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UNBALANCED BUDGETS

UNBALANCED BUDGETS

A STUDY OF THE FINANCIAL CRISIS IN FIFTEEN COUNTRIES

By

HUGH DALTON, M.A., D.Sc. (Econ.)
Reader in Economics in the University of London

BRINLEY THOMAS, M.A., Ph.D.
Assistant at the London School of Economics

J. N. REEDMAN, B.A.
Sometime Lecturer in Economics in the University of Leeds

T. J. HUGHES, B.A.

and

W. J. LEANING, B.A.



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PREFACE

The Right Honourable Sir Arthur Dyke Acland died on 9th October, 1926, aged 79. For fourteen years, from 1871 to 1885, he had been an Oxford don, and then for another fourteen years, from 1885 to 1899, Liberal Member of Parliament for Rotherham.[1] From 1892 to 1895 he sat in the Cabinet as Vice-President of the Council responsible for Education in the days before the office of President of the Board had been created. As a young man he had taken Holy Orders, but had soon relinquished them, finding the life of a clergyman uncongenial. After his retirement from active politics, he was for some time Chairman of the Executive Committee of the Imperial College of Science and Technology.

He was deeply interested in the Co-operative Movement. He was Bursar of Christ Church when the Co-operative Congress was held in Oxford in 1882, and many of his personal friendships with Co-operative leaders date from this gathering.[2] He attended many subsequent Congresses, being President on the second day of that held at Plymouth in 1886, and on the first day of that held at Lincoln in 1891, he was elected a member of the Southern Sectional Board and, on his election to Parliament, he became an honorary member of the Board, and continued to hold this position until his death. Jointly with Mr. Ben Jones, he wrote a small textbook entitled *Working Men Co-operators*,[3] which ran through many editions. In Parliament he was frequently active in efforts to secure adequate statutory recognition, and fair treatment, for Co-operative Societies.

His wife shared his enthusiasm for Co-operation and was the first President of the Women's Co-operative Guild.

I met him only once, a few years before his death, when he invited me to lunch with him. But he left with me an abiding

[1] His memory is still green in Rotherham after more than thirty years. In February, 1933, I was speaking in the Rotherham Town Hall in support of the candidature of my friend, William Dobbie, at the Parliamentary by-election which was then taking place, and heard the Chairman of the meeting, a local Town Councillor, pay a tribute, which was warmly applauded, to Sir Arthur Acland's work for education in the constituency.

[2] See a delightful article by Mr. Ben Jones in the *Co-operative Review* for March, 1928, on "Arthur Dyke Acland's work for Co-operation".

[3] Published by the Co-operative Union, price 2*s.* 6*d.*

picture of an old man, frail in body, but still young in mind, with wide social sympathies and an undimmed interest in all contemporary movements which carry a message of hope. It has been said that, " as we grow older, we live more and more in the lives of others," and this was certainly true of him.

Towards the end of his life, indeed, he moved still further to the Left in his political and social opinions, and more than once gave anonymous contributions, through personal friends, to the election funds of the Labour Party. And he made, under his will, an interesting bequest, which in some of its details was unusual. He left £10,000 for the establishment of Acland Travelling Scholarships, " with a view to encouraging an intelligent study of industrial, social, or educational conditions outside the United Kingdom." These scholarships, according to his directions, are to be administered by four Trustees, two to be appointed by the Labour Party and two by the Co-operative Union, one of whom in both cases is to be a woman. The Trustees are to be under fifty years of age, and shall not serve for more than ten years, and the scholars whom they are to select shall be between twenty and thirty years of age. These are to visit any country, or countries, outside the United Kingdom to investigate and report upon any development deemed by the Trustees to be of interest to the British Co-operative or Labour Movement.

This bequest illustrates the better possibilities of the British law of inheritance. Freedom of bequest which, within limits set by our system of graduated death duties, is the principal feature of this law, normally operates to increase the already great inequality of individual incomes. It greases the fat cattle, as some stockbreeder has said, and starves the lean kine. In the more classical language of John Stuart Mill,

> " The laws of property . . . have not held the balance fairly between human beings, but have heaped impediments upon some, to give advantage to others; they have purposely fostered inequalities, and prevented all from starting fair in the race." [1]

It is natural that those who desire to create a human society less disfigured by economic inequality than ours of to-day, should spend much thought on schemes of attack, by increased taxation, and otherwise, upon the institution of inherited wealth.

[1] *Principles of Political Economy* (Ashley's Edition), pp. 208–9.

None the less, the British, like the American, law of freedom of bequest offers possibilities of occasional social advantage, especially in bequests for education and scientific research, which are absent in those countries of Continental Europe, where the bulk of dead men's wealth passes, by rigid rules of law and in fixed proportions, to their relatives.[1] And there is, I think, no better object for public spirited bequest at the present time than the encouragement of foreign travel by young men and women who would otherwise be unable to undertake it. The primary purpose of such travel, under Sir Arthur Acland's bequest, is the study of events which have significance for the Co-operative and Labour Movements. But its secondary effects, the travellers' vision of new horizons and a better understanding of the life and mind of foreigners, are not less valuable.

The scheme came into operation in 1928, and the four trustees appointed were, for the Labour Party, Mr. Arthur Jenkins and Mrs. Barbara Wootton, and for the Co-operative Union, Miss E. M. Bradley and Mr. R. A. Palmer.

Up to 1931 five scholarships had been awarded and two interesting studies published.[2] In 1932 the Trustees approached the London School of Economics with a view to co-operation in a larger piece of research than had previously been attempted. They proposed to award three scholarships for 1932–3 and invited the School to appoint a member of its staff to plan and supervise the work of these three scholars. They contemplated, moreover, that the research to be done in 1932–3 should be part of a two years' plan. With the approval of Sir William Beveridge, I was asked, and agreed, to undertake this work. It was decided to make " a comprehensive study of recent State policy, with special reference to Public Finance, in various European countries ".

The Trustees, in consultation with representatives of the London School of Economics, awarded scholarships to Mr. T. J. Hughes, B.A., of Magdalen College, Oxford, to Mr. J. N. Reedman, B.A., of the University of Sheffield, subsequently Lecturer at the University of Leeds, and to Mr. Brinley Thomas, M.A., of the University of Wales, who had come to the

[1] Those who are interested in the social and economic problem of inherited wealth may care to refer to my book on *The Inequality of Incomes*, especially Part IV, and to Mr. Josiah Wedgwood's able study on *The Economics of Inheritance* (Routledge, 1929).

[2] *Communal Enterprises and Social Services in Germany*, by M. L. Dhonau, and *A Student in Russia*, by Paul Winterton, both published by the Co-operative Union.

London School of Economics as a Research Student and had later joined its teaching staff.

This book contains the results of their investigations. Mr. Brinley Thomas spent nine months in Berlin and Mr. Hughes nine months in Rome, while Mr. Reedman spent six months in Geneva, studying material available at the seat of the League of Nations, and three months in Paris. Part II of this book, therefore, deals with Germany, Part III with Italy, Part IV with France, and Part V with nine other European countries. Mr. W. J. Leaning, B.A., of Corpus Christi College, Oxford, acted as my Research Assistant during this period and, in addition to other enquiries, examined the material available in London on comparable events and policies in Australia and New Zealand and, in bare outline, in the United States of America, up to the accession to office of President Roosevelt. Part VI contains these studies.

Subject to a moderate measure of editing, I have left each of the contributors to tell his own story. In Part I, I have written a short introduction to the general problem and, in Part VII, I have sought to summarize briefly some of the principal results and to draw a few conclusions.

In a book thus composed, a certain unevenness is inevitable. Distinctly the most substantial of the contributions is that of Mr. Brinley Thomas, who has made good use of the large bulk of statistical and other information available in Germany.

Each of the three travellers witnessed remarkable scenes, not wholly irrelevant to the subject of his studies. Mr. Hughes was present in Rome at the Tenth Anniversary of the Italian Fascist Revolution, and at various official exhibitions and manifestations connected with this event. Mr. Brinley Thomas in Berlin saw at close quarters the birth of the Nazi State, the so-called " National Revolution ", to which no violent resistance was offered, but only a host of helpless human victims. Mr. Reedman in Geneva was able to watch the Disarmament Conference impotently dragging its slow length along, and in Paris to observe a popularly elected Parliament exercising effective pressure to modify the Budget proposals of a Government which it controlled. It is a grim thought that no other Great Power on the Continent of Europe to-day could have staged this democratic spectacle.

Many persons have contributed, by information and introductions, to make possible the enquiries published in this book. In particular, in Rome, Berlin and Paris officials in various

Government Departments and members of the staff of the British Embassies have given valuable help, as have officials of the League of Nations and of the International Labour Office at Geneva. My thanks are also due to Miss V. C. Smith, B.Sc. (Econ.), of the London School of Economics, for her help in seeing the book through the press, in making the index and in looking up points of detail.

HUGH DALTON.

LONDON SCHOOL OF ECONOMICS.
November, 1933.

PART I

INTRODUCTORY

By Hugh Dalton

Chapter I

CAPITALISM IN PARALYSIS

A crisis, when this overworked word bears its common meaning, is a short, sharp affair. It may be slow, and visible far off, in its coming. But once it has come, it goes quickly. It may leave dashed hopes, or even a corpse, behind. But, having ended the old, it opens a new chapter. It brings movement; it shifts the scene.

The so-called "crisis" in the modern world's economic and financial life lacks these swift dynamic qualities. It has dragged wretchedly on for four years, never passing clean away, but varying its monotonous intensity by stabbing, now this community and now that, into sharper spasms of pain and panic.

Some have preferred to call it a "depression", but this word too is inappropriate. It is too mild and colourless to describe the material facts, though it describes only too well the average mental state which they engender. It suggests analogies with our previous experience of "bad trade" which, plausible enough from a statistical point of view, yet miss the point of contrast. Compared with previous trade depressions, the slump of recent years presents such difference of degree, in depth and duration, and in its political consequences, as to make a difference of kind. It is, indeed, a crisis through which we have been living, and it will be clearly seen as such when the eye of history foreshortens what contemporary vision and consciousness distend. It is a crisis of Capitalism in Paralysis. An economic system, whose defenders base their case upon its alleged inherent powers of automatic adjustment to changing circumstances, has been failing to accomplish such adjustments. It has been slowing down disastrously in its primary tasks of giving output and employment. It is stiff with rigidities of many kinds. Its muscular responses have grown weaker and weaker. As Signor Jung, the Finance Minister of Italy, said to me in Rome at the end of 1932, "we seem to be approaching the Peace of Death." Analogies of the capitalist system with the human body must, indeed, be handled with discretion. For the stoutest defenders of this system reject the suggestion that it lacks a central brain, and that this defect

might be remedied by deliberate State action to create such an organ. It is argued in individualist metaphysics that, deep in the recesses of the capitalist system, there exists something akin to a brain ; something superhuman which, in the words of the hymnal, " works in a mysterious way its wonders to perform "—something which is only thwarted in its wonder-working by the ignorant interventions of impatient man.

" From the time of Hume and Adam Smith," according to Professor Hayek in his Inaugural Lecture at the London School of Economics,[1] " the effect of every attempt to understand economic phenomena has been to show that, in large part, the co-ordination of individual efforts in Society is not the product of deliberate planning, but has been brought about, by means which nobody wanted or understood, and which in isolation might be regarded as some of the most objectionable features of the system. . . . We still refuse to recognize that the spontaneous interplay of the actions of individuals may produce something which is not the deliberate object of their actions, but an organism in which every part performs a necessary function for the continuance of the whole, without any human mind having devised it. In the words of an eminent Austrian economist (Professor Mises), we refuse to recognize that Society is an organism and not an organization and that, in a sense, we are part of a ' higher ' organized system which, without our knowledge and long before we tried to understand it, solved problems the existence of which we did not even recognize."

In short, if only we would give up all childish dreams of " deliberate planning ", and grasp " the invisible hand " which first Adam Smith and now Professor Mises and his followers extend to us, we should be led into the Paradise of Eternal Equilibrium. Such is the creed, superb in its simplicity, taught by the extremists of academic Liberalism to inquiring youth. But beside these conditional promises of bliss we may set other doctrines. Speaking at the London School of Economics, in the same hall as Professor Hayek, but two years earlier, another Liberal, Lord Lothian, delivering the annual Oration,[2] asked, " is there not more truth in the Marxian diagnosis of the ills of modern Society and in the materialist interpretation of history than we have been

[1] " The Trend of Economic Thinking," *Economica*, May, 1933, pp. 129–130.

[2] Published in the *Contemporary Review*, September, 1931, under the title " Renaissance or Decline ? ".

accustomed to think? How far is it true that modern capitalism, because it is largely based on usury and exploitation, contains at its heart inner contradictions which make impossible the solution of the economic and labour problems it inexorably creates for itself? Is there an 'irrepressible conflict' between what capitalist efficiency demands and what the instinct of human freedom in man will permanently accept? Is it possible to introduce any rational planning into the economic life of mankind, so long as anybody can start production, if he thinks he can make a profit out of it, until a slump has destroyed it?" And he replies, "I confess that the prophecies of Marx and Lenin . . . are being realized with the most uncomfortable accuracy—the growth of international capitalist monopoly, the decline of democracy, the impotence of trade unionism, the weakness of the national state in face of international finance capital, the exploitation of the backward races. . . . When we look round on the Western World as it is, and the persistence of its troubles, is it not obvious that we must probe into the fundamental causes far more deeply than we have been in the habit of doing, and in doing so I think that we may find that a good deal of the Marxian diagnosis is true."

Let us turn, however, from these conflicting speculations of Liberal thinkers, from metaphysics and metaphors, and from Mises and Marx, to the simple facts of reality. As to these, in their broad significant outline, there is no dispute. There is, rather, a hopeless agreement, a dull familiarity which has produced, in ordinary minds, insensitiveness to any new presentation of the tired truth or to any new proposal for escape.

The essential facts are set out, as well as anywhere, in various publications of the League of Nations. There is the report on *The Course and Phases of the World Economic Depression*, prepared under the direction of Professor Ohlin, of Stockholm, and published in 1931 in accordance with a resolution of the Assembly of the League in 1930. I remember, as one of the British delegates at that Assembly, joining with my Indian colleague, Professor Coyajee, who had initiated the idea, in pressing successfully, in opposition to the advocates of "economy", that this inquiry should be put in hand at once and completed without delay, and not dragged out, at some trifling saving in cost, over a longer period. I thought then, and I said, that if this inquiry were not made quickly it would have little practical value. For the "crisis", I argued, would

by the end of 1931 be either passed, or at its height and on the point of breaking. I was wrong. I under-estimated its will to live.

Since then, among other documents, the League has published in 1932 and 1933, as sequels to Professor Ohlin's Report, two *World Economic Surveys*, compiled by Professor Condliffe, of New Zealand, two *Reviews of World Trade*, and a study on *World Production and Prices*, 1925–1932.

The student will find much information in these sad reports. Here I shall content myself with quoting a few principal statistics.

We may recall, though to do so requires a certain effort of memory, after our experience of the last four years, that by 1925 " the aggregate destruction of wealth caused by the war had been made good, and the world as a whole was already richer than before the war ".[1] 1925 to 1929 were years of further economic progress, especially on the Continent of Europe. But this country failed to share proportionately in this advance owing, it is widely held, to our ill-advised return in 1925 to the gold standard at the old parity, and to the deflationary policy which this rash act necessitated. But even at the beginning of 1929 clouds were gathering, and in the early autumn the storm broke. Prices, which had been slowly declining since 1925,[2] began to fall rapidly. The volume both of production and of international trade likewise began to fall, and the volume of unemployment to rise. These were world-wide movements, though the Soviet Union felt their impact only indirectly.

The fall in prices, production, and trade soon became a collapse, and unemployment rose to unprecedented heights. The collapse of the price level may be illustrated from the following table, which shows the percentage decline in wholesale and retail prices from the average levels of 1929 to March, 1933.[3]

Country.	*Percentage Decline in Wholesale Prices.*	*Retail Prices.*
Belgium	40·8	16·8
Canada	32·6	21·3
France	37·8	5·9
Germany	33·6	24·2
India	41·1	32·2
Italy	37·0	17·3
Japan	19·3	20·5
Netherlands	49·3	17·9
Sweden	25·0	10·0
United Kingdom	28·5	16·5
U.S.A.	36·8	28·2

[1] *Course and Phases of the World Depression*, p. 14.

[2]

	1925	1926	1927	1928	1929
Gold Prices	100	93·5	91	90·5	88

Course and Phases of the World Depression, p. 125.

[3] *World Economic Survey*, 1932–3, p. 53.

In agricultural price indices there was an even greater collapse, the percentage decline between January, 1929, and January, 1933, being as follows [1] :—

Argentine	51	(71)
New Zealand	49	(69)
Canada	60	(68)
U.S.A.	60	
Poland	48	
Italy	41	
Germany	41	
United Kingdom	26	(34)

The figures in parentheses indicate the percentage decline in the gold prices of agricultural products in countries which abandoned the gold standard before January, 1933.

If we turn from index numbers, based on averages, to particular prices, we find, as is to be expected, some even more sensational declines. Comparing average gold export prices for 1929 and 1932, the following percentage declines catch the eye [2] :—

Rubber (British Malaya)	84
Wool (Argentine)	72
Raw Silk (Japan)	68
Copper (U.S.A.)	65
Coffee (Brazil)	64
Bacon (Denmark)	64
Maize (Argentine)	63
Raw Cotton (U.S.A.)	63
Grey Cotton Tissues (Japan)	63
Silk Tissues (France)	61

Whatever might be true of other economic systems, the capitalist system, based on production for profit and heavy fixed money charges, cannot stand up to swift price falls of this magnitude. Production accordingly collapsed with prices, except in agriculture, where farmers, blessed by the bounty of Nature, even in the hour of bankruptcy, continued to furnish unsaleable plenty. The following table indicates changes in the volume of primary production and of industrial output in the world as a whole.[3]

Base : average 1925–9 = 100

Nature of Index.	1925	1929	1930	1931	1932
Total Primary Production	96	106	102	98	94
Including—					
Agricultural Production	98	104	103	103	102
Non-Agricultural Production	90	114	101	86	73
Total Industrial Production—					
World including U.S.S.R.	92	111	100	90	77
World excluding U.S.S.R.	93	110	96	84	69

[1] *World Production and Prices*, 1925–32, p. 104.
[2] *Review of World Trade*, 1932, p. 9.
[3] *World Production and Prices*, 1925–32, p. 10.

In particular countries industrial production is reported to have fallen in 1932, as compared with 1929, as follows: In Canada by 42 per cent, in the United States by 46, in Japan by 4 (an exceptionally small decline), in Germany by 40, in France by 31, in Poland by 46, in the United Kingdom by 23, in Sweden by 21, in Czecho-Slovakia by 43. In the Soviet Union a rise of 65 per cent is reported.[1]

Turning to particular products, the world production of pig-iron in 1932 was only 46 per cent of the 1925–9 average, that of steel only 49, that of mercantile shipbuilding only 32 (and in the United Kingdom only 16), and that of motor cars only 38.[2]

The volume of international trade shrank between 1929 and 1932 by about 27 per cent, and that of trade in manufactured goods by more than 40 per cent. In 1932 the shrinkage was greatly accelerated by the increase of trade barriers of all kinds.[3]

"The Director of the International Labour Office, in the spring of 1932, estimated the number of unemployed as 20 to 25 millions. His successor's estimate of the number, a year later, in early 1933, was 30 millions."[4]

Such are some of the statistical features of these devastating years.

Recently a World Economic Conference has assembled in London, and has dispersed, without reaching any important agreement on action to be taken. This is not surprising, since there is wide disagreement on this issue among all the tribes of experts. Some are for sitting tight; some are for more "economy" and less taxes; some are for reflation; some are for development, to be promoted by Government; some are for planning; some are for Socialism. And some, including, ironically enough, some of the youngest and cocksurest, speaking like very old men, ask only for the restoration of the vanished freedoms of last century—for "restoring the freedom of the market in the widest sense of the term", as one of them has put it—freedom to cut wage-rates without limit; to break the power, such as it is, of the trade unions; and to scrap most of our modern social legislation, including, in particular, the systems of unemployment benefit, which, they argue, by keeping wages too high for business to yield a profit, and workless men too prosperous to take a job, perpetuate "disequilibrium" and unemployment.

But the main institutional framework of capitalism—private

[1] Ibid., p. 49. [2] Ibid., pp. 64–8. [3] Ibid., p. 13.
[4] *World Economic Survey*, 1932–3, p. 109.

property in the means of production, most unequally distributed and perpetuated by inheritance, with millionaires as a by-product —would, it appears, remain standing, while these subsidiary institutions and defences come crashing about the ears of the poor. The extremists of academic Liberalism, as was once said of others, take their laws *à la carte*. Their destructive zeal limits itself unduly. They recall to me, with a minor emendation, a stanza of Swinburne's " Watch in the Night ":—

> " Economist, what of the night ?
> I cannot tell ; I am blind.
> I halt and hearken behind
> If haply the hours will go back
> And return to the dear dead light,
> To the watchfires and stars that of old
> Shone where the sky now is black,
> Glowed where the earth now is cold."

Return to the golden age of capitalist *laissez faire* ? But, as Dr. Burney has said, " the golden age had not its name from those who lived in it." If we, with all our twentieth-century knowledge and opportunities, can do no better than this, then it is high time to give up the ghost, or to turn Communist and babble of bloody fields.

But such gestures of despair may still be premature. In some countries, including our own, there are indications, even though faint and partial, of the beginnings of recovery. Public policy has done little—in some countries it has done less than nothing—to help to turn the tide. But there is, it seems, still some ultimate recuperative power in the capitalist system, in spite of the heavy handicaps, which individualists deplore, upon its natural vigour. How far such spontaneous recovery can go, and how long continue, are speculative questions.

In a few countries, public policy is consciously seeking, in a modest way, to assist recovery. But there are two outstanding cases of more powerful and thrusting effort, which to-day command attention.

In two great communities bold experiments are being made to break down the barriers which " crisis " and " depression " have been allowed to raise between mankind and better times. In the United States President Roosevelt is striving, by rush tactics and with great political skill, to engineer a return of prosperity and confidence by raising prices, production (in industry though not in agriculture), and purchasing power, in parallel lines. Here is a bigger and more dramatic " interference "

with the working of the capitalist system, though not with the roots of the system itself—and a greater and more powerful array of newly granted executive powers—than political history records, outside of war time. However it ends, it will be judged a very gallant effort.

In the Soviet Union the capitalist system itself was violently uprooted nearly twenty years ago, and a planned economy, based on the public ownership of the means of production, is still in course of being worked out, by a process of trial and error, with wonderful energy, though in face of tremendous difficulties, including some of the most backward and, at present, the most inefficient human material in the world.[1] "The maximum of organization, with the maximum of disorder," as a French observer has said. Yet this, too, is a very gallant effort, in which it is, I think, a sign of mental senility to take no interest, though of childish credulity to find no flaws.

The rest of the world, more timid and more prudent in its nervous exhaustion, can afford to watch and learn from these two experiments, running none of the risks and bearing none of the cost, except a tiny fraction, indirectly and by way of backwash, if they fail. If the excitement of trying to be active is forbidden to invalids by their doctors, the milder excitement of watching others try may still, perhaps, be permitted!

[1] See, for a further discussion, my essay on "A General View of the Soviet Economy, with special Reference to Planning", published in *Twelve Studies in Soviet Russia* (Gollancz, 1933).

CHAPTER II

UNBALANCED BUDGETS

One incident in the general mess is a world-wide epidemic of unbalanced budgets. These constitute an important part of the financial, as distinct from the economic, "crisis." It is disputed among economists—and I shall not at this point take part in the dispute—whether the fall in prices is a cause, or an effect, of the slump. For, however this may be, it is certainly the chief immediate cause of budget deficits in the slump, and of the problems which these create.

The fall in prices diminishes public revenue from almost every source. The yield of taxes which are based upon the price of goods, whether home produced or imported, falls as these prices fall. If, as happens during a slump, the volume of these taxable goods also falls, the yield falls still further. The value and the volume of business transactions fall, and the yield of stamp duties based on these transactions falls. The money income of many taxpayers falls, and the yield of income tax falls. If the tax is on a progressive scale, the yield falls more than in proportion to the fall in income. Taxpayers, being poorer, tend to delay tax payments. The profits of State enterprises fall, as the purchasing power of their customers falls. And so on, in a vicious circle as the slump gets deeper.

The fall in prices, on the other hand, has no immediate effect on that large part of public expenditure which consists of fixed money charges, not varying with prices. It has some effect, though much even of this is delayed, upon public expenditure which varies with prices, such as the purchase of stores. On the other hand, the cost on public funds of maintaining unemployed workers, however low the level of maintenance, rises as their number increases.

The Government, indeed, is stimulated to reduce expenditure, in consequence of the fall in revenue. But such reductions meet resistance, and by the time they come into effect, revenue may have fallen still further.

The Government is likewise stimulated to increase taxation, but the revenue from higher rates of old taxes, and likewise from new taxes, is apt, with falling prices and deepening slump, to drop far short of expectation.[1]

[1] The only compensations likely to accrue to the Treasury in such

I heard it said recently that, among all the governments of the world, only those of India, Palestine, and the Isle of Man [1] were at present balancing their budgets. This is an understatement. But, even so, the picture given in *The Times' Annual Financial and Commercial Review*, of 1932, dated 7th February, 1933, is certainly remarkable. "The world economic crisis continued throughout 1932," we read. In Australia, New Zealand, South Africa, East Africa, Nigeria, British Malaya, Canada, the Irish Free State, France, Belgium, Germany, Spain, Holland, Austria, Hungary, Italy, Switzerland, Denmark, Sweden, Norway, the United States, Argentina, Brazil, Peru, Chile, Turkey and Japan budget deficits are reported in detail. On the other hand, a few of the West Indian colonies, Portugal, Czecho-Slovakia and Egypt report surpluses. A number of countries, it will be noticed, are not included in this survey.

It is not, of course, to be supposed that the small minority of budget balancers are enjoying a rare prosperity in an unprosperous world. Nothing so simple as this can be inferred, even if we take all the reported surpluses at their face value. And this would allow too little for the window-dressing ingenuities of public accounting. In some circumstances, indeed, a balanced budget is a pedantic luxury, which a community, hard pressed by sudden and exceptional misfortune, can ill afford. What can be inferred is, rather, that a world where so few budgets balance, in spite of all the moral precepts and orthodox traditions of Treasuries and money markets, is in a bad way. Unbalanced budgets on this world-wide scale are just a vivid symptom of world-wide disorder, both in economics and finance.

It may be useful at this stage to make, in passing, a few points of precision. Logically, a budget is unbalanced, either

times come through a fall in the rate of interest, both long and short term. The fall in the short term rate cheapens the floating debt. The fall in the long term rate implies a rise in the value of gilt-edged securities which, in turn, facilitates conversion of maturing long term debt to lower rates of interest, and also helps to raise the yield of taxes based on capital values, such as death duties. But these compensations are generally small, compared with other damage to the budget.

[1] "In introducing the Isle of Man Budget yesterday the Governor . . . said that all accounts closed with surpluses, and beneficial new expenditure could be undertaken without new taxation. The financial position admitted of a reduction in the beer duty. New expenditure would provide for the improvement of rivers, the extension of sanatorium and orthopaedic treatment, and water and sewerage schemes for villages. He hoped before long to submit particulars of the cost of establishing an aerodrome." (*The Times*, 1st June, 1932.) Assuredly a happy island, and a financial model for more pretentious communities!

if expenditure exceeds revenue, or if revenue exceeds expenditure; it is only exactly balanced, when revenue and expenditure are exactly equal. But, according to the common use of words, it is said to be unbalanced, only if expenditure exceeds revenue. If revenue either equals or exceeds expenditure, it is said to be balanced. Likewise, budgetary "disequilibrium" is only said to exist, if expenditure exceeds revenue, though logically equilibrium in a budget is only attained when revenue equals expenditure, and an excess of either over the other constitutes a disequilibrium. In this book common usage in these respects, rather than logic, will be followed.[1]

It is less equivocal to speak in terms of a budget "surplus" or "deficit". Even here, however, there may be ambiguity. In judging whether a surplus or a deficit has been realized, public expenditure should certainly exclude all debt repayment, even under Statutory Sinking Funds.[2] If there is any net repayment of deadweight public debt out of current revenue, there cannot be a true budget deficit. Similarly, public revenue should exclude all proceeds of new loans, or of the sale of public assets. If there is any addition to the net deadweight public debt,[3] in order to cover current expenditure, there cannot be a true budget surplus.

New loans to create new public assets, or to turn over existing assets from private into public ownership, should stand outside the ordinary budget, which should take account only of current revenue and current expenditure. There is much to be said in principle for constructing also, and publishing alongside the ordinary budget, a budget showing income and expenditure on capital account. And in some countries this, or something not unlike this, is done.[4] In practice, however, there are many difficulties of definition to be overcome.[5]

[1] If it seemed worth while to try to reconcile the two, we might speak of unbalanced, balanced, and over-balanced budgets, according as revenue was less than, equal to, or greater than, expenditure.

[2] The May Committee of 1931, in spite of, perhaps, overmuch Treasury guidance, blundered grossly on this point, and misled public opinion, both at home and abroad, thereby encouraging a flight from the pound. They proclaimed an impending deficit of £120 millions, but in this estimate was included a provisional £50 millions for debt redemption. Cf. Mallet and George, *British Budgets* (*Third Series*), 1921–1933, p. 366.

[3] The net deadweight public debt equals the public debt minus the public assets.

[4] Details of foreign procedure in this matter are given in a number of the studies which follow.

[5] Thus, if it is held to be legitimate in principle that expenditure on capital improvements should be financed by loan, and not from current revenue, it follows that it is legitimate to borrow, for example, for new

If the Treasury has accumulated reserves, out of which a realized deficit can be met, it may be argued that there is no true deficit. But this is only specious, since the reserves are of the nature of capital.

