 of 6 per cents. were converted to 4½ per cents. redeemable in eight or nine years. Other attempts at refunding were not markedly successful, as too low interest was offered. By 1835, as we have seen, the debt was almost paid off, and the sinking fund was transferred from the management of the commissioners to that of the Secretary of the Treasury.

During the civil war the law of February 25, 1862, enacted that a sinking fund should be created by the surplus from import duties after they had been used to pay the interest on the debt. The surplus was to be used to buy 1 per cent. of the debt each year, and this was to be set apart as a sinking fund, the interest on which was likewise to be applied to debt reduction. The residue of the customs receipts (if any) was to be paid into the Treasury. There were no surpluses during the war, nor were the above provisions observed after it was over, but the debt as we have seen was redeemed with amazing rapidity by means of annual surpluses. The history of the refunding of the civil-war debt has already been related.

So far we have spoken only of the Federal Debt. During the first half of the nineteenth century many of

the Northern States borrowed for internal improvements, such as railroads and canals. The States in the South and West also raised loans for state banks, and in the West for various commercial enterprises. These undertakings were often unremunerative, and the newer States sometimes failed to meet the obligations which they had incurred. For example, in 1838 Mississippi invested $5,000,000 in a bank which broke. The governor recommended that the bonds should be repudiated, on account of certain irregularities, and a legislature elected on this issue carried out the repudiation. Florida acted in much the same way. Foreigners who invested in state securities found that under the Constitution the Federal Government had no power over defaulters. It was during this period that *The Times* called the States "one vast swindling shop." Even Sidney Smith, an admirer of America, was provoked by these scandals to unaccustomed bitterness.

In 1843 it was proposed that Congress should assume the state debts. This course was not adopted, and American credit continued to suffer for the dishonesty of some and the incompetence of other States. Owing to these experiences amendments were gradually introduced into many state constitutions imposing restriction on public borrowing, as, for instance, that the loans must be temporary and that the amount of each must not exceed a certain sum varying from $50,000 to $1,000,000. In 17 States loans must be accompanied by legal provision for redemption, and in 16 every act proposing a fresh loan must be referred to a popular vote.

The civil war caused a large increase in state debts,

but towards the end of last century they began to be reduced. In 1902 their total amount was $235,000,000, as against the $925,000,000 of the federal debt. In that year the rate of interest on state debts varied from 3 per cent. to 7 per cent.

CHAPTER VI

THE NATIONAL DEBT OF FRANCE

As the war debt of Great Britain dates from the "Glorious Revolution" of 1689 so that of France dates from the Revolution of 1789, when the debts accumulated by the old monarchy disappeared in the overthrow of society. These debts were very large. As early as 1561 the Debt had reached 74 million francs,[1] and a large sum was extorted from the clergy in order to reduce the royal obligations. After the civil wars the Debt had risen to the gigantic total of 337 million livres.[1] But the skill and prudence of Sully, Henry IV.'s great minister, effected large reductions, and diminished the Debt by 100 million livres. Richelieu and Mazarin failed to carry on this sound policy, and the prodigal magnificence of Louis XIV.'s reign forced his finance ministers to adopt all sorts of contrivances for the raising of money. The Tontine annuity, for example, so popular afterwards in France and England, was attempted (unsuccessfully) by Fouquet at the suggestion of an Italian, Laurent Tonti. Under Colbert, however, the borrowing system was discredited by a series of drastic measures and compulsory reductions of interest which reduced the charge for interest on the Debt from 30 million livres in 1663 to 8 million livres at his death in 1683. These measures, of course, sowed distrust among capitalist money-lenders, and made the period

[1] 81 livres Tournois were equivalent to 80 francs.

which followed a disastrous one for France, for borrowing save on exorbitant terms is impossible by a Government which has broken faith with its creditors. Thus, in spite of a compulsory conversion in 1713, the acknowledged Debt of the French monarchy, in 1715 after the death of Louis XIV., had risen to 2000 million livres. During the financial chaos of the next reign, Saint Simon, at the Regent's Council, suggested a public bankruptcy, *i.e.*, a general repudiation of State debts. The financial adventurer John Law proposed to restore prosperity by various bubble projects which captivated Paris as the South Sea Bubble captivated London. The crash involved general liquidation. The Rentes were scaled down to 2 per cent., and the life annuities to 4 per cent., with the result that in 1719 the annual charge on the French Debt was estimated at 48 million livres. Owing to the extravagance of the Court and the Seven Years' War, French finances went from bad to worse. In 1764 the revenue was estimated at 286 million livres, of which 120 millions were required for payment of debt and annuities.[1] The nominal capital of the Debt was estimated in a Memoir presented in the same year by the Parliament of Bordeaux to Louis XV. at 2400 livres. After this, more measures of bankruptcy, disguised under the fair names of reductions and consolidations, were carried out by the Abbé Terracy. Nevertheless, when Louis XVI. succeeded in 1774, the total debt charge was very nearly 120,000,000 livres, while the floating debt amounted to 235,000,000 livres.

The appointment of Turgot revived the credit of the State. The rate of interest on loans to the Government dropped in twelve months from $5\frac{2}{5}$ to 4 per cent., and

[1] Cp. Adam Smith's *Wealth of Nations*, Book V., Chapter III.

when the great minister fell he was planning a large conversion. His programme—" ni banqueroute avouée ou masquée par des réductions forcées, ni augmentation d'impôts, ni emprunts "—was a complete reversal of all French financial policy since Colbert, and might have saved the monarchy. In his two years he paid off 74,000,000 livres of debt and 58,000,000 of anticipated revenue, leaving only 10,000,000 of the latter to be dealt with by his successor. But Necker (1777-1781) reverted to the bad old plan of borrowing; and between 1783 and 1787 Calonne, the last finance minister of the ancient *régime*, added 650,000,000 to the debt. He was at last (February 1787) forced to summon the assembly of notables, and in his opening speech admitted that the last ten years had added 1,250,000,000 to the debt, and that the deficit for the current year was 115,000,000. It is not surprising that he lost his office. In 1789 a committee of the constituent assembly reported that the annual debt charge, exclusive of the floating debt, was then 208,000,000 livres.

From the above history, drawn from the best sources available—though the figures have no pretence to exactitude, so confused were the public accounts and so conflicting the estimates even of the best informed—we may infer that borrowing was one cause of the downfall of the French Monarchy, and, further, that financial ruin was due at least as much to the methods followed as to the amount raised. An open bankruptcy or confiscation is, of course, a public fraud upon private lenders, and makes it impossible for the state to raise further sums except at exorbitant rates of interest. Even more disastrous to the national trade, revenues, and credit was the favoured plan of " redeeming " debt

by issuing paper money to the creditors, the result being a general debasement of the currency or destruction of public faith in the means of exchange and a general refusal to accept money in ordinary commercial transactions. Consequently the state, receiving taxes in its own depreciated and debased currency, was unable to pay its way, the prices of things and services having increased automatically as the currency was enlarged and debased.

In spite of several declarations by the assembly that they held the national debt as a sacred trust, the public credit of France had sunk to a very low ebb. Necker, now again Finance Minister, tried to raise two loans of 30,000,000 and 80,000,000 francs, respectively, but neither was covered. The report of the committee had recommended an issue of assignats; this vile measure was voted in spite of Necker's protests, and he resigned in August 1790. The issues of assignats continued, and in 1793 a forced loan of 1,000,000,000 francs only produced 100,000,000. The "loan" (which did not bear interest) was practically a confiscation of all income in excess of 9000 francs per annum and a heavy tax up to that limit. The Government, it may be added, estimated the income without consulting its possessor. Yet this same year saw the first appearance of the public debt in its modern form. By the law of August 24, 1793, Cambon proposed the creation of a "Grand livre de la dette publique" in which all the existing debt forms were to be entered as a unified 5 per cent. debt. The annuities were afterwards added. The book entries were treated as conclusive evidence of the claim. After this reorganisation the capital value of the debt in 1793 was nearly 3,500,000,000 francs, and the

interest charge 174,000,000 francs, of which only one-quarter was paid in money and the remainder in assignats. In 1797, however, depreciation of the assignats and general financial confusion induced the Government to "pay off" two-thirds of the debt in bonds exchangeable for land; in other words, the debt was reduced to one-third of its original value, and after some further confiscations amounted at the end of the eighteenth century to 800,000,000 francs with an annual charge of 40,000,000 francs.

Under Napoleon's rule and that of his two skilful finance ministers, Gaudin and Mollien, the issues of inconvertible paper ceased, and loans were as far as possible avoided. As a result the Restoration in 1814 found the debt charge, after fourteen years of unprecedentedly costly war, augmented by only 23,000,000, *i.e.*, from 40,000,000 to 63,000,000 francs. Of this additional 23,000,000, 6,000,000 were the debts of the countries taken over by France and 10,000,000 were obligations incurred by the Directory. Only 7,000,000 (or a capital increase of 140,000,000) were attributable to the Empire. Napoleon's policy of making war "pay its way" imposed very heavy annual burdens on France and the conquered territories. Nevertheless, in consequence of this policy, the financial situation of the French Government at the end of the Napoleonic wars was enviable compared with that of the victorious Government of Great Britain.

The restored Bourbon Government had to pay a war indemnity imposed by the allies, to compensate the emigrants, and to take up the large unpaid balances of the imperial expenditure. For all this large loans were required. Although urged by some of its supporters to

repudiate the existing debt, it had the honesty and sagacity to take longer views. Even so, such was the scarcity of capital and the suspicion of the few who had money to invest, that for some time the French Government was unable to borrow at par even on a 5 per cent. basis. From 1815 to 1818, 5 per cent. loans were actually issued at prices varying from 52.50 to 67.60—that is, practically at from 9½ per cent. to 7½ per cent. It would have been wiser, as M. Leroy Beaulieu observes, to create 6 or 7 per cent. stock at a price nearer par. The actual burden would have been much the same, and it would have eased the work of redemption later. Yet stock of even lower denominations was issued, notably the emigrants' indemnity of 25,000,000 francs at 3 per cent.

In 1819 a law was passed creating auxiliary "grands livres" in every department, and so giving facilities to the provincials for investment in government stock. From this point public credit steadily rose; in 1821 a 5 per cent. loan was issued at 85.55, and another in 1823 at 89.55. A steady policy of debt redemption and budget surpluses had such an effect that the last loan contracted by the Bourbon Government (80,000,000 of 4 per cent. rentes in 1830) was issued at 102½—the only French loan, it is said, that was ever emitted above par. The debt existing in 1814 had been practically redeemed, but the additions since that date involved an annual charge of 164,500,000 francs, a good deal more than double the legacy of Napoleon, but a mere fraction of the British war debt.

During the July revolution the 3 per cent. funds fell to 46, and when in 1831 the Orleanist Government emitted a loan of 120,000,000 at 5 per cent. they could

only obtain a price of 84, which made the real charge 6 per cent. A "patriotic" loan of 100,000,000 5 per cents. at par in the same month proved an utter failure, for only one-fifth was subscribed. Several loans followed for public works, military preparations, and to meet the persistent budget deficits. They were issued, not in 5 per cents., which had risen well above par, or even in fours, but in threes, which for many years after were not near enough par to make an advantageous form of loan. The prices ranged from 75.25 to 84.75.

The strength of the funds under Louis Philippe is a curious phenomenon, and marks the extreme of French credit as compared with the early years of the Bourbons. Professor Bastable observes: [1]

"The position of the stocks over 3 per cent. would have easily admitted of conversion without any increase of capital into a 4 per cent. or even 3½ per cent. stock, but to avoid popular hostility this evidently prudent course was not taken." He gives a table showing the position of the various stocks in 1845:

	Highest.	Lowest.
5 per cent.	122.85	116.45
4½ per cent.	116.25	111
4 per cent.	110.5	106
3 per cent.	86.4	80.85

In spite of eighteen years of peace and a considerable amount of debt redemption, 13,000,000 had been added to the debt charge, leaving it at 177,000,000 francs, or a total capital debt of 3,540,000,000 francs.

The three years of the Second Republic passed amid

[1] *Public Finance*, p. 646.

grave financial disorder. As a result of the February revolution the 3 per cents. collapsed to 32.50, and when the new government tried a "patriotic" loan of 100,000,000 5 per cents. at par only 26,000,000 were taken up. During the three years the 5 per cents. fluctuated between 50 and 75. The difficulties of the government induced them to resort to such questionable measures as forced "conversions." In July 1848 some treasury bonds which fell due were not paid off, but were arbitrarily changed to 3 per cent. rentes at 55. This stock was quoted on the Bourse at 43, so that the unfortunate holder lost 20 per cent. At the same time some savings-bank deposits on current account were "converted" to 5 per cents. at 80, quoted on the Bourse at 73, or a loss of 10 per cent. In spite or because of these wretched expedients the Second Republic increased the debt charge in three years by 53,000,000 francs, making the total charge, in 1852, 231,000,000 and the capital debt 4,620,000,000 francs.

During the Second Empire (1852-1870), the government of Napoleon the Third issued in all eight loans, most of them at 3 per cent., which was much below par. In 1854-55 the investors in the Crimean War loan were given the option of 4½ per cent. at 92 and 3 per cent. at 65, but only a very small proportion of the former were applied for. All the loans were issued by public subscription, and in the grandiose language of the time Finance Ministers would speak of the "suffrage universal des capitaux." As a matter of fact the loans were generally much oversubscribed by speculators, and the policy certainly had the effect of disseminating "rentes" among the French people. In 1830 the number of rentiers was 125,000; in 1869

it had risen to 1,254,000, and in 1881 to 4,000,000—these figures of course do not allow for duplicates. The extravagance and borrowing propensities of the Second Empire increased the debt charge by 129,000,000 francs, mainly owing to the Crimean, Mexican, and Italian wars, to the undertaking of huge public works, and the necessity of meeting budget deficits. The total cost of the Crimean War to France was 1,650,000,000 francs, of which 1,538,000,000 were raised by loans—a proportion which contrasts very unfavourably with British borrowing for the same purpose.

On September 4, 1870, the account for the debt stood as follows :

[In million francs.]

	Capital.	Interest.
Perpetual rentes . . .	11,662	362
Redeemable rentes . . .	1,332	149[1]
Unfunded debt . . .	794	—
Total	13,788	—

The annual charge on redeemable rentes consisted of 55,127,034 francs in annuities and 94,168,631 francs in rentes for terms and lives, amounting, as above, to 149,296,265 francs.

From 1870 to 1872 France endured a strain of war finance unexampled in European history, after which until 1878 ensued the repayment and reorganisation of the vast obligations then contracted. There were large borrowings during the war with Germany; and at its conclusion two great loans were raised to pay the indemnity. The following table gives a conspectus

[1] Annual charge.

of the amounts raised and the burden placed on the state.

[In million francs.]

Date of Loan.	Denomination.	Amount received.	Nominal capital.	Amount of Interest.
	Per cent.			
August 1870	3	804	1,327	39.8
October 1870 [1]	6	208	250	15.0
June 1871	5	2,293	2,779	139.0
July 1872	5	3,498	4,140	207.0
		6,803	8,496	400.8

To these must be added the debt incurred to the Bank of France for its issue of inconvertible paper—1,470,000,000 francs—and the indemnities by means of annuities to the Eastern Railway Company and to towns and private individuals, which raised the total amount of indebtedness incurred during and as a result of the war to over 9,000,000,000 francs. The enormous stored-up wealth of France and the recuperative powers of the nation were then wonderfully displayed. The loan of 1871 was subscribed for twice over and that of 1872 thirteen times over. But half of the second loan was taken up abroad, and both these great issues drew forth the contents of many French hoards and led to the sale of foreign securities by French holders. During the succeeding three years there was very little French capital seeking investment.

The effect of the war on credit, which was very marked, may be gauged by the course of 3 per cent. rentes. Their highest price during the fifteen years before the war was 75.45 in 1856, their lowest 60.50 in 1859. During the years 1869 to 1872 fluctuations were as follows :

[1] The so-called " Morgan " loan.

Year.	High.	Low.
1869 [1]	73.90	69.80
1870 [2]	75.10	50.80
1871 [2]	58.45	50.35
1872 [3]	57.25	52.40

Extreme prices quarterly.

Year.	First quarter.		Second quarter.		Third quarter.		Fourth quarter.	
	High.	Low.	High.	Low.	High.	Low.	High.	Low.
1869	71.60	69.80	72.10	70.10	73.90	69.90	73.30	71.50
1870	74.72	73.05	75.10	72.25	72.95	50.90[4]	55.00	50.80
1871	52.90	50.35[5]	54.20	50.65	57.85	53.20	58.45	55.25
1872	57.25	55.45	56.00	53.55	56.30	53.15	54.80	52.40

The average prices for each year were: 1869, 71.41; 1870, 65.82; 1871, 53.85; and 1872, 54.75. The debt to the Bank of France was discharged by annual payments from 1872 to 1879 of 200,000,000 francs or over. The total payment, including interest, amounted to over 1,512,000,000 francs.