What is the most appropriate accounting period for a State budget ? A year is the most usual period, but there is no special sanctity in a run of twelve calendar months. Thus in Poland, on the advice of Sir Hilton Young, a month is now the accounting period. And no credit balance can be used for expenditure outside the estimates. British revenue and expenditure returns, on the other hand, nearly always show a deficit for at least eleven months out of the twelve, since income tax and surtax come in with a rush in the last weeks of the financial year. This unsatisfactory arrangement increases the charge for interest on the floating debt, as compared with what it would be if revenue came in more steadily, or if expenditure were planned to fluctuate more closely with revenue. A case can be made in favour of a longer period than one year.[1] The case on the other side, though reinforced by the instincts of conservatism, is mainly political. It is argued that the temptation to indulge in mere electioneering finance would be increased by a lengthening of the accounting period. But, as against this, Mr. Snowden, reputed to be a paragon of arid financial virtue, in effect lengthened the period, by providing in the Finance Act of 1930 that a realized deficit of one year should be carried over to the next, and provision made to wipe it out. In 1931, however, this austere missile, which he had aimed

road construction. Also for new schools and hospitals. But also, if capital is used in a wide sense, as by Professors Irving Fisher and Pigou, so as to include human beings in their aspect of productive agents, it may be claimed that it is legitimate to borrow for all additions to educational and health expenditure, including new teachers' and new doctors' salaries. Professor Pigou's conception of " investment in human beings " carries us very far along this road. But we must halt somewhere. Some authorities would halt at improvements which are sufficiently " revenue producing " to pay their cost out of the prices charged to users. But this is unsatisfactory, since it makes the distinction turn on the particular price policy adopted. On the other hand, if capital expenditure is financed from current revenue, a budget surplus is, to this extent, created, a policy of " sound finance " is pursued, and there is the additional social gain, that development takes place without the creation of new rentier income. Sound finance, in such cases, merges easily into Socialist finance, repugnant to rich taxpayers, as when the City Council of Vienna built working-class dwellings from the proceeds of luxury taxation.

[1] Professor Pigou (*Study in Public Finance*, part iii, ch. i) gives some tentative support to such a change. Mr. Keynes (*Means to Prosperity*, p. 13) argues more wholeheartedly that " our existing Budgetary procedure is open to the serious objection that the measures which will balance this Budget are calculated to unbalance the next, and vice versa ".

at the retreating figure and, as they seemed to him, the loose financial morals of Mr. Winston Churchill, became a boomerang. And in the Finance Act of 1931 its use was discontinued.[1]

I conclude that circumstances may often arise, in which there is a balance of advantage in lengthening the period beyond one year, or, to put the same thought in other words, in judging a series of annual budgets as a whole, rather than separately. That some should show deficits is comparatively unimportant, if others show surpluses which balance the series as a whole.[2]

But a series of deficits, particularly if these are large and give the sense of a financial situation out of control, is a bad business. And this is what we find in the recent financial history of many countries.

" This year Budgets are being worn unbalanced," said a wag some years ago. And there has been no great change since then in fiscal fashion, except that the gaps of a year or two ago have widened and the uncovered parts of the body of public expenditure have increased.

These preliminary considerations have been designed to prepare the way for what follows, and to set it in a frame of reference.

The studies which this book contains are primarily studies of fact, within a limited field, the boundaries of which, however, are not sharply fixed, nor quite identical in each study. Thus, for example, Mr. Hughes, working in Rome, covers a wider field in his examination of Italian financial institutions than Mr. Reedman in his necessarily more summary survey, conducted from Geneva, of a number of the smaller European countries. And, as regards subject matter, Mr. Brinley Thomas, in Berlin, covers a wider field than either, and covers it in greater detail.

But the studies all have the same point of departure. They all start from the strain on budgetary equilibrium, caused by the exceptionally rapid fall of prices since 1929. They are not limited, however, to the events of the last four years, but pick up the story, according to the circumstances of each country, at appropriate earlier points.

Closely connected with this question is another, that of the

[1] See Mallet and George, *British Budgets* (*Third Series*), pp. 282–3 and 318–19, on these variations of practice.

[2] Unless, of course, it is part of financial policy to provide large annual sinking funds for debt redemption. For then even an occasional deficit, or even a small surplus, is a sign of failure. An alternative mode of dealing with a heavy public debt, and, in general, in my opinion, a much better one, is to impose a special emergency levy, outside the category of current revenue, to pay off a large fraction of the debt quickly. For a discussion of this problem, see my *Principles of Public Finance*, chap. xxiii.

" rigidities ", or fixed money charges of all kinds which fail to fall with prices. This is partly a budget problem, partly a wider problem of public policy. There are, of course, many degrees of rigidity. Some of these charges fail to fall at all, unless Government intervenes to force them down. Others fall without Government intervention, but fall more slowly than the price level. Here, Government may take steps to accelerate the fall. In certain countries—in Germany, Italy, Australia and New Zealand, for example—some of these rigidities have been vigorously attacked by a series of laws and decrees. But, as will be seen, there is great variation both in the range and in the persistence of these attacks.

These studies produce, I think, a cumulative effect upon the mind. They show the same blizzard blowing in many lands, and the likeness of the ruins which it caused. The attempts to escape, or to repair the ruin, too, show a certain likeness. But there are also some significant differences in the policies pursued. And these differences are among the most interesting features of the subsequent narratives.

Each of the contributors, as I have already explained, tells his own story in his own way, and draws his own conclusions in his own field. Each is responsible for his own facts and his own opinions.

My part in the project, apart from a moderate amount of editing, has consisted in the initial planning and general supervision of the inquiry, the facilitating of personal contacts and access to information in foreign capitals, the following up of certain points of unusual interest or difficulty, and the maintenance of a regular correspondence with those engaged in the inquiry during their tenure of the Acland Travelling Scholarships.

I shall have something to say, in the two final chapters of the book, on the conclusions towards which, when read as a whole, these studies point, and of the comparisons which they suggest.

PART II

GERMANY

By Brinley Thomas

INTRODUCTION

No part of the world has suffered more profoundly from the present depression than Germany. Weakened by the ravages of the Great War and the burdens of the Treaty, the country was plunged into an orgy of inflation which had disastrous economic and political consequences. Rehabilitation proceeded rapidly in the boom of 1926–9, only to be followed, in turn, by the economic blizzard which has enveloped all countries. One or two indices will give some idea of the magnitude of the relapse in Germany. Industrial production fell from a level of 100 in 1928 to 61·2 in 1932, the output of production goods reaching as low a level as 50·2, while that of consumption goods was comparatively better maintained at 77·6. The estimated national income per head of the population, based on the 1928 purchasing power, declined from 1,185 marks in 1928 to 986 marks in 1931. The number registered as unemployed reached over six millions in 1932.

The object of the following chapters is to examine the attempts of the State to cope with the problems implied by this catastrophic slump. The study will be confined for the most part to the period 1929–32. Since the establishment of the Government of the National Revolution it has become impossible to interpret the trend of events with any degree of certainty. Yet it has been thought desirable to bring the account sufficiently up-to-date to throw some light on Nazi economic policy, without attempting to describe in detail the economic impact of the Revolution.

The first three chapters are devoted to an analysis of the Financial System as a whole and of the Reich Budget in detail. This is followed by an examination of particular aspects of State interference—Decrees reducing rates of interest, wages, prices, and rents; Public Works; Subsidies, Loans, and Guarantees; the Reorganization of the Banking System and Foreign Exchange Control. Finally, some general conclusions are offered regarding the extent of the capital consumption which has taken place in 1931 and 1932, and the relation between State policy and the trade cycle.

The author is deeply indebted for many kindnesses extended

to him during a stay of nine months in Berlin. He desires to express his appreciation of the valuable advice and assistance received from friends and experts in different fields, several of whom no longer hold their positions. He is also grateful for the unfailing courtesy shown to him in the libraries where the material for this study was collected.

CHAPTER I

SOME ASPECTS OF GERMAN BUDGETARY PRACTICE

The political and legal development of modern Germany has stamped its Budget Law with certain characteristics which call for brief explanation.

(1) THE TRANSFER OF REVENUES FROM THE REICH TO THE STATES AND MUNICIPALITIES (*Finanzausgleich*)

As a federal State, Germany evolved a system by which fixed proportions of certain taxes collected by the Reich are transferred to the States and Municipalities. Before the introduction of tariffs in 1879 it had been the practice for the Reich to receive payments from the States. Between 1882 and 1913 there was a complicated two-way traffic of transfers, the balance being in favour of the Reich. The Weimar Constitution placed the supreme authority to tax largely in the hands of the Reich and stipulated that, " if the Reich takes over taxes or other revenues hitherto reserved for the States, it must pay due regard to the maintenance of the ability of those States to exist." According to the Law of 30th March, 1920, the Reich alone was to levy taxes on Income, Corporation Income, Turnover, and Inheritance : provisionally fixed proportions of the proceeds were to be handed over to the States and a guarantee was given that the amount of the transfers should at least equal the yield of the displaced tax revenues of the States and Communes. Up to 1924 there were several provisional agreements and during the Inflation the Reich began to pay subsidies to the States.

The Dawes Report, in its comments on the German public finance system, had some severe things to say about the *Finanzausgleich* arrangements. For instance, " the States discharge wholly or in part many of the functions of government and there is no clear principle connecting their resources with their obligations. When in difficulties they press the Reich for larger subventions (as percentage of the yield of taxation) just as in turn the needy Communes press the States for greater financial aid . . . It is almost impossible to ascertain the true cost

of any of the single functions of government in view of its division between the three constitutional entities and in the absence of proper aggregated statistics of the States and still more of the Communes." [1]

The transfers made by the Reich to the States fall into two main categories :—

(*a*) Transfers of proportions of the yield of certain taxes.

(*b*) Payments made under special agreements to finance objects in which the Reich has a special interest. The taxes involved in the first category and the percentages transferred have undergone no material change in the last three years.

TRANSFERS MADE BY THE REICH TO THE STATES OUT OF THE YIELD OF CERTAIN TAXES [2]

Financial Year.	*Income.*	*Corporation Income.*	*Real Estate Turnover.*	*Real Estate Transactions.*	*Motor Car.*	*Race-betting.*	*Mineral-water.*	*Beer.*
	%	%	%	%	%	%	%	%
1931–2	75	75	30	96	96	96	96	17

In the years following Stabilization the actual amounts of this tax revenue transferred were consistently in excess of the estimates. The taxes in question exhibited more buoyancy than the other sources of revenue and the amount transferred thus represented a continually increasing proportion of the total revenue of the Reich. The Agent-General for Reparation Payments, writing at the end of 1928, observed that " not only are the transfers being made in increasing amounts, but they are now absorbing larger and larger percentages of the total increase in the tax revenues of the Reich, as the following figures show :—

	1924–5 *Accounts.*	1925–6 *Accounts.*	1926–7 *Accounts.*	1927–8 *Accounts.*	1928–9 *Estimates.*
	%	%	%	%	%
Ratio of Increased Transfers to Increase in total Tax Revenue	—	decrease	9·4	29·6	51·6

" It emphasizes the extent to which the present system deprives the Reich of the increasing yield of the taxes which respond

[1] Reports of the Expert Committees appointed by the Reparations Commission (1924), Cmd. 2105, p. 54. Since 1924 the statistical information has considerably improved.

[2] *Finanzieller Überblick über den Haushalt*, 1932 (the official review accompanying the budget estimates), Appendix 5. The yield of the Supplementary Wages Tax on single persons and the increases in taxes on income other than wages (enacted by the Emergency Decrees) went exclusively to the Reich.

most closely to the prosperity and business activity of the country and on which it would normally rely for the funds to meet its own obligations ".[1]

The second category of transfers comprises a great variety of grants spent on objects which concern the whole community as well as those which are purely local. About four-fifths of these are accounted for by the cost of police and the relief of the public assistance burden of the Municipalities.

The system of tax revenue transfers to the States was severely criticized by the Agent-General for Reparations. His " objections of principle " may be summed up in his own words :—

(*a*) " The Reich divests itself automatically of a large share of its principal taxes which respond most closely to the development of the German economy as a whole.

(*b*) " The payments to the States and Communes are made without regard to their financial condition and requirements.

(*c*) " The whole tendency of the present system is to confuse responsibility for taxation as between Reich and States and Communes. The States and Communes have the function of spending a large share of the taxes that the Reich has the responsibility of collecting."

Whereas in the boom years preceding 1929–1930 the system doubtless encouraged the States and Municipalities to spend excessively, the reaction in the depression has been in favour of the Reich. It must be remembered that the payments are the inevitable compensation due to the States for giving up sources of revenue which were formerly their own. Mr. Parker Gilbert was writing as Agent-General for Reparation Payments —obligations which were, of course, a charge on the Reich Budget. But the criterion, according to which the financial system of a federal State like Germany is to be judged, is not necessarily its capacity for paying tribute to other countries.

(2) The Ordinary and Extraordinary Budgets[2]

Up to the financial year 1928 the accounts of the Reich consisted of three separate budgets—the Ordinary, Extraordinary, and War Charges Budgets. Writing in 1927 the Agent-General for Reparation Payments expressed himself as follows : " The budgets are presented in a manner that makes it quite impossible,

[1] Report of the Agent-General for Reparation Payments, December, 1928.

[2] See Schultze and Wagner, *Reichshaushaltsordnung vom Dez.* 1922 *mit Erläuterungen* (1926) and Kühnemann, *Haushaltsrecht und Reichsetat* (1930).

even for well-informed readers, to follow them without exhaustive study and analysis. The budget as a whole contains many transfers from one budget to another, from one account to another, and from one year to another; all of which tend to create confusion and to complicate the accounting procedure." [1]

With the disappearance of the War Charges Budget in 1928 and the merging of its accounts with those of the general Reich Budget, the position became a little less obscure. The distinction between Ordinary and Extraordinary Budgets, however, is a fundamental characteristic of the German financial system.

The essence of the distinction is to be found in the significance of loans in the general Reich Budget. When a Government resorts to borrowing it is burdening future budgets with the necessity for providing interest and sinking fund payment and such a policy tends to injure the national credit. Article 87 of the Reich Constitution declares that receipts obtained from borrowing should be used only for "extraordinary" needs and as a rule only for "productive" purposes. This seeks to make a rigid and objective distinction between revenue obtained from loans, together with the expenditure thus defrayed, and the remaining ordinary sources of revenue together with the corresponding expenditure.

Ordinary Revenues include such items as receipts from Administration, realization of Reich property (with the exception of land), surpluses of Reichspost, dividends from the *Reichsbahn*, Reich's holdings in various undertakings, and the yield of taxes. It is not clear whether the yield of a non-recurring tax should necessarily be placed in the Extraordinary Budget. There are grounds for stating that, when this kind of tax is as onerous as, e.g. the Emergency Property Duty (capital levy) of 1919, its yield should be devoted only to exceptional needs and, therefore, it should appear in the Extraordinary Budget. But, apparently, it would not be illegal to put a non-recurring tax in the Ordinary Budget, since the law on this point merely states a general principle and not a strict injunction.

There is no definite regulation stating exactly the kind of expenditure properly belonging to the Ordinary Budget. The usual expenditure on current administration can, of course, include *einmalige* (non-recurring) payments and there will be some doubt as to whether they should be placed in the one Budget or the other. One criterion in this case seems to be the magnitude of the particular item. If it is relatively small, it must be defrayed

[1] The Agent-General's Report, June, 1927.

out of the Ordinary Budget. If relatively large, it may enter into the Extraordinary Budget. But this is not conclusive. It may involve a substantial increase in the Reich's outlay, while not falling into the " productive " category : in that case the ways and means for it must still come from the Ordinary Budget.

Article 87 of the Reich Constitution declares that expenditure is to be defrayed out of loans only, if it is " extraordinary " in character and serves a " productive " object. The commentary [1] on the Budget Law explains that " exceptional expenditure for a productive purpose " embraces in particular the acquisition of new or extension of existing industrial concerns or the acquisition of shares in a commercial undertaking of a " productive " character. But the description does not apply to measures which are calculated merely to maintain existing property, e.g. the replacing of an old house by a new one. It is admitted, however, that if the new house is substantially bigger than the old, this is equivalent to an extension of an undertaking. There must be a considerable measure of doubt regarding such a distinction. The principles governing this aspect of the budget are thoroughly tainted with " the fallacy of misplaced concreteness " !

Credit for " unproductive " purposes may be rendered necessary by such contingencies as war, national crisis, or grave financial stringency. If the revenue of the Ordinary Budget falls short of the outgoings, then a transfer may be made from the Extraordinary Budget in order to effect equilibrium in the former. A repetition of this procedure might, of course, have dangerous consequences.

Since it is a basic principle of the Budget Law that expenditure on productive or capital development should not be financed out of current revenue, it follows naturally that such items should appear in the Extraordinary Budget and be financed out of loans. But practice may often show a deviation from this rule. For instance, it has happened in post-stabilisation years that the Reich has had to cover expenditure in the Extraordinary Budget by drawing on surpluses in the Ordinary Budget—at times when the loan market was unfavourable. In the opinion of Mr. Parker Gilbert the " underlying fault " of the above principle is that " when applied to the Government's budget, it so easily often leads to new and unnecessary expenditures that themselves would never be incurred if they had to pass the scrutiny of the Ordinary Budget ". The fact that items of expenditure which really belong to the Ordinary Budget,

[1] Schultze and Wagner, *Reichshaushaltsordnung*.

but for which there is no cover, are often put in the Extraordinary Budget has led some authorities to the conclusion that this Budget should be abolished.[1] The official view is that the evils of such a procedure would outweigh the disadvantages of the existing arrangement. It is argued that " Extraordinary " items of expenditure do not remain at a more or less constant level from year to year, but show large fluctuations. The incorporation of such items, liable to fits and starts, in a unified Reich Budget would, according to official opinion, introduce a disturbing element and might make necessary large and variable increases in taxation from time to time. To quote the official review which accompanied the 1930 Budget Estimates, " the disadvantages of abolishing the Extraordinary Budget outweigh the advantages of a unified Budget, given the condition that in practice only productive (or capital) expenditures are put into the Extraordinary account and that, in assessing the volume of extraordinary expenditure, proper regard should be had to the ability of the capital market to supply loans."

(3) " Recurring " and " Non-recurring " Expenditure

German finance accounts divide expenditures into "recurring" and "non-recurring" (*fortdauernd* and *einmalig*). The former are normal expenses which must be met year after year : the latter, to quote the Budget Law, are " by their nature non-recurring, or are repeated only after a long period or whose recurrence in the following year is uncertain". The justification put forward for the distinction is that it meets a practical need, makes for clarity and an economical distribution of the Reich's resources. Obviously the division does not apply to the Extraordinary Budget.

It is difficult to see where the precise boundary runs. Money spent on a building programme would no doubt be classified as a non-recurring outlay. It is true that a single house takes a long time to wear out ; but from the point of view of a budgetary authority operating on a large scale there will clearly be a necessity for some expenditure on building every year.

[1] Examples of genuine " Extraordinary " items of expenditure are :—
Canal building.
Loans to *Reichsbahn-Gesellschaft*.
Purchase of debentures.
Participation in ownership of undertakings.
Agricultural settlements.
House building.
Special deposit in B.I.S.

The larger the administration, the wider is the scope of recurring expenditure.

(4) Transfers of Revenue and Expenditure Authorizations from one Financial Year to Another (*Einnahme- und Ausgabereste*)

The German Budget Law permits of the carrying forward of Expenditure and Revenue Votes from one financial year to the next. This practice often tends to obscure the real financial position. A complete view of any financial year must embrace the Expenditure Votes minus the Revenue Votes carried forward from the previous year, as well as the corresponding items handed on to the next year. It will be seen at a later stage that this extra-budgetary inflow and outflow can assume considerable significance.

(5) Some General Principles

Among the basic principles prescribed by the Budget Law is that of comprehensiveness: all revenue and expenditure of the Reich must be inserted in the Reich Budget (*Reichshaushaltsplan*). According to paragraph 75 of the Budget Law a deficit is to be met at the latest in the second following financial year as ordinary expenditure, whereas a surplus is to be applied either to the diminution of loan requirements or the redemption of debt, and in the latter case is to be inserted as ordinary revenue in the second following financial year. Paragraph 75 does not expressly admit of exceptions, but it is in practice suspended for one year whenever the surplus of one year is used to meet the current expenses of the next.[1]

Another principle declares that "expenditure must not be subtracted beforehand from revenue, nor revenue from expenditure".[2] In other words, gross, not net, receipts and expenditures are to be entered. But exceptions are provided for, partly on economic grounds and partly in order to simplify Reich accounts. The most important case is that of large undertakings owned and operated by the Reich, whose estimates are not entered separately as income and expenditure, but only in the form of an anticipated final result. If the estimated final result is a surplus it appears under ordinary revenue, if a loss under ordinary

[1] See Kühnemann, *Haushaltsrecht und Reichsetat*.
[2] *Reichshaushaltsordnung*, para. 69.

expenditure, and in the case of equilibrium it forms a blank revenue item (e.g. the Reich Printing and Publishing Offices). Strictly speaking, the new arrangement, by which only the part of the ear-marked taxes (under the *Finanzausgleich*) belonging to the Reich appears in the Reich Budget, is an offence against this principle.[1]

The canon of unity states that all revenues serve as cover for the aggregate of Reich expenditure. It is to be noted that the Railway Company is a separate legal person and the Budget Law does not apply to its revenue and expenditure. The Post Office, however, is under direct Reich administration. The principle of unity is not broken by the practice of ear-marking the yield of certain taxes for particular purposes, e.g. a part of the House Rents Tax for building, or a part of the Motor Car Tax for the upkeep of roads.

[1] See Kühnemann, op. cit.

CHAPTER II

THE GERMAN FINANCIAL SYSTEM, 1929–1932

(REICH, STATES, COMMUNES, AND HANSEATIC CITIES)

I. EXPLANATORY NOTES ON GERMAN FINANCIAL STATISTICS
- (*a*) Classification of Expenditure
- (*b*) Classification of Revenue
- (*c*) The Utility of the Classifications

II. A BIRD'S-EYE VIEW

III. ANALYSIS OF EXPENDITURE
- (1) Expenditure according to Branches of Administration
- (2) Expenditure according to Categories
  - (*a*) Categories of Expenditure in the System as a Whole
  - (*b*) The Distribution of each Category over Reich, States, Communes, and Hanseatic Cities
  - (*c*) The Expenditure of Reich, States, Communes, and Hanseatic Cities analysed according to Categories

IV. ANALYSIS OF REVENUE
- A. The Special Cover
- B. The General Cover
  - (1) Taxes and Customs Revenue
    - (*a*) The Distribution of Taxes and Customs Revenue over Reich, States, and Communes; the Transfer Taxes
    - (*b*) Taxes other than those shared between Reich, States, and Communes.
  - (2) Income from Public Enterprise
    - (*a*) The System as a Whole
    - (*b*) The Reich
    - (*c*) The States
    - (*d*) The Communes and Hanseatic Cities

V. THE INDEBTEDNESS OF THE FINANCIAL SYSTEM AS A WHOLE
- (1) The Different Kinds of Debts
- (2) Classification of Creditors
- (3) The Objects on which the Borrowed Money has been Spent

I. EXPLANATORY NOTES ON GERMAN FINANCIAL STATISTICS

In order to obtain an adequate idea of the impact of the depression on German finances it is necessary to analyse not only the budget of the Reich but also those of the States,

Communes, and Hanseatic cities. The aggregate net expenditure incurred by these authorities as a whole in 1930–1931 was 20,406 million marks, of which the Reich's share was 8,161 millions. An inquiry which confined itself to the course of Reich finances would thus leave out of account more than half the picture. Within the scope of this analysis it will not be possible to enter into a detailed consideration of the finances of the States and Communes: this chapter will rather seek to exhibit the part played by the States, Communes, and Hanseatic Cities alongside of the Reich in the development of what we may call the Financial System as a whole.

The method which the Statistical Office (*Statistisches Reichsamt*) uses to present the figures must first be briefly explained. The tabulation of the official data is based on certain fundamental concepts, an understanding of which is indispensable to the interpretation of the statistics. It is necessary at the outset to distinguish between *Finanzbedarf* and *Zuschussbedarf*. The former title (Total Requirement) is applied to the total expenditure for which cover must be found. Part of this cover will emanate from the income which Branches of the Administration receive in exchange for the services they render (administrative income, e.g. fees, fines, contributions, etc.), and from extraordinary sources such as loans, the sale of property, drawing upon reserves, etc. We shall call these two kinds of revenue Special Cover (*Spezielle Deckungsmittel*). That portion of the Total Requirement, which is not met out of Special Cover and must therefore be financed out of general taxation and the yield of public enterprise, is termed the *Zuschussbedarf* (the General Revenue Requirement). The difference between Total Requirement and General Revenue Requirement indicates the extent to which any branch of administration is self-supporting. In a few cases, such as the Administration of Justice and the Offices and Institutions of the Communes, Special Cover constitutes a substantial proportion of the Total Requirement, amounting (for the Financial System) in 1929–1930 to 46·6 per cent and 55·0 per cent respectively. That part of Special Cover which consists of current Administrative Income is fairly clearly defined: in some cases services may be rendered without fees being charged (e.g. schools), whereas in other cases fees may be levied in excess of the cost in the particular branch concerned (e.g. stamp duties), so that the fee begins to resemble a tax. The part which is of an extraordinary character, i.e. loans, drawing on reserves, etc., is not so clearly distinguishable. The principle is that these loans are ordinary market

operations for a special purpose: they meet the necessity of distributing the weight of extraordinary expenditure over a long period. When borrowing takes place to meet a deficit, the yield is not classified under Special Cover.

The sources of revenue which are drawn upon to defray the General Revenue Requirement are called *Allgemeine Deckungsmittel* (General Cover): they constitute, of course, the backbone of the Administration's receipts—taxes, customs, and the surpluses of public enterprises.

(*a*) *Classification of Expenditure* [1]

The official publications [2] classify expenditure in two ways: (*a*) according to Branch of Administration, (*b*) according to type of expenditure (*Ausgabenart*). The latter needs a word of explanation at this point. There are broadly eight categories of expenditure:—

(*a*) Personal Expenses (*persönliche Ausgaben*).

(*b*) War Pensions, etc. (*Kriegsversorgungsgebühren*).

(*c*) The Granting of Loans and Creation of Reserve Funds (*Gewährung von Darlehen und Fondsbildung*).

(*d*) New Building, Purchase of Land, etc. (*Neubauten, Grundstückskäufe*, etc.)

(*e*) Debt Service (*Schuldendienst*).

(*f*) War Indemnity (*Kriegsentschädigung*).

(*g*) Grants and Subsidies, Material [3] and Miscellaneous Expenses (*Zuschüsse und Unterstützungen, sächliche und sonstige Ausgaben*).

(*h*) Payments made by one Public Authority to another (e.g. by Reich to States, or States to Communes, etc.) (*Verrechnungsverkehr zwischen Reich, Ländern und Gemeinden: Ausgabenseite*).

The lump sum spent by each Branch of Administration (e.g. Education, Welfare) and by sub-Branches (e.g. various kinds of Schools, Welfare Institutions, etc.) is divided into the above categories.

Personal expenses include such items as salaries, compensation, employers' social insurance contributions, pensions, etc. It is

[1] See *Die deutsche Finanzwirtschaft vor und nach dem Kriege* (*Statistisches Reichsamt, Einzelschrift* No. 14).

[2] i.e. the publications of the *Statistisches Reichsamt*. The *Reichshaushaltsrechnung* (the Finance Ministry's Statement of the closed accounts) gives full details of the accounts of the separate Ministries, etc., which make up the Reich Budget.

[3] Up to 1928–9 the material (*sächliche*) expenses were shown in a separate column. Unfortunately, on the grounds of economy, the item has in recent years been merged with grants and subsidies.

important to note that this category does not include workers' wages: these appear under "material expenses" in (*g*).

Category (*b*) needs no explanation.

(*c*) The Granting of Loans and Creation of Reserve Funds. These are loans to agricultural, industrial, and transport undertakings in so far as they are engaged in carrying out work of a public and useful character. They do not include sums invested by Public Authorities (*Gebietskörperschaften*) for ordinary profit purposes: such sums belong to the sphere of Public Enterprise (*Erwerbsvermögen*). *Fondsbildung* means various kinds of renewal and reserve funds—land, new building, roads, insurance, welfare, etc.

(*d*) In the fourth class we find not only the erection of administrative buildings and offices and employees' dwelling houses, but also road construction, building and special upkeep of canals, procuring of equipment and furniture for new buildings.

Category (*g*) is very large, heterogeneous, and important. It embraces subventions to private and semi-public corporations; furtherance of industry, transport, agriculture; support of private schools at home and abroad, theatres, museums, research, exhibitions, fairs, Chambers of Commerce, Church, etc. Alongside of these are grants of a social character, e.g. in support of school pupils, artists, and students in difficulties, Welfare expenditure in kind as well as in money; grants to Health insurance carriers, maternity benefit, private and Church homes for pensioners and orphans, youth organizations, relief in case of storm or flood damage, etc. There are also the "material" expenses (*sächliche Ausgaben*), e.g. the equipment of offices, heating, lighting, insurance of buildings, libraries, etc. Outlay of this kind is obviously important in the Defence services, Police, Schools, and public institutions. Workers' wages are included here as well as miscellaneous expenses. It is very unfortunate that under this one roof several families of such divergent characteristics should have to jostle together: this statistical overcrowding and promiscuity is an illustration of the regrettable impact of the depression on German public finance sources.

When the expenditure has been sorted out according to the first seven categories, there is still another category to be accounted for, viz. various payments, refunds, etc., made by one Public Authority to another. When, e.g., several Authorities *A*, *B*, *C*, and *D* are consumers of a service whose upkeep is borne by only one of them *D*, then clearly certain transferred

sums will appear as expenditures in the budgets of *A*, *B*, and *C* and as income in the budget of *D*. This results in a very complicated web of criss-cross payments as between Reich, States, Communes, and Hanseatic Cities.[1] It does not include the transfer of fixed proportions of the yield of certain taxes by the Reich to the States and by the States to the Communes, general levies assessed by Unions of Communes on member-Communes, payments of a private legal character (interest, rent, etc.), or taxes paid by a Public Authority in its capacity as taxpayer. These inter-authority payments (*Verrechnungsverkehr*) are, of course, expenditure only from the point of view of the Public Authority making them. When we are dealing with the financial system as a whole it is obvious that the total of "expenditures" of this kind should be exactly balanced by a total of "receipts" (the same sums appearing as payments in some accounts and receipts in others).[2]

Examples of these payments are grants of the Reich to the States for Police expenditures and as compensation for the administration of Reich waterways, the States' grants to the Communes for the maintenance of roads and social charges, the Communes' contributions to the States for teachers' salaries, maintenance of theatres and road construction, grants by some Communes to others for the upkeep of hospitals, theatres, museums, schools, etc.

The financial system is made up of the Reich, eighteen States, about 50,000 Communes, and three Hanseatic Cities. The total gross "expenditure" (*Ausgaben insgesamt*) of the whole includes the eighth category of payments. The problem of eliminating double counting would be easily solved by merely leaving out this last category, if it were not for the fact already mentioned that in any given financial year the expenditure side of the inter-authority account is not equal to the income side. Deducting the total appearing as *expenditures* in this inter-authority traffic would mean leaving out certain items which do not reappear elsewhere as income in that financial year. But as regards sums which stand in the budgets of the different

[1] There is also the traffic of payments of this kind as between *Branches of Administration*; they were separately shown for the year 1928–9.

[2] The tables show that there is a disparity between the two totals. This is mainly due to the fact that grants, contributions, refunds, etc., transferred just before the end of the financial year by one Authority to another are received as income by the latter Authority when the books of that financial year are closed, with the result that they appear as income in the following year.

Authorities as *receipts* from other Authorities, there can be no doubt that there are always items of expenditure corresponding to them elsewhere. Double counting is, therefore, eliminated by subtracting the total of *receipts* arising out of the inter-authority refund traffic (*Verrechnungsverkehr: Einnahmeseite*) from the Total Gross Expenditure (*Ausgaben insgesamt*). The remainder represents the Net Total Requirement (*Reiner Finanzbedarf*), viz. the actual total of expenditure for which cover has to be found. Whenever the phrase Total Requirement is used, it means Net Total Requirement in this sense, unless otherwise stated.

In studying the Expenditures of any separate Authority (Reich or States) one can legitimately use the expenditure total, which includes the payments this Authority makes to other Authorities, without subtracting the income of the same variety which it receives from them. This aggregate—the sum of the eight categories of expenditure—is called *Bereinigte Ausgaben*. Obviously this total has no meaning for the financial system as a whole ; it can only be used roughly for certain calculations. It is this total of *Bereinigte Ausgaben* which is employed in the Tables exhibiting the relative significance of the different categories of expenditures in various years, not only for each separate Authority or group of Authorities, but also for the financial system as a whole.

(*b*) *Classification of Revenue.*

These main points having been clarified, the classification of the Revenue offers no difficulties. There is, first of all, the Special Cover, divided into its two constituent parts, (1) Administrative Income and (2) Loans, Sales of Property, Drawing on Reserves, etc. The difference between the Special Cover and the Total Requirement constitutes the General Revenue Requirement which must be defrayed out of the General Cover. The latter comprises Taxes, Customs duties, the surpluses of Public Enterprises, the profit of the Mint, and miscellaneous revenue. Receipts from borrowing undertaken with a view to meeting a deficit appear under General, and not Special, Cover.

(*c*) *The Utility of the Classifications.*

If collections of statistics are to serve a more ambitious purpose than that of mere description, it is important that they should follow categories which help to throw light on fundamental economic relationships. It is inevitable that adherents of different theories of the trade cycle, to take the supreme example,

should hold different ideas as to how official data should be marshalled. But it ought to be possible for State Statistical Offices, with their tremendous resources, to serve up their figures so as to contribute to the interpretation of those relationships which most economists agree to be significant.

The German Statistical Office has gone some way in this direction, particularly in its division of Public Expenditure according to the categories explained in the previous section.[1] It is useful, for example, to distinguish between—

(*a*) State expenditure to meet the cost of its own activities in various spheres—maintenance of law and order, defence, culture, etc.

(*b*) State expenditure which consists of the transfer of money payments to third parties in the form of subsidy or relief.[2] In the first case the State spends its resources on labour and material (*persönliche und sächliche Ausgaben*): in return for its outlay it receives an immediate equivalent from the market in the form of labour or material capital, and this means that there is so much less at the disposal of private entrepreneurs. In the second case the State hands out sums of money to third parties in the form, e.g., of subsidies, unemployment relief, pensions, or interest payments, which constitute internal transfers of purchasing power. In this way the State brings about shifts in income and therefore changes in the direction of demand and production. The statistical categories here in question are War Pensions, Loans, Debt Service, Grants, and Subsidies, whereas in the first case we are concerned with personal and material expenses. The War indemnity category represents the extent of the transfer of purchasing power outside the country.

The statistics may also give a rough index of public investment. Categories (*c*) and (*d*), viz. the Granting of Loans, the Creation of Reserve Funds and New Building, the Purchase of Land, etc., can with certain qualifications be looked upon as a criterion of the proportion of public expenditure applied to the building up of capital. This is, however, a very rough guide; for such expenditures comprise partly "barren transfers" from the capital market and only partly the creation of new capital.

[1] Professor G. Colm's attempt at an economic theory of state expenditures (*Volkswirtschaftliche Theorie der Staatsausgaben* 1927) was a sequel to the same author's statistical study: *Die Staatsausgaben von Grossbritannien, Frankreich, Belgien und Italien in der Vor- und Nachkriegszeit* (*Statistisches Reichsamt, Einzelschrift* No. 2).

[2] See Hugh Dalton, *Public Finance* (1929), chap. xvii, "Grants and Purchase Prices."

Another category whose magnitude deserves close attention is State expenditures which constitute consumers' income—e.g. personal expenditure, War and old age pensions, relief payments, etc. This element in modern State expenditure has assumed increasing significance and sheds important light on the problem of the "authoritarian" factor in distribution.

Unfortunately the pressing need for economy has forced the German Statistical Office to compress its information, with the result that the categories in which the figures are graded since 1929 are not as illuminating as they were previously. For instance, the material expenses (*sächliche Ausgaben*) are merged under the same heading as Grants, Subsidies, and Miscellaneous: this is to be deplored as they are qualitatively distinct types of expenditure.

With the material at our disposal it will, however, be possible to discern with some degree of clarity and understanding the profound impact of the great depression on the German Financial System.

II. A Bird's-eye View [1]

Some notion of the tremendous swing of the pendulum may be given by presenting figures showing the Total Requirement and the General Revenue Requirement of the Financial System since 1925–6.

Total Requirement (i.e. Net Total Expenditure) and General Revenue Requirement (i.e. Net Total Expenditure minus Special Cover) (Reich, States, Communes including Unions of Communes, and Hanseatic Cities)

	Total Requirement.		*General Revenue Requirement.*	
Financial Year.	*Total. Mrd RM.*	*Change compared with previous year. Mrd RM.*	*Total Mrd RM.*	*Change compared with previous year. Mrd RM.*
1925–26 .	14·5		11·7	
1926–27 .	17·2	+ 2·7	13·6	+ 1·9
1927–28 .	18·8	+ 1·6	15·0	+ 1·4
1928–29 .	20·8	+ 2·0	17·0	+ 2·0
1929–30 .	20·9	+ 0·1	16·7	− 0·3
1930–31 .	20·4	− 0·5	17·1	+ 0·4
1931–32 [2] .	17·0	− 3·4	14·3	− 2·8
1932–33 [3] .	14·8	− 2·2	12·4	− 1·9

[1] The statistics in this section are based on the special supplement to *Wirtschaft und Statistik*, 1932, No. 24, "Die Ausgaben und Einnahmen des Reichs, der Länder und der Gemeinden für die Rechnungsjahre, 1929–1930 bis 1932–1933."

[2] Provisional Results.

[3] Estimates.

Between 1925–6 and 1929–30 the Expenditure Total rose by no less than 6·4 milliard marks, or 44 per cent, under the influence of the upward swing of the trade cycle, the increasing responsibilities of the Public Authorities, and the burden of Reparations. By 1931–2 the scale of public expenditure had shrunk to the level of 1926–7, and in 1932–3 it is probably down to that of 1925–6.

Turning to the Revenue side we have the following picture :—

	Total Revenue. General and Special Cover.		*General Cover only.*	
	Total.	*Change compared with previous year.*	*Total.*	*Change compared with previous year.*
	Milliard Marks.			
1925–26 .	13·9		11·1	
1926–27 .	16·4	+ 2·5	12·8	+ 1·7
1927–28 .	18·7	+ 2·3	14·9	+ 2·1
1928–29 .	19·6	+ 0·9	15·8	+ 0·9
1929–30 .	19·9 [1]	+ 0·3	15·8 [1]	+ 0·0
1930–31 .	19·3 [1]	− 0·6	15·9 [1]	+ 0·1
1931–32 [2] .	16·4	− 2·9	13·7	− 2·2
1932–33 [3] .	13·8	− 2·6	11·4	− 2·3

The slump in revenue as a consequence of the world depression was all the more felt in Germany, as the reserves built up in the first year after stabilization were more than exhausted, even before the turn of the tide. During the phase of relative prosperity up to 1929 the yield of taxation and public enterprise could not keep pace with the rapidly increasing total of public expenditure.

The figures for the last three years, 1930–3, though not all founded on the closed accounts, are sufficiently reliable to indicate the tremendous shrinkage which the German public economy has been forced to undergo. Total Revenue has fallen by approximately 6·1 milliard marks in this period.

It will be our task in the following sections to exhibit in detail how the Financial System has reacted to this colossal deflation, what changes have taken place in the relative significance of different types of expenditure and sources of revenue in Reich, States, Communes, and Hanseatic Cities, and the effects on the role played by these various Authorities in the Financial System as a whole.

[1] Excluding cover for previous years' deficits, viz. 1929–30, 0·2; 1930–1, 0·6 mrds.
[2] Provisional Result.
[3] Estimate.

III. Analysis of Expenditure [1]

It is, first, necessary to inquire where the increases and decreases of different types of expenditure in the system as a whole are to be observed.

Changes in the Total Requirement and General Revenue Requirement, 1931–2 compared with 1929–30 [2]

Total Requirement. *Type of Expenditure.*	*Change.* Million RM.	%	*General Revenue Requirement.* *Branch of Administration.*	*Change.* Million RM.	%
Entire Financial System [3]	− 3,840	− 18·4	Entire Financial System	− 2,450	− 14·6
Decrease.			*Decrease.*		
War Indemnity . .	− 1,400	− 71·5	External War Charges .	− 1,400	− 71·5
Granting of Loans, Creation of Reserve Funds, etc. . .	− 1,350	− 71·1	Housing . . .	− 550	− 57·3
			Education, etc. . .	− 630	− 22·2
			Welfare (excluding Unemployment Relief) .	− 250	− 20·2
New Buildings, Purchase of Land, etc. . .	− 1,125	− 63·4	Internal War Charges and Pensions . .	− 260	− 12·8
Personal Expenses .	− 720	− 12·6	General and Finance Administration . .	− 190	− 12·9
War Pensions, etc. .	− 300	− 18·2	Defence and Justice .	− 210	− 11·0
Material and Miscellaneous . . .	− 425	− 8·7	Industry and Transport	− 100	− 7·6
Unchanged.			Miscellaneous Administration . . .	− 60	− 5·0
Debt Service . .	+ 8	+ 0·6	*Increase.*		
Increase.			Unemployment Relief [4] .	+ 1,200	+ 67·5
Social Charges [4] . .	+ 1,200	+ 67·5			

Between 1929–30 and 1931–2 the Total Expenditure of the Financial System has fallen by 3,840 milliards, or 18·4 per cent, whereas the General Revenue Requirement shows a smaller degree of reduction, viz. 14·6 per cent. This is, of course, explained by the fact that the part of Special Cover consisting of Loans has been greatly damaged by the credit situation in the last two years. This means that expenditure has had to be defrayed in a greater degree from the general pool of taxation.

(1) *Expenditure according to Branches of Administration*

It will be convenient to examine the situation, first, as it is reflected in the figures for the General Revenue Requirement of Branches of Administration. The two cases of outstanding

[1] The statistics in this section are based on the supplement to *Wirtschaft und Statistik*, 1932, No. 24.

[2] The General Revenue Requirement is that part of the Total Requirement which is not covered out of Special Sources of Income (Admin. income, borrowing, etc.), and must therefore be met out of the general revenue.

[3] On account of the difference between Expenditure and Income in the refund traffic between Public Authorities the sum of the single types of expenditures does not equal the Total Requirement of the entire Financial System.

[4] The General Revenue Requirement of the Administrative Branch " Economic Assistance and Unemployment Relief ".

shrinkage are External War Charges and Housing, viz. 71·5 and 57·3 per cent respectively. The reduction of 1,400 millions in the Reparations burden was the result of the Hoover Moratorium, whereas the striking decline in the expenditure on Housing amounting to 550 millions was due to the diminished portion of the yield of House Rents Tax devoted to building. Savings of over 20 per cent each were effected in Education and Welfare (excluding Unemployment Relief). But it must not be inferred that this considerable drop in expenditure on such socially important purposes is the consequence wholly of a deliberate policy of economy. These two branches of administration have a relatively high proportion of the material (*sächliche*) type of expenditure and thus their costs have been appreciably diminished by the fall in prices. Moreover those internal sources of income which we call Special Cover, e.g. fees of various kinds which contribute an important share of the maintenance of Education and Welfare, have been adjusted upwards, so that the General Revenue Requirement of these two Branches has decreased.

The item Internal War Charges and Pensions declined by 260 millions or 12·8 per cent. It is to be noticed that the *category* of Expenditure called War Pensions, etc., in the other column, exhibits a much sharper fall, viz. 18·2 per cent. The reason for the more moderate reduction in the Expenses of the Branch of Administration is the fact that under Internal War Charges are included the *Osthilfe* grants, in aid of East Prussia, which have shown a substantial rise.

Defence and Justice expenditure fell by only 11 per cent: in this connection it must be remembered that the salary cuts enacted by the Decrees of 5th June, 1931, and 8th December, 1931, did not apply to the Police and Military, except in the higher grades. The decline of only 7·6 per cent in outlay on Industry and Transport will be more clearly explained in later Tables. Suffice it to state here that the Reich's share in this Branch shows an increase in the period owing to grants given to assist the agricultural market and rationalize co-operative societies. If we confine ourselves to the States, Communes, and Hanseatic Cities, we find that the expenditure of this Administrative Branch fell by 22 per cent between 1929–31 and 1931–2. The Miscellaneous Branch includes Debt service, which has remained more or less constant.

The change in the relative significance of the different Branches of Administration may be seen in the following Table :—

	General Revenue Requirement (Million RM.)			*Per cent of Total.*	
	1929–30	1930–1	1931–2	1929–30	1931–2
General Admin., Finance, and Tax (Customs) Admin.	1,457·5	1,455·3	1,270·0	8·8	9·0
Police	766·3	780·7	1,680·0	12·3	11·7
Admin. of Justice	383·1	390·6			
Defence	737·8	739·1			
Education	2,828·2	2,690·6	2,200·0	17·0	15·4
Economic Assistance and Unemployment Relief	1,779·1	2,706·1	2,980·0	10·6	20·9
Welfare	1,227·6	1,051·4	980·0	7·4	6·9
Housing	959·4	858·9	410·0	5·7	2·9
Industry and Transport	1,363·4	1,481·2	1,260·0	8·2	9·0
Debt Service of Reich and States	761·4	713·1	710·0	4·6	5·0
Internal War Charges and Pensions	2,052·0	1,970·5	1,790·0	12·3	12·5
External War Charges	1,964·7	1,812·4	560·0	11·8	3·9
Miscellaneous	449·2	410·5	440·0	1·3	2·8
	16,729·7	17,060·5	14,280·0	100	100

EXPENDITURE OF ADMINISTRATIVE BRANCHES AS PER CENT OF GENERAL REVENUE REQUIREMENT (R.S.C. AND H.C.)

	Financial Year. 1929–30 %	1931–2 %
External War Charges	11·8	3·9
Housing	5·7	2·9
Unemployment Relief [1]	10·6	20·9
Remaining Branches	71·9	72·3

The influence of the Hoover Moratorium is clearly discernible. The outlay on External War Charges (Reparations) has declined from 11·8 to 3·9 per cent. The share taken by Housing has been halved. On the other hand the proportion claimed by Unemployment Relief has risen from one-tenth to one-fifth. It is interesting to note that, in spite of these violent changes in the relative significance of these Branches of Administration, taken together they represent about the same proportion of the whole, viz. 28 per cent, in 1931–2 as they did in 1929–30. Among the remaining Branches there are no substantial modifications of relative importance. Police, Justice, Defence and Education show a slight decrease and Debt Service and Industry and Transport a slight increase.

[1] The Branch called Economic Assistance and Unemployment Relief.

(2) *Expenditure according to Categories*

Further light can be obtained by considering the changes that have taken place in different categories of expenditure. When the total expenditure is reshuffled, as it were, in order to bring out the part played by distinctive *kinds* of outlay, one is better able to gauge the economic significance of public expenditure. The categories into which German expenditure is divided have been already defined.

(*a*) *Categories of Expenditure* (*Reich, States, Communes, and Hanseatic Cities*), 1927–31.

	Personnel Expenditure	War Pensions, etc.	Granting of Loans and Creation Res.	New Building, Purchase of Land	Debt Service	War Indemnity	Grants, Subsidies, Material, and Miscellaneous	Gross Total Requirement (*Bereinigte Ausgaben*)
1927–28	5,085·6	1,513·7	1,710·8	1,861·2	918·8	1,779·2	5,979·3	19,528·1
1928–29	5,644·0	1,702·6	1,817·5	1,778·2	1,206·9	2,158·8	6,509·6	21,629·4
1929–30	5,720·6	1,626·6	1,898·0	1,774·1	1,332·0	1,964·2	6,635·9	21,743·2
1930–31	5,683·8	1,583·9	1,224·1	1,166·8	1,339·7	1,879·1	7,457·8	21,377·8
1931–32	5,000·0	1,330·0	550·0	650·0	1,340·0	560·0	7,410·0	18,110·0
	EXPRESSED AS PER CENT OF GROSS TOTAL REQUIREMENT							
1927–28	26·0	7·8	8·8	9·5	4·7	9·1	30·7	100
1928–29	26·1	7·9	8·4	8·4	5·6	10·0	30·1	100
1929–30	26·4	7·5	8·8	8·2	6·1	9·1	30·6	100
1930–31	26·6	7·4	5·7	5·5	6·3	8·8	34·9	100
1931–32	27·6	7·3	3·0	3·6	7·4	3·1	40·9	100

This Table reveals some significant displacements. A notable feature is the enormous fall in the investment outlay—Granting of Loans, Creation of Reserves and New Buildings, Purchases of Land, etc.—from 3,672 millions in 1929–30 to 1,100 millions in 1931–2, and in War Indemnity, the significance of which has already been commented upon. The two categories making up the Investment group declined in importance from 17·0 per cent of the Gross Total Requirement in 1929–30 to 6·6 per cent in 1931–2, the indemnity category from 9·1 to 3·1 per cent. On the other hand there is the striking upward progress of Debt Service and Grants, Subsidies, Material, and Miscellaneous Expenditure. The former rose from 918·8 millions in 1927–8 to 1,340·0 millions in 1931–2, from 4·7 to 7·4 per cent of the total: the latter category increased from 5979·3 to 7410·0 millions in the same period, its relative importance rising from 30·7 to 40·9 per cent. Whereas these two categories together constituted a little more than one-third of the Gross Total Requirement in 1927–8, in 1931–2 their share had risen to almost a half. The expenditure on War pensions, etc., has fallen absolutely, and even relatively, since 1928–9; while in the last three years

Personnel Expenditure shows an absolute decline, but a relative rise.

(*b*) *The Distribution of each Category of Expenditure over Reich, States, Communes, and Hanseatic Cities,* 1929–30—1931–2.

The following Table enables us to see how the aggregate of each type of expenditure is divided out over Reich, States, Communes, Hanseatic Cities, and the extent of the shifts that have taken place in the last three years. The figures bring to light several modifications within the system as a whole : they can be seen most clearly by studying the percentages. Let us begin by studying the Public Investment categories (*c*) and (*d*). It is plain that the Communes are normally responsible for the bulk of this kind of outlay. In 1929–30 the Communes undertook 45·9 per cent of the total spent on the Granting of Loans and Building up of Reserves ; the Reich came second with 31 per cent and the States third with 19·4 per cent. In 1931–2 the position had quite altered. The share of the Communes rose to 52·7 per cent ; the States took the second place with 25·5 per cent, while the Reich's activity in this sphere dropped to no more than 18·2 per cent of the much diminished total. When we examine the other investment category—New Building, Purchase of Land, etc.—the story is different. Here the relative share of the Reich has increased from 9·6 to 19·2 per cent, and that of the Communes has fallen from 76·2 to 66·2 per cent. It is of interest to note these divergent effects of the drastic shrinkage in the two investment categories.

The increase in the aggregate Debt Service has been caused mainly by the Communes, whose relative share has gone up from 38·2 to 43·5 per cent. The Reich's part has fallen both absolutely and relatively. Category (*g*), comprising Grants, Subsidies, material, and miscellaneous expenditure, should be split up to give a more correct interpretation. The figures in the Table indicate that the Reich has had to assume a relatively growing burden (27·7 to 33·1 per cent of the total) : this is the consequence of the policy of economic and social relief forced on the Reich in the course of the depression. The performance of the States in this respect has declined (18·8 to 14·1 per cent) : the Communes still remain the most important carrier of this kind of expenditure, being responsible for half the total.

Personnel expenditure is a sticky category and was the target of some of the drastic Emergency Decrees. There have been no appreciable changes in its distribution : the States and

Communes still bear in equal shares almost 80 per cent of the total cost.

The proportions in which the various categories of expenditure are borne by Reich, States, Communes, and Hanseatic Cities are, of course, determined by the distribution of different functions among these authorities. The administration of Justice is largely a matter for the States. The cost of canals, fire brigades, etc., is carried exclusively by the Communes and Communal Unions.

THE DISTRIBUTION OF EACH CATEGORY OF EXPENDITURE OVER REICH, STATES, COMMUNES, AND HANSEATIC CITIES, 1929–30—1931–2 [1]

	Personnel Expenditure (*a*)	War Pensions (*b*)	Granting of Loans and Reserve Building (*c*)	New Building, Purchase of Land (*d*)	Debt Service (*e*)	War Indemnity (*f*)	Grants, Subsidies, Material and Miscellaneous (*g*)
1929–30							
Reich	995·3	1,626·6	589·9	169·9	621·9	1,964·2	1,820·8
States	2,235·2	—	368·6	161·8	155·9	—	1,247·8
Communes	2,264·2	—	872·0	1,349·1	507·8	—	3,325·8
Hanseatic Cities	225·9	—	67·5	93·3	46·4	—	241·5
Total	5,720·6	1,626·6	1,898·0	1,774·1	1,332·1	1,964·2	6,635·9
1931–32							
Reich	910·0	1,330·0	100·0	125·0	540·0	560·0	2,450·0
States	1,980·0	—	140·0	70·0	172·0	—	1,050·0
Communes	1,910·0	—	290·0	430·0	580·0	—	3,680·0
Hanseatic Cities	200·0	—	20·0	25·0	48·0	—	230·0
Total	5,000·0	1,330·0	550·0	650·0	1,340·0	560·0	7,410·0

EXPRESSED AS PER CENT OF TOTAL OF EACH CATEGORY

	%	%	%	%	%	%	%
1929–30							
Reich	17·4	100·0	31·0	9·6	46·8	100·0	27·7
States	39·1	—	19·4	9·1	11·7	—	18·8
Communes	39·6	—	45·9	76·2	38·2	—	50·1
Hanseatic Cities	3·9	—	3·7	5·1	3·3	—	3·4
	100·0	100·0	100·0	100·0	100·0	100·0	100·0
1931–32							
Reich	18·2	100·0	18·2	19·2	40·3	100·0	33·1
States	39·6	—	25·5	10·8	12·9	—	14·1
Communes	38·2	—	52·7	66·2	43·5	—	49·7
Hanseatic Cities	4·0	—	3·6	3·8	3·3	—	3·1
	100·0	100·0	100·0	100·0	100·0	100·0	100·0

Before the War, Police expenditure was defrayed by the States and Communes: since the War the Reich contributes about 30 per cent of this item. The States and Communes are also mainly responsible for financing Education. Social expenditure such as *Wohlfahrt* (Poor Law Relief, etc.), has always been the speciality of the Communes (they met 74 per cent of the total *Wohlfahrt* expenditure in 1913–14 and 60 per cent in the years

[1] The figures for 1931–2 are provisional.

1925–7). The abnormal unemployment of the last few years has thrown an almost intolerable burden on the Communes; and the Reich has been obliged to make successive grants to endeavour to alleviate it. Moreover, the Communes undertake a good 50 per cent of the expenditure of the Administrative Branch, Industry and Transport.

(*c*) *The Expenditure of Reich, States, Communes, and Hanseatic Cities analysed according to Categories.*

We have already obtained some idea of how each Category of Expenditure is spread over the four constituent parts of the Financial System. We can now proceed to analyse the qualitative make-up of the expenditure of each of these parts and to note the changes since 1929.

THE EXPENDITURE OF REICH, STATES, COMMUNES, AND HANSEATIC CITIES ANALYSED ACCORDING TO CATEGORIES 1929–30 AND 1931–2

	Personnel Expenditure (*a*)	War Pensions (*b*)	Granting of Loans and Building of Reserves (*c*)	New Buildings, Purchase of Land (*d*)	Debt Service (*e*)	War Indemnity (*f*)	Grants, Subsidies, Material and Miscellaneous (*g*)	Total Gross Expenditure (*Bereinigte Ausgaben*) (*h*)
Reich								
1929–30	12·4	20·2	7·3	2·0	7·7	24·4	22·6	100
1931–32	13·7	20·1	1·5	1·9	8·2	8·5	37·0	100
States								
1929–30	49·0	—	8·1	3·6	3·4	—	27·4	100
1931–32	51·0	—	3·6	1·8	4·4	—	27·1	100
Communes								
1929–30	26·7	—	10·3	16·0	6·0	—	37·9	100
1931–32	27·0	—	4·1	6·1	8·2	—	51·9	100
Hanseatic Cities								
1929–30	33·5	—	10·0	13·8	6·9	—	35·8	100
1931–32	38·1	—	3·8	4·8	9·1	—	43·8	100

The position revealed by the Reich figures will not be submitted to detailed interpretation in this connection. Suffice it to note that the proportion of the total which flowed abroad in Reparations fell from 24·4 to 8·5 per cent, whereas the claim of social and economic relief rose from 22·6 to 37 per cent. There was, further, a serious shrinkage in the proportion devoted to Granting of Loans and Building up of Reserves.

The States.—The interesting feature about the States is that no less than half their Total Requirement is for Personnel Expenditure. The investment categories exhibit the inevitable diminution. Debt Service constitutes a comparatively small part of the total outlay, but it shows the expected increase. The States are unique in another respect, viz. that the proportion spent on economic and social relief (including material and miscellaneous expenditure) has not risen. This is, of course,

due partly to the fact that the States are not involved in unemployment relief. The make-up of State finances is such that a good margin for economies exists in the administrative spheres—General and Tax administration, Justice, and Education. A glance at the absolute figures will make this clear.

THE STATES

CHANGES IN TOTAL REQUIREMENT AND GENERAL REVENUE REQUIREMENT

	1931–2 *compared with* 1929–30.	
	Million RM.	%
Net Total Requirement	— 690	— 16·7
General Revenue Requirement	— 570	— 17·4
Including—		
Education	— 260	— 17·3
General and Finance Administration and Justice	— 155	— 16·5
Housing	— 115	— 45·7

These figures for Administrative Branches serve to illuminate the situation shown by the Categories. Three-quarters of the savings in the General Revenue Requirement of the States were made in the three Branches—Education, General and Finance Administration, and Justice—spheres where personnel expenditure (salaries, etc.) plays an important part. The portion of the yield of the House Rents Tax devoted to the building of dwelling-houses has been increasingly applied to meeting pressure at other points on the expenditure front: this explains the falling-off in the case of Housing. The structure of the States' expenditure is, thus, on the one hand, immune from the colossal disturbance implied by unemployment relief in time of deep depression; but, on the other hand, it contains only to a very small extent the material category of expenditure, the cost of which falls automatically with the price-level. Personnel expenditure is a predominating element and the States have thus, more than any other part of the Financial System, been interested in the various measures taken to reduce the salaries and pensions of those in public employment.

The Communes and Hanseatic Cities.—The finances of the Communes and Hanseatic Cities have experienced the full blast of the economic blizzard; and the havoc wrought is even more serious than in the case of the Reich. The structural changes are seen in a high light partly because the investment categories (*c*) and (*d*) form a larger share of the total than in the case of the Reich and States. Taking the Communes we observe that

the 26 per cent devoted to investment ((*c*) and (*d*)) in 1929–30 fell to 10 per cent in 1931–2; whereas in the same period 44 per cent spent on debt service, economic and social relief grew to 60 per cent. The outstanding factor has been the shifting of the incidence of unemployment relief more and more on to the Communes. They have to contribute one-fifth of the cost of Extended Benefit (*Krisenfürsorge*) and also to bear the full relief of the unemployed who have exhausted this class of benefit. In spite of a grant of 225 million marks from the Reich, the (general revenue) Requirement of the Communes for unemployment relief increased by 520 millions between 1929–30 and 1931–2. But although they had to carry this extra load, the total net expenditure of the Communes between 1929–30 and 1931–2 declined by no less than 1,570 million marks. This extraordinary result could never have been achieved without the most prodigious economy measures. Some notion of how it was done may be derived from the following details:—

NET TOTAL REQUIREMENT AND GENERAL REVENUE REQUIREMENT 1931–2 COMPARED WITH 1929–30

	Communes.		*Hanseatic Cities.*	
	Million RM.	*% Change.*	*Million RM.*	*% Change.*
Net Total Requirement	— 1,570	— 19·6	— 155	— 23·9
General Fund Requirement	— 660	— 12·2	— 65	— 14·4
Including—				
Unemployment Relief	+ 520	+ 45·7	+ 40	+ 71·2
Housing	— 390	— 61·7	— 45	— 69·6
Education	— 340	— 28·9	— 20	— 21·3
Industry and Transport	— 180	— 22·2	— 15	— 36·0

Considerable savings have been made at the expense of Education, Housing, and the Industry and Transport Branch. They have taken the form of drastic reductions in salaries, wages, and pensions, the transference of the portion of the proceeds of the House Rents Tax from the financing of Housing to general purposes, economies in education, especially in the material needs of schools, etc. (the material category bulks very large in the Communes' expenditure on education), and drastic curtailment of the outlay, under Industry and Transport, on waterways, roads, etc., which explains the substantial drop in the investment categories. If the expenditure of the material type could be separated from category (*g*), it would exhibit a considerable fall, whereas the increase in pure social and economic relief would stand out more clearly. It is thus perfectly clear that the Communes have been obliged to wield the axe mercilessly on objects of vital social importance, in order to try to shoulder

the ever-increasing load of unemployment relief which has been pushed on to them.

The displacements within the Reich's expenditure structure, though of considerable significance, are to be associated in a large measure with the shrinking of the War indemnity item from one-quarter of the whole in 1929–30 to well under one-tenth in 1931–2 as a direct result of the Hoover Moratorium. For the Communes, however, there was no such *Deus ex Machina*. A wholesale redistribution of expenditure had to be effected. The vital social and economic services which the Municipalities exist to perform have been drastically curtailed and their reserves pumped almost dry. It is not too much to say that the whole structure of Municipal public finance is threatened to its foundations as a result of the Rake's progress of the last three years.[1]

IV. Analysis of Revenue [2]

It is now our task to turn to the other side of the picture and inquire into the effects of the depression on the sources of revenue of the Financial System. It has already been pointed out that every Branch of Administration has to a greater or less extent disposal over internal incomes which are termed Special Cover. The part of the total public outlay not met out of this source constitutes the General Revenue Requirement. These special sources of income merit our first attention.