The debt history of the last thirty years falls under three heads. From 1878 to 1882 loans were undertaken to carry out those ambitious schemes of public works which are associated with the name of M. de Freycinet. After the crisis of 1881-82 it was obvious that the country's resources were not yet equal to such undertakings, and the loans during the next ten years were mainly incurred to meet chronic budget deficits. From 1881 to 1891 the net total of extra-budgetary expenses was over 5,000,000,000 francs, or more than the amount

[1] Before war. [2] During war. [3] After war.
[4] War declared July 16, 1870. [5] Peace signed February 26, 1871.

of the German war indemnity. The last great loan in 1891—869,000,000 francs—added 28,000,000 to the annual debt charge.

The French debt increased from 13,000,000,000 francs before the war of 1870 to 31,000,000,000 in 1891—that is, by 18,000,000,000—and the annual charge from 511,000,000 in 1870 to 1,286,000,000 in 1892—that is, by 775,000,000. The total increase in public revenue during the same period was 1,082,000,000, so that 71 per cent. was absorbed by the service of the debt. The main causes to which this gigantic and alarming increase of public indebtedness must be ascribed are:

	Francs.
The war of 1870 and the Commune . . .	8,418,000,000
Reparation of the effects of the war, and army and navy reform	2,118,000,000
Public works and education . . .	5,637,000,000
Subvention to the Caisse des Retraites . .	348,000,000
Other expenses	1,575,000,000
Total	18,096,000,000

After 1891, until the Morocco expedition in 1912, expenditure and receipts were more or less equalised, though a small funded loan was issued—in 1901.

The next table shows some of the variations in capital value of the interest-bearing debt since 1877:

	Francs.
1877	19,909,000,000
1887	24,661,000,000
1907	25,850,000,000
1909	25,510,000,000
1914	32,787,000,000

All these years the French debt was the largest in the world. After the Morocco crisis and the tension which then became more pronounced between France and Germany, an enlarged military and naval expenditure caused constant and growing deficits, until, at the outbreak of the Great War, the French was very nearly double the British debt. The only alleviation that seems probable is the reversion of the chief railway lines to the state between 1950 and 1960, which should bring in a very large and expanding revenue.

The variations in French credit since 1877 may be gauged by the yield of the 3 per cent. rentes. In that year, when the influence of the war was still felt, the yield was 4.27, more than that of the 4 per cent. German imperial loan. In 1881 it fell to 3.58, but in 1884 rose to 3.91, when it was 0.7 above the German yield. In 1897 it reached its lowest point, 2.91 (0.46 below British consols for the same period). In June 1910 it was 3.12, while the yield of British 2½ per cent. consols was about 3.03. From about 96½ in 1910 the rentes fell to about 87 in 1913.

French terminable annuities are not generally open to the public, but are arranged by the State with large corporations, such as the Bank of France, the railway companies, chambers of commerce, and municipalities. The 3 per cent. stock, repayable in seventy-five years, created in 1878, is quoted in terms of 100 francs, but cannot be delivered in amounts of less than 500 francs. It is not much favoured by small investors.

The method of redemption by periodical drawing has some peculiarities. The stock is divided into 175

series, and each subscriber has the option of taking each " coupure " from a different series, so that the subscriber for 175 " coupures " may hold one in each series. They are redeemed by lot—1879-1907, 1 series in each year; 1908-1925, 2 series in each year; 1926-1938, 3 series in each year; 1939-1945, 5 series in each year; 1946-1953, 6 series in each year.

The policy of debt redemption in France has not been carried out with conspicuous success, owing to the failure of French statesmen to grasp the rudimentary principle that the only real sinking fund is a surplus of revenue over expenditure. In 1816 a sinking fund (Caisse d'amortissement) was begun and endowed with 20,000,000 francs a year, which sum was raised in 1817 to 40,000,000, and again from 1818 to 1825 to 77,000,000. But the State was buying its funds back at a higher price than that at which it had issued them, the difference amounting to 105,000,000 francs during the eighteen years 1816 to 1834. In 1833 the sinking fund was reduced to 44,000,000, and it was suspended by Louis Napoleon from 1848 to 1852. The caisse still existed in name, but its funds were diverted to other objects. In 1866 it was reorganised, but finally suspended in 1871.

A more successful method of debt reduction during the last half century has been by conversions effected in years when the national credit has been rising. But for this process the debt charge would present an even more portentous total. It may be noted that owing to the large number of fundholders conversion has not always been easy, and to avoid unpopularity opportunities have been neglected at times when the price of the funds would have favoured the operation—*e.g.*, under Louis Philippe, and more recently, from 1878 to 1883.

In 1852 the government of the Second Empire converted 3,500,000,000 five per cents. to 4½ per cent. stock, with a saving to the State in interest of 17,500,000 francs. Less than 75,000,000 of capital had to be paid to dissenting creditors. The conversion of 1862 was not so satisfactory. "For the sake of a premium the 4½ and 4 per cent. stocks were converted into 3 per cent., with a proportionally increased capital. This unjustifiable measure brought a premium of 157,500,000 francs to the State, but, on the other hand, it increased the capital of the debt by almost 1,600,000,000 francs and precluded the hope of further speedy conversion."[1] In 1883 the old 5 per cents. were converted into 4½ per cents. without any increase of capital, but with a proviso against further conversion for ten years. An annual saving in interest of 34,000,000 francs was the result. In 1894 the high price of this stock allowed a successful conversion to 3½ per cent. Out of a capital of nearly 6,800,000,000 only about 1,400,000 was demanded by the holders and the gain in interest amounted to 67,000,000 annually. In 1902 M. Rouvier carried out a further conversion of this stock to 3 per cent., with a bonus of 1 per cent. to the acceptors and a guarantee that no further conversion would be attempted for eight years. By this measure all the existing funded debt was consolidated under one denomination.

The steadiness in price of French rentes has often been remarked and is usually ascribed to the wise policy of the French Government in appealing to the small investor's appetite for small bonds. Before the Great War of 1914, the 3 per cent. rentes were distributed among more than 4,500,000 persons. Another ex-

[1] Bastable, *Public Finance*, p. 647.

planation of this stability of price may be found in the fact that from 1890 to 1910 the debt of France was practically stationary. Yet another is the policy of the Bank of France in setting its face against changes in the discount rate—a policy made possible by the law enabling it to refuse payment in gold. Thus France avoided the smaller fluctuations of the money market, and Paris, though a great loan market for Russia, Southern Europe, and South America, ceased to vie with London as a centre of international banking and exchange.

A Postscript may be added on the growth of war debt in 1914–1916. Unfortunately for France, its finances had been in disorder for some time owing to a series of unfunded budget deficits. Moreover a big loan for 900 million francs, in 3½ per cents. at 91, redeemable in 25 years, issued on July 7, 1914, just before the war, proved a failure. Even after convertibility into future war loans was promised, only 515 million francs were subscribed, and most of this was applied to redeem Bons du Trésor. Accordingly, at first, the war was financed by advances from the Bank of France, and by short 5 per cent. bonds (3, 6, and 12 months) called Bons de la Défense Nationale, issued under a decree of September 13, 1914. On February 13, 1915, 5 per cent. ten-year bonds were issued at 96½. Then came the Anglo-French loan in the United States and the so-called "Loan of Victory," besides Treasury Bills placed in London and New York. Altogether some 30,000 million francs were borrowed for the war up to December 31, 1915. If the war lasts till August 1, 1916, the National Debt of France will probably have risen from 1300 to about 2900 millions sterling.

CHAPTER VII

GERMANY'S IMPERIAL DEBT

THE debts of most European countries fall into two divisions, national and local. The national debt represents mainly wars, armaments, and budget deficits, while the local debt generally represents public utilities and revenue-producing or health-producing or pleasure-producing assets, such as light, water, roads, tramways, sanitation, parks, etc. But the German Empire is a Federation of twenty-seven States.[1] Three, indeed, of these States, Hamburg, Bremen, and Lubeck, are themselves towns, and many of the smaller principalities are more like counties than kingdoms. Nevertheless, the public debts of Germany, like those of the United States, require a triple classification, municipal, state, and imperial or federal. The interest charge on the Imperial Debt is borne by the whole of the inhabitants of the Empire, that of a State like Saxony by all the inhabitants of Saxony, and that of a town like Dresden by the inhabitants of the town. In 1908 the Debt of the Empire amounted to only 4253 million marks, that of the States to 14,362, and that of the towns and local authorities to 7400 millions. Of the State debts, Prussia's share represented 7963, Bavaria's 1574, Saxony's 917, Wurttemberg's 585, and Baden's 470 millions of marks. The debts of some of the States are largely productive, including, in the case of Prussia, such important assets

[1] Counting Saxe-Coburg-Gotha as two and including Alsace-Lorraine.

as State railways, forests, etc. Of the Bavarian Debt in 1908 less than one-fifth consisted of general or dead-weight debt, most of the remainder being capital invested in the Bavarian State railways.

The German Empire was described by Count von Bülow, the late Imperial Chancellor, as a "parvenu" among the Great Powers. This, the greatest military power in the world, is not a third as old as the United States, for it was born from a union of states less than forty years ago, when modern Japan was also being evolved. But Prussia, of course, was already strong 160 years ago.

The financial history of the German Empire since its development has been remarkable, whether we consider the progress of its expenditure, of its revenues, or of its debt. The following table [1] gives an official conspectus of the budgets and borrowings from 1872 to 1908:

[Amounts are expressed in millions of marks.]

Annual average for the years	Total expenditure.		Total revenue.	
	Ordinary.	Extra-ordinary.	Ordinary.	Extra-ordinary.
1872-1875	1,146.1	—	1,149.7	670.3
1876-1880	774.1	—	759.8	163.3
1881-1885	776.2	—	767.6	50.1
1886-1890	1,113.8	258.9	1,134.4	218.4
1891-1895	1,411.3	141.7	1,413.9	154.4
1896-1900	1,775.6	102.9	1,807.7	55.5
1901-1905	2,083.3	169.8	2,060.3	226.9
1906	2,157.3	235.1	2,111.8	264.7
1907	2,421.4	388.5	2,351.4	340.7
1908	2,519.3	265.5	2,519.3	265.5

[1] Most of the figures in this chapter are taken from official sources, chiefly from the valuable *Denkschriftenband zur Begründung des Entwurfs eines Gesetzes betreffend Aenderungen im Finanzwesen*, compiled by officials in the German imperial treasury, published in 1908.

It will be seen that, although there were from the first extraordinary sources of revenue, yet the distinction between ordinary and extraordinary expenditures (a distinction drawn in order to supply reasons or excuses for borrowing in times of peace) was not introduced into the accounts of expenditure until the year 1886; and it was not until 1908 that the propriety of making the extraordinary expenditure tally with the extraordinary revenue was recognised in the imperial accounts.

The previous table showing the total expenditure and revenue must be supplemented by a second table showing the net expenditure and revenue, after deducting the profits earned by some of the government departments, such as the post office, the imperial railways, and the printing department. The net expenditure and revenue (excluding loans) then work out as follows:

[Amounts are expressed in millions of marks.]

Annual average for the years	Net expenditure.	Net revenue.
1872-1875	377.0	267.0
1876-1880	462.1	283.1
1881-1885	456.9	415.0
1886-1890	604.9	576.1
1891-1895	813.5	726.8
1896-1900	908.9	915.9
1901-1905	1,041.0	1,013.7
1906	1,261.2	1,230.6
1907	1,410.0	1,320.8
1908	1,503.2	1,417.3

Applying the net expenditure and revenue to the population we find that the net expenditure of the Empire per head of the population rose from 9.1 marks on the average of the years 1872-1875 to 17.7 marks in 1901-1905 and 23.9 marks in 1908, the corresponding

revenue figures being 6.4, 17.3, and 22.5, so that the average taxation paid into the imperial exchequer yearly by each person in the German Empire had almost quadrupled in the course of thirty-six years, having risen from 6 to 22 marks; and neither figure takes account of the extra burdens caused by the fact that most of the customs duties are protective, so that in many cases only a small part of what the consumer pays in higher prices finds its way into the treasury.

Turning now to the details of expenditure we find that the cost of the army rose from an average of 324 million marks in 1872-1875 to 462 in 1891-1895, 622 in 1901-1905, 854 in 1908, and 945 millions in 1912. The corresponding figures for the navy were 36 million marks in 1872-1875, 84 in 1891-1895, 223 in 1901-1905, 339 in 1908, and 470 in 1912. The cost of the foreign department (*Auswärtiges Amt*) rose from an average of 6.7 million marks for 1872-1875 to 17.8 for the year 1908 and 19.2 in 1912. The cost of the colonial department (established in 1896) rose from 8.8 million marks in 1896-97 to 58.4 million marks in 1907, reverting to 28 million marks in 1912.

In 1913 and 1914 in order to provide for fortifications and fresh armaments without adding to the debt a capital levy of 50 millions in three instalments began to be levied on property-owners throughout the Empire.

Another branch of expenditure is entitled capital accounts (*Kapitalfonds*), including (*a*) the imperial pension fund, (*b*) the expended funds;[1] which again fall into (1) the imperial fortification funds, (2) Reichstag building fund, costing 26 million marks and paid for out of the French indemnity; (*c*) the famous war reserve

[1] *Aufgezehrtefonds.*

(*Reichskriegschatz*) kept in the castle at Spandau, and consisting of 120 million marks set aside from the French indemnity; (*d*) money set aside for a Working Capital Fund.[1]

The accounts of the empire are complicated by the financial relations of the federated empire to the states of which it is composed. From 1872 to 1878 the states paid matricular contributions to the empire, varying between 51 and 82 million marks a year. The tariff revision and financial changes of 1879 enlarged the financial resources of the empire, and from 1883 to 1898 (with the exception of the two years 1893 and 1894) the empire made annual contributions to the states. This contribution was usually small, but occasionally became substantial, as in 1889, when it rose to 139 million marks. From 1899 onward the imperial finances again became unequal to the strain of increasing expenditure, and matricular contributions were again required from the states. These contributions had risen to 247 million marks in 1912.

The art and theory of a public debt are comparatively new to Germans;[2] but modern Germany it must be admitted has proved itself an apt pupil of older kingdoms and empires alike in the theory and the practice of borrowing for income. We shall trace the growth of the imperial debt from its commencement in 1877; but before so doing it will be convenient to take a general view. As Germany is an imperial

[1] A useful table showing the increasing cost of imperial administration under nine different branches from 1879-1908 is given on pages 94-95 of the *Denkschriftenband*. The charge for Schuldendienst or service of the debt appears in a later table.

[2] Even after the Seven Years' War Prussia had not attained to the luxury of a Public Debt.

federation of States with a developed system of local government the debt falls into three great classes—the debt of the Empire, the debts of the individual States, and the debts of the urban and rural communities. The following table shows the growth of debt in the Empire, the States, and the "Kommunen" of Germany from 1881 to 1908 : [1]

[Amounts expressed in millions of marks.]

Year.	Debt of Empire.	Debt of States.	Debt of communities with more than 10,000 inhabitants.
1881 . . .	267.8	5,244.3	771.8
1891 . . .	1,317.8	9,230.0	1,400.5
1901 . . .	2,395.7	10,796.7	3,097.7
1908 . . .	4,123.5	13,343	5,295.7

This shows a growth in twenty-seven years of 3,855,000,000 marks in imperial debt, of 8,098,000,000 marks in the aggregate debt of the German States, and of 4,523,000,000 marks in local debts. The imperial debt was multiplied more than fifteen times; that of the States was not quite trebled; while the local debt was nearly seven times larger at the end than at the beginning of the period. In 1912 the imperial debt had risen to 4,922,000,000, and those of the States to 15,697,000,000. The Prussian debt was about double that of the Empire. This summary is not complete as it does not include the debts of the Prussian "Landkreise" and Provinces, or of school and poor law authorities, or of communities with less than 10,000 inhabitants. If

[1] The figures are all taken from official sources. The leading authority for the debts of German towns is Most's *Die Anleiheaufnahme der Grosseren deutschen Stadte in Jahrzehnt* 1897-1907.

all these were added to the local indebtedness, the official figure would have been not 5,295,000,000 but 7,420,000,000 marks. Most of the local debt and a great part of the state debts are, of course, more or less reproductive; but the imperial debt is in the main what we call in England "dead-weight" debt.