(A) THE SPECIAL COVER

There are two sorts of Special Income: (*a*) Administrative Income such as fees, contributions, etc.; (*b*) the proceeds of loans, the repayment of loans, drawing on reserves, etc. Their development during the last few years in the System as a whole is as follows:—

Reich, States, Communes, and Hanseatic Cities
Special Cover (Million RM.)

	1927–8.	1928–9.	1929–30.	1930–1.	1931–2.
Administrative Income	1,998·5	2,152·8	2,290·3	2,244·4	2,190·0
Income from Loans Repayment of Loans Drawing on Reserves	1,826·7	1,680·7	1,851·6	1,100·7	560·0
Total Special Cover	3,825·2	3,833·5	4,141·9	3,345·1	2,750·0
Net Total Requirement	18,800·9	20,801·3	20,871·6	20,405·7	17,030·0

[1] See Herbert Gross, "*Die Lage der Finanzen.*" *Wirtschaftsdienst*, 20th January, 1933. A. Köttgen, *Die Krise der Kommunalen Selbstverwaltung*, 1931. Forsthöft, *Die Krise der Gemeindeverwaltung im heutigen Staat*, 1932.

[2] Except where otherwise stated, the statistics in this section are based on the supplement to *Wirtschaft und Statistik*, 1932, No. 24.

CHANGE BETWEEN 1929–30 AND 1931–2

	Decrease (—).	
	Million RM.	%
Total Special Cover	— 1,390	— 33·6
Comprising—Administrative Income	— 100	— 4·4
Proceeds of Loans, Repayment of Loans, and Drawing on Reserves, etc.	— 1,290	— 69·8

The income from both types of Special Cover was increasing up to 1929–30. The slump had a devastating effect on the extraordinary receipts—Loans, Repayment of previous Loans, drawing on reserves, etc. Their yield declined by no less than 1,290 millions, or 69·8 per cent, between 1929–30 and 1931–2. This was a consequence of the serious state of affairs on the credit market and the practical impossibility of raising loans. Current administrative income fared much better and only declined by 4·4 per cent in the period. But this relatively very favourable result was achieved only after various fees had been drastically raised. This kind of income is of considerable importance in the administration of Justice (45 per cent of the Total Requirement of the Branch in 1930–1) and in the Institutions and Offices of the Municipalities (46 per cent in 1930–1).

The contrast of the yields of the two component parts of Special Cover is shown by the respective proportions of the Total Requirement covered by them in the financial years 1929–30 and 1931–2.

PERCENTAGE OF THE TOTAL REQUIREMENT COVERED

Type of Revenue.	1929–30. %	1931–2. %
Special Cover	19·8	16·1
Comprising —		
Administrative Income	11·0	12·8
Proceeds of Loans, Repayment of Loans, Drawing on Reserves	8·8	3·3

It is significant that in 1931–2 a greater proportion of the Total Expenditure of the whole System was financed out of current administrative income than in 1929–30, whereas the part played by the extraordinary receipts dwindled from 8·8 to 3·3 per cent.

THE REGIONAL AUTHORITIES

Of the four parts of the Financial System, the Communes are predominantly interested in both types of Special Cover.

Both in 1929–30 and 1931–2 the Communes received about 60 per cent of the administrative income in the system as a whole and about 70 per cent of the Proceeds of Loans, Drawing on Reserves, etc. The proportion of total expenditure financed out of the two kinds of Special Cover varies considerably as between Reich, States, Communes, and Hanseatic Cities, and has undergone notable changes since 1929–30. The following Table indicates that administrative income is of only minute significance in the finances of the Reich, representing cover of the order of about 2 per cent. To the States, and particularly the Communes and Hanseatic Cities, this income is of much greater weight. No less than 20 per cent of the expenditure of the Communes was financed out of this source in 1931–2. The last three years have not altered this picture very much.

THE SPECIAL COVER OF THE DIFFERENT REGIONAL AUTHORITIES

	Administrative Income (Million RM.)					Borrowing, Repayment of Loans, etc. (Million RM.)				
	Total	Reich	States	Communes	H. Cities	Total	Reich	States	Communes	H. Cities
1927–28	1,998·5	165·3	590·1	1,135·8	107·3	1,826·7	138·1	315·0	1,299·9	73·7
1928–29	2,152·8	153·6	648·0	1,236·5	114·7	1,680·7	122·7	265·5	1,226·0	66·5
1929–30	2,290·3	166·8	673·6	1,331·2	118·7	1,851·6	279·2	199·6	1,301·8	71·0
1930–31	2,244·4	150·9	639·2	1,341·4	112·9	1,100·7	106·8	211·0	745·7	37·2
1931–32	2,190·0	165·0	600·0	1,330·0	95·0	560·0	15·0	150·0	390·0	5·0
	Proportion of Total Expenditure covered									
	%	%	%	%	%	%	%	%	%	%
1927–28	10·6	2·3	12·6	16·0	18·7	9·7	1·9	7·9	18·3	12·8
1929–30	11·0	2·1	16·3	16·6	18·1	8·8	3·5	4·9	16·2	10·8
1931–32	12·8	2·5	14·5	20·6	19·0	3·3	0·2	4·3	6·0	1·0

The case is different with the proceeds of Borrowing, Repayment of Loans, Drawing on Reserves, etc. Here the Communes have suffered a colossal loss of income, a decline from 1,301·8 millions in 1929–30 to 390 millions in 1931–2, which meant that in the latter year only 6 per cent of their Total Requirement could be met from this item as compared with 16 per cent in 1929–30. The Hanseatic Cities have been equally badly hit. The States managed to avoid a serious falling off in the proportion covered in this way [1]; in the case of the Reich this form of income practically disappeared altogether.

[1] This was due to the fact that in 1931–2 Prussia was able to borrow to the limit of loan authorizations brought forward from the previous year.

(B) THE GENERAL COVER

When Special Incomes have been taken into account, the remaining cost of public expenditure—which is, of course, the predominant part—has to be financed out of general revenue. It is easy to deduce from the previous table the relative magnitude of this General Revenue Requirement.

THE GENERAL REVENUE REQUIREMENT AS A PERCENTAGE OF THE TOTAL REQUIREMENT

	Entire Financial System.	*Reich.*	*States.*	*Communes.*	*H. Cities.*
	%	%	%	%	%
1927–28 . .	79·6	95·6	77·1	65·8	68·8
1929–30 . .	80·2	94·4	79·0	67·2	71·1
1931–32 . .	83·9	97·3	78·3	73·4	80·0

The Financial System has become more and more dependent on General Cover sources and this development is particularly striking in the case of the Communes and Hanseatic Cities.

It will be convenient to divide these General Cover sources into two broad groups: (*a*) Taxes and Customs and (*b*) the surpluses of Public Enterprises, including the profits of the Mint and Miscellaneous General Revenue. The yield of these two main streams of revenue and their relative significance may be exhibited in the following table :—

GENERAL COVER OF REICH, STATES, COMMUNES, AND HANSEATIC CITIES

	General Revenue Requirement.	*Taxes and Customs.*	*Surpluses of Public Enterprises, including Seigniorage on Coinage and Miscellaneous.*	*Excess of Expenditure (Mehrausgaben).*
	Million RM.			
1927–28	14,975·8	13,545·5	1,361·2	— 69·1
1928–29	16,967·8	14,296·6	1,460·9	— 1,210·2
1929–30	16,729·7	14,379·0	1,401·2	— 949·5
1930–31	17,060·5	14,141·8	1,768·8	— 1,149·8
1931–32	14,280·0	12,190·0	1,485·0	— 605·0
	Percentages of General Revenue Requirement			
1927–28	100	90·4	9·1	0·4
1928–29	100	84·2	8·6	7·1
1929–30	100	86·0	8·4	5·7
1930–31	100	82·7	10·3	6·7
1931–32	100	85·3	10·4	4·2

In this preliminary statement of how the bill has been met the figures convey the impression of a desperate struggle to achieve budgetary equilibrium. In 1930–1, the General Revenue Requirement was even slightly higher than in the previous year ;

but the yield of Taxes and Customs had already begun to swing downwards in spite of the stiffening of tax rates. Public Enterprise income manifested a welcome buoyancy. But as the axe had not yet been adequately applied to the Expenditure side, the year closed, in the System as a whole, with an aggregate excess of expenditure over income of 1,149·8 million marks. In 1931–2 the scaling-down process took a swift course and, as we have already seen, far-reaching reductions were made in expenditure. The depression left its mark on the proceeds from Taxes and Customs, which fell by no less than 2,190 millions, or 15·2 per cent between 1929–30 and 1931–2. The income from Public enterprises, together with the Mint and Miscellaneous receipts, kept up remarkably, the total being even higher than in 1929–30. The excess of expenditure was considerably less than in the previous year. These two large and heterogeneous groups of Revenue will be further analysed in more detail in order to show how their component parts have behaved.

But first it is desirable to glance at the evolution of the two groups of General Cover in Reich, States, Communes, and Hanseatic Cities taken separately.

GENERAL COVER OF SEPARATE PARTS OF THE ENTIRE SYSTEM

	General Revenue Requirement		Taxes and Customs	Public Enterprise and Miscellaneous Cover	Excess of Expenditure	General Revenue Requirement		Taxes and Customs	Public Enterprise and Miscellaneous Cover	Excess of Expenditure
	REICH					STATES				
	Million RM.		% of General Revenue R.			Million RM.		% of General Revenue R.		
1927–28	6,850·6	100	92·8	6·6	0·6	3,062·0	100	90·0	9·2	0·8
1929–30	7,595·9	100	88·7	5·4	5·9	3,269·4	100	87·5	7·9	4·6
1930–31	7,903·5	100	84·0	8·1	7·9	3,181·8	100	88·3	5·8	5·9
1931–32	6,440·0	100	89·6	9·8	1·6	2,700·0	100	91·5	4·8	3·7
	COMMUNES					HANSEATIC CITIES				
1927–28	4,670·5	100	85·4	12·3	2·3	392·8	100	87·5	13·7	0·2
1929–30	5,397·4	100	81·3	12·3	6·4	467·1	100	82·3	14·6	3·1
1930–31	5,496·8	100	78·7	15·7	5·6	478·4	100	76·0	16·6	7·4
1931–32	4,740·0	100	77·0	16·7	6·3	400·0	100	75·0	17·0	8·0

The Reich comes out of this analysis best. If we compare 1931–2 with 1929–30, the fact stands out that the Reich was able to call on Taxes and Customs, as well as Public Enterprises, to furnish increased proportions, leaving an expenditure excess of only 1·6 per cent of the General Revenue Requirement. The States, however, seem to have been unable to bring about

such a result ; for the relative role of Public Enterprises in meeting the General Revenue charge steadily declined throughout the period, due in particular to the falling off in receipts from Forestry and Domains, while the percentage financed from Taxes and Customs 1929–31 did not increase sufficiently to prevent deficits. The Communes and Hanseatic Cities manifest common features—a progressive transfer of the relative burden from Taxes and Customs to Public Enterprise receipts. Thus we shall see later that under the stress of circumstances the charges of municipally-owned public utilities have undergone such stiff increases that, strictly speaking, part of the income yielded is of the nature of taxation.

(1) *Taxes and Customs Revenue*

Revenue from Taxes and Customs is a fundamental constituent of any system of Public Finance. It is in this sphere that the world depression has worked the greatest havoc : it is also here that one is tempted to undertake an inquiry into the varying degrees of susceptibility to industrial fluctuation shown by different kinds of taxes. One or two attempts have already been made in Germany to measure the *Konjunkturempfindlichkeit* of certain sources of taxation. But such an inquiry bristles with difficulties both in theory and in statistical method. For the course of industrial fluctuation and the policy of the Finance Minister interact one on the other. Moreover, changes in the rates at which taxes are levied, and the manner in which they are collected, complicate comparisons.

Rather than plunge into such deep waters, we must be content at this stage with remaining in the shallows—and they will prove tricky enough. Owing to the complicated character of the transfers between Reich, States, and Communes, it will be necessary to discover to what extent the tax yields of the different regional authorities have been influenced by legislative and administrative modifications. We shall then be in a better position to draw conclusions as to the impact of the depression on various sources of revenue (Table on p. 53).

The year 1930–1 witnessed a great effort to secure equilibrium and this implied the raising of tax rates and the introduction of new taxes. The result was that only a modest decline in revenue was experienced. Different taxes, however, varied considerably. Income and Corporation Income Tax fell by 11 per cent compared with the previous year and the House

Rents Tax by 7 per cent, in spite of the stiffening of the rates in both instances. Compensating items were the higher yields obtained from the Taxes on Land and Buildings, Tobacco, and Beer, and from new taxes such as the Poll Tax and Municipal beer and drinking taxes.

REVENUE FROM TAXES AND CUSTOMS IN THE FINANCIAL SYSTEM AS A WHOLE

	1930–1 *compared with* 1929–30. *Difference.*		1931–2 *compared with* 1930–1. *Difference.*	
	Million RM.	%	*Million RM.*	%
Taxes shared between R., S., and C.				
Income and Corporation Income Tax	− 409·5	− 11·4	− 724·7	− 22·9
Turnover Tax	− 21·3	− 2·1	− 7·4	− 0·7
Miscellaneous	+ 35·5	+ 4·4	− 151·9	− 18·0
Total	− 395·3	− 7·3	− 883·9	− 17·6
Other Reich taxes	+ 204·2	+ 7·4	− 373·0	− 12·7
Customs	− 12·3	− 1·1	+ 64·4	+ 5·9
State and Municipal Taxes.				
Land and Buildings Tax [1]	+ 205·4	+ 16·7	− 47·0	− 3·3
Trade Profits Tax (*Gewerbe*) [2]	− 0·1	− 0·0	− 218·2	− 22·8
House Rents Tax	− 113·9	− 6·9	− 252·7	− 16·4
Slaughter House Tax	+ 5·8	+ 39·5	+ 19·4	+ 93·7
Poll Tax	+ 69·7	—	+ 160·3	+ 299·9
Municipal Beer and Drink Tax	+ 28·7	+ 33·8	+ 103·3	+ 90·9
Miscellaneous	− 25·7	− 7·9	− 78·1	− 25·9
Total	+ 169·9	+ 4·0	− 313·0	− 7·1
Taxes and Customs (excluding Reparations Levies)	− 33·4	− 0·3	−1,506·8	− 11·2
Reparations Levies	− 203·8	− 23·6	− 442·5	− 67·0
Grand Total [3]	− 237·2	− 1·6	−1,946·8	− 13·8

At the close of the year 1930–1 efforts were made to ease the burden of taxation in some directions, while at the same time the weight of other taxes was increased and new ones introduced. Examples of the former were the reduction of the Land Tax by 10 per cent and Trade Profits Tax by 20 per cent.

[1] Including Services in kind and Land Tax on Large Estates.

[2] Including Taxes on Itinerant Occupations and Stores, Mines and Railways.

[3] On account of rounding off of the provisional results for 1931–2 there are small discrepancies between these Difference figures and the total figures.

The Industrial Charge dropped from 350 millions in 1930–1 to 270 millions in 1931–2, of which only 180 millions were earmarked for the Reich Budget. From 1st January, 1931, the free limit for Property Tax was raised from 5,000 to 20,000 RM.; the tax on capital yield was abolished as far as fixed interest bearing securities were concerned; the Motor Car Tax and the Company and Securities Taxes were reduced, and the Mineral Water Tax was abolished as from the beginning of 1932.

On the other hand, in June, 1931, the Sugar Tax was doubled, and the Crisis Tax was introduced in July; and from 1st January, 1932, the Turnover Tax rate was more than doubled. There were changes in the dates of collection for assessed Income Tax and Corporation Income tax: Wages Tax refunds were stopped. The new State and Municipal Taxes, such as Slaughter-House and Beer and Drink Taxes, were stiffened.

These mighty efforts could not avail to prevent a fall of 1,506·8 millions in the revenue from Taxes and Customs (excluding Reparations Levies) in 1931–2, as against the previous year. Not only did the Income and Corporation Income and House Rents Taxes renew their swift downward course, but in contrast to the previous year the revenue from Tobacco, Beer, Land and Buildings, and Trading Profits showed a sharp falling-off. The Sugar Tax, which had been doubled, though the increased rate was not in operation for the whole year, gave a yield which was only 40·7 per cent higher than in 1930–1. There were higher receipts from the Poll Tax and Communal Beer and Drink Taxes, and it is also notable that Customs revenue was slightly better than in the previous year.

Such were the momentous consequences of the depression in the years 1930–2. The aggregate revenue from Taxation and Customs, including Reparations Levies, in 1931–2 was 12,195·0 millions, only slightly higher than the 11,675·4 millions which represented the income from these sources in 1926–7.

(*a*) *The Distribution of Taxes and Customs Revenue over Reich, States, and Communes.*

The object of this section is to show how the aggregate Taxes and Customs revenue of the Financial System is distributed over the component parts. This must be done in two stages: first the distribution of the taxes which the Reich shares with the States and Municipalities, secondly that of the revenue from all remaining taxes and customs.

TRANSFERRED TAX REVENUES [1]

DISTRIBUTION OF REVENUE FROM TAXES WHICH THE REICH SHARES WITH STATES AND MUNICIPALITIES (INCLUDING SPECIAL COMPENSATION TRANSFERS [2] AND BEER AND COMPANY TAXES).

	Reich.		*States, Communes, and Hanseatic Cities.*		*Whole Financial System.*
	Million RM.	%	*Million RM.*	%	*Million RM.*
1927–28	1,778·2	36·4	3,105·3	63·6	4,883·7
1928–29	2,022·0	36·6	3,497·2	63·4	5,519·0
1929–30	2,038·9	37·7	3,370·3	62·3	5,409·2
1930–31	1,944·1	38·8	3,069·8	61·2	5,013·9
1931–32 [3]	1,764·9	42·7	2,365·2	57·3	4,130·0

It appears from this Table that the Reich's share of the yield of these taxes began to rise in 1929–30. But there was a special reason for this. Brüning had made an arrangement that the revenue from Income Tax in 1929–30, over and above the sum of 1,300 millions, should be devoted to assisting Social Insurance. The extent of the surplus available was 96·1 millions: it did not become an effective item in the Reich Budget, but flowed directly to the Miners' Pensions Fund and Health Insurance. When allowance is made for this, the Reich's share in 1929–30 works out at 36·6 per cent, so that during the three years 1927–9 the distribution of these tax receipts remained practically unchanged. In the last two years, however, the proportion received by the Reich has appreciably increased, from 36·6 to 42·7 per cent. These "Transfer Taxes" are of such central importance to the whole financial structure that it is desirable here to analyse the nature of this development, which has proved so detrimental to the budgets of the States and Municipalities.

The Table on p. 56 is an official estimate of the effect of legislative changes since 1929–30 in decreasing or increasing the receipts of the States and Communes from the yield of various Transfer Taxes.

In 1930–1 the loss suffered by the States and Communes, owing to the fact that the Reich retained the extra income tax paid by bachelors and other additions to that tax, was practically offset by their receipts from Turnover and Mineral Water Taxes.

[1] *Wirtschaft und Statistik*, 1932, No. 22, p. 711. The *Finanzausgleich* System has been explained elsewhere.

[2] Received by Bavaria, Würtemberg, and Baden (59·4 millions per annum).

[3] Including the transfer of 50 millions, according to § 3 of 1931 Budget Law, and of 20 millions due to introduction of Agriculture Value Tax.

But in the following year 1931–2 the scales were weighted heavily against the States and Communes as a result of the retention by the Reich of the revenue from the New Crisis Tax, additions to Income Tax, and from abolition of Wage Tax refunds, deductions accompanying salary cuts, and the abolition of the Mineral Water Tax on 1st January, 1932–3. Compared with the previous year, the States and Communes suffered a loss of 262·9 millions. The year 1932–3 is a little more favourable

HIGHER (+) OR LOWER (−) TRANSFERS TO STATES AND COMMUNES OUT OF CERTAIN TAXES CAUSED BY LEGISLATIVE CHANGES SINCE 1929–30[1]

	Differences as Compared with 1929–1930. Million RM.		
	1930–1.	1931–2.	1932–3.
Income and Corporation Income Tax—			
Retention of Bachelor Tax and other additions to Assessed Income Tax	− 108·6	− 139·8	− 87·4
Retention of Crisis Tax	—	− 165·9	− 105·0
Deduction following Salary Cut	—	− 44·0	—
Reduction of Extra Income as result of abolition of Wage Tax Refunds	—	− 45·0	− 60·0
Turnover Tax. Deduction following Salary Cut	—	− 6·0	—
Reich Beer Tax	+ 77·5	+ 61·4	+ 50·0
Mineral Water Tax (introduced 16th May, 1930, abolished 1st January, 1932)	+ 13·6	+ 11·5	− 10·0
Total (difference as against 1929–1930)	− 17·5	− 327·8	− 212·4
Difference in each case as against previous year	− 17·5	− 262·9	+ 40·0
Grants towards Communes' relief burden	—	+ 233·8	+ 672·0
Grand Total (difference as against 1929–1930)	− 17·5	− 94·0	+ 459·6
Difference in each case as against previous year	− 17·5	− 29·1	+ 478·2

to the States and Communes, mainly because the deduction in conjunction with salary cuts is to be discontinued.

So much for the influence of legislative changes. The other cause of the shift in favour of the Reich is to be traced to the character of the Taxes concerned. The Income and Corporation Income Taxes, of the yield of which 25 per cent goes to the Reich, are much more susceptible to the worsening of economic conditions than the Turnover Tax, of which the Reich takes 70 per cent and which was increased from 0·8 to 2 per cent on

[1] See *Wirtschaft und Statistik*, 1932, No. 22, p. 712.

1st January, 1932. The States and Communes may well complain that what they gained in the years previous to the slump pales into insignificance compared with their serious losses since 1930. This is true as far as the system of revenue transfers is concerned. But it is very important to note that the sins against the principles of a true *Finanzausgleich* are being atoned for by the Reich's having to give the Communes considerable grants to assist them to bear the almost intolerable unemployment relief burden. This assistance amounted to 233·8 millions in 1930–1; it is estimated to cost the Reich 672·0 millions in 1932–3, and will undoubtedly be more than this. To a small extent, viz. 60 millions in 1931–2 and 80 millions in 1932–3, these grants were financed from the extra income accruing to the Reich from the abolition of Wage Tax refunds. For the rest they have to be raised wholly out of the Reich's tax resources. The division of the revenue from transfer taxes as between States and Communes remained more or less the same throughout the period, as the following table shows:—

DIVISION OF TRANSFER TAX RECEIPTS BETWEEN STATES AND COMMUNES[1]

	States.		*Communes (excluding Hanseatic Cities).*		*Total.*
	Million RM.	%	*Million RM.*	%	*Million RM.*
1927–28	1,491·5	50·3	1,471·6	49,7	2,963·1
1928–29	1,667·6	50·3	1,649·8	49·7	3,317·4
1929–30	1,600·7	50·1	1,595·8	49·9	3,196·5
1930–31	1,487·6	51·0	1,427·1	49·0	2,914·7
1931–32[2]	1,160·0	53·1	1,025·0	46·9	2,185·0

We are here confronted with one of the major problems of present day public finance in Germany. A radical reform of the *Finanzausgleich* system is now inevitable. Whether the well-known suggestions[3] of the outstanding authority on the subject—Professor Popitz—will at last be put into operation remains to be seen. The Government of the National Revolution has already (April, 1933) effected a sweeping change in the constitutional status of States and Communes: it is impossible to predict in what form the *Finanzausgleich* system will emerge from the melting-pot. One thing is certain; it must reappear

[1] Including Beer and Company Taxes Compensation.

[2] Excluding the transfer of 50 millions according to § 8 of 1931 Budget Law, and of 20 millions on account of introduction of Agricultural Value Tax. The rise in the proportion retained by the States in 1931–2 is due to the fact that the Communes' shares of the Income, Corporation Income, and Turnover Taxes had not been fully transferred.

[3] J. Popitz, *Der künftige Finanzausgleich zwischen Reich, Ländern und Gemeinden* (1932).

in one shape or another for, unlike many other legacies of the "November regime", it simply cannot be made to disappear altogether! The Nazis are apparently bent on abolishing the present Federal States and replacing them by subordinate units more in line with the distribution of the old Germanic tribes. In these circumstances it will not be surprising if the Popitz plan, which was regarded as radical in 1932, will be rudely rejected as an obsolete figment of the "Weimar" mentality.

(*b*) *Taxes other than those Shared between Reich, States, and Communes.*

The revenue from these taxes has fluctuated considerably in the case of the Reich, Communes, and Hanseatic Cities, owing to the predominant part played in their Total Requirement by such items as Reparations and Unemployment Relief. The receipts of the States from this source have manifested remarkable steadiness.

REVENUE FROM TAXES AND CUSTOMS (EXCLUDING TRANSFER TAXES AND REPARATION LEVIES)[1]

	Reich.	*States.*	*Communes.*	*H. Cities.*	*Reich.*	*States.*	*Communes.*	*H. Cities.*
		Million RM.			1925–6 = 100.			
1925–26	2,622·8	1,126·4	1,959·8	120·4	100·0	100·0	100·0	100·0
1926–27	3,199·1	1,194·0	2,316·7	157·2	122·0	106·1	118·2	130·6
1927–28	3,698·5	1,262·5	2,619·0	201·8	141·0	112·1	133·6	167·6
1928–29	3,588·5	1,269·5	2,747·1	214·9	136·8	112·7	140·2	178·5
1929–30	3,338·0	1,260·0	2,794·3	213·8	146·3	111·9	142·6	177·6
1930–31	4,029·8	1,321·4	2,905·9	210·7	153·6	117·3	148·3	175·0
1931–32	3,721·2	1,310·0	2,625·0	190·0	141·9	116·3	133·9	157·8

The Reich figures are strongly influenced by the receipts from Customs duties, which grew by 350 millions in 1926–7 and 310 millions in 1927–8 and fell by 146 millions in 1928–9. The disposal over the Industrial Charge and the higher revenue from the Tobacco Tax were largely responsible for the expansion in the years 1929–30. The factors operating in these latter years are fully discussed elsewhere.

The course of the States' revenue shows unusual smoothness. The rise in the early years was caused by the yield of the House Rents Tax; the comparatively sharp increase in 1930–1 is accounted for by the raising of the Prussian Land Tax. The explanation of the very moderate falling-off in 1931–2, which stands out in such contrast to the other authorities, is (*a*) the role of the Land tax which is not very susceptible to economic changes; (*b*) the deflection to general purposes of a large portion of the House Rents Tax revenue, which had previously been earmarked for the financing of Housing.

[1] See *Wirtschaft und Statistik*, 1932, No. 22, p. 713.

The desperate endeavour to increase tax revenue is clearly discernible in the figures of the Communes and Hanseatic Cities. After reaping a good harvest from the Land and Buildings and House Rents Taxes in 1926–7 and from the Trade Profit Tax in 1928–9, the Communes were forced, under the severe impact of the depression, to tap new sources, such as the Poll Tax and Drink Taxes. The aggregate yield in 1931–2 would probably have been maintained at almost the previous years' level, if it had not been for legislation which reduced the Trade Profits and House Rents Taxes.

(2) *Income from Public Enterprise*

(*a*) *The Income of the Financial System as a whole from Public Enterprise.*[1]

The data regarding the yield of public enterprises are based on Reich finance figures.[2] They differentiate between undertakings and general funded and landed property. The former comprise concerns which are publicly owned or in which " the Public Hand participates " ; while the latter includes income-earning property which does not belong to the public concerns, nor fulfil functions attached to the administrative organs, e.g. real estate and short and long-term investments. The budgetary " income " from a public enterprise is the net sum transferred, when grants from the Treasury have been allowed for. Since these transfers may represent only a portion of the profits of the concern, it would be misleading to regard these Reich finance figures as a correct index of profitability. These general principles apply to the statistics covering all kinds of public authority ; further explanatory details regarding the Municipalities will be supplied in a later section. The aggregate figures for the Financial System as a whole exclude the income of the Municipalities from Landed and Funded Property.

The income from Public Enterprise of the whole Financial System, leaving out of account the extraordinary sales or purchases of *Reichsbahn* preference shares and the income of the Communes from General Landed and Funded Property, increased from 458·0 millions in 1925–6 to 958·2 millions in 1930–1. The only interruption in this extraordinary expansion occurred in 1929–30 when the yield fell by about 60 millions compared with the previous year.

[1] The statistics are based on *Wirtschaft und Statistik*, 1933, No. 10, pp. 315–17.

[2] See *Wirtschaft und Statistik*, 1930, No. 10, p. 419.

INCOME OF THE FINANCIAL SYSTEM AS A WHOLE FROM PUBLIC ENTERPRISE 1925–1932 [1]

	Million RM. [2]		1925 = 100.	*Per Head of Population. RM.*	*Change compared with previous year. Million RM.*	*%*
1925–26	458·0	(238·0)	100	7·34		
1926–27	627·7	(627·1)	137·1	10·06	+ 169·7	+ 37·1
1927–28	748·7		153·5	12·00	+ 121·0	+ 19·3
1928–29	920·7		201·0	14·75	+ 172·0	+ 23·0
1929–30	861·3		188·1	13·80	− 59·4	− 6·5
1930–31	958·2	(1,258·2)	209·2	15·35	+ 96·9	+ 11·3
1931–32	737·0	(752·8)	160·9	11·81	− 221·2	− 23·1
1932–33 [3]	735·0	(775·0)	160·5	11·78	− 2·0	− 0·3

This rapid development reflects two factors: the upward swing of the trade cycle and the increasing role played by the

THE NET INCOME FROM DIFFERENT BRANCHES OF PUBLIC ENTERPRISE IN THE FINANCIAL SYSTEM AS A WHOLE

	MILLION RM.				
	1925–26.	1928–29.	1929–30.	1930–31.	1931–32.
Electricity	158·9	290·9	313·4	402·9 [4]	304·3
Gas	91·9	123·7	130·1	148·5	143·3
Water	38·7	51·6	55·6	88·1	101·3
Total Public Utilities	289·5	466·2	499·1	639·5	548·9
Post Office [5]	− 0·0	150·0	149·9	131·4	232·2
Railway Co. [6]	—	51·2	51·2	50·0	28·7
Miscellaneous Transport	13·9	45·7	13·9	19·8	− 12·8
Total Transport	13·9	246·9	215·0	201·2	248·1
Remaining Undertakings	154·6	207·6	147·2	117·5	− 60·0
Total	458·0	920·7	861·3	958·2	737·0
	%	%	%	%	%
Electricity	34·7	31·6	36·4	42·0	41·3
Gas	20·1	13·4	15·1	15·5	19·4
Water	8·4	5·6	6·5	9·2	13·8
Total Public Utilities	63·2	50·6	58·0	66·7	74·5
Post Office	—	16·3	17·4	13·7	31·3
Railway Co.	—	5·6	5·9	5·2	3·8
Miscellaneous Transport	3·0	5·0	1·6	2·1	− 1·7
Total Transport	3·0	26·9	25·0	21·0	33·6
Remaining Undertakings	33·8	22·5	17·1	12·3	− 8·1
	100	100	100	100	100

[1] Excluding the income of the Communes from General Landed and Funded Property.

[2] The figures in parentheses allow for the sales or purchases of Railway preference shares.

[3] Estimates.

[4] Including 32·0 millions non-recurring income of City of Berlin.

[5] After subtracting personnel expenses for Post Office.

[6] Preference share dividend.

"Public Hand" in the economic system. The results of the financial year 1931–2 exhibit the brunt of the depression—a decline of 221·2 millions compared with the previous (peak) year. The Government's price-reducing policy, together with the fall in consumption of public utility services, contributed to bring about this retrogression.

The summary table on p. 60 gives the contributions of different branches of public enterprise in 1925 and 1928–31.

The outstanding importance now assumed by Public Utility income is the chief feature of the above table: electricity, gas, and water undertakings made up no less than three-quarters of the total net receipts in 1931–2 compared with one-half in 1928–9. As we shall see in detail later, this is to be imputed to the policy of the Municipalities during the depression. The rapid rise in the proceeds coming from the Post Office is the consequence of the Reich's strenuous endeavours to balance the budget.

The distribution of Public Enterprise income over the four component parts of the Financial System is given in the following table:—

NET PUBLIC ENTERPRISE INCOME OF THE REICH, STATES, COMMUNES (MUNICIPAL UNIONS), AND HANSEATIC CITIES

	Reich.[1]	*States.*	*Hanseatic Cities.*	*Communes*[2] *(incl. Unions).*	*Financial System.*
		Million RM.			
1925–26 . .	— 9·2	141·0	28·2	298·0	458·0
1926–27 . .	94·0	123·1	23·8	386·8	627·7
1927–28 . .	113·0	176·8	33·9	425·0	748·7
1928–29 . .	200·5	208·7	31·5	480·0	920·7
1929–30 . .	161·4	178·4	39·3	482·2	861·3
1930–31 . .	178·2	106·4	38·0	636·0	958·6
1931–32 . .	165·0	23·5	45·5	503·0	737·0
	PERCENTAGES OF TOTAL PUBLIC ENTERPRISE INCOME				
1925–26 . .	— 2·0	30·8	6·1	65·1	100
1926–27 . .	15·0	19·6	3·8	61·6	100
1927–28 . .	15·1	23·6	4·5	56·8	100
1928–29 . .	21·8	22·7	3·4	52·1	100
1929–30 . .	18·7	20·7	4·6	56·0	100
1930–31 . .	18·6	11·0	4·0	66·4	100
1931–32 . .	22·4	3·2	6·2	68·2	100

The Municipalities have increased their share of the System's total income from Public Enterprise from a little over a half in

[1] Excluding Railway Company's contributions to Reparations and various sales and purchases of Railway Company preference shares.

[2] Excluding the Landed and Funded Property of the Communes and Unions of Communes.

1928–9 to well over two-thirds in 1931–2. The States have experienced a catastrophic set-back, whereas the Reich and the Hanseatic Cities show a slight relative advance. The unique evolution of Public Enterprise in Germany and its significance for the public finance system call for a more extensive inquiry and the following sections attempt to fill in the details.

(*b*) *The Income of the Reich from Public Enterprise.*[1]

The composition of the Reich's income from this source has been strongly influenced by the fact that, while Germany paid Reparations, the whole railway system was mortgaged for that purpose. The only benefit the Reich budget received from its railway property was the annual dividend on its holding of 7 per cent preference shares. In these circumstances it is the Post Office surpluses that have constituted the backbone of the Reich's income from its own undertakings.

The general position may be seen in the following Table which, it must be noted, does not include the revenue from the Mint (seigniorage on the coinage).

NET INCOME OF THE REICH FROM ITS OWN ENTERPRISES (INCLUDING PARTICIPATIONS)[2]

	Ordinary Type.	*Extraordinary Type.*	*Total.*	*Proportion of General Revenue Requirement of Reich.* (%)
1925–26 . .	23·5	— 252·8	— 229·3	—
1926–27 . .	32·4	61·0	93·4	1·54
1927–28 . .	119·4	— 6·3	113·1	1·65
1928–29 . .	222·8	— 22·3	200·5	2·47
1929–30 . .	224·6	— 63·2	161·4	2·12
1930–31 . .	227·3	250·9	478·2	6·05
1931–32 . .	299·3	— 118·4	180·9	2·79

The ordinary type of income increased steadily throughout the period. The irregular course shown by the amounts in the Extraordinary column can be explained by closer analysis. The net surpluses received by the Reich seem small as proportions of the General Revenue Requirement; but it must be remembered that these percentages are strongly influenced by transactions of a capital character, shown in the Extraordinary column. It is only after the above table has been split up into its component parts that a true view of the position can be obtained.

[1] The figures are based on *Wirtschaft und Statistik*, 1933, No. 6, pp. 182–4.

[2] Excluding the sums yielded by the Railway Company under Reparations agreements.

The net surpluses of the ordinary kind are made up as follows :—

THE REICH'S NET INCOME OF THE ORDINARY KIND [1]
(Thousand RM.)

	Total.	*Post Office.* [2]	*Railway Co.* [3]	*Viag.*	*Reich Printing.*	*Reichs-Bank.*	*Miscellaneous Undertakings and Participations.* [4]
1925–26 . .	23,485	— 38	—	2,635 [5]	5,472	12,185	3,231
1926–27 . .	32,370	12,045	2,966	6,000	4,198	4,205	2,956
1927–28 . .	119,358	69,956	29,903	7,200	4,799	5,512	1,988
1928–29 . .	222,823	149,953	51,159	8,400	4,282	5,240	3,789
1929–30 . .	224,554	149,928	51,170	9,600	4,430	5,324	4,102
1930–31 . .	227,303	131,434	50,041	10,464	4,431	18,034	12,898
1931–32 . .	299,265	232,159	28,687	9,949	5,170	—	23,300
			Percentages.				
1925–26 . .	100	— 0·2	—	11·2	23·3	51·9	13·8
1926–27 . .	100	37·2	9·2	18·5	13·0	13·0	9·1
1927–28 . .	100	58·6	25·1	6·0	4·0	4·6	1·7
1928–29 . .	100	67·3	23·0	3·8	1·9	2·3	1·7
1929–30 . .	100	66·8	22·8	4·3	2·0	2·4	1·8
1930–31 . .	100	57·8	22·0	4·6	2·0	7·9	5·7
1931–32 . .	100	77·6	9·6	3·3	1·7	—	7·8

The important part played by the Post Office comes out clearly in this table. Between 1928–9 and 1930–1 the other undertakings were becoming relatively more prominent, the increases being particularly noticeable in the case of the Reichsbank, *Viag*, and miscellaneous group. But in 1931–2 the Post Office was responsible for no less than 77·6 per cent of

EXTRAORDINARY GRANTS TO (−) AND RECEIPTS FROM (+) PUBLIC ENTERPRISES
(Thousand RM.)

	Purchase and Sale of Railway Co. Preference Shares	Participation in Credit Undertakings	Participation in Viag	Participation in and loans to Neckar and Rhine-Main Cos.	Grants to the Deutsche Werke Kiel	Participation in Motor Car Cos.	Miscellaneous Receipts and Payments
1925–26	− 220,000	—	− 10,336	− 14,394	− 9,638	− 1,082	+ 2,700 [9]
1926–27	− 618	− 10,000	− 733	− 12,679	− 2,117	− 718	+ 87,866 [9]
1927–28	—	—	—	− 7,331	− 2,500	− 502	+ 4,000 [9]
1928–29	− 56	− 10,500	—	− 11,412	—	− 382	—
1929–30	—	− 50,000	− 247	− 7,884	− 6,000	− 47	+ 1,000 [10]
1930–31	+ 300,000	− 9,039	− 18,464 [6]	− 9,751	− 8,500	− 195 [7]	− 3,107 [11]
1931–32	+ 15,924	− 113,578	− 11,890	− 7,298	− 2,000	+ 471 [8]	—

[1] Based on closed accounts of Reich budget; excluding the sums yielded by the Railway Company under the Reparations agreement.
[2] Allowing for personal expenditure (salaries, pensions, etc.).
[3] Preference share dividend.
[4] After deducting grants from Exchequer.
[5] The total dividend amounted to 6·0 millions, of which 2·6 millions were handed over in cash and the rest in Viag shares.
[6] Including 8 millions for the acquisition of shares in the *Rheinische Metallwaren- und Maschinenfabrik A.G.*, which was incorporated in *Viag*.
[7] Cost of liquidating motor-car companies.
[8] From sale of holdings and yield of liquidations.
[9] From surpluses and capital of Reich Corn Board (1927–8 one million)
[10] From the funds of the Reich Printing Office.
[11] Winding up of participation in *Emelka*.

the total, the absolute amount of the surplus transferred being almost double that of the previous year.

Details regarding the items of an extraordinary character are shown in the table on p. 63.

These items are for the most part sales or purchases of shares. The large sum of 113 million RM. of participations in credit undertakings reflects the serious credit crisis of July, 1931 ; the canal companies have always been a liability.

A summary table may be given to show from which categories of enterprise the Reich receives its income.

TOTAL NET PUBLIC ENTERPRISE INCOME OF THE REICH, ACCORDING TO INDUSTRIAL GROUPS
(Million RM.)

	Transport	Commercial and Industrial	Credit	Waterways	Undertakings Miscellaneous Participation	Total	Seigniorage on Coinage	Total (Including Mint)
1927–28	99·1	14·6	5·5	− 7·2	1·1	113·1	83·5	196·6
1928–29	201·2	14·7	− 4·3	− 11·3	0·2	200·5	120·8	321·3
1929–30	201·3	11·4	− 43·8	− 7·7	0·2	161·4	65·0	226·4
1930–31	481·5	− 13·3	10·4	− 9·7	3·9	472·8	26·1	498·9
1931–32	277·4	3·5	− 111·5	− 7·3	18·8	180·9	353·9	534·8

The very high net income obtained from the transport group in 1930–1 was, of course, due to the proceeds of 300 million RM. got from the sale of Railway preference shares. In the following year the Post Office supplied the sum of 232·2 million RM. The amount which would have corresponded to the legal requirement, which lays down that the Post Office must deliver 6 per cent of its income to the Reich, was 114·8 millions : the additional 118·8 millions represented the savings reaped by the Post Office as a result of the first two salary cuts brought about by the Emergency Decrees.

The Reich's industrial and electrical enterprises and participations are included in one large holding company *Vereinigte Industrie-Unternehmungen A.G.*, generally referred to as *Viag*. The total capital of the companies in which *Viag* participates amounted on 1st March, 1932, to 708·4 millions RM., of which *Viag* held 288·0 millions.

The credit crisis of summer, 1931, compelled the Reich to extend its interests in the banking world. The details of these transactions are elucidated in a later chapter.

The sudden increase in the revenue from the miscellaneous group in 1931–2 is mainly due to the Reich Maize Board, which doubled its net surplus compared with the previous year.

It is not easy to compress into a short section a review of all the manifold activities of the Reich in the sphere of public enterprise. Taken in the strict sense the income from public enterprise has played only a small part in supplying cover for the General Revenue Requirement. But if we extend the boundary to embrace the receipts from the Mint this source of cover becomes less insignificant.

INCOME FROM PUBLIC ENTERPRISE (INCLUDING MINT) AS % OF GENERAL REVENUE REQUIREMENT

1929–30.	1930–31.	1931–32.
%	%	%
3·0	6·3	8·3

In 1931–2 the Mint brought the Treasury a windfall of 353·9 millions which was actually almost double the net amount forthcoming from the Reich's undertakings. Had it not been for the large liability caused by the Banking Crisis, the net income from public enterprises and the Mint would have been well over 10 per cent of the General Revenue Requirement. Seigniorage on the Coinage, however, is to be classified as extra-ordinary : in the normal course of things the type of revenue under consideration comes chiefly from the Transport group, in particular the Post Office.

(c) *The Income of the States from Public Enterprises.*[1]

The composition of the public enterprises of the States is such as to make this source of income very susceptible to changes in the general economic situation. The following are the figures for recent years.

THE STATES

	General Revenue Requirement.	*Public Enterprise Income.* *Ordinary.*	*Extra-ordinary.*	*Total.*	*% of General Revenue Requirement.*
	(*Million RM.*)				
1925–26	2732·7	160·3	— 19·3	141·0	5·2
1926–27	2870·6	133·8	— 10·7	123·1	4·3
1927–28	3062·0	195·9	— 19·1	176·8	5·8
1928–29	3270·7	230·8	— 22·1	208·7	6·4
1929–30	3269·4	189·7	— 11·3	178·4	5·5
1930–31	3181·8	121·8	— 15·8	106·0	3·3
1931–32	2717·1	40·4	— 19·1	21·3	0·8

[1] Figures based on *Wirtschaft und Statistik*, 1933, No. 2, p. 54 ff. and No. 23, p. 739 ff.

The series of minus quantities in the extraordinary column denotes that in each year the extraordinary grants exceeded the extraordinary revenue : it must be remembered that these are not losses but capital investments, which correspondingly diminish the ordinary surpluses.

The precipitate decline after 1928–9 is due almost entirely to the fall in receipts from forest land as a consequence of the catastrophic slump in the price of timber. In Prussia the net yield of public enterprises in 1928–1930 fell from 103·7 to 37·9 millions or by 61·5 per cent ; in Bavaria from 38·7 to 16·8 millions or 56·6 per cent : in this period the revenue from forestry fell in Prussia from 77·1 to 14·8 millions, and in Bavaria from 31·1 to 11·1 millions. The significance of public enterprise surpluses has appreciably diminished from 6·4 per cent of the General Revenue Requirement of all States in 1928–9 to 3·3 per cent in 1930–1. In 1931–2 it is probably below 1 per cent.

An analysis of the income according to different categories of enterprise gives the following result :—

NET BUDGET INCOME OF STATES FROM PUBLIC ENTERPRISE

Type of Enterprise.	1927–8.	1928–9.	1929–30.	1930–1.	1931–2.
			(*Million RM.*)		
Land and Forestry :—					
Domains	14·3	18·3	13·4	8·9	4·3
Forestry	115·6	147·3	108·2	42·3	− 25·6
Industrial	13·1	3·1	12·3	2·5	2·5
Transport, etc.	0·7	0·8	1·1	1·4	0·9
Waterways	− 1·7	− 1·6	− 1·5	− 3·4	− 2·6
Public Utilities	3·0	7·6	7·8	8·8	2·9
Banking and Credit	6·7	7·4	8·6	8·7	0·1
Lotteries	24·9	25·3	28·6	36·0	34·6
Mint	0·3	0·5	0·05	0·7	4·3
Total	176·8	208·7	178·4	105·9	21·3

In 1928–9, before the depression set in, the net surplus from Forestry made up no less than 70 per cent of the States' total public enterprise income. By the year 1930–1 the proportion had dropped to 40 per cent ; in 1931–2 there was actually a loss of 25·6 million RM. This illustrates the considerable risk incurred by a State whose enterprises are largely of the type which reflects the full force of the trade cycle. In this respect the States stand in sharp contrast to the Communes, which are deeply entrenched in public utilities and were able to take advantage of their monopolies to expand this kind of income. The States have also made gradual inroads into the public utility sphere, particularly electricity. Since 1927, Prussia owns the *Preussische Elektrizitäts*

A.G. Berlin, whereas Bavaria has three big companies as well. The States' receipts from electricity works have steadily increased and in 1930–1 comprised 8·2 per cent of the total public enterprise income, compared with 1·1 per cent in 1926–7; but a heavy fall in 1931–2 could not be avoided.

The industrial enterprises are primarily coal mines, foundries, and salt works, which at one time were Crown possessions. Of predominent importance in the aggregate are the Prussian coal companies which since 1929 have been merged into a holding company called *Die Vereinigte Elektrizitäts- und Bergwerks A.G.* Such industrial surpluses are rather susceptible to changes in the price level.

The States have been reaping a growing income from their banking and credit undertakings: it rose from 4·0 millions in 1925 to 8·8 millions in 1930–1. The State banks were almost entirely responsible for this development, as the receipts from the States' participations in private enterprises remained fairly constant.

DEVELOPMENT OF BUSINESS OF STATE BANKS

	Published Net Profit (including Profit carried forward).	*Distribution of Profit. To Capital.*	*To State Treasuries.*	*General Purposes and carried forward.*
		Thousand RM.		
1926–27	17,326	8,025	4,695	4,606[1]
1927–28	13,877	7,652	5,945	276
1928–29	14,269	7,808	6,255	206
1929–30	13,583	5,643	7,543	397
1930–31	16,002	7,601	7,910	491

In the years 1924–1930 the banks enjoyed a period of prosperity. They applied a large proportion of their profits to strengthening their capital and the transfers to the State Treasuries amounted to 37·4 millions or 40 per cent of the profit made during the period. The year 1931–2 brought a sharp set-back, due chiefly to losses suffered by certain small banks in which the States have an interest.

Lotteries have assumed an increasingly significant role as a source of revenue for the States. By far the largest is the Prussian—South German *Klassenlotterie*. The total revenue rose from 16·1 to 36·0 millions in 1925–1930: there was an appreciable rise in 1929–1930 from 28·6 to 36·0 millions. Some States, which have renounced their own Lotteries, receive compensation from the proceeds of the big one. It is clear that the States

[1] 4,578 for meeting loss carried forward.

have paid some attention to one of their few squeezable sources of income. Its remarkable buoyancy in 1931–2 has offset the disastrous losses on Forestry and Waterways.

The Mint proceeds are unimportant. The large opportunity for gain by exploiting the difference between the face value and metallic value of token coins is, of course, exclusively within the province of the Reich. But such was the financial strain in 1931–2 that the larger States actually managed to extract a net income of 4·3 millions from minting for public and private purposes.

(*d*) *The Income of the Communes and Hanseatic Cities from Public Enterprises.*[1]

It has been clear from previous analysis that the tremendous burden thrown upon the Communes, together with the falling-off in their tax revenue, have forced them to concentrate on increasing the yield of public enterprises. The proportion of the General Revenue Requirement met out of Taxes fell from 85·2 per cent in 1928–9 to 77·0 per cent in 1931–2 ; the proportion financed from the two classes of Public Enterprise income rose from 12·0 to 13·7 per cent and from 0·27 to 3·0 per cent respectively in the same period.

THE COVER OF THE GENERAL REVENUE REQUIREMENT OF THE COMMUNES

	1928–9		1929–30		1930–1		1931–2[2]	
	Million RM.	% of G.R.R.	Million RM.	% of G.R.R.	Million RM.	% of G.R.R.	Million RM.	% of G.R.R.
General Revenue Requirement .	5,157·6	100	5,397·4	100	5,496·8	100	4,740·0	100
Covered from—								
Net Income of Public Enterprise . .	620·6	12·0	611·2	11·3	752·4	13·7	650·0	13·7
Miscellaneous General Cover	38·5	0·7	54·7	1·0	113·5	2·0	140·0	3·0
Taxes . .	4,396·8	85·2	4,390·0	81·3	4,333·1	78·8	3,650·0	77·0
	5,055·9	97·9	5,055·9	93·6	5,199·0	94·5	4,440·0	93·7
Excess of Expenditure .	101·7	2·1	341·5	6·4	297·8	5·5	300·0	6·3

Public Enterprises, in Municipal statistics, include not only undertakings owned and operated by the Communes, but also those leased or turned into companies and businesses in which the Municipal non-profit-making services, like street cleaning, hospitals, canals, and removal of refuse, are included. The only exceptions in this category are slaughterhouses and market

[1] For figures see *Wirtschaft und Statistik*, 1933, No. 1, p. 23.
[2] Based partly on estimates.

buildings, since these are generally run on profit-making lines. Income in these figures means the sum flowing as surplus from the Enterprise to the Municipal Treasury: Grant is the sum paid by the Treasury to the enterprise: the net income or liability appearing in the Municipal budget is the difference between these two amounts. A distinction is drawn between Industrial Property and General Landed and Funded Capital. The latter is a part neither of ordinary Municipal administration nor of the productive enterprises. Most Communes possess large tracts of land which they let for various purposes, e.g. dwelling-houses, factories, or smallholdings: the rents appear as income, and administration and acquisition of new land as expenditure. The funded capital comprises long- or short-term investments like bank deposits, securities, loans, mortgages, and miscellaneous obligations.

The table (p. 70) exhibits the manner in which the Communes increased their Public Enterprise income in 1929–30 and 1930–1. It was done partly by cutting down the grants usually given to the undertakings. For instance, in the case of Landed Property this item fell by 19·6 millions, or 27·6 per cent, which implies that the purchase of new land was severely curtailed. There was a net total decline in the grants paid of 16·5 millions or 11·2 per cent. But the enterprises also furnished appreciably higher surpluses. The only exception was Landed Property: this included domains and forestry, the receipts from which slumped heavily on account of the drop in the price of timber. It is interesting to note that the effect of this was most felt by the smaller Communes with under 5,000 inhabitants, which are more dependent on this class of income than the larger ones. There is a positive correlation between the size of the Municipality and the extent of the percentage increase in the net surplus shown. The increase in the total surpluses of all the Communes was 124·7 millions, or 16·4 per cent.

The outstanding example of expansion is afforded by the City of Berlin—an increase in income of 90·6 millions or 196·1 per cent. This was made possible mainly by the higher receipts from public utilities: the three big undertakings, electricity, gas, and water, raised their surplus from 32·9 millions in 1929 to 92·0 millions in 1930: it is estimated that 59·1 millions of this was the direct result of increased charges. These three main public utility services were used by all the bigger Municipalities as a means of relieving the budget stringency, and the cutting down of working capital and depreciation allowances has been practised

The Budget Receipts of Communes (and Unions of Communes) from Public Enterprise

	Income Received				Grants Paid				Net Income or Net Grant (−)			
	1929.	1930.	Difference 1930 compared with 1929. Million RM.	%	1929.	1930.	Difference 1930 compared with 1929. Million RM.	%	1929.	1930.	Difference 1930 compared with 1929 + or −. Million RM.	%
	Million RM.				Million RM.				Million RM.			
I												
Industrial Property (including Participations)—												
Electricity . .	290·2	376·9	+ 86·7	+ 29·9	3·0	2·1	− 0·9	− 30·0	287·2	374·8	+ 87·6	+ 30·5
Gas	120·3	141·6	+ 21·3	+ 17·7	1·3	1·7	+ 0·4	+ 30·8	119·0	139·9	+ 20·9	+ 17·6
Water Supply . .	71·4	97·2	+ 25·8	+ 36·1	17·6	13·0	− 4·6	− 26·1	53·8	84·2	+ 30·4	+ 56·5
	481·9	615·7	+ 133·8	+ 27·8	21·9	16·8	− 5·1	− 23·3	460·0	598·9	+ 138·9	+ 30·0
Transport . . .	22·1	28·1	+ 6·0	+ 27·1	12·9	11·9	− 1·0	− 7·8	9·2	16·2	+ 7·0	+ 76·1
Credit	16·6	22·4	+ 5·8	+ 34·9	4·4	3·3	− 1·1	− 25·0	12·2	19·1	+ 6·9	+ 56·6
Slaughter Houses and Cattle Market . .	7·7	9·7	+ 2·0	+ 26·0	1·9	1·6	− 0·3	− 15·8	5·8	8·1	+ 2·3	+ 39·7
Miscellaneous . .	8·7	9·6	+ 0·9	+ 10·3	13·7	15·9	+ 2·2	+ 16·1	−5·0	− 6·3	− 1·3	− 26·0
Total of I . . .	537·0	685·5	+ 148·5	+ 27·7	54·8	49·5	− 5·3	− 9·7	482·2	636·0	+ 153·8	+ 31·9
II												
General Landed Property (including Land and Forestry) . . .	144·8	117·5	− 27·3	− 18·9	71·0	51·4	− 19·6	− 27·6	73·8	66·1	− 7·7	− 10·4
Funded Capital . .	76·6	80·1	+ 3·5	+ 4·6	21·4	29·8	+ 8·4	+ 39·3	55·2	50·3	− 4·9	− 8·9
Total of I and II . .	758·4	883·1	+ 124·7	+ 16·4	147·2	130·7	− 16·5	− 11·2	611·2	752·4	+ 141·2	+ 23·1
Berlin . . .	46·2	136·8	+ 90·6	+ 196·1	23·2	16·0	− 7·2	− 31·0	23·0	120·8	+ 97·8	+ 425·2

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to an extent which is undoubtedly endangering the future productivity of these undertakings; whereas the prices have been raised to a level which means a heavy tax on the consumers.

Finally, the Hanseatic Cities must be included, in order to complete the picture. Their income from public enterprise reflects the influence of the same set of conditions which we have analysed in the case of the Communes. It rose practically without interruption between 1925–6 and 1931–2, the actual figures being as follows :—

INCOME OF HANSEATIC CITIES FROM PUBLIC ENTERPRISE [1]

1925–26.	1926–27.	1927–28.	1928–29.	1929–30.	1930–31.	1931–32.
			(*Million RM.*)			
28·2	23·8	33·9	31·5	39·3	38·0	45·5
			As Percentages of General Revenue Requirement			
8·9	6·9	8·6	7·2	8·4	7·9	11·4

The sudden rise in the last year is further evidence of the severe strain, through increased charges and lowered grants for depreciation, which undoubtedly spells capital consumption.

V. THE INDEBTEDNESS OF THE REICH, STATES, COMMUNES (INCLUDING UNIONS OF COMMUNES) AND HANSEATIC CITIES [2]

It is fitting to conclude this chapter with a brief account of the indebtedness of the Financial System as a whole. In previous sections estimates were given of the relative significance of Debt Service in the expenditure structure of the different Public Authorities. With the aid of the latest available figures, viz. those relating to the position on 30th September, 1932, we may now give fuller details of the composition of the aggregate of public indebtedness, its distribution over Reich, States and Communes, and over various sorts of debt, and the objects upon which the borrowed money has been spent.

The debts of the German System mounted very rapidly during 1929–30 and 1930–1, viz. by 3·45 milliard RM., or 30 per cent, in the former year and by 3·0 milliards, or 20 per cent, in the latter. This development in 1930–1 was particularly serious in view of the strong ebb in the industrial tide which had set in during that time: its direct cause was the sudden necessity for filling the gaps left by the suddenly declining income resources of the different Authorities. The banking crisis in the middle

[1] *Wirtschaft und Statistik*, 1933, No. 10, p. 316.
[2] For figures see *Wirtschaft und Statistik*, 1933, No. 7, p. 194 ff.

of 1931 dealt a rude shock to the possibilities of further credit on these lines, with the result that the exchequers were forced to seek a bedrock adjustment of income and expenditure without further reliance on credits. Consequently in 1931–2, as we have seen, the total expenditures of the whole system (Reich, States, and Communes) fell by no less than 3½ milliards whereas the net increase in new indebtedness was only 400 millions, or 2 per cent. The total debt liability was 24·18 milliard RM. at the end of March, 1932, and this was only 0·6 per cent higher than in March, 1931.

The position in 1932–3 has again somewhat altered, chiefly in view of the very relaxed state of the money market. The continuance of the acute financial crisis, and the necessity for the Reich and one or two States to grant extraordinary assistance to threatened undertakings, led to a rise of about 125 millions in the total indebtedness of the whole system during the first half of 1932–3. The condition of Communal finances is also chronic, but the reluctance of lenders to venture into this sphere kept their debt figures more or less constant.

Apart from the indebtedness of the Public Authorities, the debts of Public Enterprises have also been swiftly increasing, viz. from 2·82 milliards on 31st March, 1931, to 4·47 milliards on 31st March, 1932, or by about 59 per cent.

(1) *The Different Kinds of Debts*

The depression reacted earlier on the foreign sources of credit than on the internal. Between March, 1929, and March, 1930, the rise in foreign indebtedness was only 300 millions, or 13 per cent, while internal debts increased by over 3 milliards, or 34 per cent. Since the liabilities to foreign lenders were mostly of a long-period character it was to be expected that the creditors would react by selling their bonds, and thus their prices fell sharply. With regard more particularly to the credit obtained from the internal market, a dangerous trend was to be observed in the period 1928–1930. The danger signal presented by the more unfavourable conditions of supply of capital for long-period investments was ignored, and the Public Authorities postponed the evil day by borrowing increasingly on short term. Later, when the risks of such a procedure became more and more evident, efforts were made to consolidate these short debts, but with only partial success. The proceeds of these short loans had been sunk largely in long-period capital expenditure or used for the cover of deficits; so the Authorities found themselves

swept into the credit crisis of 1931 with their assets largely frozen. The following are the figures of the new credits obtained on the inland market, 1929–1931.

CHANGE IN THE CHARACTER OF NEW INTERNAL INDEBTEDNESS

	1929–30.		1930–31.		1931–32.	
	Million RM.	%	*Million RM.*	%	*Million RM.*	%
Long Period	891·8	37·7	913·5	96·6	205·6	51·0
Middle Period	328·6	13·9	— 4·6	— 0·5	180·8[1]	44·8
Short Period	1,145·2	48·4	37·0	3·9	17·0[1]	4·2

The short-term debts of the German system as they stood on 31st March, 1932, are set out in the following table :—

SHORT-TERM INDEBTEDNESS OF REICH, STATES, COMMUNES, AND HANSEATIC CITIES ON 31ST MARCH, 1932

	Reich		States		Hanseatic Cities		Communes		Total	
	Mln. RM.	% of New Indebtedness	Mln. RM.	% of N.I.	Mln. RM.	% of N.I.	Mln. RM.	% of N.I.	Mln. RM.	% of N.I.[2]
Non interest-bearing Treasury Bills	503·4[3]	13·4	481·7[4]	23·0	97·4	19·4	—	—	1,082·5	7·1
Interest-bearing Bills	400·0	10·6	2·0	0·1	—	—	80·0	0·9	482·0	3·2
Other Short Term	159·1	4·2	184·3	8·8	73·5	14·7	1,588·4	18·0	2,005·2	13·2
Total Internal Short Term	1,062·5	28·2	667·9	31·9	170·9	34·1	1,668·4	18·9	3,569·7	23·5
External Short Term	524·4	14·0	82·1	3·9	132·7	26·5	48·0	0·5	787·2	5·1
Total Short Term	1,586·9	42·2	750·0	35·8	303·6	60·6	1,716·4	19·4	4,357·0	28·6
Including—										
Cash Credit	145·4[4]	3·9	80·0[5]	3·9	10·0[5]	2·0	150·0[5]	1·7	385·4	2·5

From this table it is seen that the Reich and Han eatic Cities have a relatively large proportion of their new indebtedness (i.e. debts incurred since stabilization) in the form of Treasury Bills and the like ; the Communes have the highest absolute total, viz. 1,716 millions.