The total funded debt of the German Empire rose by leaps and bounds. The expedition to China cost altogether about 290 million marks and the wars in South-West Africa entailed an expenditure of about 429 million marks, while another sum of 109 million marks was required for the construction of the Kaiser Wilhelm (Kiel) Canal. In 1877 the imperial debt of Germany was only 72 million marks, rather more than 1½ marks per head of the population. On October 1, 1908, the debt amounted to 4253 million marks—rather more than 67 marks per head of the population. The following official table shows the total funded debt of Germany on March 31 in various years from 1877 to 1912, viz.:

March 31.	Total Debt.
	Million marks.
1877	72.2
1881	267.8
1886	440.0
1891	1,317.8
1896	2,125.3
1901	2,395.7
1908	4,003.5
1912	4,582

In 1914, before the outbreak of war, the Imperial debt had risen to 5017 million marks, and the debt charge to 177 million marks.

In order to frame proposals for the reform of the

German finances in 1908-9, the imperial treasury made a very careful analysis of the objects upon which the sums raised by imperial loans had been expended up to the end of the financial year 1907.

I. Sums expended out of loans on behalf of all the states of the Bund :

	Million marks.
For the imperial army	1,670.1
For the imperial navy	768.4
For the imperial railways	252.4
For the colonies	7.4
For the currency	46.4
For printing	5.3
For the inclusion of Hamburg and Bremen in the Zollverein	52.0
For the Kiel Canal	109.1
To meet deficits in the ordinary budget	114.3
For workmen's dwellings, etc.	9.4
Expedition to China	287.1
South-West African wars	379.1
Expedition to East Africa	1.8
	3,702.8

II. Payments made by all the states of the Bund except Bavaria (which has its own army) for the military forces of the Empire, 121.6 million marks.

III. Expenditure by all the states of the Bund except Bavaria and Wurttemberg (which have their own postal systems) for post and telegraphs, 263.8 million marks.

It will be seen therefore that the imperial debt consists of three parts, the first and by far the greatest being that which is raised for the purposes of the whole empire, which accordingly defrays the interest. The second part of the debt is raised and defrayed by all the states except Bavaria. The third part is raised and defrayed by all the states except Bavaria and Wurttemberg.

It was, of course, inevitable that as the capital of the debt grew there should be a proportionate growth in the annual payment for its maintenance. The following table shows the charge for interest and management of the debt (which of course has to be defrayed in the annual budget) in every fifth year from 1880 to 1905 and in 1907-8.

Debt Charge

[Amounts expressed in millions of marks.]

Year.	Charge for interest and management of debt.	Year.	Charge for interest and management of debt.
1880 . . .	6.2	1900 . . .	79.0
1885 . . .	17.4	1905 . . .	119.8
1890 . . .	48.3	1907 . . .	148.4
1895 . . .	71.7	1908 . . .	155.5

At the beginning of this century the rapid growth of the debt began to attract serious attention; and in the year 1901 rules were formulated for the different spending departments to show what classes of expenditure might properly be defrayed out of loans. In the budget memorandum of that year the items of expenditure defrayed out of loans were for the first time stated separately. The following were the rules then laid down to govern borrowing by the four great spending departments—army, fleet, railways, and post office.

1. *The army.*—The cost of fortifications and of perfecting the network of military railways may be defrayed out of loans.

2. *The navy.*—Expenditure on the enlargement of the fleet, subject to the provision that 6 per cent. of the

total value of the fleet must be spent out of ordinary revenue on the construction of new ships.

3. *Railways.*—Capital expenditure for the opening of new traffic, and also outlay upon unusually costly buildings and improvements, which would be an excessive burden on the ordinary estimates.

4. *Posts and telegraphs.*—The cost of acquiring and equipping telegraph lines by sea and of laying telegraph and telephone wires underground. All expenditure on telegraphs and telephones for military purposes may also be defrayed from loans, and since 1902 any extensions of the telephone system which promise to be immediately profitable have also been placed to capital account.

The principles formulated in 1901 for the regulation of loan expenditures were afterwards supplemented, the following additional rules being prescribed in a memorandum of 1907:

(a) *Home administration.*[1]—Loans may be employed for the purchase of land and other functions in connection with the housing powers entrusted to the home office. Money may also be borrowed to defray some of the larger structural alterations in the Kaiser-Wilhelm Canal, which are costly enough to exceed the limits of current maintenance and go beyond the ordinary extensions required by the growth of traffic.[2]

(b) *Military administration.*—Not only the cost of building forts (*Festungsbauten*), but also expenditures for general purposes connected with fortifications

[1] *Im Bereiche des Reichsamts des Innern.*

[2] *Etwaige grossere bauliche Anderungen am Kaiser-Wilhelm Kanal, die schon wegen des erheblichen Aufwandes uber den Begriff der laufenden Unterhaltung und der durch die regelmassige Fortentwicklung des Verkehrs bedingten Erweiterung hinausgehen.*

(*Festungszwecke*), may be defrayed out of borrowed money.

(c) *Naval administration.*—The excess above the 6 per cent. described in the regulations of 1901 may take the form of an additional sum in the extraordinary budget.[1] War ships only are to be included in this category, the cost of arming the ships with guns and supplying them with mines and torpedoes must be defrayed out of taxes and included in the ordinary estimates.

(d) *Posts and telegraphs.*—In addition to the provisions of 1901, the losses occasioned by renting rooms below the market price to underpaid officials and workmen may be thrown on the capital expenditure of the post office if not otherwise provided for by the general fund. Nothing could better illustrate the straits into which treasury officials were driven by the widening gap between revenue and expenditure. The wording, however ingenious, cannot excuse what is practically the part payment of ordinary wages and salaries out of loans.

(e) *Railways.*—The rules of 1901 are repeated at greater length, with slight modifications. As regards loans for things rapidly used up which are only treated as capital because of their unusual cost, it is prescribed that they shall have special and appropriate sinking funds attached, the interest and sinking fund being charged on the ordinary railway budget. This device is borrowed from the British system of loans for works.

It may cause surprise that a writer should have gone so far into the debt of the German Empire and

[1] *Wird das Mehrbedarf in Gestalt eines Zuschusses des ausserordentlichen Etats auf Anleihe übernommen.*

the regulations which govern or restrict its increase without any reference to a general sinking fund. But in sober fact there neither is now, nor ever has been, a sinking fund for the imperial debt of modern Germany, though in the 1907 rules a sinking fund was prescribed for special types of railway loan expenditure. A law, indeed, was passed on June 3, 1906, providing that from 1908 onwards a provision of three-fifths of one per cent. of the debt should be set aside for its extinction. For eloquent brevity a later comment of the German treasury upon this law cannot easily be surpassed. "*Eine Tilgung ist auf Grund dieser Bestimmung noch nicht erfolgt.*" "This provision for a sinking fund has not yet produced any results." In truth the object of a sinking fund is to reduce debt. The extinction of a small amount of debt with one hand while you create a large amount with the other is not practical; in fact, it is wasteful. Most modern states indeed indulge in this sham of a sinking fund probably in the hope of encouraging their creditors. The German Reichstag sensibly determined not to enforce its own law until the Government has contrived to balance revenue and expenditure.

As regards the actual method of issuing new debt, the following official account may serve:

"If the Government adopts the system of open sales with the Reichsbank as its agent, the transaction is spread according to market conditions over a longer or shorter period. But if the Imperial or Federal Government assigns the new scrip to financial and other institutions, then the day on which the purchase money due to the Imperial Government is to be paid wholly or in part, is considered as the date for the conclusion of

the transaction. The same holds good when the issue is assigned to an Imperial Government department or a State institution which has funds to invest. But when, according to the method now usually adopted, the scrip is issued to a 'consortium' or syndicate presided over by the Reichsbank and the Seehandlung, then there are three dates marking three different stages in the transaction. The first is the day on which the agreement is entered into between the Imperial Government and the consortium of banks, when the conditions of the issue are fixed; then comes the day on which the loan to be issued is offered for public subscription; thirdly, there is the period within which the consortium which has taken over the loan is bound to complete its cash payments to the Imperial Exchequer. The first Imperial Loan of June 17, 1877, was emitted by a consortium, but from that time to the end of the 80's this method was only once resorted to, namely, in 1887, when an Imperial loan of 100,000,000 marks was entrusted to an association of banks and financial houses. From 1889 onwards, as the debt rose more rapidly, this method became more common, and since 1900 it has been constantly adopted in the case of important issues."

So much for the funded debt.

The unfunded debt of Germany consists of long-term and short-term treasury issues. As to the first it is officially admitted that a great increase took place in the ten years 1898-1908. The explanation given is that owing to general industrial conditions and demands the strain on the German capital and loan market was so great as to preclude the possibility of consol issues on a scale sufficiently large to meet the deficits.

Many issues of long-term treasury bonds (*lang-*

fristigen Schatzscheinen) were made between the years 1900 and 1908.

Short-term treasury bills are used to meet temporary deficiencies at times when the revenues coming in are inadequate to cover the expenditures. They have been regularly employed for the purpose of strengthening the balances of working capital. For a few years after the war the French indemnity sufficed for this purpose. In 1877, however, 24 million marks worth of these treasury bills were put into circulation, and since then they have been freely used. In 1908 the legal maximum was raised to 475 million marks. Prussia, Bavaria, and several other States also issue treasury bills.

This shows, as has been officially pointed out, that after 1903 a " latent debt " grew up of varying amount indeed, but still of permanent character. As a government expert put it: " Since 1903 the Empire has had treasury bonds in continuous circulation; so that a service for strengthening the working balances has to some extent degenerated into a concealed debt consisting of short-term bonds." The procedure adopted for taking up treasury bills has been thus described:

" When the necessity for an issue of floating debt arises the Imperial Chancellor directs the Department of the Debt to make an estimate of its immediate prospective requirements and to prepare a corresponding issue of Treasury Bills, which are then deposited with the Reichsbank. As soon as the credit to be maintained by the Treasury at the Reichsbank falls below 10,000,000 marks, the Reichsbank thereupon without any special notice draws from the Treasury Bills deposited whatever number may be required to restore

the Government's balance, buying them (usually) at its current official rate of discount. It either keeps these bills in its bill-cases until they fall due or rediscounts them. In exceptional cases Treasury Bills are allotted to other public departments or private firms."

In conclusion it may be pointed out that just as the increase of the floating debt during the Boer War proved a disquieting factor in the London money market, so the great increase of treasury bills used to be a source of anxiety in German banking circles, and there was a strong desire to restrain the output.

The debts of the 26 or 27 States of the Bund have not advanced as a whole at anything like the ratio of the imperial or local debt. The lion's share of the increase is due to Prussia, whose debt at the beginning of the period was not half as large again as Bavaria's. The following table excludes the very small States whose debt is insignificant:

Debts of 13 German States

[In million marks.]

	1881	1891	1901	1908
Prussia	1,965	5,834	6,602	7,963
Bavaria	1,341	1,331	1,362	1,754
Saxony	673	625	829	917
Wurttemberg	418	439	495	585
Baden	322	339	335	470
Hesse	31	35	284	407
Mecklenburg-Schwerin	37	94	108	127
Oldenburg	36	36	55	58
Brunswick	84	69	58	50
Lubeck	23	11	37	55
Bremen	80	80	160	235
Hamburg	160	271	406	545
Alsace-Lorraine	19	25	30	35

The total funded debt of all the States, large and small, was officially computed on November 1, 1908,

to be 13,807,423,000 marks, and there was also outstanding a floating debt of 555,000,000 marks, of which 545,000,000 fell to Prussia. Of the Bavarian debt, 302,000,000 marks were general or dead-weight debt and 1,551,000,000 marks represented capital invested in the Bavarian state railways. In 1914 before the war the total debts of the nine larger States exceeded 750 millions sterling, and were therefore more than treble the debt of the Empire. Prussia's debt had risen to 495, Bavaria's to 124, and Saxony's to 43 millions sterling. In the last two decades Prussian and imperial credit have been very much on a par, and when, as frequently happens, the premier State and the Empire both wanted loans the issues were usually brought out together by a "consortium" of German banks and in the same denominations. At the end of April 1909, when both the Prussian State and the German Empire were suffering from large deficits, Prussia requiring 480,000,000 marks and the Empire 320,000,000, there was some difficulty in arranging for the joint issue, and a long conference took place between the representatives of the two Governments and the bankers, the former pleading for a 3½ per cent. issue, while the bankers stood out for 4 per cent., arguing that the German public had got accustomed to expecting 4 per cent. for its money, and that a 3½ per cent. issue would not be taken up, in spite of the favourable condition of the money market. The government officials, of course, in the interests of the taxpayer and of German credit, were anxious that Germany should not have to borrow on the same basis as Spain or on worse terms than Italy. Eventually it was arranged that half the loans should be in 4 per cent. and the other

half in 3½ per cent. denominations, both to be irredeemable until the year 1918. The 4 per cent. loans were taken over by the bankers at 102 and issued to the public at 102.70, while the 3½ per cents. were taken over at 94.80 and issued at 95.60, both loans being three-fourths of 1 per cent. lower than were the existing 3½ and 4 per cents. on the day when the loan was announced. The "consortium" of bankers, which issued the loans on this occasion, was composed of the leading bankers and finance houses of all the principal cities of Germany.

German credit suffered considerably between 1904 and 1914. The Imperial Threes, which have always been quoted on the London Stock Exchange, declined from a mean price of about 89 in 1905 to 84½ in 1910, and 75½ in 1913. This stock had fallen to 45 on the London Stock Exchange by March 1916; but in neutral markets the price was of course higher.

The history of Prussian credit after 1886 may easily be traced by following the average prices of Prussian 3½ per cent. consols from that year to 1908 on the Berlin Bourse. The average price in 1886 was 102.1. They fell back to 99.8 next year, but rose to 103 in 1888 and 104.4 in 1889. In 1890 the price receded to 100.5 and in 1891 to 98.4. For the next two years they stood at par, and ran up to 102.4 in 1894, 104.4 in 1895, and 104.6 in 1896. This was the high-water mark, though the highest actual quotation in the year (105.6) was just below the record of 105.8 which had been touched in 1889. The price now sank steadily to 95.8 in 1900, but recovered to 99.4 in the following year and to 102.2 in 1903. Then another shrinkage began which lasted until 1909, when cheap money more than offset the continuance of heavy borrowing. In that year the mean price

was about 94. Then a rapid decline set in, till the mean price in 1913 was only 84. The following table will show the close correspondence of the Prussian and Imperial 3½ per cents. from 1904 to 1908:

Year.	Prussian.	Imperial.
1904	101.89	101.94
1905	101.41	101.33
1906	99.59	99.54
1907	94.89	94.66
1908	92.25	92.21

Commenting on these figures in 1910 I wrote:

"The slight superiority of Prussia's credit to that of the Empire may be explained by the fact either that Prussia has more tangible assets or that the Empire is a comparatively youthful and artificial creation compared with the Kingdom of Prussia. Certain it is that some German and foreign investors are inclined to prefer the security of a German State to the collective guarantee of the Empire."

The credit of Saxony, judged by her 3 per cent. rentes, at one time stood higher than that of either the Empire or Prussia. But in 1898-99 Prussia stood better with the market than Saxony; for in 1898 Saxony issued a 3 per cent. loan at 83, while Prussia issued 3 per cent. stock for a similar amount in the following year at 92. In the same year Bavaria raised a 3½ per cent. loan at 99 and Brunswick got no better than par for a small 4 per cent. issue. Ten years later the situation was very different, owing to the heavy and persistent deficits of Prussia. In 1906 a Prussian 3 per cent. loan could still be issued at par, but in 1907 and 1908 large blocks of Prussian 4 per cents. had to be marketed at 99 and 98. Meanwhile in 1907 small issues of Bavarian and Hessian fours fetched 100 and 102, respectively, while Brunswick

and Hamburg also borrowed on a 4 per cent. basis at par. It is clear that in 1907 and 1908 both Prussia and the Empire were issuing stock faster than it could be absorbed. In 1907 and 1908 Prussia added 600,000,000 marks to her funded debt and issued 345,000,000 of long-term treasury notes. But the Prussian debt went on rising year by year, and reached 9428 million marks in 1912. Saxony alone of the important States reduced its debt in this period.

After the Morocco crisis, Germany with its ally Austria, like France and Russia, redoubled its military and naval preparations. The debt grew, though its growth was checked (as we have seen) by a capital levy in 1913. The debt of the Empire and the States together just before the war may be put at over 1000 millions sterling, and that of the Empire alone at 250 millions. Owing to a falling off in customs and other receipts the new war debt of Germany will exceed the whole cost of the war. In his last budget speech (March 1916) Dr. Helfferich admitted a ninefold increase in the imperial debt charge. "The service of the imperial debt," said he, "for 1916 takes 2303 million marks, against 1268 in 1915 and 250 in the last peace budget. We are thus, in the midst of the war, brought face to face with what will be the great economic problem of the peace."