(2) *Classification of Creditors*

With the worsening of conditions on the money market, it was natural that the Public Authorities should have less and

[1] Including credits taken in order to assist private undertakings. Without these, the figures would be — 76·4 and — 176·4 respectively.
[2] Excluding politically occasioned sums and Treasury Bills for purpose of granting security.
[3] Excluding 130·9 millions.
[4] Allowing for the cash reserve of the Reich Exchequer and items of payments communicated but not then carried through.
[5] So far as they can be regarded as anticipations of certain ordinary revenues.
[6] 62·5 millions Treasury Bills as security basis.

less resort to the private market. Banks and other financial institutions have become the important creditors. According to the most recent figures only one-third of the total internal debts are the result of direct issues, whereas almost two-thirds consist of obligations such as mortgage bonds issued by credit institutions and various individual creditors. Among such institutions an important part is played by public and semi-public banks, in particular the head associations of Communal banks. In 1930, these were responsible for no less than 58 per cent of all internal credit (excluding bearer-stock) : loans by private banks and insurance companies comprised between 16 and 18 per cent. Out of a total internal debt of 1·18 milliards on 31st March, 1932, the Reich and States owed 0·46 milliards, or almost 40 per cent, to social insurance carriers, etc., and 0·27 milliards, or 23 per cent, to private banks. Creditors who are only lenders as a side-line, e.g. private and public enterprises and individuals, are responsible for 7 per cent in the case of the Reich and States : sums owed to the Railway Company and Post Office amounted to 17 per cent.

The Interest Rate

The burden of the service of the debts will be dealt with in detail at a later stage when the reductions of the interest rate by Emergency Decree will be described. In this connection it is only necessary to point out that the average interest rate on Reich debts (6·08 per cent on post-stabilization debt as on 31st March, 1932) is somewhat lower than that on State and Communal debts (6·8 to 7·0 per cent on post-stabilization debt as on 31st March, 1932).

THE INTEREST CHARGE OF REICH, STATES, COMMUNES, AND HANSEATIC CITIES (31ST MARCH, 1932)

	1929.	1930.	1931.	1932.
Reich . . .	394·2	501·5	585·2	600·4
States . . .	127·4	141·5	147·5	153·5
Hanseatic Cities .	30·9	41·8	41·3	45·4
Communes [1] .	596·0	721·5	796·5	725·0
Total [2] . .	1097·4	1357·3	1520·8	1469·1

The end of this period saw the interest charge maintaining a practically constant level, except in the case of the Communes

[1] Partly estimated in 1931 and 1932.

[2] The interest on debts incurred out of public sources are included in the figures for the single Authorities but not in the total.

where there was a noticeable fall. The annual sinking fund payment of all the authorities is due to rise from 100 millions in 1932 to 230 millions in 1945.

(3) *The Objects on which the Borrowed Money has been Spent*

A very instructive table may be given to show the striking change which has come over the general purposes for which credits have been taken.

APPLICATION OF MONEY BORROWED SINCE STABILIZATION

	1928–29.		1929–30.		1930–31.	
	Mln. RM.	%	*Mln. RM.*	%	*Mln. RM.*	%
Transport	796·1	20·7	487·1	14·1	701·9	23·6
Public Utilities	334·1	8·7	150·8	4·4	94·6	3·2
War Charges	613·5	15·9	796·6	23·1	720·1	24·3
Housing	404·0	10·5	260·5	7·5	208·7	7·0
Assistance to Industry	− 38·2	− 1·0	78·4	2·3	68·2	2·3
Cash Reserve and Cover of Deficits	653·7	17·0	680·5	19·7	843·3	28·4
Miscellaneous Undertakings	59·5	1·5	131·3	3·8	35·7	1·2
Miscellaneous Institutions	95·1	2·5	90·9	2·6	32·7	1·1
Welfare and Health	560·0	14·5	523·3	15·1	162·3	5·5
Education	134·3	3·5	100·1	2·9	38·5	1·3
General Administration	18·1	0·5	62·9	1·8	15·8	0·5
Miscellaneous	223·2	5·8	91·4	2·7	48·5	1·6
Total	3853·4	100·0	3453·7	100·0	2970·3	100·0

In 1930–1 the most important item is Cash Reserve and Cover of Deficits. During a period when the debts incurred fell so appreciably, the amount spent for this purpose increased from 650·0 millions (1928–9) to 840·0 millions (1930–1). On the one hand the amount applied to profitable investment (Transport, Public Utilities, and Housing) fell by more than a third, while on the other hand the sum claimed by War Charges, Welfare, Cover of Deficits, and Cash Reserves actually increased (1·72 to 1·73 milliards).

In the financial year 1931–2 further resort to the credit market had to be made to enable the Reich and States to come to the rescue of important undertakings which were in difficulties. The Reich's outlay for this purpose was about 400 million marks : in the case of most of the other items a proportion of the outstanding debts was repaid. The figures of the Communes underwent no material change.

The position as shown by the latest figures is as follows :—

THE EXPENDITURE OF BORROWED MONEY (POST-STABILIZATION)

	Reich.	*States.*	*Hanseatic Cities.*	*Communes 31st March,* 1931.[1]
		31st March, 1932.		
Public Utilities and Transport .	765·9	581·0	300·3	3,452·5
War Charges	3,223·5	—	—	—
Cash Reserve and Cover of Deficits	1,255·4	565·0	56·0	888·6
Housing and Economic Assistance	742·0	513·4	103·1	2,608·7
Health and Welfare . . .	614·5	329·9	37·6	652·4
Education.	—	32·5	20·5	454·1
Miscellaneous	261·3	251·5	81·3	2,018·5[2]
Total	6,862·6	2,273·4	598·7	10,074·7

This table throws important light on the debt position. Almost a half of the 6·9 milliards borrowed by the Reich since Stabilization was devoted to War Charges, which means mostly Reparations. The other big item—Cash Reserves and Cover of

SUMMARY TABLE

THE DEBTS OF THE REICH, STATES, COMMUNES, AND HANSEATIC CITIES (1929-1932)
(Million RM.)

	31st March, 1929	31st March, 1930	31st March, 1931	31st March, 1932	Reich	States	H. Cities	Communes
1. Old Debt .	5,557·6	5,407·6	5,273·1	5,062·6	3,940·4	28·2	74·9	1,019·1
2. Securities and Bills .	1,045·5	901·2	769·1	741·3	630·9	6·3	24·4	79·6
3. Post Stabilization Debt—								
Foreign .	2,293·5	2,595·2	4,799·2	4,679·6	3,215·2	466·4	263·1	734·9
Internal—								
Long period	5,075·4	6,392·7	7,487·5	7,802·6	1,961·6	471·0	41·0	5,326·0
Middle and Short .	4,187·1	6,021·9	5,693·3	5,891·1	1,686·0	1,219·0	196·8	2,789·4
Total Internal .	9,262·5	12,414·5	13,180·8	13,693·7	3,647·5	1,693·0	237·8	8,115·4
Total Post Stabilization .	11,556·0	15,009·7	17,980·0	18·373·3	6,862·6	2,159·4	500·9	8,850·4
1929 = 100 .	100	130	156	159	228	130	142	136
All Debts 1–3 .	18,159·2	21,318·5	24,022·1	24,177·1	11,434·0	2,193·9	600·2	9,949·1
1929 = 100 .	100	117	132	133	139	127	125	129
4. Debts from Public Resources[3] .	(1,259·2)[4]	1,329·7)[4]	(1,444·1)[4]	(1,577·5)[4]	—	114·0	97·8	1,345·7
Total[5] 1–4 .					11,434·0	2,307·9	698·0	11,294·8
1929 = 100					139	120	140	129

[1] Communes and Unions of Communes. Partly estimated. No figures available for 1932.

[2] Including particularly 828·5 millions for landed property and 518·6 millions for Communal Institutions and Equipment.

[3] Loans given by Reich and States for Housing and Productive Unemployment Relief and Debts out of House Rents Tax sources.

[4] These totals in parentheses include double counting.

[5] Totals for the whole Financial System are impossible owing to double counting.

Deficits—comprises nearly one-sixth of the whole. Only about 35 per cent was spent on objects of social utility.

The Municipalities are saddled with a total debt of over 10 milliard marks. About one-third of this has been sunk in Public Utilities and Transport, and over one-quarter has gone into Housing and the granting of economic assistance. The large Miscellaneous item of over 2 milliards includes 830 millions for landed property and 520 millions for municipal institutions and sundry equipment. The other objects are comparatively subordinate.

The Reich has been borrowing chiefly in order to pay Reparations and help to balance its budget; but the Communes incurred their impressive aggregate of debt mainly in order to invest in such things as electricity, gas, water, and transport undertakings, houses, landed property, etc. After the purge of the inflation a great need for resources for equipment was to be expected. The credit crisis, however, put an end to the borrowing facilities of the Communes and their enormous load of indebtedness is now one of the most serious aspects of the grave situation in which the Financial System finds itself.

CHAPTER III

THE REICH BUDGET, 1928–1933

I. THE GROWING DEFICIT.
II. THE LEGACY OF THE YEAR 1932–3.
III. THE FIRST NAZI BUDGET.
IV. THE "INVISIBLE" BUDGET.
V. FUTURE PROSPECTS.
APPENDIX: THE EMERGENCY DECREES AND THEIR EFFECT ON THE BUDGET.

I. AN ANALYSIS OF THE GROWING DEFICIT

If the Reich Budget situation [1] is to be seen in its proper perspective, a distinction must first be drawn between the cumulative deficit and the current deficit. In assessing the exact position revealed by the closed accounts of any year one must leave out of consideration the surplus or deficit which was carried forward from the previous year. Secondly, the difference between the Ordinary and Extraordinary Budget must be borne in mind. Unfortunately, Finance Ministers have not always consistently adhered to the distinction as defined in the Budget Law: important items, e.g. revenue from the Mint and Expenditure on Productive Unemployment Relief, have appeared in one year in the Ordinary Budget and in another year in the Extraordinary. Care must also be taken to recognize transfers from one Budget to the other. Thirdly, allowance must be made for authorizations, to spend and to receive revenue, which are transferred from one year to the next. If we are studying the closed accounts of, let us say, the financial year 1931–2, it is necessary to remember that—(*a*) the Expenditures consist partly of expenditure authorizations [2] transferred from the previous year, and (*b*) unutilized expenditure authorizations belonging to 1931–2 have been handed on to the following year. Therefore, the expenditure authorizations carried forward from the previous year must be subtracted from the expenditure total of the year 1931–2; and the

[1] As distinct from the cash (*Kasse*) situation.
[2] Unless otherwise stated the term "expenditure authorization" always means "transferred votes of expenditure minus transferred votes of revenue".

votes handed on to the following year must be added to that total. By thus allowing for the inflow and outflow of transferred authorizations at the beginning and end of the year, one can arrive at the total which is relevant to the year in question. Finally, if a budget surplus accumulated in the past is used to balance the accounts of subsequent years, such elements in the revenue of these years must be subtracted because they really belong to the year (or years) which yielded the surplus. For instance, the Reich Budget closed in 1924 with a large Mint surplus which was formed into a Reserve Fund. This was drawn upon in 1927–8 (190 million marks) and in 1928–9 (61·9 million marks) and these sums appeared in the budget as revenue. Since they were in fact the revenue of the year 1924–5, they must not be regarded as income in the years 1927–8 and 1928–9.

Bearing these points in mind we may now turn to examine the Reich Budget under the influence of the world depression, paying special attention to the extent of the current and cumulative deficits. The Summary Table (p. 80) contains the essential data bearing on the Reich deficit in the period since Stabilization.

It was only in the first year following Stabilization that the Reich Budget produced a genuine surplus ; in each subsequent year there was a deficit. The transferred authorizations in the years 1925–7 reached a considerable magnitude, ranging between 482 and 778 millions. In the three years 1925–6 to 1927–8 the fact that the votes handed on to the next year exceeded the authorizations carried forward from the previous budget served to hide the real extent of the deficit : the deficiency shown by the closed accounts was in each case well below the genuine deficit. In 1928–9 the deficit according to the closed accounts, after deducting 61·9 millions of revenue obtained from the Reserve Fund, reached the enormous sum of 1,137·4 millions ; but since the expenditure votes transferred to the 1929–30 account (273·7 millions) were very much smaller than those which had been received as a legacy from the previous budget (778·5 millions), the true deficit of 1928–9 works out at 632·6 millions. The last three years of the period, when the tide of industrial activity was swiftly receding, had moderate deficits compared with the budgets of the previous boom phase. This was associated with the severe stringency in the loan market and the necessity for securing true budgetary equilibrium without resort to borrowing. Transferred authorizations played a smaller

REAL FINANCIAL POSITION OF THE REICH IN EACH YEAR SEPARATELY, 1924–31 (ORDINARY AND EXTRAORDINARY BUDGETS) [1]

Financial Year.	*Votes carried forward from Previous Year.*	*Closed Account of the Year. Excess of Revenue (+). Excess of Expenditure (−).*	*Votes transferred to the following Year* [2]	*The actual Balance of each year separately. Surplus (+). Deficit (−). (Columns 2 + 3 − 4.)*
		(in Million Marks.)		
(1)	(2)	(3)	(4)	(5)
1924–25	—	+ 1,143·9 [3]	395·6	+ 748·3
1925–26	395·6	− 109·8	482·0	− 196·3
1926–27	482·0	− 524·2	630·0	− 672·2
1927–28	630·0	− 231·1 [4]	778·5	− 379·5
1928–29	778·5	− 1,137·4 [5]	273·7	− 632·6
1929–30	273·7	− 312·7 [6]	112·4	− 151·4 [6]
1930–31	112·4	− 120·5 [7]	233·0	− 241·2
1931–32	233·0	− 182·4 [7]	215·7	− 165·1
Total	—	−1,474·3	—	−1,690·0

part and—most important of all—a real attempt was made to stop the leakage in the Extraordinary Budget.

II. THE LEGACY OF THE YEAR 1932–3

With the closing of the books for the financial year 1932–3 the cumulative deficit has increased from 1,690 to 1,880 million marks. 420 million of the floating debt was paid off, so that it may be said that the deficit originating in 1930 was cut down from 770 to 350 millions which—together with the 449·1 + 470·9 = 920 millions belonging to 1931—made up a total of 1,270 millions as the deficit from past years.

[1] See *Wirtschaft und Statistik*, 1930, p. 632, and 1932, p. 516.

[2] i.e. Transferred Expenditure Votes after allowing for Transferred Revenue Votes (minus Transferred Loan Authorizations). The Transferred Votes in this Table include those belonging to the Extraordinary Budget, although assets for their cover were not transferred. The sums in question were as follows: 1925–26, 100·0 millions; 1926–27, 281·5 millions; 1927–28, 258·3 millions; 1928–29, 73·3 millions; 1929–30, 47·0 millions; 1930–31, 73·5 millions; 1931–32, 58·0 millions.

[3] Including 251·9 million RM. revenue from the Mint in 1924, which was turned into a Working Fund and out of which 190·0 millions were taken in 1927–8 and 61·9 millions in 1928–29.

[4] Excluding 190·0 million revenue from Working Fund. Cf. Note (3).

[5] Excluding 61·9 million revenue from Working Fund. Cf. Note (3).

[6] Allowing for the surplus in the Extraordinary Budget, 1929–30, of 132·8 million which was used to reduce the Extraordinary Budget deficit of 904·5 millions carried forward from the previous year.

[7] Excluding 465 millions in 1930–31 and 420 millions in 1931–32 devoted to redemption of floating debt; this operation adds to the deficit of the years in question and correspondingly diminishes the deficit of previous years.

The year 1932–3 brought a further deficit of 610 millions. It was chiefly due to the slump in tax revenue, taxes and customs giving a yield 817 millions below the estimates. Of this deficiency 427 millions was borne by the Reich and 390 millions by the States and Communes. Moreover, instead of the 100 millions of income expected from the sale of Railway preference shares, only 54 millions could be realized. The remainder of the deficit is explained by excess expenditures of 143 millions minus 6 millions excess revenue.

The difficulties due to the stringent cash position show themselves in the fact that the expenditure authorizations transferred to 1933–4 comprise 225·4 millions, compared with 157·7 millions in 1931–2.

The Extraordinary Budget deficit of 470·9 millions was carried over to the Ordinary Budget. At the end of the year 1931–2 there was an asset of 57·9 millions in the Extraordinary Budget destined for the cover of transferred votes of expenditure. Expenses were of a minor character and amounted to 20·8 millions, thus leaving a surplus of 37·1 millions which will serve to meet such outlays as still remain to be carried out. The Extraordinary Budget has thus been virtually suspended.

The final deficit total is as follows :—

From 1930	350	millions.
,, 1931	920	,,
,, 1932	610	,,
Total at close of 1932–3 .	1,880	,,
Total at close of 1931–2 .	1,690	,,
Increase in 1932–3 . .	190	,,

Count Schwerin-Krosigk, the Finance Minister, has described the results of the year 1932–3 as not unfavourable, considering the economic circumstances. The deficit, it is true, is not very considerable when compared with that of countries like the United States. But it must be emphasized that in the German financial economy a floating debt of this size is a luxury which may prove dangerous.

The Closed Accounts for the Year 1932–3

The available figures concerning revenue and expenditure in 1932–3 are set out in the following table :—

EXPENDITURE AND REVENUE OF REICH, 1932–33.[1]

Ordinary Budget.

	(*Million RM.*) *Estimate.*	*Actual.*	
Revenue.			
Taxes, Customs, and Fees	7,464·3	6,647·0	
Sale of Railway Preference Shares	100·0	53·6	
Post Office and Printing Office surpluses	263·4	253·8	
Mint	107·0	110·5	
Remaining Items	304·3	316·6	
Tota	8,239·0	7,381·5	
Expenditure.			*Votes transferred to following year.*
Transfers to States	2,113·5	1,723·0	
Social Insurance	422·7	404·5	
Social Services and Pensions	1,381·5	1,313·7	
Emergency Unemployment Benefit, Grants to Communes for Unemployment Relief, Voluntary Labour Service, Public Works, etc.	887·0	887·7	
Salaries of Officials, etc.	700·0	695·3	0·3
Internal War Charges	347·6	311·4	62·7
External War Charges	145·0	182·7	—
Reich Debt Service	945·7	917·2	3·2
Police	190·0	190·0	—
Army and Navy	493·8	382·9	100·4
Ministry of Agriculture	152·3	132·4	22·6
Other Items	617·8	783·0	36·2
Total	8,396·9	7,923·8	225·4
Excess of Expenditure		542·3	
Excess of Expenditure Votes handed on to 1933–4 over those carried forward from 1931–2		67·7	
Amount of Deficit		610·0	

The most striking features of the account are the serious deficiency of 817 millions in revenue from taxes, customs, and fees, and the corresponding relief to the Reich due to the Tax Transfers to the States falling below the estimate by 390 millions. Otherwise, from the information before us, there seem to be no surprises. Schwerin-Krosigk has reaped the reward of a patient, conservative financial policy; and he is on the whole justified in regarding the outcome as not unsatisfactory. The volume of expenditure authorizations transferred to the year 1933–4 exceeds by 67·7 millions the amount inherited from the preceding budget. This sum, added to the expenditure excess on the year's working of 542·3 millions, makes up the deficit of 610·0 million marks.

[1] See *Wirtschaft und Statistik*, 1933, No. 15, pp. 479–82.

III. The First Nazi Budget

One of the minor consequences of the Revolution of 1933 was that it was impossible to enact the new Budget in time. A Decree was issued prolonging the 1932–3 budget for the first three months of the new financial year, and this gave Count Schwerin-Krosigk time to adjust his ideas to the new situation. The estimates were finally published at the end of June. Those who expected a " revolutionary " budget have been disappointed : the Nazi leaders are much more successful in providing circuses. Financial policy is a *Schicksalsfrage* for Germany, as Professor Schumpeter has rightly emphasized ; and, in spite of the deep impression which the Hitler dictatorship has already left on German life, the fundamental criteria, by which the ordering of the national accounts must be judged, have altered very little. In the long run perhaps more depends on the accuracy of the Finance Minister's assumptions than on the Chancellor's constitutional and social innovations, or the Propaganda Minister's supply of bright ideas.

The 1933 budget balances at 5,927·5 million marks. The sum of actual expenditure in 1932–3 amounted to 7·9 milliards. The 1933 expenditure estimates are about 2 milliards lower owing to a change in the presentation of the Reich budget. The fraction of the yield of certain Reich taxes which is transferred to the States under the *Finanzausgleich* system is no longer included in the Reich accounts as " expenditure " and " revenue." The Reich figures include only the Reich's share of these taxes. Tax and Customs revenue is fixed at 5·1 milliards in 1933–4 : the Finance Minister thus expects to get 200 million more than the actual yield in 1932–3. The Tax transfers to the States are estimated at 1,781 millions, i.e. 58 millions higher than the yield in the previous year. It is obviously assumed that the bottom of the depression has been touched and that the coming year will see a steady recovery. Nothing is allowed for a possible economic set-back as a consequence of the political excesses of the Nazi revolution : on the contrary the Government's elaborate public works schemes are relied upon to bring about an improvement.

A few comments may be offered on the revenue estimates (see Appendix). The total tax and customs revenue of the Reich, estimated at 5,089 millions, is 262 millions below the sum entered in the previous budget. But it must be noticed that this total of Reich tax income includes 150 millions expected from the

levying of the Fats Tax and the latter sum is ear-marked for the policy of cheapening fats in the interests of the poor. Reference to the Expenditure side shows that the amount allocated to the Welfare section of the Ministry of Labour has been accordingly increased by 150 millions. The genuine decline in estimated tax revenue compared with 1932–3 is, therefore, 412 millions.

Seigniorage on the coinage, which played such a significant part in the crisis years 1931–2, is conspicuous by its absence : the income expected from General Finance Administration falls, as a result, by 130 millions. A new source of revenue amounting to 70·0 millions is to be secured from the administration of the oil-seed monopoly. A glance at the separate tax estimates gives one the impression that the Finance Minister has been guided by one golden rule : taxes which produced more than the expected amount in 1932–3 are regarded as hardy and reliable, so their estimates are raised ; those whose yield was below expectation are scaled down. The Property tax, which did surprisingly well in 1932–3, has been appreciably raised, the estimate being 310 millions compared with 280 millions. The Turnover tax is maintained at the severe rate of 2 per cent, and it is hoped to obtain 1,500 millions, though the anticipated sum of 1,825 millions inserted in the previous budget was far from being realized. The taxes on Bills of Exchange transactions, which are very sensitive to changes in business conditions, illustrate the Finance Minister's optimistic anticipations. These are expected to produce revenue up to the preceding year's estimates, though their yield failed to reach that level ; while the tax on Stock Exchange transactions, having brought in only a half of the expected sum in 1932–3, is given the task of producing one-third more than the previous estimate, viz. 30 millions instead of 22 millions. Even the Betting tax estimate is raised from 30 to 35 millions ; but if the notable buoyancy of the Lottery and Betting tax yields in the last few years has been a reflection of the psychological effects of bad times, one cannot be certain that the anticipated business revival will prove a further stimulus to revenue from this quarter. The Income Tax estimate is put at 1,290 millions. If we add the 40 millions expected from the new Bachelor tax, which is to be devoted to general financial purposes, we obtain a total of 1,330 millions, which is 300 millions higher than the previous estimate and about equal to the yield in 1932–3.

Turning to indirect taxation, we find that beer is expected to bring in 20 millions more than it realized in 1932–3. The

Sugar tax and the Spirit monopoly, both of which have proved productive, have their estimates scaled upwards by 15 millions and 10 millions respectively. The Salt tax, after giving a disappointing yield in 1932–3, is estimated to produce 65 millions instead of 40 millions ; and the anticipated revenue from customs and tobacco is left unchanged.

If these rosy hopes are to be fulfilled, it is fairly clear that a genuine trade revival and reduction in unemployment must be experienced. Two further points of importance may be noted. A substantial non-recurring item of revenue is provided for in the shape of an increase in the estimated yield of the Automobile Tax of 48 millions as a result of the process of compounding. The Finance Minister again budgets for the receipt of 100 millions from the sale of Railway Company preference shares. He will be exceedingly fortunate if the capital market revives sufficiently to enable this to be accomplished. The result of the similar endeavour made in 1932–3 is not very reassuring. The increases in the estimates which have been outlined will serve to compensate for the disappearance of the Crisis Tax and the Industrial Charge.

A striking change has taken place in the part played by different sources of revenue. Between 1928 and 1932 the yield of Customs, Income, and Consumption taxes fell by 2·7 milliard marks. No less than $1\frac{3}{4}$ milliards of this decline is to be attributed to the Income Tax, which fell from 3,110 millions in 1928–9 to 1,333 millions in 1932–3. Similarly the Corporation Income Tax suffered a heavy diminution from 608 to 106 millions in the same period. Meanwhile Customs duties and taxes on consumption have been stiffened up. The result is that the Income Tax has ceased to be the backbone of the revenue system. It now produces one-third of the taxation income instead of one-half as previously, i.e. up to 1930. The Turnover Tax, which used to yield only one-third of the Income Tax, now actually yields more. This tendency is enhanced by the 1933 Budget estimates. In the first group—Taxes on Income, Property, Transport, etc.—there is a net fall in the estimated revenue of 774 millions compared with the previous year's estimates ; whereas the second group—Customs and Consumption Taxes—is estimated to produce 180 millions more than in 1932–3, mainly as a result of the introduction of the new Fats Tax.

The Expenditure side casts the shadow of future administrative changes. An item of 520 millions appears for Unemployment Relief and Public Works : this is 410 millions lower than the

previous year's total. It is well known that the whole Unemployment Insurance System is now in the melting-pot and the new scheme will doubtless have an important effect on the distribution of the burden as between the Reich and the Municipalities. Nothing can be gathered from these budget estimates as to what the intention of the Government is. The yield of the poll tax on those in employment (*Beschäftigungssteuer*) goes directly to the Federal Institute for Unemployment Insurance and this helps to fill the gap created by the suspension of the Crisis Tax. One cannot avoid the impression that a substantial decline in the average volume of unemployment is presupposed.

Included in the vote for the Ministry of Economic Affairs is a sum of 102 millions to meet the redemption of Treasury Certificates handed over to the Dresdner Bank in the reconstruction in payment for preference shares.

An item of 35 millions is intended to meet possible obligations of the Reich arising out of its outstanding Guarantees. There are no important changes in the sums allocated to the social services.

Five hundred and twenty millions are inserted for Debt service. Provision has not been made for the special redemption of Floating Debt to the extent of 420 millions, as was the case in the two preceding budgets: instead we find 100 millions for meeting previous years' deficits. Dr. Schacht's motive in introducing this obligation at the end of 1929 was to curb excessive public expenditure and it may now be argued that circumstances have completely changed. Nevertheless, the suspension of this provision means that the Finance Minister is depriving himself of a very useful secret reserve. If he experiences cash stringency during the current year, he will not have a strong line of defence to fall back on. The liquidity of the money market may well be over-emphasized, for allowance must be made for the cumulative effect of a growing volume of Public Works bills and the uncomfortable size of the Floating Debt.

The aggregate estimated expenditure reaches 5,797·5 millions, which is about 400 millions lower than the actual expenditure of the previous year. The new budget, however, contains a proviso that equilibrium depends on savings to the amount of 50 millions being made during the year.

The essential features of this budget give no indication that it is the financial plan of the Government of the National Socialist Revolution. It might equally well have been the work of a Hilferding or a Brüning. But the ugly trace of the Nazi hand

may be seen in one of the corners of the pattern. Two departmental budgets are created for the new Propaganda and Air Ministries. The estimated expenditure of the " Ministry for Enlightenment and Propaganda ", which is under the control of Dr. Goebbels, is 14·2 million marks, but this represents no extra charge on the budget, for it is to be supported out of the revenues of the Broadcasting Corporation. Furthermore, a saving of over one million marks is realized in the budget of the Reichstag as a result of the " outlawry " of the non-Nazi political parties. It will be interesting to see whether the Nazi representatives are sufficiently attached to the totalitarian principle to renounce their salaries and privileges as " members of the Reichstag ". But perhaps this is one of the remains of a despised parliamentary democracy which will now be allowed to survive !

The official statement on the 1933 budget issued to the Press concludes with the following words : " The Government of the National Socialist Revolution presents a balanced budget for 1933. The condition on which its equilibrium can be maintained is that a revival of employment, industry, and finances, will be forthcoming as a result of the working of the Law for the Reduction of Unemployment of 1st June, 1933, and that taxpayers will punctually fulfil their current obligations and pay up all arrears as soon as possible. If these assumptions are realized, then in addition an improvement in the budgetary position of States, Municipalities, and Municipal Unions will necessarily follow. The Government of the National Socialist Revolution is determined to straighten out German public finances. It expects the full and intelligent co-operation of all sections of the German people to this end." The budget is a professed gamble on the possibility of an industrial revival in Germany in the current year. Beginning with the year 1934–5 the Reich will have to shoulder considerable burdens which were thrown on to the future in the crisis years 1931–3. These mortgages on the revenue of 1934–8 will be considered in detail in the next section. If the expected business improvement does not take place, Germany will be entering on the period which von Papen had visualized as the years of plenty, with a seriously unbalanced budget, a floating debt of threatening magnitude and the dead hand of the past curtailing its available revenues.

IV. The " Invisible " Budget

As a result of the extraordinary methods of financing current expenses forced upon the Reich by its inability to raise loans,

it is necessary to examine carefully the " invisible " items which have assumed considerable importance since 1931. The device of meeting expenditures, such as public works or bank reorganization, by handing out Treasury Certificates which will fall due in the near future, has loomed large in the financial policy of the Reich in the last two years. This form of mortgage on future revenue is the substitute for the function which the Extraordinary Budget used to perform when the loan market was at the Finance Minister's disposal. One would obtain a very misleading notion of the real state of Reich finances if these " invisible " transactions were left out of account.

The chief ways in which expenditure has been met without burdening the current budget are :—

(*a*) Treasury Certificates and Bills issued to finance Public Works, e.g. the Brüning, Papen, and Hitler schemes.

(*b*) The Tax Vouchers granted under the Papen Plan of September, 1932.

(*c*) Treasury Certificates given as Government subsidies or assistance to reorganized undertakings.

(*d*) Guarantees undertaken by the Reich.

Only rough estimates can be given in each case. The aggregate of Public Works Certificates are made up as follows :—

Brüning and Papen instalments .	340 millions.
Schleicher—Gereke Programme .	500 ,,
Hitler Plan	1,000 ,,
Total	1,840 ,,

With the exception of a sum of 115 millions which falls due within the year 1933–4, this total will have to be met in the five years beginning 1934.

The Papen Plan originally provided for the issue of 2·2 milliards of Tax Vouchers, 700 millions of which were designed for employers who could show increases in their labour force. The latter part of the Plan proved a failure, and it is, therefore, improbable that the gap in the Reich's revenue between 1934–5 and 1938–9 will amount to the full 2·2 milliards. It has been estimated that the actual volume of outstanding Vouchers up to 1st October, 1933, will be in the neighbourhood of 1,500 millions.[1] The financial reconstruction and subsidy policies of the Reich have involved considerable grants of Treasury Certificates : the largest single operation was, of course, the

[1] A. Brecht, " Die Reichsfinanzen," *Vossische Zeitung*, 14th June, 1933.

Bank Reorganization of February, 1932. The total of these obligations lies between 750 and 1,200 millions. Moreover, an important deficiency in the revenue of the period 1934–8 will be caused by the compounding of the House Rents Tax, originally introduced owing to the relatively favourable position of house property owners after the inflation.

The effect of these claims on future revenue may be set out in the following Table :—

FUTURE REVENUE OF THE REICH ALREADY EARMARKED

	Tax Vouchers under Papen Plan of September, 1932.	*Public Works Treasury Certificates*	*Treasury Certificates given as Government Assistance.*	*Winding up of House Rents Tax.*
		(*Million RM.*)		
1933–34 . .	—	115	125–200	—
1934–35 . .	500	415	125–200	—
1935–36 . .	500	415	125–200	200
1936–37 . .	500	300	125–200	200
1937–38 . .	500	300	125–200	400
1938–39 . .	500	300	125–200	400
	2,500	1,845	750–1,200	1,200

This gives the formidable total of 6½ milliards, or on an average over 1 milliard per annum, in the period 1933–4 to 1938–9. Adding the Reich's uncovered deficit of 1,880 millions at the end of 1932–3, we reach an aggregate of 8·4 milliard marks, which constitutes the sum which the Finance Minister must find during the next six years, if Germany's budget is to be in equilibrium.

The method of financing which has led to this accumulation of obligations in the near future has been forced on the Finance Minister by economic and political circumstances. It is interesting to compare this procedure with what has always been the practice in the State of Prussia. Being without an Extraordinary Budget, Prussia had what is called an *Anleihe* (Loan) Budget : that is to say, when it wished to finance " extraordinary " expenses, it had to secure special legislation to authorize it to borrow. When the loan market was normal, the expedient of an Extraordinary Budget enabled the Reich to incur certain types of expenditure by postponing payment by means of long-period loans for twenty or twenty-five years. The method practised in the last two years of issuing Treasury Certificates maturing within five years is a half-way house between the Extraordinary Budget and the normal way in which outlays are met. The

shortness of the period and the large volume of expenses met in this way make it a dangerous policy. The estimates for 1933–4 are based on the assumption that a strong revival of trade is in the offing. In 1934–5 the Reich will have to procure over one milliard marks to meet liabilities maturing during that year. This can be done through increased revenue and lower expenditure, and perhaps a consolidation loan if the market has improved. If the anticipated industrial revival does not materialize, the 1933–4 budget will not balance and the Finance Minister will be facing a very serious problem in 1934–5.

The figure of $6\frac{1}{2}$ milliards of mortgaged revenue given above is a gross amount. To a small extent the Reich will be receiving incomes which will serve to diminish the net burden. For example, under the terms of the Bank Reconstruction it is stipulated that a certain proportion of future dividends should be paid to the Reich. But, as against this, there is also the possibility that assistance originally rendered in the form of loans will have to be written off as bad debts. An expert has estimated the total of the Reich's irrecoverable grants under this category at 600 millions.[1] Then the redemption of the 1,000 million marks involved in the Hitler public works scheme will be partially covered by annual repayments of loans granted by the Reich to States, Municipalities, Municipal Unions and other Corporations, and the proceeds of the Voluntary Fund for the Encouragement of National Labour, as well as sums received in repayments of loans granted to married couples. But even if this income is received in full it will only go a very small way to offset the bulk of the Reich's obligations. Furthermore, as has been already pointed out, it is probable that only about 1,500 millions of the Papen Tax Vouchers will be actually outstanding after 1st October, 1933. Finally, the account would not be complete without an estimate of the Reich's probable liability as a consequence of the considerable volume (about 2 milliards) of Guarantees which it has undertaken. This is estimated at 150 millions for road and canal building, and 150 millions as the probable loss in connection with all the other guarantees.[1]

We are now in a position to correct the superficial impression conveyed by the deficit in the " visible " budget. To measure the real extent of the disequilibrium in the Reich budget in 1931–2 and 1932–3 we must add to the " visible " deficiency

[1] Brecht, loc. cit.

the volume of expenditure in those years which was actually financed by mortgaging the future. The Work Treasury Certificates of the Hitler Plan are thus left out of account, and it may be estimated that, in the two financial years 1931–2 and 1932–3, about two milliards of Certificates have been really given out, 1·4 milliards of which in the year 1932–3. Accordingly, by adding the invisible deficit to the visible, we obtain a sum of 2·0 + 1·8 milliards, i.e. 3·8 milliards. In normal circumstances it would have been legitimate to defray this amount out of the proceeds of a long-period loan.

The aggregate debt of the Reich, including the Floating Debt and the bonds arising out of transactions in the "invisible" budget, is between 12 and 12½ milliard marks. This figure does not embrace the 340 millions of Treasury Bills in the Brüning-Papen instalment of Public Works, the 300 millions estimated as the Reich's Guarantee liabilities, the Tax Vouchers, 700 millions of which had been given out up to May, 1933, and the 500 millions of Treasury Certificates belonging to the Schleicher-Gereke public works programme. If we add to these items the remainder of the Tax Vouchers which will be issued and the "Work Treasury Certificates" put into circulation by the Hitler Plan, we reach a total Reich debt of between 15 and 16 milliards. The Reparations obligations may be regarded as to all intents and purposes dead. The Young Plan is suspended until either the Gentleman's Agreement is ratified or one of the Powers concerned declares its inability to ratify. In the second case, a further conference would have to be called. The German internal debt, including the "invisible" budget items, amounts to about 12 milliards. The pre-war, war-time, and pre-stabilization debt of a value of 130 milliard gold marks has been practically wiped out as a result of the inflation: it only accounts for 5 milliards of the present debt. In comparison it is interesting to note that the internal debt of the United Kingdom is the equivalent of 130 milliard gold marks (90 milliards after the departure from gold), while the French internal debt is about 46 milliard gold marks.

The case of Germany shows that the abolition of a burdensome internal debt, when it is the consequence of a wrecked currency, is but an illusory relief. It is true that Germany's internal debt, compared with that of the United Kingdom and France, is relatively insignificant. But the criteria by which the German economy must be appraised are quite different. A floating debt of 1,800 million marks is in itself quite a modest amount for

a country of the size of Germany. The connection between the German money and capital market, however, has been so gravely dislocated that the usual method of consolidating floating debt, viz. by giving relatively small interest concessions, is not at present open to the Finance Minister. For about three years it has been impossible to raise a loan. Meanwhile, profiting by the very fluid state of the money market, the Reich Exchequer is able to finance long-term operations by creating short bills which it is able regularly to prolong. This is a very inadequate substitute for a live capital market.

V. Future Prospects

The equilibrium of the German Reich budget will come to depend more and more in the near future on the possibility of debt consolidation. Recent expansionist policy, as exemplified in the Papen Plan, assumes that it will be feasible during the next five years of revival to restrain expenditure in relation to revenue in order to allow a margin for the service of Treasury Certificates and to fill up the gap caused by the Tax Vouchers which will be received in payment of taxes. The postponed burden will be already over 1 milliard marks in 1934–5; and at the same time the problem will arise whether, after the artificial reduction in taxation made possible by the Tax Vouchers, it will be practicable to return to the previous level. The year 1933–4 will feel the trough in the productivity of the Assessed Income Tax and the Corporation Income Tax due to the time lag. The Wages Tax cannot possibly offset this, for, even though there might be more recipients of wages, the fall in the average income of labour has brought many workers and black-coated officials below the tax limit. It thus appears that the next two years, 1933–5, will be a severe testing time. Even granted that a strong trade recovery will set in and that the Dictatorship will be able to keep down public expenditure to the utmost, it is extremely doubtful whether the margin necessary to meet accumulated liabilities can thus be created. The gamble on industrial revival implies also a gamble on the possibility of debt consolidation. If the Exchequer can raise long-period loans of about 500 to 700 million marks each year, then the situation can be saved.

Any estimate of economic prospects in Germany would be extremely unreal, if it failed to take into account the implications of the new Nazi regime. Before there can be any prospect of

restoring life to the capital market, Hitler must succeed in eating his words, while persuading his turbulent followers that he is really fulfilling them. This is proving a very difficult task, as the continued local interferences with the economic system by irresponsible Nazis testify. Current political changes are so swift and far-reaching that it is idle to prophesy what the outcome will be after a year. The left wing of the Nazi rank and file must first be brought to acquiesce in the re-establishment of a reformed private capitalism : a refusal will mean a fundamental cleavage in the Nazi party itself. The gamble which the Finance Minister is taking depends largely on whether " the Second Revolution " can really be avoided and whether the streams of private initiative can flow more effectively in the new beds created by the National Socialist Revolution.

APPENDIX

THE EMERGENCY DECREES[1]

The 1931–2 Budget as passed by the Reichstag balanced at 10·7 milliards (Ordinary + Extraordinary). But it was obvious then that the progress of the depression would upset the equilibrium. In order not to delay the passing of the Budget the Reichstag, through an important regulation of the Budget Law, empowered the Government to reduce expenditure in the Ordinary Budget to the extent made necessary by the fall in revenue and unavoidable increases in expenditure. This authority was further amplified in the Second Emergency Decree, 5th June, 1931. By virtue of these powers, the Government was able to set the Budget right as circumstances demanded. The process entailed a drastic scaling down. In the Third Emergency Decree in September, 1931, the Budget was estimated to balance at 9·3 milliards. The year actually closed with a deficit of 449 millions even after the tremendous efforts made " by decree " to achieve equilibrium.

A. THE FIRST EMERGENCY DECREE (1ST DECEMBER, 1930) FOR THE SAFEGUARDING OF THE ECONOMIC STRUCTURE AND NATIONAL FINANCE

(1) *Cut in Salaries, etc., of Public Officials*

Since 1st September, 1930, a levy of 2½ per cent had been in operation (*Reichshilfe*). This Decree introduced a cut of 6 per cent

[1] See *Finanzieller Überblick über den Haushalt*, 1932.

on all salaries over 1,500 RM. (it applied to salaries, compensation payments to officials, pensions, etc.), to start on 1st February, 1931. This cut displaced the *Reichshilfe* levy, and was estimated to reduce expenditure in the 1931–2 Budget by 65 millions.

The States were asked to cut their expenditure on personnel and that of Communes and Public Corporations.

The Reichspost was ordered to hand over its surplus (got from a salary cut) to the Reich, and this was estimated to yield an extra revenue of about 65 millions.

(2) *Increases of Income Tax on Income other than Wages*

Increase of 5% affecting those getting over 8,000 RM.
Increase of 10% affecting single men getting over 8,000 RM.
Increase of 10% in tax on Directors' fees.
Estimated yield = 84 millions in 1931–2.

(3) *Increase in Tobacco Tax*

From 20 to 23% on cigars.
,, 33 to 38% ,, cigarettes.
,, 33 to 35% ,, pipe tobacco.
Estimated yield = 167 millions in 1931–2.

(4) *Expenditure Cuts*, so called *Ausgabenplafond.*—The aim was to prevent any further rise in public expenditure in the years 1932 and 1933 : and general instruction to this effect was issued applying to Reich, States, and Communes.

(5) *Miscellaneous*

Instructions for the simplification of taxes and regarding the net profit of the Reichsbank.

Through this Emergency Decree, which was issued at the beginning of the Reichstag debates on the 1931 Budget, the Government anticipated that the 1931–2 Budget would balance, assuming the world depression began to lift after February, 1931.

B. The Second Emergency Decree (5th June, 1931)

By the time the 1931–2 Budget estimates, which had been laid before Parliament in November, 1930, had been passed into law at the end of March, 1931, it was obvious that the assumption of an abatement of the world crisis was to be completely falsified. The deficit for the year was estimated in May as follows :—

	Millions.
Falling off in Custom and Tax receipts (Reich share) . . .	495
Deficit in Crisis Relief and Provision of Relief Work . . .	385
Imperative extra expenditure (including Miners' Pensions 47) .	79
	959

moreover,

Deficit in States' share of certain Tax yields	440
Deficit of Reich Unemployment Insurance Institute	400
Deficit of Communes' relief funds	300

Without allowing for the shrinkage of the tax receipts of States and Communes there was thus an estimated aggregate deficit of 2 *milliards*. The Second Emergency Decree proposed to cover the Reich deficit of 959 millions as follows :—

Expenditure Side.	*Millions.*	
Cuts in salaries, including delivery of surplus of Reichspost	101	
Cut in Reich social expenditure payments (pensions, etc.)	85	
Other cuts	120	
	—	306
Revenue Side.		
Increase in Sugar Tax	110	
,, ,, tariff on mineral oil	75	
,, ,, duty levied on imports and exports with object of keeping statistics of them	3	
Transition to monthly settlement of Turnover Tax	80	
Introduction of a " Crisis Tax "	385	
	—	653
Aggregate		959

The deficit of 400 millions of the Unemployment Insurance Institute was to be met through measures taken by that Institute itself.

In the States and Communes the salary cuts were made immediately applicable. The estimated result was a reduction in expenditure of 207 millions.

The Reich was to grant 60 millions towards the welfare relief funds of the Communes. The change to monthly reckoning of Turnover Tax was estimated to yield 35 millions for the States and Communes in 1931–2. For the rest the Reich Government insisted that the States and Communes should themselves endeavour to make both ends meet. This would, of course, prove impossible for the Communes with their enormous relief burdens.

The Terms of the Emergency Decree

(1) *Cut in Salaries*

Reich officials and salaried employees : salaries, compensation payments, maintenance grants to recipients of half pay and pensions were subjected to a reduction ranging from 4 to 8 per cent according to the amount of earnings, etc. This cut to operate alongside of that instituted by the previous Decree. Family allowance payment for children of officials and salaried employees reduced for one child from 20 RM. to 10 RM. After the expiry of their wage agreement, wage earners in the employ of the Reich were to have a corresponding cut in their daily rate of wages.

(2) *Reich's Social Expenditure (on Maintenance, etc.)*

It was difficult to economize on war wounded and their dependents, but children's allowances for the slightly wounded were done away with: local bonus was scaled down: rules regarding pensions coming from public sources were made more stringent. Wounded unable to work were excepted.

(3) *Various Cuts in Expenditure, yielding* 120 *millions*

(4) *Introduction of a "Crisis Tax"*

To meet the deficit accumulating owing to heavy relief burdens everybody was expected to contribute in this way according to capacity.

The Crisis Tax was in two parts—

(*a*) On wage and salary earners, a tax at the source, together with the ordinary income tax.

(*b*) On recipients of income other than salaries: assessed together with income tax.

Both were graduated.

(*a*) Minimum earnings taxable = 300 RM. a month: a monthly 1 per cent of the gross earnings rising to 5 per cent.

(*b*) Minimum non-salary income of 3,600 RM. per annum, at the rate of ·75 per cent rising to 4 per cent.

The Crisis Tax was to last from 1st July, 1931, to 31st December, 1932, and was estimated to yield 775 millions in this period. The estimate of 385 millions for 1931–2 proved much too high.

The Emergency Decree of June, 1932, prolonged this tax till 31st March, 1933.

(5) *Other Measures*

(*a*) Sugar Tax raised to 21 RM. per 100 kg.

(*b*) Mineral Oil Tax raised from 10 to 17 RM. per double zentner.

For the remaining nine months of 1931–2 these were estimated to yield, sugar 110 millions, oil 75 millions.

(*c*) Statistics Duty raised to yield 3 millions.

(*d*) Those persons whose business turnover in the previous year had amounted to more than 20,000 RM. were put back on the monthly reckoning of the Turnover Tax.

Estimated yield 80 millions to Reich and 35 millions to States.

THE CREDIT CRISIS OF JULY, 1931, AND ITS REPERCUSSIONS

Rapid sequence of events.

May, 1931. *Credit Anstalt* closed its doors.
The Reichsbank sees its reserve dwindling owing to foreign withdrawals of balances.

13th June. Bank rate raised from 5 to 7 per cent.

20th June. Credit restriction.
21st June. Hoover Plan announced: to operate from 1st July.
With this the situation in Germany eased a little. But delay in negotiations produced further uncertainty and more withdrawals of balances.
13th July. Darmstädter und National Bank obliged to close its doors. The Reich found it necessary to render assistance to threatened banks; issue of Treasury bonds and participation in their ownership. All this had a very detrimental effect on the Budget prospects.

On the basis of tax yields for July, August, and September, the estimates had to be further revised.

	Millions.	
Another fall in Reich's tax revenue of . . .	543	
Reich grant (for relief) to Communes had to be increased by	170	(60–230)
Further grant for Crisis relief payments of . .	100	
Total deficit of	813	

It was to be covered as follows :—

	Millions.
Relief owing to Hoover Plan	732
Contribution of Railway Company to external war burden .	52
Administrative Revenue	6
Cuts in expenditure	23
	813

Third Emergency Decree (6th October, 1931)

This comprised an increase in the Reich's relief payments, a decrease of the highest pensions, and cut in daily salary of non-established officials.

For the Communes—a sharp increase in the Poll Tax and duty on intoxicants. Reich assistance towards meeting floating debt of States and Communes was decreed.

There were various other orders regarding unemployment relief, regulation of debts of Communes, rents tax, agricultural settlement, savings banks, motor traffic, etc. Also simplification and economy measures in the sphere of administration of justice.

Fourth Emergency Decree (8th December, 1931)

Increasing severity of slump. The yield of taxes in October was below even the revised estimate. The departure of England and

other countries from the gold standard injured Germany's export trade and affected customs receipts. At the beginning of December a further deficit of 450 millions was estimated.

	Millions.
Further decrease in tax revenue	250
Failure to sell German Railway preference shares, the proceeds of which had been put into the Budget as revenue	150
Unexpected new expenditure—winter relief measures, etc.	50
	450

To avoid cash stringency in the winter months ahead, this deficit had to be met and the Government was forced to pile on more burdens.

	Millions.
Raising of Turnover Tax from 0·85 to 2%	120
Administrative change in Income Tax	50
Third cut in salaries	50
Various expenditure cuts	60
Profit of Mint	170
	450

Measures were also taken to force down prices and the cost of living. Moreover the " flight tax " (*Reichsfluchtsteuer*) was introduced to penalize those transferring capital abroad. Its yield for the remainder of the year was estimated at 600,000 RM.

General Survey

(Not allowing for Tax Transfers to States and Communes)

Deficits.	*Estimates.*	*Millions.*	
Fall in yield of Taxes		1,288	
New Expenditure :—			
Emergency Relief		485	
Reich Grants to Communes' Relief Funds		170	
Various increases in Expenditure		129	
Failure to dispose of Railway preference shares		150	
			2,222
Cover provided by Emergency Measures during the year :—			
Increases in Taxes		690	
Changes in date of Tax collection		130	
Relief through Hoover Moratorium		732	
Contribution of Railway Companies to external war charges during Hoover year		52	
2nd and 3rd Salary Cuts		151	
Cuts in Reich's social payments		85	
Administrative Revenue		9	
Mint Profit		170	
Various other measures		203	
			2,222

This balanced on paper : but even after all these heroic measures the year 1931–2 closed with a deficit of 449·1 millions.

The stiff increases in taxation during the year could only mitigate the fall in the aggregate yield below the original estimates.

The Actual Results for 1931–2

Revealed a new *deficit in the Ordinary Budget* of 449·1 millions, comprising 115·7 millions due to the failure of revenue to come up to revised expectations and 333·4 millions due to extra expenditure.

	Millions	
Failure of Revenue to reach Estimated Amounts.		
Taxes and Customs	382	
Failure of Railway Shares proceeds	134·1	
Reichsbank profit	25·0	
Reichspost transfer	11·7	
	− 552·8	
Excess of Revenue over Estimated Amounts.		
Mint Profit	416·3	
Tax on Note issue	18·6	
Administration Revenue	2·2	
	+ 437·1	
		− 115·7
Excess of Expenditure.		
Reich Grant to Unemployment Insurance	15·5	
Housing and Settlement (agricultural)	42·0	
Cheapening of Meat and Coal for the Poor	26·0	
Assistance to Banks (Dresdner, Acceptance Bank and *Norddeutsche Kreditbank*)	113·7	
Mint Costs	57·4	
Modification of terms of agricultural loans (subsidy)	35·8	
Support and stabilizing of agricultural market	74·6	
Rationalizing of Co-operative Societies	20·0	
Loans to States	85·4	
	− 470·4	
Diminution of Expenditure.		
Crisis relief	69·7	
War burdens	37·4	
Redemption of Rentenbank notes out of profit of Reichsbank	25·0	
Proportional Tax transfers	3·5	
Miscellaneous	1·4	
	+ 137·0	
		− 333·4
(Ordinary Budget) Total Deficit =		− 449·1

REVENUE RESULTS FOR 1932–33 AND ESTIMATES FOR 1933–34 [1]

	Closed Accounts for 1932–33	Estimate for 1932–33	Decreased Estimate	Increased Estimate	Estimate for 1933–34
I. *Taxes on Income, Property, etc.*		(Million Marks)			
Income Tax :—					
(*a*) Wages	748·5	828·0	78·0	—	750·0
Bachelor		72·0	72·0	—	—
(*b*) Interest and Dividends	40·9	30·0	—	10·0	40·0
(*c*) Assessed Income Tax	543·2	655·5	155·5	—	500·0
Additional		44·5	44·5	—	—
			350·0	10·0	
Total Income Tax	1,332·6	1,630·0	340·0		1,290·0
Tax on Directors' fees	—	—	—	2·0	2·0
Levy to foster Marriage	—	—	—	40·0	40·0
Corporation Income Tax	105·8	120·0	20·0	—	100·0
Crisis Tax	141·7	140·0	139·0	—	1·0
Property Tax	330·3	280·0	—	30·0	310·0
Industrial Charge	138·7	40·0	40·0	—	—
Inheritance Tax	61·7	70·0	5·0	—	65·0
Turnover Tax	1,354·4	1,820·0	320·0	—	1,500·0
Land Tax	18·7	24·0	2 0	—	22·0
Capital Transactions :—					
Company Tax	15·8	20·0	—	—	20·0
Securities	0·5	6·0	3·0	—	3·0
Stock Exchange Transactions	9·1	22·0	—	8·0	30·0
Automobile	172·1	180·0	—	48 0	228·0
Insurance	57·6	65·5	5·0	—	60 0
Betting	23·1	30·0	—	5·0	35·0
Lottery	44·8	60·0	15·0	—	45·0
Bills of Exchange	35·6	42·0	—	—	42·0
Passenger Transport	94·0	112·0	12·0	—	100·0
Goods Transport	85·1	96·0	6·0	—	90·0
			907·0	133·0	
Total of I	4,022·8 [2]	4,757·0	774·0		3,983·0
II. *Customs and Consumption Taxes*					
Customs	1,106·0	1,140·0	—	—	1,140·0
Tobacco	762·0	775·0	—	—	775·0
Sugar	285·8	270·0	—	15·0	285·0
Salt	26·4	40·0	—	25·0	65·0
Beer	260·8	300·0	20·0	—	280·0
Spirits	137·0	130·0	—	10·0	140·0
Acetic Acid	2·8	2·3	—	—	2·3
Champagne	4·8	4·5	0·6	—	3·9
Tax on Lighting Materials	12·1	11·0	—	—	11·0
Lighting Materia[1] Monopoly	4·2	3·5	—	—	3·5
Illuminants	7·7	9·0	—	—	9·0
Playing Cards	2·2	2·3	—	—	2·3
Statistics Fee	5·4	6·0	—	—	6·0
Saccharine Tax	0·2	0·2	—	—	0·2
Mineral Waters	0·3	0·4	0·3	—	0·1
Brandy	0·0	0·1	0·07	—	0·03
Mineral Oil	6·4	13·0	—	1·0	14·0
Fats Tax	—	—	—	150·0	150 0
			20·97	201 0	
Total of II	2,624·2	2,707·3		180·03	2,887·37
Total I and II	6,647·0	7,464·3	593·97	—	6,870·37
Less Transfers to States	1,723·0	2,113·5	332·15	—	1,781·33
Share of Reich	4,924·0	5,350·8	261·82	—	5,089·03
III. *Public Enterprise and Administration.*					
Income	729·6	767·7	51·0	—	706·7
Special Transfers to States	—	—	—	—	131·8 [3]
Total I to III	5,653·6	6,118·5	312·8 [4]	—	5,927·5

[1] See *Wirtschaft und Statistik*, 1933, No. 16, p. 508.

[2] Including 0·3 Mn. from *Obligationensteuer*.

[3] According to the revised presentation of the budget in 1933, only a small part of the tax revenue transferred by the Reich to the States appears as "revenue" and "expenditure" in the Reich Budget. Such special transfers include, for instance, the compensation paid to certain States for the beer revenue which they relinquished in favour of the Reich.

[4] In view of the change in the presentation of the Reich Budget, the figure of expenditure comparable with the 1932–33 total is 5927·5 million minus 131·8 million, i.e. 5795·7 million. Hence the Decreased Estimate total of 312·8 million.

SUMMARY OF EXPENDITURE ESTIMATES FOR 1933–34[1]

	Estimate.
Social Insurance	520·0
War Pensions	1,040·0
Unemployment Relief and Public Works	520·0
Salaries of Officials	700·0
War Charges	425·0
Dresdner Bank Preference Shares	100·0
Reich Debt	520·0
Police	190·0
Special Agricultural Measures	140·0
Housing	100·0
Welfare including 150 millions for cheapening of Fats	200·0
Meeting Previous Year's Deficit	100·0
Civil and Military Personnel	270·0
Other Items	972·5
Reich Expenditure Proper	5,797·5
Special Transfers to States	130·0
Total	5,927·5

[1] See *Wirtschaft und Statistik*, 1933, No. 16, p. 512.

Chapter IV

GOVERNMENT INTERFERENCE TO BREAK DOWN RIGIDITY : PRICES AND WAGE-RATES

I. The Reduction of Prices by Decree. First Phase.
II. The Activity of the Commissioner for Price Control.
III. The Effect of the Policy.
IV. The Extent of the Achievement.
V. Wages.
VI. The Papen Plan.

The severity of the depression compelled the German Government to take vigorous measures to endeavour to defeat the rigidity displayed by the retail prices of certain goods, wage-rates, interest-rates, and rent. The methods and results of such a policy merit the closest attention.

I. The Reduction of Prices by Decree

The First Phase.—The course of the depression in 1928–1930 revealed a striking disparity between the trend of free and fixed prices.

Index Numbers: Fixed Prices and Free Prices, i.e. Industrial Raw Materials and Half-finished Goods [1]

	Fixed Prices.	*Free Prices.*
1928 January . .	99·7	110·0
1928 December . .	104·2	102·9
1928 Average . .	102·1	106·8
1929 ,, . .	105·0	97·4
1930 ,, . .	103·1	79·7

The free prices fell from 110·0 in January, 1928, to 68·3 in December, 1930, whereas the fixed prices hardly moved at all in this period (99·7 to 97·1). This divergence inspired the Government to take its first step in the direction of interference in this sphere. The Decree of 26th July, 1930,[2] for the Alleviation of Financial, Economic, and Social Hardships contained a section entitled "The Prohibition of Uneconomic Price Agreements": a Supplementary Decree was issued on 30th August. These were

[1] *Konjunktur-Statistisches Handbuch*, 1933, p. 121.
[2] *Reichsgesetzblatt*, 1930, i, p. 311.

aimed at cartel agreements. Towards the end of the year the Reich Economic Council recommended the Government to bring about a compulsory reduction in the prices of the so-called " branded articles ".

These were estimated to comprise about 10 per cent of the total retail turnover of 35 milliard marks.[1] The Decree concerning the fixing of Prices of Proprietory Articles, of 16th January, 1931, declared that agreements compelling dealers in such commodities to demand fixed prices on re-sale to consumers shall be null and void if (*a*) the fixed price has not been reduced at least 10 per cent compared with 1st July, 1930, and (*b*) the dealer is prevented by the agreement from granting to the consumer, in addition to this reduction, rebates which he was entitled to grant on 1st July, 1930.

Evidence is available that in the case of the articles mentioned in this Decree a reduction of at least 10 per cent actually took place in the early part of 1931, or alternatively the quantity or weight was correspondingly increased for the old price. The success of Government policy in this respect was mainly due to the peculiarities of the goods concerned. There was doubtless a notorious margin of unjustifiable profit which invited interference. The State's threat to repeal the laws under which such articles enjoyed protection was sufficiently effective to force the undertakings to yield.

The chief points regarding the 1930–1 policy are, first, that it was confined to a narrow range, that of proprietory articles. Secondly, no direct compulsion with an elaborate system of inspection was used. The Decree rather gave the traders one of two alternatives: either a 10 per cent reduction or freedom for the retailers. Moreover, the action was carried out by the Government itself, and no special organ was created for the purpose, as in the following winter, 1931–2. The policy was a preliminary step leading to the ambitious programme of price reduction in the sphere of free, as well as fixed, prices enacted in the important Emergency Decree of 8th December, 1931.

II. The Activity of the Commissioner for Price Control

Part I, Chapter II of the 4th Emergency Decree[2] provided for the appointment of a Reich Commissioner for Price Control, and the post was accepted by Dr. Goerdeler, Lord Mayor of

[1] *Der deutsche Volkswirt*, 21st November, 1930.
[2] See Appendix to this Chapter.

Leipzig. On 1st January, 1932, there appeared an article from his pen in *Der Heimatdienst*, a semi-official periodical published for the benefit of Germans abroad. It contained a comprehensive statement of the factors calling for Governmental action and the manner in which it was hoped to achieve the ends in view.

He began by emphasizing the fact that the vast majority of people are normally both consumers and producers and that a policy of reduction of prices must be pursued in such a way that the disadvantages will not outweigh the advantages. Price reduction must, therefore, be a part of a larger programme. England's departure from gold had, among other things, exercised a detrimental influence on Germany's competitive capacity. To retrieve her position, Germany must drive down her price level. Moreover, the compulsory 10 per cent wage and salary cut which was effected in the Decree of 8th December, 1931, had affected 35 milliards of the German national income: in other words, it had meant a sudden loss of 3·5 milliards of purchasing power. Thus, for this reason, too, a rapid adjustment of the price-level of consumers' goods was urgently necessary. The task was to ensure that a "juster price" prevailed, i.e. a "price which covers total prime costs and which guarantees to those who share in the production and marketing of the product an existence on a level corresponding to the prevailing economic situation". No more and no less!