CHAPTER VIII

THE DEBTS OF RUSSIA, AUSTRIA, ITALY, BELGIUM, AND JAPAN

THE public debt of Russia, as we read in a standard work,[1] used to be composed of loans raised in pounds sterling, Dutch florins, metallic roubles, and paper roubles, and as the exchangeable value of the paper rouble used to fluctuate widely, "the statements put forth at different times of the debt of Russia have differed very materially according to the rates of conversion adopted." Thus in 1814 the paper rouble was only worth a shilling, but in 1825 it had risen to 1s. 6d., and before the Crimean War to 3s. 2½d., which was then par, *i.e.*, the gold value of the silver rouble. In 1854, after the beginning of the Crimean War, the paper rouble fell to 2s. 5d., but recovered after the war to 3s. 1½d. After the Turkish War, between 1879 and 1889, it fluctuated between 19 pence and 26 pence. Of late years the paper rouble has been treated like the yen as roughly equivalent to two shillings. Thanks to the backing of a large gold reserve and to the strong financial support of the French investor (who is supposed to have put at least 400 millions sterling into Russian Government securities) the Russian exchange has been pretty steady in ordinary times up to the outbreak of the present war, the London rate being round about 97 roubles to ten pounds. In the course of the war, owing to the blockade of exports and to large

[1] Fenn, *On the Funds*, 1889.

issues of paper currency, the exchange value of the paper rouble fell heavily, until in the early months of 1916 it varied from 150–160 roubles to the ten pound note.

The total debt of Russia, foreign and internal, rose from 352 million roubles in 1817 to 808 million in 1847, and 1543 million in 1857. In 1875 the total was 3235 million roubles, but of this amount nearly 2000 millions were represented by railways. In the next five years the Turkish wars and further railway construction brought the total debt up to 4480 million roubles. In 1887, according to an elaborate calculation made in Fenn, the Russian debt had risen to about 5144 million roubles, of which the English equivalent was estimated at 538 millions sterling; the debt being about £5 9s. 4d. per head of the population. The war with Japan (1904–5) seems to have added over 200 millions sterling to the debt, of which a large part was borrowed in France. In 1909, as a result of the war and a series of deficits, caused partly by railway construction, the debt was 905 millions sterling. After this Russia's finances began to recover. In 1911 the debt had been reduced to 895 millions sterling. In the next years, however, there was heavy expenditure on armaments, and when the Great War broke out the debt was upwards of £930,000,000. The cost of the war to January 1, 1916, is estimated at 1300 millions sterling, and as the revenue had lost heavily in customs, and through the suppression of the drink traffic, the addition to the debt must have been considerably more. The money was raised by printing paper currency, by internal loans, and by borrowing in Paris, London, New York, and Tokio.

A thorough examination of the debts of the Dual

Monarchy would involve minute investigations into a complicated system of administration which has gone through many changes and vicissitudes since the Congress of Vienna. From 82 millions sterling (allowing ten gulden to the pound) it rose to 125 millions in 1848, the year of the Revolution and of the Hungarian rising. In 1862, after the war with France and Italy, the debt had doubled, and from 252 millions in that year, it rose to 300 millions in 1868, largely as a result of the war of 1866 with Prussia and Italy. In 1887 the Austrian debt, according to Fenn, was 388 millions, and the debt of Hungary, chiefly for railways, was estimated at 148 millions. Between 1866 and 1869 the financial difficulties of the government led to a compulsory reduction of interest on the debt. In the latter year the Council of Foreign Bondholders in London took action to expose the bad faith of the Austrian Government, and the London Stock Exchange removed Austrian securities from the official list. In 1871 an arrangement was come to by which some compensation was given to Austrian bondholders, and Austrian and Hungarian loans were again admitted to the London Stock Exchange List. For twenty years after 1887 the public debt of Austria remained comparatively stationary, though the provincial and municipal debt rose rapidly. In 1907 the Austrian debt was about 400 and the Hungarian about 198 millions sterling. After this, the Dual Monarchy began to participate in the race of armaments and its finances fell into disorder. Twice at least in these years there were costly mobilisations. On the eve of the Great War, in midsummer 1914, the debt of Austria was probably over 530 millions sterling, and that of Hungary about 240 millions sterling.

On January 1, 1916, it is computed that the public debt of Austria-Hungary had nearly doubled, having risen to round about 1450 millions sterling.

The kingdom of Italy dates from the Treaty of Villafranca (July 1859) which brought to a conclusion the first war with Austria. In the following year the public debt of the new kingdom was estimated at just under 100 millions sterling. Unfortunately from the very start the public finances were badly managed. Already in 1870, when the French garrison was withdrawn from Rome, the Italian debt had risen to 331 millions sterling. In 1886 it was reckoned at 454 millions, with an interest charge of over 20 millions sterling. In the 'nineties there was great expenditure on naval armaments and a spirited policy in Somaliland and Abyssinia, which ended disastrously. The debt rose, and the lire depreciated. From 1900 onwards, however, a change for the better set in. The debt was about 516 millions in 1900; in 1909 it was no higher than 522 millions. Public economy was associated with a growth of private prosperity, and a large part of the Italian debt which had been held in France and England was bought up by Italian investors. The expedition to Tripoli and alarm about Albania led, however, to a fresh outburst of unprofitable expenditure. Nevertheless, the public credit was maintained on a four per cent. basis, though the debt seems to have risen by the end of 1914 to about 600 millions sterling. For the first ten months of the war (from August 1914 to June 1915) Italy preserved an armed neutrality which cost her from about ten to twelve millions sterling a month. Italy then declared war on Austria, but not on Germany; and after this the cost seems to have been about 24 millions sterling

a month. The accounts are not very clear, and are complicated by advances from Great Britain of an unknown amount. But a Danish authority, which is before me, suggests that the Italian debt had risen to at least 800 millions sterling on January 1, 1916.

The cost of the Belgian army, fighting in West Flanders and France, as well as the cost of the Belgian Government, has been defrayed by loans from France and Great Britain. Up to the end of 1915, the German Government appears to have extorted by war levies on Brussels, Antwerp, and other occupied towns about 48 millions sterling. At the same time it has refused to allow the Belgians to get food from Germany. Accordingly, the task of feeding Belgium (and the occupied districts of Northern France) through Holland has devolved on the Belgian Relief Commission. The distribution was organised by an American staff under Mr. Herbert Hoover. The money for purchasing the food has been found partly by voluntary contributions, but mainly by advances from Great Britain and France, which have recognised this as a necessary exception to their food blockade of Germany. It is, therefore, quite impossible to make any calculations as to what was the national debt of Belgium on January 1, 1916. Before the war it amounted to about 120 millions sterling.

The Japanese Government began to study "Dutch finance" and Western culture after the Revolution of 1868, when the family of the Mikado resumed power. The first essay was a customs loan for £1,000,000 at 9 per cent. interest floated by Messrs. J. H. Schroeder in London. It was used for railway purposes, and the first Japanese railway was opened in 1872. At that

time the total imports and exports of Japan were only about 8 millions sterling in value. How, mainly under British influences, Japan developed railways, banking, currency, and a large foreign commerce; and how, mainly under German influences, her government became afflicted by military and naval ambitions, is a story which might be told in terms of debt and taxation. The first war with China, which arose out of a Japanese claim to reform and control Corea, ended with the Treaty of Shimonoseki in 1895, by which China was to pay an indemnity besides ceding the island of Formosa and the Liao Tung Peninsula. Thereupon Russia, Germany, and France combined and ordered Japan off the mainland. The Japanese Government submitted and abandoned the peninsula in return for another 5 millions sterling added to the indemnity, which paid for the expenses of the war. But in 1897 Germany seized Kiao Chao, Russia Port Arthur, and Great Britain Wei Hai Wei, while France took another concession and Italy asked for a bay. These events produced the anti-foreign Boxer movement in China and fierce indignation in Japan. In 1902 an alliance was concluded with Great Britain, and great military and naval preparations began to be made. But as yet the Japanese debt was only 59 millions sterling. In February 1904, encouraged by the financial support of London, Japan launched an ultimatum against Russia, and eventually achieved her territorial ambitions. Port Arthur fell in January 1906, and the Russian fleet was destroyed in the Tsushima Straits at the end of May. But the Treaty of Portsmouth in August brought no indemnity, and by 1910 the Japanese debt in consequence of the war, followed of course

by increased armaments, had risen to 281 millions sterling, from which it was with difficulty reduced to about 260 millions at the beginning of 1914. To support this and the growth of armaments very heavy taxation (including an income tax graduated up to about 25 per cent.) has been imposed. Towards the end of the year 1915, however, Japanese commerce and shipping began to prosper; the revenue advanced and the Japanese government was able to reduce its indebtedness to London and Paris.

CHAPTER IX

THE DEBTS OF THE BALKAN STATES AND TURKEY

AT midsummer 1915 there was published by the Clarendon Press a very remarkable work on the Near East. It is really a diplomatic and economic investigation of the causes and consequences of the war waged by the Balkan Allies against Turkey in 1912, and of the fratricidal war which in 1913 despoiled Bulgaria of the fruits of victory. As such it constitutes the first comprehensive account of the consequences entailed by these two wars on the budgets and debts and economic life of the Balkan States and of Turkey.[1] The first war is described in this book as the War of Coalition, and the second as the War of Partition. The writer's general view is that the War of Coalition might have been avoided if reforms in Macedonia had been undertaken in time, but that at last it became inevitable, and brought about certain necessary and beneficial results at a not excessive cost. The same cannot be said of the War of Partition. This, the second Balkan War, is represented as an unmitigated misfortune :—

"The author is of opinion that the War of Coalition could have been made to show an economic profit to each of the Allies, in spite of the heavy cost of life and of war material, even leaving all political

[1] *Nationalism and War in the Near East*, by Diplomatist; edited by Lord Courtney. (Oxford) Clarendon Press, 12s. 6d. net. I am also indebted for much of the statistical material contained in this chapter to the first financial Bulletin of a Danish War Study Society, published at Copenhagen on March 1, 1916.

gains out of the account, in view of the great accession of territory. It does not follow that a war which is politically justified will also justify itself economically, though the same conditions of a long overdue development which cause a war of liberation are also likely to cause a war of annexation. But when we come to the War of Partition we find that, if the cost of opening up Turkey in Europe to Western democratic development was not excessive, undoubtedly the cost of distributing the shares between the partners was so. The cost of the War of Coalition, considered as the purchase price of a new property for Western exploitation, was perhaps not such as would over-capitalise the enterprise; but the cost of the War of Partition, considered as expenses of flotation, has made the acquisition a very questionable investment."

The first war was about as much as the States engaged could manage, with the armaments, stores, cash, and credit which they had accumulated. The second war went beyond the credit and capacity of the belligerents. If the first peace had been permanent, then Greece and Servia might have got rid of the foreign financial control over the revenues assigned to their foreign debts, with the help, that is, of the revenue from their new territory. After the second war this was out of the question. In fact, it might be made "a condition of further loans that the International Commissions be given some control over military expenditure, so that their savings may not again be used for making war." These words were written before the Preceptor States of Europe—the same Christian Powers which in the days of Gladstone and Salisbury formed the Concert of Europe—began the great world struggle that is now devastating civilisation. How unfit, however, the Great Powers had become to inculcate peace and economy upon their Balkan pupils had already been shown lamentably enough by the military and naval "missions" to Greece and Turkey, in which the armament firms of Germany

and Great Britain collaborated with German and British diplomacy. It is true, however, that loans for armaments, and indeed for any useful purposes, will be very scarce and hard to get for years to come. The close ring of capitalists, to whom "Diplomatist" feared that the second war had handed over Servia, Bulgaria, and Greece, will probably be impotent for some time after this conflagration is quenched.

The first war did not greatly raise the price of living, and it was mainly a regular war between armies, not between populations, except to a small extent between Bulgars and Turks in Thrace, and to a still less extent between Greeks and Turks in Epirus. "Moslem villages were, it is true, ruined; and an exodus of Moslem refugees imposed a serious temporary expense on Turkey. But the War of Partition in Macedonia [Bulgaria against Servia and Greece] was a war of deliberate devastation and depopulation—a policy which, however explicable politically, is an economic extravagance for which the victor will pay as heavily as the vanquished."

As yet no final balance-sheet can be presented of the Balkan Wars; for we are warned that those officially responsible for the budgets do not profess to know the real cost of the two wars. Even the direct losses of men, money, and materials cannot be precisely ascertained, and the indirect losses—the value of the slain and the damage to trade and agriculture—these can only be guessed. "Some idea can be obtained; but it must be conveyed rather by facts than by figures; or where figures are used they must be considered as estimates rather than as statistics."

Starting with Greece, and looking broadly at the results on the assumption that peace would continue for some

time, "Diplomatist" expected that the Greek Government would, in the end, have to borrow about 25 millions sterling "to pay for the war and to provide for the development and defence of the new territories." The actual budget cost of the two wars was put at over 16 millions by the Minister for War, M. Diomedes; and the Greek Government, when it was claiming an indemnity and seeking to avoid liability to share in the Ottoman Debt, laid before the Paris Commission figures purporting to show that in the first war against Turkey it had spent over 18 millions, including, however, wear and tear of guns, pensions to wounded, maintenance of prisoners, etc. It is interesting to note that, apart from clothing and equipment, the Government, even in this estimate, calculated the maintenance of its Army at from 2 to 2.50 fr. only per man per day. The actual spoils of war taken from the Turks and Bulgars might, to judge from an official statement, be valued at from one to two millions sterling. In March 1914 Greece had the luck to float a 20 millions loan in Paris, of which eight millions were paid up before August. At the end of 1915, the Greek debt had risen to 1540 million drachmas, and deficits were accumulating.

Passing in our survey from Greece to Servia, we find that the total cost of the Servian share in the War of Coalition is put at 11 millions, though for the purposes of the Paris Commission the Servian Government made an estimate of 23 millions sterling. The cost of the second war against Bulgaria (the War of Partition) is placed at four millions, giving a total of 15 millions as the budget cost of the wars to Servia. Of the 15 millions about two millions were paid out of surpluses and economies, so that some 13 millions would seem to

have been added to the public debt. As Servia had been armed mainly by French companies on short credit, a loan of 10 millions sterling was floated soon after the war in Paris. This raised the Servian debt to 920 million dinar before the Sarajevo murders.

The Bulgarian estimate of the cost of the first war, laid before the Paris Commission, was 50 millions sterling, the biggest items being :—

1. Pensions of £20 yearly to the families of 29,711 privates, and of £120 a year to the families of 313 officers.
2. The maintenance of 620,567 men at 1.4 fr. per day.
3. The maintenance of 216,731 animals at 2.20 fr. per day.

If the total direct and indirect cost of the first war was as much as 50 millions, then that of the second war would be at least 15 millions, without allowing for the damage done by invasion. "Diplomatist," though he warns us to take a discount off the official figures submitted at Paris, holds that the total losses of the two wars to Bulgaria may well have been 75 millions sterling —a vast burden to so small a State. But the direct outlay by the Bulgarian Government on the same basis as Greece and Servia is put at 20 millions for the first war against Turkey, and at another eight millions for the War of Partition. As the funded debt of Bulgaria before the war was about 25 millions and the floating debt about £2,250,000, " the direct cost of the war will more than double the funded debt, and the indirect cost may well eventually treble it." One of the heaviest items consisted of requisitions for food, bullocks, waggons, etc., laid upon some half-million families.

These aggregated some 12 millions sterling, and were to be dealt with by a 6 per cent. internal loan. But as the Bulgarian armaments were mainly supplied on credit by Krupp it was proposed to raise a loan in Berlin. This, however, was withheld for a time, in consequence of the outbreak of war in August 1914. On obtaining this money (and much more) Bulgaria entered the Great War in October 1915 on the side of the Central Powers in the hope of recovering Macedonia. At that time the total debt of Bulgaria was estimated at over 1400 million lei.

The territorial losses of Turkey in the Balkan wars, though large, might have proved a positive gain had the Turks remained neutral in the war of 1914-16, for the Budget of the European vilayets used to show an annual deficit of about half-a-million sterling. The population of the lost provinces numbered nearly five millions, but half the Turkish inhabitants—say, a quarter of a million—emigrated to Anatolia. The Turkish command of credit and of men drew from "Diplomatist" some reflections which deserve quotation :—

"So irresistible still is the appeal to militant Islam that the willingness of these Asiatics to have their lives wasted in war is subject to no such checks as restrict the use of civilised armies, and such as we find beginning to work in Bulgaria in the war of partition. So inexhaustible is the supply of men that still can be commanded by the Empire, and so unquestioning is their militarism, that it is well, perhaps, that the factor of money becomes annually more important. The Imperial command of credit can only be explained by the access that the Empire has already had for a century to the accumulated capital of Western civilisation, first in France, then in Great Britain, now in Germany—perhaps some day in America. The more backward that Imperial administration remains, and the lower that civilisation is in consequence among the Moslem majority of the population, the more ready will the latter be to take arms in the Imperial cause and against their own national interests. Similarly, the more bankrupt the Imperial finances become, the more ready are the moneylenders and armament firms of

Europe to bolster the credit so as to save their bad money by sending the good money of the public after it. It is often easier for a bankrupt to raise money for extravagance than it is for a business man to get it for a sound enterprise. But in these Balkan wars the Empire came very near exhausting the supplies of Asiatic fanatics and of European financiers." [1]

As to the cost of the Balkan wars to Turkey, the Turkish Government between January 1, 1912, and September 1913, borrowed from 20 to 25 millions—about a year's revenue, and an addition of about one-fifth to the old debt. Adding requisitions, arrears of pay, etc., we get a new war debt of from 40 to 50 millions. Europe has been fighting against or about Turkey from before the Fall of Constantinople, and the Turkish debt has been a standing international dish since the Crimean War, when Great Britain and France constituted themselves champions of the Sultan against the Czar. Some day, perhaps, a competent historian will relate how the half-civilised populations of Turkey were fleeced by a corrupt government, and how that government was led by diplomacy into the hands of concession-hunters and armament-mongers. Gradually a sort of international financial control was placed over Turkey which improved the system of revenue collection and made possible the regular payment of debt. Thus Turkish credit was re-established and the armament firms were encouraged to push their trade in Constantinople, as well as in Bucharest, Sofia, Belgrade, and Athens. Before the Balkan war, which broke out in the autumn of 1912, the consolidated debt of Turkey is estimated to have been 131 million and the floating debt eight million pounds (Turkish). Over 45 millions sterling of new debt seem to have been added by the

[1] *Nationalism and War in the Near East*, p. 325.

two Balkan wars, about half of which was covered in the spring of 1914 by a loan raised in Paris. After this loan it was computed that, of the whole Turkish debt, 62 per cent. was held by French and 26 per cent. by German investors. The Turkish bondholders claimed 24 millions from the Balkan States in respect of Thrace, Macedonia, and Albania; but up to August 1914 nothing had been paid. The commissioners for the settlement of this question had been sitting at Paris and separated just before the outbreak of the Great War. Turkey joined Germany at the end of October 1914. This action relieved her of over two-thirds of the debt charge; and in addition nearly seven millions of the French loan is stated to have been available. The Turkish armies have doubtless been financed largely by Germany and Austria—to the extent of about £T.34,500,000 up to March 1916. Our authority for this is Talaat Bey, the Turkish finance minister, who computed the total expenditure for the year ending March 31, 1916, at 62 million pounds Turkish, of which nearly 50 millions would be for war.

So far Roumania has successfully outwitted all its neighbours and rivals. It was Roumania's adhesion to Greece and Servia that ended the War of Partition on such unfavourable terms to Bulgaria by the Treaty of Bucharest. The victorious and unopposed march of the Roumanian army into Bulgaria was not altogether fortunate; for cholera invaded the invaders, and caused 1500 deaths in the army and 3000 more in the civil population. The war expenditure, including a long mobilisation, is computed at eight millions sterling, and this was covered by a 4½ per cent. gold loan for £9,900,000, which was subscribed in England, Germany,

Holland, and Roumania. It is computed that the revenue of the Dobrutscha territory ceded by Bulgaria to Roumania will meet the extra debt charge if it does not lead to further trouble. During the Great War of 1914–16 Roumania made large military preparations and received advances from both sides, without, however, abandoning her neutrality.

We may conclude with a brief table showing (1) the estimated Budget cost of the Balkan wars to each of the States, and (2) the net gain or loss of territory and population.

	Budget Cost	Territory Gained or Lost	Population Gained or Lost
	£	Sq. Kilometres	
Greece	16,000,000	+ 61,386	+ 2,000,000
Servia	15,000,000	+ 39,000	+ 1,175,000
Bulgaria	28,000,000	+ 17,760	+ 225,000
Turkey	50,000,000	— 143,200	— 4,750,000
Roumania	8,000,000	+ 8,000	+ 350,000
Montenegro	—	+ 3,980	+ 120,000

Montenegro has been for years in a chronic state of bankruptcy, relieved, according to political humours, alternately by small advances from Austria or Russia.

PART III

ON THE GREAT WAR OF 1914–16

"Let men beware how they neglect and suffer matter of trouble to be prepared; for no man can forbid the spark, nor tell whence it may come."—BACON.

PART III

ON THE GREAT WAR OF 1914–16

CHAPTER I

THE OUTBREAK OF WAR AND ITS EFFECT ON CREDIT, EXCHANGE, AND COMMERCE [1]

"Hinc usura vorax, avidumque in tempora fœnus, et concussa fides, et multis utile bellum."—*Lucan.*

THE sudden development of the European crisis in the last week of July 1914 sent a shiver through the world. Finance trembled and quivered in all its limbs. London, the nerve centre of the world's commerce and finance, had to face the most critical emergency in its history. The London Stock Exchange closed on July 31, unable to withstand the flood of continental liquidation; New York followed. Practically every Bourse throughout the world had by then ceased work; commodity markets closed right and left; the foreign exchanges broke down, and the whole machine of international finance and commerce was thrown out of gear. On July 28 Austria declared war on Servia; Russia, Germany, and France began to mobilise. On August 1 Germany declared war against Russia; on August 3 against France. Two days later Great Britain declared war upon Germany, and thus a final blow was dealt to

[1] In this chapter use has been made of a war supplement which I edited for the *Economist* newspaper in December 1914.

the already shaken fabric of world credit. Our government had at once to face the task of patching up a new system of credit, which should enable bankers, accepting houses, manufacturers, and traders to carry on, and set the streams of commerce flowing once more to neutral countries, India, and our colonies. Most of the arrangements, hastily improvised by Mr. Lloyd George, the Chancellor of the Exchequer, in consultation with the Bank of England and the City authorities during the prolonged Bank holidays, were afterwards approved by competent critics. The general moratorium proclaimed on August 6, which terminated on December 3, might perhaps have been avoided, and the complete closing of the Stock Exchange was also a questionable policy. But the arrangements under which the Bank of England, backed by a government guarantee, discounted pre-moratorium bills, the issue of small currency notes convertible into gold at the Bank of England, and other measures of temporary relief undoubtedly helped the City through a crisis of extraordinary difficulty and danger. Alone among the belligerents, Great Britain has so far maintained from the first its gold standard and the bulk of its foreign trade. Never has there been such a call upon the resources of any modern people. We have in the army and navy over four millions of men; we are acting as bankers, lenders, and shippers to the armies of France, Russia, Italy, Belgium, and Servia, besides maintaining large expeditionary forces in Flanders, East Africa, Salonica, and the Persian Gulf; people of moderate means are already contributing a quarter of their incomes under the budget of April 1916 to the ex-

chequer; we are spending 5 millions a day and are borrowing vast sums at 4½ to 5 per cent.

Before the war the City of London was the world's banker. The bill on London was international currency. There was a free gold market, and the Bank of England would exchange its notes for gold to an unlimited extent. Enterprising banks in all parts of the world had branches near Threadneedle Street, and most of the great State Banks, such as the Imperial Banks of Russia and Germany, kept sterling bills on London which enabled them to draw gold. Free trade in gold and commodities lay behind the banking power of London; but this very banking power and the liquid resources of so many mighty institutions helped in their turn to make England an entrepôt of trade as well as a centre of exchanges. An annual overflow of British capital of from 150 to 200 millions was directed by the City into foreign and colonial loans. Thus all things worked together, and our vast merchant marine, comprising half the ships of the world, served our geographical position, our trade policy, and our banking power. The City, in short, was the wonder of the world, of which it took daily toll.

On the outbreak of war in August 1914 this delicate machinery was shattered for the first time. The unsubstantial but highly profitable fabric of international credit faded into nothingness. Most of our foreign creditors wanted to cash their bills on London and for the first time they found it impossible. For a few days credit communication with the outside world was cut off. War is an arbitrary act which suspends all commercial and financial dealings. To meet the situation and save the City arbitrary action was necessary. The

measures taken by the Treasury and the Bank of England restored security. After a few days or weeks exchange dealings with Paris, St. Petersburg, New York, and most neutral centres were resumed, and the discount market on a reduced scale began to revive. The closing of the Stock Exchange and the restrictions under which it has since laboured have, of course, hampered the City, and our commercial strength has been weakened by the diversion of new capital from external enterprises into new war debt. Our exports to America are insufficient and our imports from Russia are insufficient. Brazil and some other countries have frequently found it impossible to get exchange on London, and violent fluctuations in all directions have introduced an uncertainty into commercial transactions which is very detrimental to trade. The most striking depreciation of foreign money in countries with which London communicates has been in the currencies of Russia and Italy, owing to their issues of inconvertible paper and their inability to export in adequate quantities. On the other hand, the currency of the United States soon began to show unprecedented strength, and our sales of American securities have failed to turn the exchanges in our favour.

In normal times it is possible at a moment's notice to telegraph a payment of money from London to any part of the world at a trifling cost. There is a par of exchange between the sovereign and the metallic or paper money of all countries. So many dollars, francs, marks, roubles,[1] gulden, yen, etc., go to the pound sterling. In the uncertainty and chaos caused by the outbreak of war all these exchanges became practically

[1] Roubles are quoted to the ten-pound note.

unworkable; distrust and doubt subsided into consternation and chaos. For a time communication with some important neutral centres was interrupted and arbitrage ceased. The first effects of war on the principal exchanges appear in the following table :—

Cheques, Telegraphic, or Mail Transfers.	Rate just before War.	From August to mid-December.	
		Lowest.	Highest.
Paris	25.16	24.00	25.50
Switzerland	25.17	24.00	26.00
Brussels and Antwerp	25.29	24.00	27.50
Amsterdam	12.15	11.70	12.60
Italy	25.50	24.00	28.50
Madrid	26.10	24.45	26.70
Lisbon	46½	35½	41
St. Petersburg, now Petrograd	97.20	110	120
Christiania	18.30	18.30	19.20
Copenhagen	18.30	18.30	19.20
Stockholm	18.30	18.30	19.20
Berlin	20.53½	—	—
Vienna	24.32	—	—
New York	4.93	4.93	6.50

The earlier course of the exchanges deserves closer attention. Between July 27 and July 30, on which day and on August 1 dealings became more and more a matter of negotiation, the French exchange fell from 25.17 francs to the pound to 24.95; the German exchange rose from 20.55 marks to the pound to 20.82; the Austrian from 24.33 krone to the pound to 26.50; and the Italian from 25.41 lire to the pound to 26.5. The Russian exchange, which is calculated in roubles to the ten-pound note, rose from 95.6 on July 27 to 100.5 on July 29, and on July 30 the rate was quoted at 110 to 120. The New York rate, which represents dollars to the pound, was 4.9 on July 27, on July 30 it was 5 to 5½, and on August 1 it was called 5½ to 7.

The Bank holidays lasted from August 1 to August 6, and there were practically no rates until August 11, when the Paris exchange was 24.5 and the New York exchange 4.97½. By August 21, according to a valuable table which I have had the privilege of inspecting, five exchanges were operating freely, namely, the French 24.7, the Belgian 26.8, the Dutch 12.4 (gulden to the pound), the American 5.01, and the Scandinavian 18.45 (crowns to the pound). The Paris rate rose to 25.7 in September, but sank again and was just below 25 at the beginning of December. In the spring it began to rise, and by June, 26 francs went to the pound, marking a depreciation of about 4 per cent. in the French currency. The American exchange rose above 5 during the second half of August and the beginning of September, after which it began to fall, and under the stimulus of increasing exports to the Allies and diminishing exports it fell to normal in December, and then turned against this country. By June 1915 the rate of dollars to the pound had fallen to the unprecedentedly low figure of 4.78. The Spanish peseta, which stood at 26.12 on July 27, 1914, appreciated in a remarkable way. On August 27 the rate was 24.5. During the autumn and winter it varied from 25 to 26½. From February to May 1915, under the influence of industrial activity in Barcelona, which was manufacturing for the French army, the rate varied from 23.9 to 24.9, rising again to a little above 25 at the end of May.

With this strength of the peseta may be contrasted the weakness of the Italian lire, which stood above 26 during most of the autumn, and after some improvement in December (*e.g.*, it was 25.6 on December 16), it rose again on the expectation of war

to 27.5 on February 17 and 28.5 on March 3. Then, after falling a little, it returned to above 28 in May and June 1915. The Russian rouble rate was very wide in September, varying from 108 to 120. In the autumn and winter it fluctuated from 110 to 120. In March and April it varied from 113 to 116, in May it rose again, and in the middle of June 1915 it marked 125, a very severe depreciation. Meanwhile, measured by Amsterdam, Germany's inconvertible paper currency had fallen about 14 and that of Austria about 30 per cent.

The effects upon industry of this great war at home and abroad, in belligerent and neutral countries, will some day, I hope, be traced in detail by the patient collaboration of many skilled inquirers. Here only a few provisional observations can be attempted. The outbreak of war, preceded and accompanied, as we have seen, by a stock market and banking panic, as well as by a paralysis of nearly all the London exchanges, was of necessity followed by something like a complete stoppage of normal industry in those countries where a general mobilisation was decreed. In France, Germany, and Austria factories were emptied in a day of their best hands, and for a time trade was almost brought to a standstill. The harvest was got in with difficulty by old men and women and children; but large stocks of corn and fodder were destroyed by the over-running, early in the war, of Belgium, Northern France, and East Prussia. An absolute famine in Belgium and in the districts of Northern France occupied by the German army has only been staved off by the devoted exertions of an American organisation supported partly by voluntary contributions from Belgium, the United States,

and Great Britain, partly by monthly advances from the British and French Governments.[1] In Great Britain and Ireland the immediate and complete stoppage of trade with Germany,[2] our largest customer after India, was the principal factor, for it meant the suspension of very large payments and the cancellation of enormous contracts. The seizure of British merchant ships in the Baltic and North Sea was also on a large scale, and for some weeks most of the trade routes were endangered by German cruisers. For a time our Indian and South American trade suffered most. If the British Government had restricted itself to the policy marked out by its previous preparations of maintaining the command of the seas, acting as banker and manufacturer to its Allies, and supporting them at most with a small expeditionary force of 100,000 men, the problem of unemployment at home would have been more serious at first; but even so, the men thrown out of work by the great reduction of our commercial customers would soon have been busy on war contracts. As it was, a large number of men lost their work at the very beginning of the war; but as the War Office called for more and more recruits, the unemployed were speedily absorbed in the ranks of the army. Miners and agricultural labourers, and, indeed, all classes, flocked to the colours, and for a long time the War Office had more men at its disposal than it could equip. Already by Christmas there was

[1] The occupation of Belgium by the Germans deprived it of its overseas trade, and the German Government declared that it could not provision the civil population of Belgium from Germany because the British navy was seizing all food destined for Germany.

[2] Save for a Glasgow iron firm which was convicted (in June 1915) under Trading with the Enemy Acts of selling to Krupp's through Holland in September 1914.

an unparalleled shortage of labour, and as the demand for fuel, food, and clothing was much greater than the supply, the price of nearly all articles of consumption began to rise rapidly. The reduced purchasing power of money soon caused a demand for more wages, and in most of the organised industries war bonuses were conceded. The Lancashire cotton trade, which was depressed before the war, was hard hit by the crisis, and was slow to recover. The fishing industry of the east coast suffered terribly, first from the mines in the North Sea, and afterwards from the attacks of the German submarines. The trawling fleets of Grimsby, Hull, and Aberdeen sustained very heavy losses and many of their vessels were commandeered by the Admiralty. The fish markets, of course, suffered in proportion. But the fishermen who continued to ply their dangerous trade gained fabulous profits. In the middle of April 1916 a Grimsby expert wrote to me as follows :—

"In 1913 1,200,000 tons of fish were landed on these shores, the value being just over £14,000,000; last year (1915) the quantity was 428,000 tons, and the value £9,700,000, a decrease of 772,000 tons. Wholesale prices of fish are over 110 per cent. more than they were in pre-war time, whilst there are far more fish in our home waters than there were before the war, for two breeding seasons have now passed without molestation. There are signs everywhere that the harvest of the sea will be exceptionally heavy after the war. This, coupled with the increase in meat prices, which is likely to be high for a long time unless freights come down to a pre-war level, is bound to bring exceptional prosperity to the industry. Of the herring supplies Germany took close on £3,000,000 in 1913, and if the folly of a tariff war is to follow the present catastrophe we shall no doubt suffer here."

The entry of Turkey into the war and the consequent closing of the Dardanelles held up the Russian wheat crop and contributed to a great rise in the price of bread,

which was checked towards the end of May 1915 by favourable crop reports from North America and other countries. But the rise in the price of meat continued; after ten months of the war the cost of living had risen about 25 to 30 per cent., and after 18 months of the war it must have risen from 50 to 60 per cent. A panic in the sugar market at the beginning of the war led to unfortunate intervention by the British Government, which bought enormous quantities in the East and West Indies at extravagant prices. The classes most hit by the war were undoubtedly those dependent on luxury trades which could not be converted into war trades. Thus the diamond trade in South Africa, Amsterdam, and London practically came to an end. The fur trade and the trade in ostrich feathers were almost paralysed and nearly all the industries connected with sport were for the time being ruined. The shopkeepers of London suffered heavily, though less, of course, than those of Paris, Berlin, and Vienna. The building trade dwindled to very small proportions, but even so the better class of house property in many parts of the country depreciated rapidly in value—a process which is certain to continue as the high income tax forces the wealthy to contract their scale of living. In France, Germany, and Austria privation was felt from the very first, and the change from a peace to a war footing affected every family. The vast size and population of Russia protected its populations, except on the frontiers, from the intense pressure exerted by the conscriptionist system on the Central Powers. Food at first remained cheap and plentiful in most parts; for the same blockade of the Baltic and Black Seas, which stopped imports, prevented the sale of the surplus crops except through Roumania.

Later on prices, especially in Petrograd, began to rise rapidly, and but for the prohibition of vodka conditions might have become very serious in the populous districts.

The gains and losses of various neutral countries will be touched upon later. But the position of the United States requires particular attention here; for there is a sense in which the exhaustion of the Great Powers of Europe means a large transference of power to America.

The United States has been the great neutral of this war, as Great Britain was the great neutral of the Franco-German War of 1870–1. And, comparatively speaking, the United States has gained as much as the United Kingdom did then. New York has drawn up to London as fast as London drew away from Paris. But New York was at the beginning of the war such a purely American centre, and had so small a surplus of loanable capital to play with after the domestic demands of her own continent had been met, that she could only take the place of London and Paris and Berlin to a very small extent. Still the Wall Street bankers did arrange some substantial credits for the belligerents—especially for the British and French governments, so as to enable them to buy war munitions of all kinds without exporting bullion. They also assisted in a small Argentine loan, and came to the rescue of the Canadian towns. "Canadian provinces and municipalities," wrote an American journalist early in 1915, "usually market most of their bond issues in London. Now they are coming here in droves—$25,000,000 being the recent record of sales.[1] As the new financial centre of the

[1] The collapse of international credit found Canada suffering from the consequences of an exploded boom, including a collapse in land

world, it must be said that New York is accepting the many tributes pouring in from all quarters with an ease and grace not to be expected of a novice in the rôle." But this position only began to be acquired in the new year. At first Wall Street bent and broke under the European storm.

The financial interdependence of New York, London, Paris, and Berlin, Hamburg, Frankfort, Antwerp, and Amsterdam, to say nothing of Liverpool, Manchester, Havre, Boston, Barcelona, Calcutta, Bombay, Tokio, and other great ports or exchanges, did not need to be demonstrated by a war. It is possible for London and other European centres of finance to stand up when Wall Street falls down, because America lends little to Europe and has borrowed much therefrom. They endured even the panic of 1907, when all the American banks suspended cash payments. But the panic which raged in Europe during the last week of July, when Austria, Germany, and Russia began to hasten towards war, was as violent in Wall Street as in Throgmorton Street, and the bankers of New York, Philadelphia, Boston, and Chicago were hardly less alarmed than their correspondents and collaborators in London and on the Continent. As Mr. W. C. Van Antwerp, a governor of the New York Stock Exchange, put it: "When the blow fell no portion of the globe outside the actual zone of

values, a decline of imports with a corresponding one in revenue, a falling off in immigration, tight money, general stagnation of trade, and a disappointing wheat crop, which in South Alberta and South Saskatchewan had been a positive failure. Australia was hard hit by drought and South Africa by the collapse of diamonds and ostrich feathers. These facts make their exertions and achievements in the war all the prouder.

war felt it more acutely than Wall Street."[1] When the war suddenly burst upon us, adds this competent observer, "we were unable to grasp its staggering significance. Like bewildered spectators of a monstrous confusion, we were but dimly aware that a new and incomprehensible tragedy was shaking the world to its base." The great Government banks of Berlin, St. Petersburg, and Paris had been piling up gold for months, and the chief Stock Exchanges had added their warning by a persistent liquidation. The murder of the Austrian Archduke at Sarajevo on June 28 was the spark which, after some diplomatic sputterings, exploded the magazine.

But financiers had already been warned more than once that "the long-smouldering jealousies, race-hatreds, and distrust among nations, which for many mad years had found expression in the armament mania, were driving Europe towards the abyss. . . . Preparation for war had reached the breaking-point. It could not go on, and it could not stop. Peace had become a luxury too expensive to be borne. Bankruptcy or war was inevitable." What was needed, and what, alas, was lacking, had been a strong, statesmanlike effort to bring about an international limitation of armaments, and with it a peaceful concord in Europe.

On July 23 the panic began in New York. Sterling exchange rose rapidly. Paris bid almost frantically for gold. Europe sold its American securities heavily. The slump had begun. On July 27 all the symptoms became worse, in spite of some hopeful and reassuring telegrams. Though no advance was made in the

[1] *The War and Wall Street.* An excellent address delivered at Rochester, N.Y., on November 14, 1914, by W. C. Van Antwerp.

official Bank rates of Europe, 12 million dollars in gold went out on that day from New York to London, "at rates which expressed the fear of shippers and insurers that a hostile fleet might intercept it on the ocean, while prices of securities again crashed all over the world, and American wheat rose 7 cents a bushel." Next day, July 28, Austria declared war upon Servia. In the ten days following gold to the amount of 9 millions sterling left the United States for Europe. "All Europe demanded instantly all its credit balances, while simultaneously ceasing to pay its own debts through a resort to the moratorium." The net debt of the United States to Europe has been computed at over 100 millions sterling annually. This explains the drain upon gold, and the extreme difficulties of New York when the chaos of war began. The bankers co-operated with the Government at Washington, the emergency currency provided for under the Aldrich-Vreeland Act was issued, and special legislation introduced into Congress converted warehouse receipts for cotton, tobacco, etc., into a basis for currency, and so saved thousands of planters and merchants from ruin. The credit of New York City was saved by a big municipal loan, and pressing foreign obligations were met by the co-operation of bankers. Clearing-house reserves fell below the legal minimum. The Stock Exchange of New York closed the morning after that of London. It would, of course, require volumes to describe adequately all the effects of the European war upon finance and business in the United States. Towards the end of August the most severe strain of the panic period had passed. The superiority of the British Navy had made it possible for the United States to ship

enormous quantities of wheat and other foodstuffs to Great Britain at enhanced prices. The chief commercial difficulty was an enormous fall in the price of cotton, which became practically unsaleable. There was little or no demand from the Continent and less than usual from England owing to depression in Lancashire. The right of search claimed and exercised by the British Navy, as well as the so-called "closing" of the North Sea, and the practical abandonment by the British Foreign Office of the Declaration of London introduced much uncertainty into the trade of the United States with Scandinavia, Holland, Italy, and other European markets. The interception of oil ships and other measures led to controversy between London and Washington, but the difficulties as they arose were adjusted, and the Declaration by Great Britain, followed some time later by France, placing cotton on the free list eased off the friction. In December the exchange between London and New York was working normally, and credits were opened in New York by all the belligerent governments. Enormous quantities of clothing and boots and munitions of war began to be executed in American factories for the French, British, and Russian governments. The difficulties and dangers of shipping contraband, including copper, to neutral countries, with Germany and Austria as their possible destination, proved almost insuperable, owing to the vigilance of the British fleet and French cruisers. In spite of Government orders, trade on the whole was bad, and there was an unusual amount of unemployment in the great industrial districts of the United States until the spring of 1915. The falling off in Customs duties made it necessary for the President to ask Congress to vote new "war taxes." Hence an Emergency Revenue

Law was voted on October 22, by which an addition of about 20 millions sterling was expected to the revenue.

The whole situation was reviewed in a report of the Secretary of the Treasury, presented to Congress on December 9. In its opening paragraph the report stated: "The outbreak of the European war precipitated many grave problems. Confidence has now been restored, and specie payments have been maintained in the face of the world. At no time since the war broke out has there been, to the knowledge of the department, with the exception of a few isolated cases, a failure on the part of any solvent national bank to honour its cheques in currency or money, or to meet its obligations."

The foreign trade of the United States was very badly hit in August and September, but a recovery began in October when the exports to the United Kingdom and Russia were a little higher, and the exports to Italy much higher, than in 1913. The exports to Germany had almost ceased and there was a severe shrinkage in the trade with France, the Low Countries, Canada, Japan, Argentina, and Brazil. Trade, as we have seen, was generally bad, and the great railway corporations were economising in every direction. At the end of November the steel trade was estimated to be working at only 35 per cent. of its capacity.[1] Unfortunately for the United States the fine mercantile marine which she possessed before the Civil War and the Protectionist tariff had decayed, and her ocean-going ships were too few to profit the country much. According to the December circular of the National City Bank vessels carrying the American flag were "in

[1] In the spring of 1916 it had more orders than it could execute. The trouble then was congestion of the American railways and a severe shortage of shipping facilities.

great demand and commanding high pay, being particularly wanted for the trade to German ports, taking our cotton and bringing in dyestuffs, potash, and sugar-beet seed." With the help, however, of new legislation a certain amount of belligerent tonnage was purchased and placed under the American flag.

After the turn of the exchanges the Almighty Dollar soon became more almighty than ever. To quote the New York *World*, of February 26, 1915: "The American dollar is now at a premium in the currencies of every principal country in Europe. These currencies, in other words, are now at a discount in terms of the American dollar. The premium or the discount not only exists and persists. It is of extraordinary proportions. At the par of exchange, $4.86 will buy one English pound sterling. At the prevailing quotation in this market, only $4.80 will buy a pound sterling. Ordinarily 95 cents will buy four German marks. Now less than 84 cents will buy four marks. Ordinarily an American dollar will buy in this market 5.19 Italian lire. Now a dollar will buy as much as 5.75 lire." On March 13 a writer in the *World* put the case as follows:—

"International trade for years without number has been financed through London. Credit in English pounds sterling has been the standard and desideratum of the world's commerce. This is now turning to New York, and in terms of the dollar. The scramble for American dollars or American credit is practically universal and has become acute. To get either, the belligerent and other peoples are offering unheard-of prices in their own money. They do not want the dollars to take away. They want them here and to be spent here. Unable or unwilling to send their own gold in payment of the enormous purchases made to supply their war and other needs, they are willing to sacrifice great sums of money in substituting promises to pay gold later on. During January alone they took from the United States $145,500,000 worth of goods above what were paid for in exports to the United States."

New York has become, " to all intents and purposes, for the period of the war, at any rate," wrote the New York *Evening Post* at the end of May, " the central money market of the world;" and Mr. Warburg, a member of the Federal Reserve Board, on May 25 described the day of the opening of the Federal Reserve Banks as " the advent of our financial independence." " We are now able," he said, "to finance our own imports and exports by the use of American acceptances. More than that, we are in a position to finance other nations, and to play in this respect the part of an international banker that has heretofore been played almost exclusively by England."

In the last week of May 1915 the 12 Reserve Banks held $295,000,000 deposits, and the reserve held against them was $280,000,000, or 95 per cent. But by law these banks might increase their deposits to $800,000,000 without increasing their reserve. It was thought in the United States that very large sums could be lent to the Allies, at any rate temporarily, for the purpose of financing the enormous exports which were being sent over. M. Ribot, the French Finance Minister, estimated in May that the Allies were contracting a debt of from 7 to 8 hundred million francs a month to the United States. The United States was then by far the greatest exporter among the nations of the world, and all the important exchanges were more than ever in its favour. For some months after this the mark remained fairly steady, but the pound sterling deteriorated, until, in the autumn of 1915, an Anglo-French exchange loan was negotiated in New York. After that the mark fell and the sterling exchange steadied.

CHAPTER II

THE COST OF THE WAR AND ACCUMULATION OF DEBT

"'Tis all one to be plundered by a troop of horse, or to have a man's goods taken from him by an order from the Council-table."—*Selden.*

THE few competent writers who applied themselves after the first Hague Conference to problems of military and naval expenditure agreed in predicting that the cost of the next great war would far surpass all records. To arrive at such a conclusion no prescience was required, only a little knowledge of war organisation and of the rapid improvement in all the machinery of destruction, whether by land, sea, or air. It is computed that in the wars of the French Revolution and of the First Empire, covering a period of twenty-three years, over 2 millions of men perished. Those wars cost the British Exchequer over 800 millions sterling; but the annual drain was less than one-twentieth of the present. The losses of continental states cannot be reckoned, because the destruction and confiscation of private property, the decline of trade, and the debasement of currencies were vast and incalculable factors. The total expenditure caused by the Crimean War has been estimated at 340 millions, to which Russia contributed 160, Great Britain 74, and France 66 millions sterling. The daily war expenditure of Russia then averaged just about one-sixteenth of the daily average in this war; but in the war with Japan, Russia's daily expenditure rose to above one-fifth of the present figure. The war of France and Italy against Austria in 1859 cost about 50 millions

sterling, according to M. Leroy-Beaulieu, Austria's share being 25, that of France 15, and that of Italy 10. In the American Civil War, which lasted four years, the North spent over 500 millions sterling, and put over 2½ millions of men into the field. It has been calculated that the total expenditure of Federals and Confederates was 1000 millions, and that 2000 millions more must be allowed for the destruction of property and decline of production. The market value of the poor slaves, in whose emancipation the war ended, was estimated at 160 millions sterling. The expenses of the Danish War in 1864 were about £14,000,000, while the six weeks' campaign of 1866 cost about 66 millions. The Franco-German War of 1870-71 threw a burden of 506 millions on France, including an indemnity of 225 millions, which more than covered Germany's budget expenses. The privations and commercial losses of the French people have been put at another 500 millions, though the hostilities only lasted from July to January. According to Bloch, Russia spent on the war of 1877-8 161 millions sterling, and Turkey perhaps about half that figure. The Boer War, as we have seen, cost the British Exchequer 250 millions sterling. The cost of the Russo-Japanese War is indicated by the debts of the two belligerents. That of Japan rose from about 60 millions before the war to about 240 millions after the war, while the Russian debt rose from about 700 to nearly 900 millions. But, of course, these figures do not allow for savings on civil expenditure and additions to taxation. The financial results of the Balkan Wars of 1912–13 have been examined in a previous chapter. With most of these lessons before him, and with no desire to minimise the cost of a European struggle,

Bloch, towards the end of last century, after collecting vast materials for the purpose, put the daily outgoings in a war between the Triple and Dual Alliances at a mere fraction of the amount which is actually being expended by four of these Powers and Great Britain. He estimated that a war breaking out in 1896 would work out as follows :—

	Army.	Daily Cost.
Germany . .	2,550,000	£1,020,000
Austria . . .	1,304,000	521,600
Italy . . .	1,281,000	512,400
Total for Triple Alliance		2,054,000
France . . .	2,554,000	1,021,600
Russia . . .	2,800,000	1,120,000
Total for Dual Alliance		2,141,600

This, it will be seen, gives a total daily expenditure for the five Powers of under £4,200,000 a day.

In September 1914 I put the daily expenditure on the war to all the Powers then concerned at about 10 millions sterling, and a similar total was arrived at by independent estimates in France and Germany, one being a little more, and the other a little less. The cost of mobilisation to neutral states might be included, and the successive entry of Japan, Turkey, Italy, and Bulgaria into the struggle soon made it certain that this figure would fall far short of the mark. On my reckoning the total budget cost of the war for the first year would have been £3,650,000,000. According to a calculation made on March 1, 1916, the actual total was about 3750 millions sterling, so that for the first year my guess proved remarkably accurate. But the expenses of the second year may prove to be nearly double. Among the belligerents Great Britain alone has paid a tiny fraction

of the cost by augmenting taxation. All the Continental Powers have suffered a heavy loss of revenue, but they have paid by privation, and by issues of depreciating currency, as well as by loans and borrowings from their State Banks.

At Copenhagen there was published on March 1, 1916, the first Bulletin of a society founded for the study of the social consequences of the war.[1] In this Bulletin the investigators endeavoured to ascertain for every European country at war, and also for some of the neutrals, what may be called the Budget cost of the war to date, and their work affords proof of painstaking efforts to arrive at the truth. On the whole, I conclude, after checking some of the results, that their estimates of expenditure on the war up to January 1, 1916, are very near the mark, and their calculations of the total cost of the war if it lasts for two years, *i.e.*, if it lasts until August 1, 1916, are not likely to prove exaggerated. Moreover, it is to be remembered, for many years to come the belligerent States, in addition to debt charges, will have to pay an enormous annual sum in war pensions to disabled men, to widows and orphans. As the war continues the claims for such pensions multiply, while the means of paying them dwindles. At first both sides cherished high hopes of success as a result now of crushing victories, then military attrition, and finally financial exhaustion came to be discussed. To some of us the third possibility, or a settlement forestalling it, seems the most probable; but the process may be long drawn out; for, thanks to

[1] "Selskabet for Social Forsken af Krigens Folger." The Bulletin consists of 52 pages, costs 1 krone, and is to be had from the Secretary, at 56c, Osterbrogade, Copenhagen.

the perfection of credit and of debt-creating machinery, the modern State is proving its aptitude, by rapid but almost imperceptible degrees, to confiscate by loan and mortgage not only the liquid capital but most of the private property of a country.

To begin with Germany. First of all, according to these Danish investigators, the aggregate income of all the inhabitants of Germany before the war may be put at 2000 millions sterling, of which a little more than a quarter was taken by the Empire and by the States. The annual revenue of the German Empire before the war was about 175 and that of the States about 360 millions sterling. And the total capital value of all the factories, houses, land, and other property in Germany is estimated at 15,000 millions sterling, exactly the same sum being entered for the United Kingdom. Now the imperial debt of Germany before the war was only 250 millions sterling. On January 1, 1916, it had risen to 1620 millions, and by August 1 it is expected to be nearly tenfold the amount it had reached just two years before, namely, £2,450,000,000. As to the debt charge we shall be pretty safe in allowing 5 per cent. on the total, which would give a total debt charge of about £122,500,000, on the assumption that the war comes to an end by August 1. As the debt charge before the war was only eight and a half millions sterling, the new revenue to be raised from German taxpayers merely in order to pay interest to themselves on the new war debt will therefore be about 114 millions. Moreover, in the first few years of peace the charges for pensions, etc., will probably make the annual expenditure of the German Empire nearly double what it was before the war. It is hard to see how the Empire can hope for

many years to pay full interest on its debt without heavy annual borrowing, the only alternative being a measure of general disarmament.

The financial outlook for Austria-Hungary is even worse. The Budgets of the Dual Monarchy amounted to 220 millions sterling before the war. But the total income of the population was only estimated at 625 millions, and the capital wealth at 5250 millions. The public debt was 750 millions before the war. It is already doubled, and is expected to reach 1800 millions sterling by August 1. The interest charge will have risen in the two years from 32 to 100 millions sterling.

The public debt of France before the war was the largest in the world, and it has already doubled. Russia's debt came next, and (according to the Danish estimate) it will have trebled by August. Then, after Austria-Hungary came Great Britain, with a deadweight debt of 706 millions, inherited chiefly from wars with the American Colonies, with Napoleon, with Russia, and with the Boer Republics. That debt has already trebled, and will probably have quadrupled by August 1, while the debt charge will necessarily have grown in a much greater proportion, as the bulk of the old debt was in 2½ per cent. stock. If the war should last till March 31, 1917, the National Debt may rise to nearly 4000 millions, involving at 4½ per cent. an interest charge of 180 millions. The case of Italy is only less serious if we disregard the existing burden of taxes.

The financial position of the four great allied powers may now be presented in two tables. The first gives the aggregate income and capital, and the pre-war expenditure in millions sterling :—

	Total Income.	Total Property.	Pre-war Budget.
Great Britain . .	2,200	15,000	198
France . . .	1,460	11,680	208
Russia . . .	—	—	370
Italy . . .	400	3,200	104

No one has ventured to make a serious guess at the total income or capital wealth of the vast Russian Empire, and these estimates leave our colonies and India out of the account. The income and wealth of Italy are probably understated. The second table shows the debts and debt charges of the Allies. I take the debts first :—

THE NATIONAL DEBTS OF THE ALLIES (in Millions Sterling).

	Before the War.	Jan. 1, 1916.	Aug. 1, 1916.
France . . .	1,320	2,520	2,920
Great Britain . .	707	2,125	2,900
Italy . . .	570	760	920
Russia . . .	920	2,220	3,000

It will be seen that by August 1, Germany and Great Britain will head the list for new war debt, while the gross public debts of Russia and France will stand first. But if the public debts of the German States are added to those contracted by the German Empire, Germany after this war will have a larger debt than any country in the world. And again, if and when our allies are able to repay us what we have lent them during the war, the British debt will be considerably lessened.

THE DEBT CHARGES OF THE ALLIES (in Millions Sterling).

	Before the War.	Jan. 1, 1916.	Aug. 1, 1916.
Great Britain . .	22*	86	124
France . . .	53	100	125
Russia . . .	45	108	145
Italy . . .	17	26	33

I have affixed a star to the pre-war debt charge of Great Britain because it includes a large sinking fund of about five millions sterling, which would reduce the estimate for August 1 to 119 millions. If the charge for war pensions were something over 30 millions there would be an *additional* charge upon the British Budget after the war of about 130 millions sterling, which would bring the Budget up from about 200 to about 330 millions sterling, assuming the military, naval, and civil expenditure to stand as before the war. After Mr. McKenna's bold budget and lucid financial statement of April 4, 1916,[1] we may be confident that, if the war ends by the summer, British credit will be strong enough to enable us to fund our short-term debt pretty quickly on terms which would considerably reduce the debt charge as above calculated, seeing that a large margin of revenue is already provided by war taxation. But those who are able to comprehend even faintly the meaning of these vast figures will probably endorse the opinion expressed by the *Westminster Gazette*, in a leading article on March 21 :—" The war will leave us with a vast burden of debt, and the greatest social question will be, who shall pay for it ? " It is a question, however, which, thanks to our direct system of taxation, has been more nearly answered in the United Kingdom on equitable lines than in any of the other belligerent countries.

But the financial loss, even had the war only lasted a year, and even (which is impossible) if war expenditure had then terminated, would have been by no means all. In estimating the real cost of the war, there are at least

[1] Under this budget and its predecessors it is anticipated that 300 millions sterling will be raised in the year ending March 31, 1917, by new taxation imposed since the war.

three other big factors to be allowed for. First there is the actual destruction of property in the devastated areas; secondly, the loss of trade and production to each country as a result of the dislocation caused by the war; and thirdly, the slaughter and maiming of millions of men, the flower of the manhood of Europe. Mr. Edgar Crammond, secretary of the Liverpool Stock Exchange, in a paper read to the Royal Statistical Society in March 1915, taking all these elements into account, brought up the total loss for the first year to £9,148,000,000 without allowing for Servia, Montenegro, Japan, or Italy (which was then still a neutral), or for the losses to neutrals. Mr. Crammond's estimates for the destruction of property, and also for the losses of production, were, however, in my judgment, exaggerated. For example, he put down 250 millions for the destruction of property in Belgium. But a shrewd neutral observer, on whose judgment and power of observation I place great reliance, has assured me that an expenditure of less than 50 millions would probably restore all the damage done to houses, farms, factories, railways, and other productive property in that country. Fifteen millions sterling appears to be the German official estimate for the damage done in East Prussia by the Russian army. Probably the destruction of property in Austrian and Russian Poland will equal, if it does not exceed, the damage done in Belgium. Servia and Montenegro had less to lose, but relatively they have probably lost as much or more than any of the devastated countries. The damage inflicted on property in Asiatic Turkey and German Africa must also be entered in the final account.

The valuation of human life and suffering in terms

of money is a painful exercise. A cold calculation of the value of a free man as if he were a slave, a mere instrument of production, is revolting to our feelings; but some notion of the magnitude of the economic loss may be formed from the calculation of a French actuary, that the average value of a British soldier is not less than £800. How the value of a young man of military age who has been withdrawn from productive work to take part in war should be computed is not easy to decide, but supposing such a man to be killed, or incapacitated for further work by severe wounds or by disease contracted during the campaign, the loss might perhaps be assessed by ascertaining, (1) How long he would have been likely to live in health and strength; (2) What amount of taxes he was paying; (3) The cost of supporting his family, if any. Further considerations would be his purchasing power, the profits on his labour, and his savings.

After two years of hostilities, the total losses of the five leading belligerents in men may perhaps work out somewhat as follows: and I have placed in a second column a valuation based upon the supposition that a British soldier represents a loss of £600, a German and a Frenchman a loss of £500, an Austrian a loss of £400, and a Russian a loss of £300 to the community of which he is a member.

KILLED, DIED OF DISEASE AND WOUNDS, OR MAIMED.

	The numerical loss.	Economic loss.
The British Empire . .	450,000	£270,000,000
France	1,200,000	600,000,000
Germany	1,750,000	875,000,000
Austria	1,000,000	400,000,000
Russia	1,800,000	540,000,000
	6,200,000	£2,685,000,000

Clearly after the war the governments of all the belligerent states will have to find, if they can, a very large new revenue for the purpose of paying the interest on their new war debt and pensions to invalid soldiers, or to the widows and children of those who have been killed in the war. And they will have to meet these charges from a gravely diminished trade and revenue. Thus they will be compelled either to repudiate interest on their debt—which means the confiscation of the property of their own subjects—or to compound with their creditors, or to make very heavy additions to a scale of taxation, which had already become oppressive before the war, or finally they will have to abandon by mutual consent the system of conscription and be content for a long time to come with a very small expenditure upon armies and navies. The last of these methods alone offers a tolerable prospect for Europe in the long years of industrial and commercial depression that lie ahead. But its adoption is very unlikely, unless, indeed, the statesmen and diplomatists of Europe have the wit to strive for a settlement which does not sow the seeds of a future conflict.

CHAPTER III

WAR FINANCE—THE MOBILISATION OF ASSETS

"It is an easy thing to ruin thyself when thou art well, a difficult one to bring thyself back again."—*Guicciardini.*

MODERN war involves a gigantic confiscation by each state of the property, the labour, and the life of the individuals who compose it. Even in so-called democracies the control of the State is in the hands of a very few men, and the supreme issue of peace and war is in no case decided by the people. Moreover, a modern state, whether it is ruled by an absolute monarch, or by a parliamentary ministry, is so highly organised, and so well supported by credit, that it can place in the field for a considerable time a very large proportion of its male population, armed with the latest weapons of destruction. Thus in June 1915 the belligerent governments—so I calculated at the time—had succeeded in achieving results somewhat as follows :—

	Population.	Percentage.	Men under arms.
Russia . . .	171,060,000	5	8,550,000
France . . .	39,602,000	10	3,960,000
Italy . . .	35,239,000	5	1,750,000
Servia . . .	2,912,000	10	290,000
Belgium . .	7,000,000	1	70,000
United Kingdom .	45,370,000	5	2,270,000
			16,890,000
Austria . . .	49,210,000	10	4,921,000
Germany . .	64,926,000	10	6,493,000
Turkey . . .	21,274,000	5	1,063,000
			12,477,000

Of these on an average perhaps 1 per cent. were killed or captured every month and about 3 per cent. wounded. The continental systems of conscription, imitated by Great Britain early in 1916, which have driven such vast armies into the field, would be of less than no avail in war were it not for another system which may be called "Mobilisation of Assets," its effect being to spread the cost of a year of war over ten, twenty, fifty, or may be a hundred years of anticipated future peace. In earlier pages we have seen how at first wars came to be financed largely by loans. But thanks to conscription, and to the enormously increased cost of warlike machinery and munitions, war expenditure has grown far faster than revenue, income, or capital, so that in this war, of all the Powers concerned, Great Britain alone could follow the old method of paying its way by simple credit, *i.e.*, by borrowing at the market rate of interest, with some aid from the taxes.

British War Finance was clarified in the financial statement made by Mr. Lloyd George on May 4, 1915. From this it appeared that for the first eight months of the war, *i.e.*, up to March 31, the Treasury paid out 360 millions, of which £52,370,000 sterling were loans to our colonies and to our Allies. Thus the net cost of the war, assuming these advances to be duly repaid with interest, would be £307,416,000. But as the government had spent about 28 millions in buying sugar, wheat, meat, and other commodities (all of which it expected to get back) this sum was not really a net sum. The true cost, according to Mr. Lloyd George, was 279 millions for the first eight months. The progressive increase was startling. For the first four months

the war cost 102 millions, including mobilisation; for the second four months it cost 177 millions. In Mr. Lloyd George's words: "Our forces in the field have increased rapidly. Enormous orders for equipment and munitions are maturing for payment, and therefore the cost is an increasing one." As to the effect of the war upon the National Debt the results were still more sensational, because the government had borrowed heavily in advance of its own expenditure over and above the 52 millions odd which went to Russia, Belgium, and Servia, Australia, South Africa, and Canada. By March 31, 458 millions sterling had been added to the total indebtedness of the country, which then stood higher than ever before, higher even than at the end of the Napoleonic wars. The total national indebtedness on March 31, 1915, was £1,165,802,000. Previous to the war (as before mentioned), Liberal Administrations had succeeded since 1906 in paying off 107 millions of debt—a very creditable achievement, which represented about two-thirds of the sum added to the National Debt by the Boer War. This sum of 107 millions, said Mr. Lloyd George, was "wiped away by two months of war." Next may be observed the effect of the new debt upon the debt charge. The fixed debt charge, including interest and sinking fund, was £24,500,000 before the war; but, assuming that the war was to continue till the end of September, the National Debt services outside the fixed debt charge would reach £30,726,000 for the financial year, or five millions less after deduction of the sinking fund. So that the National Debt charge for interest would have risen from 19 to 50 millions in 14 months of war. Assuming a 14 months' war Mr. Lloyd George

put the total Consolidated Fund and Civil Services at £90,674,000 for the year, the cost of the army at 400 millions, the navy at 120 millions, railway compensation and miscellaneous 18 millions, and advances to Allies and colonies 100 millions. Thus the votes of credit would come to 638 millions, and the total Budget for the financial year, if the war lasted until the end of September, would be £790,458,000. On a second assumption that the war continued until March 31, 1916, the advances to Allies and dominions were to be doubled, *i.e.*, raised to 200 millions sterling; the army would cost 600 millions and the navy 146 millions. The total Budget would then be £1,132,654,000.

The statement made by Mr. Lloyd George's successor, Mr. McKenna, a few weeks later (June 21), in proposing a new loan at 4½ per cent. interest, provided some further particulars. He reminded the House of Commons that on November 17, 1914, a Loan Bill, which yielded 331 millions, was introduced. By March 31, 1915, 334 millions of borrowed money had been spent. But besides the loan, 48 millions had been borrowed on Exchequer bonds and 235 millions on Treasury bills. These had been gladly taken in the City in place of ordinary commercial bills, whose volume had dwindled to a fraction of the normal. After deducting various items, including the Bank of England's guaranteed advances to accepting houses and others, only 30 millions were still in hand, and it was not considered expedient to resort much further to Treasury bills. For this reason, and also in the hope of assisting the American exchanges, the Chancellor of the Exchequer had decided to issue a new 4½ per cent. loan of unlimited amount with rights of conversion for holders of consols

and of the first war loan. Thus up to midsummer 1915 Great Britain's liquid wealth and capital, helped by sales of American securities, had sufficed to finance the war without serious resort to the manufacture of paper or to the other methods which may go under the general head of "Mobilising Assets."

Unfortunately, in spite of the growth of our war expenditure (which rose from an average of one million a day in the first three months of the war to an average of over 4½ millions a day in the last five months of 1915), Mr. Lloyd George failed to propose any new taxation in May 1915, and Mr. McKenna waited until September. By that time the exchange position had become serious; for in spite of heavy gold exports, sterling exchange was falling in New York and other neutral centres. By the first war budget, that of Mr. Lloyd George in November 1914, the income tax and supertax had been doubled and the duties on beer and tea increased. By the second war budget, that of Mr. McKenna in September 1915, the income tax and supertax were again increased, a tax of 50 per cent. was imposed on war profits, and many indirect duties (including some of a protective character) were imposed. The third war budget was introduced by Mr. McKenna on April 4, 1916. A huge deficit was in retrospect, and a huger one in prospect. The expenditure for the year had been 1559 millions sterling, of which 1222 had been borrowed, as follows:—

	£
4½ per cent. War Loan	600,000,000
Exchequer Bonds	154,000,000
Anglo-French Loan in the United States . .	50,000,000
Balance obtained by sale of Treasury Bills .	418,000,000
	1,222,000,000

When this was added to previous borrowings and the old national debt, our total indebtedness on March 31, 1916, came to the gigantic figure of 2140 millions. Against this could be set the 368 millions advanced to our Allies and Dominions, which Mr. McKenna expects to be repaid in time; but at the moment he had to provide for an annual interest burden of 95 millions.

Turning to the estimates for the new financial year, which began on April 1, Mr. McKenna had to face the cost of a larger and ever larger army. Assuming the war to last for another whole year he reckoned 1120 millions for the Navy, Army, and Ministry of Munitions. The total may be given in a table :—

	£
Navy, Army, Munitions	1,120,000,000
Miscellaneous	30,000,000
Advances to Allies and Dominions	450,000,000
Interest, etc., of debt	138,000,000
Civil Services, etc.	60,000,000
	1,798,000,000

This total is raised to 1825 millions by adding the 27 millions for the Post Office, but since the post is a remunerative trading monopoly, it is better omitted. To make an inroad upon the deficit, Mr. McKenna proposed new and additional taxation, which (with an excess profits tax increased to 60 per cent.) would yield 151 millions. Thus he brought his estimated revenue up to the enormous total of 509 millions and so reduced his prospective deficit (if the war lasts to March 31, 1917) to less than 1300 millions sterling; which, however, would raise the whole national debt to nearly 3500 millions sterling, even if all our loans to Allies and colonies are repaid. Allowing for a big sinking fund Mr. McKenna

put the debt charge for the year at 145 millions sterling—a sum exceeding our whole expenditure on army, navy, and civil service a few years ago. As guardian of public economy, Mr. McKenna can only plead impotence; but as guardian of the public credit he is entitled to his proud boast:—"We never borrow a pound without making provision in advance by new taxation sufficient to cover both interest and a liberal sinking fund." He was also justified in adding that, while Great Britain was raising 300 millions sterling by new taxation, the German Finance Minister had only been able to announce "a doubtful increase of 24 millions sterling." If British finance had compared equally well with German on the expenditure side, Mr. McKenna would have deserved a far larger meed of praise. But the war departments have been released from Treasury control since Gladstone's days, and the lessons of the Boer War were never learnt. Thrift and business ability were unhonoured and unsought, until scandals and complaints of wholesale waste began to leak out even into the London Press.

All the other countries, as before stated, were compelled from the beginning to resort to artificial measures. In the first place, they all made large issues of inconvertible paper. The banks of France and Germany ceased to pay gold or silver in exchange for notes, and in all the belligerent countries of the Continent, except France, the exchanges at once deteriorated, indicating a depreciated currency.

But the issue of paper currency is at best a poor expedient; for, as soon as it begins to be used freely, its purchasing power falls, and prices rise so fast that the embarrassments which it causes soon become greater

than the embarrassments from which it releases the government. A much safer and more ingenious device is that to which the expression "mobilisation of assets" properly applies. It is a mystery to many how a comparatively poor country like Germany, with a large income it is true, but with a marked want of free capital, could have financed the war so long and so successfully, while at the same time supporting Austria and subsidising Turkey. The mystery is deepened when one reflects that Germany has been at war with three of her principal customers; and that the Austrian market for German goods must have shrunk to very small dimensions. No doubt, thanks to her command of the Baltic, Germany's trade with Scandinavia has been considerable, and also with Roumania, Switzerland, Holland, and Italy, until that Power joined the Allies. A large stock of Swedish and Danish securities held in Germany has also been liquidated. Meanwhile the mercantile marine of Germany has been earning nothing except in the Baltic trade, and nearly all the normal activities of Hamburg and Bremen have been suspended. A small trade with the United States is carried on by neutral ships, chiefly *via* Holland and Scandinavia. But in a large measure Germany has been cut off from the outside world—so much so indeed that it has been deemed inadvisable to publish the statistics either of the foreign trade or of the custom revenue. What was to be done in face of a shrunken revenue and the necessity for an expenditure four or five times the normal? The German Government answered this question by raising early in September a loan for £200,000,000 at 97½ in 5 per cent. bonds, of £5 and upwards; and a further £50,000,000 in Treasury notes. This was followed at the

end of February by a loan of unlimited amount, which is supposed to have realised some 400 millions sterling.[1]

To enter into the complicated machinery and ingenious devices which were adopted for the purpose of obtaining subscriptions from people who had no bank balances would be a tedious and unprofitable task. But in order to make clear to the plain man what the mobilisation of assets means, and how almost unlimited sums may be raised by the German System, an imaginary dialogue between an imaginary German banker, Mr. Goldschmidt, and his client, Mr. Schmidt, may here be recorded :

G—— " I have come, Mr. Schmidt, to ask you to subscribe to the new Imperial 5 per cent. Loan. It is a patriotic duty."

S—— " Alas, I have no money."

G—— " Oh ! but surely you have securities ? "

S—— " Yes, I have 25,000 marks in Brazilian bonds, but Brazil has defaulted and they are unsaleable."

G—— " Ah ! there I can help you. You shall hand over the securities and we will lend you 21,000 marks. You shall keep the 1000 marks for yourself, and the 20,000 you can subscribe to the Imperial Loan."

It is hardly necessary to say that this transaction was most acceptable to Mr. Schmidt. He took his bonds to the bank, received 21,000 nicely printed marks, kept 1000, and paid 20,000 over the counter for the new Imperial bonds. When the second Imperial Loan

[1] The requisitions and indemnities exacted from Belgium and Northern France may be set against the Russian devastation of East Prussia.

came along, Mr. Schmidt had no more securities to "mobilise"—at least he thought he had not—but the ingenious banker reminded him that his first war loan bonds could be deposited as security for a subscription to the second war loan, and further that his furniture could be pledged.

Theoretically this method of raising money for the war might be pursued until all the property in Germany had been pledged to the state; for after all war loans are a mortgage on the property and industry of a country. But, in the first place, however cleverly the thing is arranged, this inflation of credit tends also to inflate the currency and to raise prices. And in the second place, a point must soon be reached at which the whole commercial and financial community will take fright. The credit of the state is all the time being impaired. In the first instance, perhaps, it promises to set aside a revenue of £20,000,000 to pay the interest on the new debt, then £50,000,000, then £100,000,000, and so on until investors see the spectre of repudiation and confiscation drawing unpleasantly near. At last there must come a collapse, and the artificial fabric which has been created by a forced liquidation of securities and a so-called mobilisation of fixed property will crumble.

What will be the condition of Europe, when peace comes through exhaustion, after the continental states have used up all their credit and borrowed all that can be borrowed, may be left to the imagination of those who can see further than the writer through the gathering gloom. How commerce will be financed, how manufactures will be revived, how banking will be carried on, how public bankruptcies on an unheard-of scale are to be avoided—these are questions which defy experience and baffle even the wisest heads.

CHAPTER IV

INDUSTRIAL AND SOCIAL CONSEQUENCES

"The harvests of Arretium this year old men shall reap."—*Macaulay.*

EVEN an abstract analysis of the industrial consequences of modern warfare presents difficulties; but when the political economist passes from the abstract to the concrete, and endeavours to trace, historically or geographically, at home, in the colonies, and abroad, its immediate and subsequent effects not upon one, but upon all industries, he will be faced with a task of almost insuperable dimensions. Here we must be content with a few brief indications by way of supplement to what has been said of the first results of this war. If an individual suddenly begins to spend more upon fireworks than he previously spent upon food, clothing, and other necessaries or comforts, his expenditure produces a real activity and a certain prosperity. The difference between productive and unproductive expenditure is not seen at the moment. While the expenditure goes on, the effect upon the labour market is very much the same. Thus, much the same amount of labour and wages and salaries may be spent on a two-million Dreadnought as upon the building of twenty merchant vessels costing £100,000 apiece. But the merchant fleet, after it is once built, will, if judiciously employed and financed, earn dividends and will also yield a sinking fund sufficient to rebuild it in the course, perhaps, of twenty years. The Dreadnought,

on the other hand, is a burden on the taxes, costing probably at least £200,000 a year to maintain, until when it is scrapped after twenty years it fetches only a few thousand pounds. War expenditure is like armament expenditure, but more so. From an economic point of view, it is not merely waste, but destructive waste, whatever moral or political benefits it may elicit. It is far too early to forecast the full social and economic consequences of the war even at home. We already see the approach of hardships which from the very first invaded the Continent. We see women and boys and old men trying to do the work of the strong. In some important branches—mining especially—the enlisted men cannot be replaced, and there is no real remedy for diminished output, scarcity, and high prices of coal. A government monopoly of shipping has been proposed, but it would, of course, bring in its train inefficiency and favouritism. The shortage of merchant ships has been an even more serious handicap to the Allies than the shortage of coal; but it is due far less to German submarines than to the policy of equipping and maintaining distant expeditions like those which operated in the Dardanelles and Mesopotamia. After ten months of war, freight rates in most parts of the world had multiplied from five to ten fold, and the Board of Trade had begun to prohibit unnecessary imports. Everywhere it is seen that government control means less work, or compulsion and friction. If the war ends before the industrial, commercial, and financial situation has become unmanageable, peace may be followed by some irregular activity in industries where stocks are low. But after a great permanent decline in the world's consumption it is difficult to see how even

low-paid employment can be found for a disbanding army of three millions, most of whose places have already been taken by more or less efficient substitutes. With taxes nearing confiscation there cannot be a full recovery for many years in the luxury trades of France and Great Britain. Credit will be scarce and dear, liquidation difficult, competition severe. The districts that depend on French and German custom will suffer most. Hard times for the east coast may be permanent after what has happened in the North Sea. Clearly the laws and practices of naval warfare no longer afford security to peaceful shipping. The thriving seaports of the North Sea will not soon forget the terrors and insecurities of this war, with its floating mines and submarine horrors. There is, however, a bare possibility that after the peace commerce and shipping may rise up and force the professional interests to surrender some of the rights and privileges of belligerency. Otherwise there may be no sufficient funds to feed armaments in the future.

This conflict exhibits the destructive effects of war on an unprecedented scale and in unprecendented variety. If you compare the economic spectacle with previous examples, it is like the difference between looking at tiny insects with the naked eye and looking at them through a microscope. In the first place it is *par excellence* a War of Munitions. In one indecisive trench battle at Neuve Chapelle, when ten or fifteen thousand combatants on each side were killed or wounded, more shells were expended by the British artillery alone than were expended by our forces during the three years of the South African War. In fact, shell-fire, variegated with machine guns, poisonous gases,

hand grenades, and bombs thrown from the air, has been the staple of this war. Consequently a tremendous output of shells and ammunition and of great and small guns has been required. In Germany, Austria, France, Great Britain, and Russia factories have been diverted wholesale to these purposes, and all the great armament concerns—Krupp, Creusot, Skoda, Armstrong, Vickers, etc.—have been increasing their output all the time.[1] In this respect alone there has been an extraordinary dislocation of industry. A neutral writer, describing the business situation in Berlin on December 13, 1914, mentioned a number of cases in which plants had been converted to other forms of production: "A talking machine factory is busy trimming shrapnel shells to prepare them for the explosive filling; a piano factory makes cartridges; a bicycle factory turns out iron bedsteads for military hospitals; a wood-working establishment makes barracks to be set up where wanted to accommodate prisoners of war; and a sewing machine factory is producing shrapnel." Similar examples could be drawn in almost any number from our own industrial districts; and when the war ends, war plant of all kinds will be on a most colossal scale. The whole world will have converted itself into a vast war machine; but as all the savings of peace will have been dissipated, and the future heavily mortgaged, there may be no sufficient credit to reconvert the machine and set it going again at its normal task. For, after all, the fortunes made by the war will be a mere bagatelle in the aggregate when compared with the destruction of savings and capital.

[1] Essen, which, as the home of Krupp, has won the nickname of the Devil's Foundry, is reported (April 8, 1916) to have attained a population of 500,000, more than four times the population twenty years ago.

Another curious, if comparatively trifling, effect of the war has been the sudden prosperity it has brought to comparatively small or unsuccessful industries, both at home and abroad. The profits made by dye works at home and in Switzerland (owing to the practical cessation for a time of German dye exports and the unprecedented rise of prices) must have been phenomenal. Again, quite a harvest seems to have been reaped by toy factories in the United States. Thus we read that the town of Winchendon, in Massachusetts, is a lucky heir to the industry which Nuremberg has practised for centuries. Winchendon makes tools and toys, and already in October 1914 it was "enlarging its mills, putting in new machinery, and taking on fresh bands of workmen."

At first there was an idea in British newspapers that the home manufacturers might "capture German trade" in neutral countries; but this illusion was soon dissipated; for the managers of our staple industries, when many of their best workmen had joined the army, found that after executing war orders they could not supply fully even the diminished requirements of their old customers. A more sensible battle-cry, "Business as Usual," followed, to give place in its turn to a campaign for "national economy," which might persuade the people by self-imposed privations to diminish imports, release home manufactures for exportation, and spare more money for public loans and taxes. Towards the end of the year 1915 the Conscriptionists and Protectionists began to busy themselves, at the expense of the political truce, with a success which has proved again the old saying that politicians are more adhesive to office than to principles.

At first the paralysis of the exchanges, the blockade of Germany, and the risks of the seas produced many violent results. The price of cotton was halved and the Southern States of America were in despair. Dyes, drugs, and chemicals rose as fast as cotton fell. Food and coal became almost everywhere dearer and dearer as winter advanced.[1] The jute planters in India were almost equally embarrassed. A tin and rubber crisis invaded the Malay States. Business throughout South America was brought to a standstill, and for a time those neutral countries which were not forced to mobilise seemed to be harder hit than the belligerents. No doubt very large profits were made by farmers and merchants in Holland, Scandinavia, Roumania, Italy, and Switzerland, who had stocks of the things most needed by Germany and Austria. But there was an immediate accession of unemployment and privation in Rotterdam and Amsterdam, owing to the quasi-blockade established by the British and French fleets and to the awful mining perils which menaced fisheries and shipping on the North Sea. Moreover Holland has been hard hit by the cost of a defensive mobilisation and by a generous expenditure on the maintenance of Belgian refugees. In Italy acute unemployment in the large towns prevailed from the very beginning. In Spain the fruit growers and many other industries suffered terribly; but the needs of France, deprived of many factories by the German invasion, soon gave much profitable business to Barcelona and other factory towns. The hard case of the luxury trades has been touched on in

[1] Curiously enough while wheat advanced rice declined, and in the late autumn of 1914 the government of Japan took artificial measures to raise the price for the benefit of the farmers.

a previous chapter. Even the sensational newspaper has been punished; for it depends on the advertiser, and the volume of advertisements has dwindled, while the cost of paper had already doubled or trebled in the spring of 1916. Hundreds of struggling periodicals in all the warring countries have expired since August 1914.

Under the influence of immense war orders, unemployment (at first acute) in the industrial parts of the United States rapidly disappeared during 1915. The prosperity of corn and wheat growers had been a set-off to the losses of cotton planters. But it was not until after a year of war that the United States could claim more than a comparative prosperity. Cuba and the Philippines were hard hit. About the same time conditions in Argentina began to improve. There, however, as well as in Chili and Brazil and all other new countries, the loss of the fertilising capital which has been pouring in from the old world will be long and severely felt. The Far Eastern trade was brought to a standstill by the dislocation of the exchanges and the exploits of the German cruisers. The embarrassments of China were increased after the capture of Kiao Chau by the threatening attitude of Japan. But the blockade of Russia's Baltic and Black Sea ports, with the German occupation of Poland, made her dependent for many kinds of supplies and munitions upon Japan; and as 1915 wore on Japanese trade and shipping became very active and prosperous. A Persian correspondent declares that of all neutral countries Persia has suffered most. But in Europe at any rate the case of Switzerland seems to be the hardest. Tri-racial and tri-lingual, her sympathies are divided between three belligerents. Surrounded by war her people have the utmost difficulty in buying from and selling to

the outside world. With dwindling revenues the little republic has had to maintain a large force mobilised in case her neutrality should be assailed. Finally, the chief industry of Switzerland—the hotels which serve the Playground of Europe—is almost at an end and can hardly hope to return for many years to its old prosperity even if peace should be restored in Europe before the end of this year.

. . . . . .

My book ends with Switzerland and the Red Cross. Pharaoh's heart hardened after each plague. But amid all these cruelties and atrocities it is well to remember that every Belligerent Power has done its best for wounded prisoners. Never has so much medical skill been lavished upon healing the wounds and mitigating the agony which devilish inventions have wrought. There is another little neutral country, Holland, whose Hague Conferences promised peace to mankind. Is it quixotic to hope that before this book has been long in print there may be repentance in Germany, or that the spirit of Holland and Switzerland will enter into the Chancelleries of Europe and inspire a settlement founded not on passion but reason, and pointing not to revenge but to reconciliation? If force leads nowhere and offers no remedy, reason must be summoned to save Western Europe from social and economic ruin. Perchance the new world may recall sanity to the old. But even if the terms of peace satisfy idealists, long troubles must be anticipated. "Though we had peace," said Selden during our Civil Wars, "yet 'twill be a great while ere things be settled: though the wind lie, yet after the storm the sea will work a great while."

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