The Commissioner admitted that the factors influencing price determination were very different in various lines of production. In all cases the claims of public expenditure and social services would have to be taken into account and it was obvious that budgetary economy was the only remedy as far as these costs were concerned. He expressed a pious wish that there should be a return to free competition. He concluded with a direct appeal to menfolk, as well as housewives, to be alive to their interests and to play their part actively, for eternal vigilance on their part was the only sure guarantee that a "juster" price determination would ensue.

With these reflections, Dr. Goerdeler began his campaign to reduce free retail prices all along the line—a campaign which was to be as vigorous as it was short-lived. It lasted about two months.

In a broadcast speech on 29th February, 1932, he pointed out that a continuance of the policy would lead to withholding of orders and consequent serious damage to industry. It was therefore desirable to have a period of stability. Supervision

of food prices would continue to be exercised by the State authorities. As regards charges for water, gas, and electricity, further inquiries were necessary, and some members of the Commissioner's staff would remain for that purpose. Dr. Goerdeler expressed dissatisfaction with the course of the prices of butter and bread: that of butter had temporarily increased as a result of higher duties (!) whereas the prevention of a further rise in the price of bread would necessitate very stringent measures.

The Commissioner pointed to a fall in the cost of living (as shown by the index number) of 6·9 per cent as the result of his period of office (8th December, 1931–29th February, 1932)—the largest fall in so short a space of time since Stabilization. He was of opinion that further measures should be taken in the sphere of cartel prices, but reiterated the need for a period of stability.

III. The Effect of the Policy as seen in the Cost of Living Index Number and the Course of Free and Fixed Prices

It is obviously a difficult matter to measure the effect of State interference with the price mechanism by studying the behaviour of index-numbers. This is true, even when the index number purporting to represent the cost of living is constructed with the maximum of accuracy and objectivity. So many complicated factors contribute to bring about a given price that it is scarcely possible to impute a certain percentage decline to authoritarian interference. The Commissioner for the Control of Prices, when he laid aside his axe after about three months of extreme activity, proudly claimed a 6·9 per cent fall in the cost of living as the reward of his labours. This, of course, assumes that all the other influences playing on prices during this period remained constant.

The German cost of living index number[1] shows the course of Foodstuffs, Rent, Heat and Light, Clothing, and Miscellaneous Items (including Travel fares). Reference to the figures shows that in January, 1932, all these items exhibited a sudden fall. Compared with the previous month there was a decline of 4·5 per cent (from 130·4 to 124·5) in the general cost of living. The Decree reduced the rents of old houses (i.e. those built before 1919) by 10 per cent, so that the corresponding index number fell from 131·6 to 121·5.

[1] Figures taken from *Wirtschaft und Statistik*.

The following Table shows the level of the different items in the cost of living in January, 1932, as compared with December, 1931, and January, 1931; and February, 1932, compared with January, 1932, and February, 1931.

	Total Cost of living.	*Total Cost of Living excluding Rent.*	*Food Stuffs.*	*Rent.*	*Heat and Light.*	*Clothing.*	*Miscellaneous Needs*	*Food, Rent, Heat, Light, Clothing.*
	%	%	%	%	%	%	%	%
Jan., 1932, compared with Dec., 1931 .	− 4·5	− 3·8	− 3·2	− 7·7	− 5·6	− 4·0	− 5·2	− 4·5
Jan., 1932, compared with Jan., 1931 .	− 11·3	− 12·2	− 13·0	− 7·8	− 6·6	− 15·4	− 8·6	− 11·7
Feb., 1932, compared with Jan., 1932 .	− 1·8	− 2·2	− 1·9	0·0	− 2·4	− 3·0	− 2·2	− 1·7
Feb., 1932, compared with Feb., 1931 .	− 11·9	− 12·8	− 13·1	− 7·8	− 8·9	− 16·9	− 10·4	− 12·1

It is clear that most of the sudden fall in December–January was due to State interference initiated by the Decree of 8th December. Coal and Lignite Syndicates had to cut their prices by 10 per cent: the average price margin in the retail trade was reduced by 15 per cent. These measures led to an average fall in the retail price of 11·4 per cent for coal and 11·9 per cent for lignite. Inside the Miscellaneous item, the prices of branded articles fell according to the Decree. Among foodstuffs, there was a striking decline in the price of milk, dairy produce, and margarine. The latter fell by 8·3 per cent in January, compared with the previous month. The fall in the prices of pork, beef, and mutton was less substantial, 3·9, 3·7, and 3·7 per cent respectively, compared with the previous month.

The February figures reveal a more moderate decline. The general cost of living fell by 1·8 per cent compared with the previous month. Meat showed a relatively conspicuous fall, pork 5·1 per cent and beef 4·3 per cent. Eggs fell by 17·3 per cent, owing to a sudden increase in foreign supplies and a falling off in demand. Coal and lignite fell by 1·6 and 1·0 per cent respectively.

In March, the general index number remained at about the same level as in February. In foodstuffs there was a rise in the prices of vegetables and potatoes by 14·1 and 6·7 per cent respectively. Compared with March, 1931, the price of vegetables was 20·5 per cent lower, and that of potatoes 3·8 per cent higher.

These details serve to show how market forces continued to assert themselves and the net result of a complicated set of

factors showed itself in a renewal of the steady fall in the cost of living through the summer months. A graphical representation of the cost of living index number would bring out quite strikingly the sudden fall in the first two months of 1932: the curve would then pursue a more leisurely course downwards.[1] Perhaps a projection of the trend of 1931 would have reached the same point in the summer or autumn of 1932 as was actually reached: or it may be argued that the absolute level of the cost of living in the summer and autumn of 1932 was lower than it would have been had there not been that sudden jump downwards at the beginning of the year. If the validity of the latter argument could be established then, clearly, the Government would be justified in claiming that it had done something to adjust the purchasing power of the mass of the population to the fall of 10 per cent in nominal income. But even this assumes, among other things, that the price-cutting policy itself does not involve a further shrinkage in the nominal income of the mass of the population concerned.

FREE AND FIXED PRICES.[2] (Industrial Raw Materials and Half-finished Goods)

	Index Numbers. 1926 = 100.			
	Fixed Prices.		*Free Prices.*	
	1931.	1932.	1931.	1932.
January	95·2	84·3	66·2	51·2
February	94·8	84·1	65·6	50·2
March	94·7	84·0	65·6	49·7
April	94·0	84·0	65·0	47·9
May	93·9	84·0	62·8	46·7
June	94·0	83·9	61·4	45·2
July	93·8	83·7	62·0	45·1
August	94·1	83·7	59·7	46·6
September	93·9	83·6	56·6	48·2
October	93·7	83·9	55·6	47·2
November	93·4	83·7	55·7	46·5
December	89·5	83·7	54·0	45·7
Average	93·8	83·9	60·8	47·5

If we consult the movement of Fixed and Free prices we discover a sudden temporary fall in December, 1931, and January, 1932. It was very marked in the case of the Fixed prices from 93·4 in November, 1931, to 84·3 in January, 1932. Here again the attack on these prices in the Fourth Decree can be cited as the prime cause.

[1] The cost of living between December, 1931, and December, 1932, fell by 9·2 per cent; and no less than a half of this fall was registered in the first month, i.e. January, 1932.

[2] *Konjunktur-Statistisches Handbuch*, 1933, p. 121.

IV. The Extent of the Achievement

When the general tendency of the world price-level is downwards, Decrees to enforce reductions have a fair chance of success. Whether in the long run they achieve more than would have been achieved by the unaided forces of the market is problematic. State interference of this kind raises the hopes of buyers that more reductions are to come, with the consequence that there is an unnatural tendency for purchases to be postponed. This has a disorganizing effect on the market: and it is significant that this was one of the factors alluded to by the Commissioner in his swan-song. The attack on the "fixed prices" was rewarded by a reasonable amount of success: the reduction in the prices of public services and public utilities was comparatively easy to carry out and no doubt helped general adjustment.

The obvious objection, however, is that this particular species of State policy was contradicted and offset in other departments of State interference. The tariff kept the prices of certain agricultural products artificially high. Moreover, the sensational raising of the Turnover Tax from ·85 to 2 per cent in the Fourth Emergency Decree was bound to militate against the capacity and willingness of traders to reduce prices. The State in Germany has interfered to such a far-reaching extent with all sections of the economic system that it is natural to expect conflicting forces to be at work.

The policy was an interesting experiment; but it must not be taken too seriously. Governments must endeavour to show a desperate people that they are doing something. In so far as it shortened the normal lag between the fall of wholesale and that of retail prices, in so far as it forced cartels and syndicates to lower controlled prices, the Government no doubt succeeded in quickening the forces making for adaptation. But it could scarcely have seriously expected a vigorous two months' campaign of this nature to revive the home market by strengthening purchasing power and put new life into Germany's competitive capacity abroad. A mere glance at the course of total income from wages and salaries and that of the cost of living makes it quite clear that a big disparity remains—due mainly to the havoc wrought on income by unemployment and short time. Moreover, the fall in wage-rates and salaries has been partially offset by inroads into savings and this has tended to keep up the price of consumers' goods.[1]

[1] For a discussion of this experiment, see: Zahn, "Die deutsche Preissenkungsaktion an der Jahreswende, 1931–2," *Allgemeine*

V. WAGES

Fairly accurate figures [1] can be presented to show how far time wage-rates have declined during the depression. The downward progress took place in three waves. In the first phase—from the peak at the end of 1930 to the end of April, 1931—wage-rates fell on an average by 5·8 per cent. This reflected the adjustment forced on the economic system by the reaction after the boom. During 1931, as we have seen in our review of the Emergency Decrees, the Government interfered in order to reduce the personnel costs of public authorities, in particular to relieve the Reich budget. In the period September, 1931, to February, 1932, average wage-rates fell by 11·9 per cent, 10 per cent being due to the Emergency Decree of 8th December, 1931. The year 1932 witnessed a slow and unevenly distributed decline : from 1st August to 1st October, 1932, there was only a fall of about ½ per cent. From the peak of 1930 wage-rates had dropped by over one-fifth. The relevant data are given in the following Table :—

DECLINE OF HOURLY WAGE RATES IN INDUSTRY AND TRANSPORT SINCE THE PEAK OF 1930 [2]

Groups of Workers	Position on 1st Nov., 1930	Position on 1st May, 1931	Fall from 1st Nov., 1930, to 1st May, 1931	Position on 1st Sept., 1931	Fall from 1st Nov., 1930, to 1st Sep., 1931	Position on 1st Jan., 1932	Fall from 1st Nov., 1930, to 1st Jan., 1932	Position on 1st Aug., 1932	Fall from 1st Nov., 1930, to 1st Aug., 1932
	Rpf.	Rpf.	%	Rpf.	%	Rpf.	%	Rpf.	%
Male, Skilled .	102·9	96·9	5·8	96·3	6·4	84·9	17·5	81·1	21·2
Unskilled .	83·4	79·0	5·3	78·6	5·8	69·3	16·9	68·7	17·6
Assistants .	80·8	76·1	5·8	75·7	6·3	66·9	17·2	63·4	21·5
Female, Skilled & Unskilled	64·7	61·1	5·6	61·0	5·7	53·5	17·3	53·2	17·8
Assistants .	53·7	50·7	5·6	50·7	5·6	44·1	17·9	44·0	18·1

It need hardly be pointed out that these hourly wage-rates give no true indication of the average actual earnings of the worker per hour. For an estimate of the latter we need statistics of earnings, which take different forms according to whether

Statistisches Archiv., Band 22, ii ; Findeisen, " Technisches der Preissenkungsaktion," in *Zeitschrift für Kommunalwirtschaft*, 11th April, 1932 ; Kuczynski, " Probleme der Preisentwicklung," *Gewerkschaftsarchiv*, April, 1932 ; Bandmann, " Löhne und Lebenshaltungskosten," *Wirtschaftsdienst*, 4th March, 1932 ; Meyer, " Bilanz der Preissenkung," *Städtetag*, 5th March, 1932 ; Schumpeter, " Weltkrise und Finanzpolitik," *Deutsche Volkswirt*, 4th March, 1932 ; A. Hüsseuer, *Die Senkung der gebundenen Preise*, 1932 ; Morgenstern, " Free and Fixed Prices in the Depression," *Harvard Business Review*, October, 1931.

[1] These figures relate to industrial groups for which hourly wage-rates are published.

[2] *Wochenbericht des Instituts für Konjunkturforschung*, 23rd November, 1932, p. 138.

time or piece rates are paid. Data of a reliable character are available for the coal-mining industry and they show that from the boom peak (1929) to August, 1932, average hourly earnings fell by between 20 and 27 per cent. It is not possible to reach any general conclusions from this result owing to the variety of conditions in different industries. Approximate information exists, however, regarding extra earnings (*übertarifliche Verdienste*) in some branches of industry.

EXTRA EARNINGS IN CERTAIN INDUSTRIES [1]

Period of Return.	*Extra Earnings as % of Wage rate per hour.* [2]	*Fall of Extra Earnings* [3]	*as % of*
October, 1931.			
Iron and Steel Industry .	17·3	October, 1928.	38
Production of Iron and Steel goods . .	19·0	,, ,,	28
Machine Production .	19·7	,, ,,	13
March, 1932.			
Shoe Industry . .	5·7	March, 1929.	64

One would have expected that in a time of wage decreases the scope for extra earnings would be closed to the individual worker. But the figures lend colour to the suggestion that it was advantageous for the employer in many firms, in spite of the excessive supply of labour, to remunerate a portion of the labour force at a rate higher than the agreement rates.

It is, of course, difficult to estimate exactly how much of the average fall in wage-rates we can impute to Government interference. The estimated average decline between the boom peak (1930) and August, 1932, was 20 per cent: it may be roughly concluded that about a half of this was due to the sweeping all-round 10 per cent cut decreed in December, 1931.

Wages of Public Officials.—A close view of the activity of the Government in bringing down wage-rates may be obtained by examining the course of public officials' salaries.[4] The salaries of German officials remained unchanged from the autumn of 1927 to August, 1930. The first brunt of the deflationary policy was felt when the Emergency Decree of 26th July, 1930, was enacted. A *Reichshilfe* in the form of a 2½ per cent cut was levied on all persons in public employment earning over 2,000 marks per annum, i.e. from officials and salaried employees of

[1] *Wochenbericht of Institut für Konjunkturforschung*, op. cit., p. 138.
[2] Average of groups for which comparison was feasible.
[3] In comparable areas.
[4] See Hans Völter, "Die deutsche Beamtenbesoldung" (*Schriften des Vereins für Sozialpolitik*, vol. 184).

the Reich, States, Communes, Reichsbank, public corporations, Railway Company, and recipients of pensions and superannuation payments. This was to be in force until 31st March, 1931. On 1st December, 1930, came the "Decree for the Security of the Economic System and Public Finances": it enacted that the *Reichshilfe* should lapse on 1st February, 1931, and be replaced by a cut of 6 per cent of the 1927 rates. The free limit was lowered from 2,000 to 1,500 marks and, as cold comfort for the poor man, the salaries of the President, Chancellor, and Reich Ministers were reduced by 20 per cent.

A reduction was again brought about by the Emergency Decree of 1st July, 1931—this time with a vain attempt at tempering the wind to the shorn lamb. The rate of reduction, allowing for previous cuts, was now to be 10 per cent on the 1927 rates for salaries above the free limit up to 3,000 marks, 11 per cent for those between 3,000 and 6,000 marks, 12 per cent for 6,000–12,000 marks, and 13 per cent for those over 12,000 marks. The monthly family allowance of 20 marks for the first child was reduced by a half. This drastic provision defeated the object of the progressive graduation and, in practice, actually meant a higher percentage cut for the lower grades than for the higher.[1] States, Communes, and other public authorities were instructed to reduce their officials' wages in so far as they remained higher than the corresponding Reich rates.

A Decree of 24th August, 1931, empowered State Governments to execute measures necessary to maintain the equilibrium of State and Communal budgets. All States took advantage of this, and some introduced further cuts of 5 to 7 per cent in officials' salaries or attacked the higher income groups; whereas others modified basic rates and bonuses. State Decrees generally tended to bear particularly hard on bachelors or married men without children.

Finally, the famous Emergency Decree of 8th December, 1931, applying to Reich, States, and Municipalities, reduced the pay of officials by 9 per cent of the October, 1927, rates. There was no free limit, so that even the lowest grades were touched.

The result of this cumulative series of cuts was that officials' salaries underwent an average fall of 20 to 21 per cent: they were thus pushed back to the nominal levels of December, 1924. To discover what this meant in terms of purchasing power resort must be had to the cost of living index number—though it is an unsatisfactory criterion in view of the difference in the make-up

[1] See Hans Völter, op. cit., p. 78.

of expenditure in the households of officials, salaried employees, and wage-earners.

Roughly speaking, by October, 1932, the effect of the cuts had been to reduce officials' real income to the level of October, 1927. For some grades this meant a real wage of between 5 and 10 per cent above the 1913 level; while for others it implied a reduction of about 12 per cent and in some cases over 25 per cent below the pre-War standard.[1]

VI. The Papen Plan: An Ingenious Attempt to Quicken the Pulse of the System[2]

The underlying idea of the Papen Plan was to give industry immediate relief from taxation without thereby diminishing the current revenue received by the Treasury. The achievement of such an object required a certain amount of ingenuity. 1·5 milliards of Tax Vouchers were to be issued during the period October, 1932–September, 1933, up to a fixed percentage of the yield of certain taxes in that period. They were divided out as follows:—

	Estimated Yield during the Year October, 1932–September, 1933.				
Tax.	*Reich.*	*States and Communes.*	*Total (Million RM.)*	%	*Tax Voucher Total.*
Turnover	1,500	—	1,500	40	600
Passenger Transport	90	—	90	100	90
Goods Transport	80	—	80	100	80
Land and Buildings	—	1,280	1,280	40	512
Trade Profits	—	600	600	40	240
					1,522

Thus Tax Vouchers were to be handed out to the amount of 40 per cent of the revenue from the taxes on Turnover, Land and Buildings, and Trade Profits, and to the full extent of the yield of the taxes on Passenger and Goods Transport.

Moreover, if an employer in any quarter of the period 1st October, 1932–30th September, 1933, were to employ on an average more workers than in the three months, June–August, 1932, he would qualify for the receipt of 100 Tax Vouchers per additional worker per quarter. A total of 700 million vouchers were allocated for this purpose.

[1] For details see Hans Völter, op. cit.

[2] See *Verordnung zur Belebung der Wirtschaft*, 4, September, 1932; Part I, *RGB.*, 1932, i, p. 425.

An aggregate of 2·2 milliards was intended for distribution: the 1·5 milliards would find their way into different branches of the system according as they contributed to the taxes in question, whereas the 700 million "employment premium" vouchers would be taken up wherever the labour force could be expanded. The *Institut für Konjunkturforschung* made a tentative estimate of their probable distribution in the following Table [1]:—

Economic Group.	*Tax Vouchers. For Taxes Paid.*	*As Employment Premium.*
	Nominal Value in Million RM.	
Agriculture	160	—
Small Masters (*Handwerk*)	117	50
Industry	490	550
Trade and Transport	330	50
House Ownership and "Free" Professions	255	—
Railway	170	50
	1,522	700

The Tax Vouchers will be accepted in payment of Reich taxes (with the exception of Income and Corporation Income tax) to the extent of one-fifth of their nominal value, plus a small premium, in each year of the period 1st April, 1934, to 31st March, 1939. The following was the original estimate [1] of the annual flow of Tax vouchers (including premiums) which will reach the Treasury between 1934–8:—

Financial Year.	*Vouchers for Taxes paid.*	*Voucher for increased Employment.*	*Total.*
1934–35	316·6	145·6	462·2
1935–36	328·8	151·2	480·0
1936–37	340·9	156·8	497·7
1937–38	353·1	162·4	515·5
1938–39	365·3	168·0	533·3
	1,704·7	784·0	2,488·7

On the assumption that the whole of the 700 million employment vouchers would be taken up, the Treasury would have to be prepared for a gap of about half a milliard RM. in the tax revenue of each year.

The basic postulate of the whole scheme is that the rising tide of trade in these years will produce an aggregate of revenue which will be at least sufficient to offset the fact that Tax vouchers of the specified amounts will be received in payment of taxes instead of cash. The Papen Government had reason to believe

[1] *Wochenbericht*, 14th September, 1932.

that in the autumn of 1932 the bottom of the depression had been touched and that the upward swing had already begun. So it decided to take time by the forelock and accelerate the incipient revival by giving the economic system a good dose of artificial respiration, the cost of which is to be borne by the years of plenty which are to follow. Papen was a little inclined to assume that the stimulating consequences of his scheme would make the industrial revival doubly certain. Another vital assumption implicit in the Plan is that public expenditure in the good years can be prevented from rising in such a way as to absorb the margin which the Government will need to cover Tax voucher deficiencies.

The Plan couples a compulsory loan with taxation relief. Its instinct in lifting the burden from those taxes most onerous to the entrepreneur was correct, for it is clear that the self-healing elements which make themselves felt in the normal trade cycle are vitiated by the extraordinary character of the world depression. The " employment premium " device was an attack on the rigidity of wages : it proved a failure owing to the strong opposition of the trade unions. Professor Röpke was right in declaring that it represented a much more drastic interference with the private market than a public investment policy.[1] The whole programme was an interesting attempt to quicken the early stage of a revival which follows the bottom point of a depression. Given a general setting less unfavourable than that which existed in Germany, it might have yielded fruitful results.

APPENDIX

The Substance of the Price Reduction Policy set out in Emergency Decree of 8th December, 1931.[2]

Part I : Chapter I

The Adjustment of Fixed Prices to the Changed Economic Situation

Fixed prices are to be reduced as from 1st January, 1932, at least 10 per cent below their level on 30th June, 1931.

Fixed prices are those to the maintenance of which the parties to such agreements as those described in the 26th July, 1930, Decree,

[1] W. Röpke, " Wirtschaftsbelebung durch Notverordnung ? ", *Sparkasse*, 15th October, 1932.

[2] *Vierte Verordnung des Reichspräsidenten zur Sicherung von Wirtschaft und Finanzen und zum Schutze des inneren Friedens*, 8th December, 1931, *Reichsgesetzblatt*, 1931, No. 79.

have committed themselves, e.g. Cartels, Syndicates, and Rings, in such industries as iron and steel, metal, building, chemical, paper, glass, and textiles, and artificial fertilizers.

The Minister for National Economy can enforce a cut of more than 10 per cent if he sees fit.

If this order is not carried out the agreements in question (or those sections of them in question) shall be null and void.

The prices of "branded" articles are also to be reduced by 10 per cent below the level of 30th June, 1931; and the other regulations also apply.

A special order was made for the coal and potash industries. As from 1st January, 1932, the latest coal syndicate prices published in the *Reichsanzeiger* to be reduced by 10 per cent. The Minister can make further orders regarding the price policy of the Syndicate. The same applies to potash. Coal syndicates and wholesalers are not allowed in future to penalize retailers because they have not adhered to prices fixed regionally. Special instructions are to be issued regarding the retail coal trade.

In particular circumstances, where great economic disadvantages are to be feared, the Minister can make exceptions. Moreover, exception is also made of fixed prices in cases where the participants are bound by international cartel agreements. All such agreements are to be laid before the Ministry of National Economy by the 1st of January, 1932.

The Minister's decision in questions arising out of this chapter is final.

In order that the policy shall be effective, it is enacted that no fixed prices can be raised and no new price agreements entered into up to 1st July, 1932, without the approval of the Ministry of National Economy. (This does not apply to coal and potash.)

Punishment through fine (of unlimited amount) is prescribed for refusal to comply with these regulations.

In cases where the fixed prices apply only to a particular region or regionally situated group of persons, the Government can delegate its authority in this sphere to the State authorities. The Minister for National Economy and the Minister for Agriculture will decide the period for which the provisions of this chapter shall remain in force.

PART I: CHAPTER II

Measures Against Excessive Prices

(1) In order to protect the population against excessive prices for important goods and services of everyday need, a Reich Commissioner for the Supervision of Prices is appointed. The Government will decide the duration of his duties.

(2) The Commissioner has the task of supervising the price margins and surcharges of the above-mentioned goods. If he finds prices, price margins, or surcharges excessive he is empowered to reduce them.

(3) The Government of the Reich shall decide on the penalties which may be laid down in regulations to be issued in virtue of this chapter. In so far as no penalties are specified, the supreme State authorities shall upon request of the Reich Government instruct the Police authorities to carry out in individual cases by a Police order the general measures provided for in this chapter; and if necessary to apply coercion for this purpose in accordance with the laws of the State. An appeal in an administrative law court can be made against such Police order. The Government can issue further regulations in this connection.

(4) Private railways, light railways, and tramways shall, on the request of the Commissioner, be wholly or partly freed from the Transport Tax if they adequately reduce their transport tariff in force at the time this chapter becomes effective.

(5) The Commissioner can transfer his powers wholly or partly to the Supreme State authorities. In so far as he makes use of this authorization, the Supreme State authorities can pass on powers transferred to them to subsidiary authorities.

The regulations of this chapter shall be carried out by the State authorities. The authorities of the Reich, the States, and the Districts, as well as other public bodies shall render assistance for the carrying out of the provisions of this chapter free of charge.

(6) The Government is empowered to issue decrees and administrative regulations in pursuance of this chapter. In particular it can issue regulations regarding the manner in which price reductions are to be carried out, the placing of price labels and price lists, as well as prohibition to carry on businesses and the closing down of working and business premises.

It can order that this chapter or some provisions of it shall become invalid, and it can issue the necessary transitional regulations.

Decree Concerning the Powers of the Reich Commissioner for Price Control (*8th December*, 1931)

(1) The Reich Commissioner can issue regulations concerning the prices of vital commodities in daily use or the charges for vital services satisfying daily needs; he can in particular regulate the price margins and surcharges which accrue in the various processes of sale. He may endeavour to induce the parties to make a reduction voluntarily or he can lower the price margins, or surcharges, through suitable regulations: he can do this either directly or by means of other measures which may have the desired effect.

Infringements are punishable with imprisonment or fines or both. No limit is fixed as to fines.

(2) The Commissioner can prohibit the continuation of undertakings which deal in vital goods of daily use or which render vital services for meeting daily needs if the owner or manager of the undertaking contravenes the regulations issued in virtue of the present Decree or if other facts justify the assumption that the owner or manager does not possess the necessary reliability. The Commissioner can order the closing of such undertakings.

An appeal may be lodged with the Economic Court of the Reich within one week against a prohibition or closing ordered under the above provisions. The decision of this court shall be final and shall be given within one month of the appeal.

(3) The Commissioner can prescribe that vital objects of daily use which are exhibited for sale in shops, shop windows, showcases, weekly markets, market buildings, or streets, shall be furnished with price labels showing the exact sale price of each type of goods. He can further prescribe that persons selling vital articles of daily use by retail, without exhibiting them, must affix a price list which is easily visible in the shop, shop window, showcase, or selling counter. He can make the same regulation regarding those performing vital services satisfying daily needs.

(4) The Commissioner can define which is to be regarded as a vital object of daily use or vital service for meeting daily needs.

(5) The Commissioner can demand information under Decree of 3rd July, 1923.

(6) In case of special necessity the Commissioner can form price Committees from among those affected in order to hear their opinion regarding price margins, and surcharges, and he can lay down the powers of such committees.

CHAPTER V

THE REDUCTION OF INTEREST RATES AND RENTS BY DECREE

I. A SURVEY OF GERMAN INDEBTEDNESS.
II. THE RIGIDITY OF THE INTEREST CHARGE.
III. THE GROWTH OF MORTGAGE CREDIT.
IV. THE PROBLEM OF AGRICULTURAL DEBTS.
V. THE COMPULSORY REDUCTION OF MONEY MARKET RATES.
VI. THE PROBLEM OF URBAN RENTS AND MORTGAGE CREDIT.
VII. A SUMMARY OF THE TOTAL REDUCTION OF INTEREST IN 1932.
VIII. PUBLIC DISCUSSION OF THE DECREES.
IX. THE CASE IN FAVOUR.
X. THE DEMERITS OF THE POLICY.
XI. POLITICAL COMPLICATIONS.

Many factors contributed to keep the rate of interest in Germany very high during the years following Stabilization. Herr Erich Welter concludes that the heavy burden of taxation was the chief cause [1] and that the saving undertaken by the State was too insignificant to have a counteracting influence. Reparations not only impoverished the country, but were the cause of an extra risk premium which German borrowers had to pay on the capital they imported from abroad.[2] It is also argued that entrepreneurs had to speed up rationalization in order to offset the handicap of high wage-costs: hence the tendency to prefer investments in which the proportion of capital to labour cost is large.

The gaps left by the ravages of the War and inflation, together with the needs of an increasing population, exercised a powerful influence on the demand side. Excessive public expenditure on housing and on the encouragement of agriculture led to a dissipation of scarce capital resources and to misdirected investment. Agriculture incurred debts amounting to $7\frac{3}{4}$ milliard marks between 1924 and 1928; and only 3 milliards of this

[1] E. Welter, *Die Ursachen des Kapitalmangels in Deutschland* (1931), p. 194. It is estimated that the total burden of taxation, including social insurance charges, constituted 28·6 per cent of the national income in 1929, compared with 11·5 per cent in 1913. See E. Wagemann in *Kapitalbildung und Besteuerung*, vol. iv, p. 187.

[2] K. Diehl in concluding chapter of *Wirkungen und Ursachen des hohen Zinsfusses in Deutschland.*

represented an addition to real capital.[1] The farmers were not only sheltered from foreign competition by a high tariff, but were regaled with credits at artificially cheap rates. Too great a proportion of public investment funds, e.g. the yield of the House Rents Tax, was used to subsidize the building of houses. The widespread control over production and prices exercised by trusts and cartels also aggravated the scarcity of capital. The practice of re-investing undivided profits often meant that resources were utilized in a manner which would be ruled out if market forces had their way. This had a tendency to drive up the rate of interest, to the disadvantage of profitable channels of investment. The flight of capital from Germany in the years 1924–1930 reached a volume of between 4½ and 5½ milliard marks : this factor naturally helped to increase the rate of interest.

I. A Survey of German Indebtedness

Germany is much more dependent on short-term credit than she was before the War. The aggregate of debt (excluding joint-stock credit) at the end of 1931 was 93·8 milliard marks, of which about two-thirds was long-term. The corresponding total at the end of 1913 was 117·5 milliard marks, of which 84 per cent was long-term.

The distribution of the debt and the estimated interest charge at the end of 1931 is exhibited in the following Table.

Distribution of German Debt and Interest Charge at the end of 1931 [2]

	Debt.	*Interest.*
	(*Milliard RM.*)	
Agriculture	11·97	1·01
House Ownership	27·95	1·83
Public Administration	22·22	1·43
Public Undertakings	5·30	0·43
Trade, Transport, Industry, Handicraft	26·36	3·00
	93·80	7·71

The total foreign indebtedness of Germany at the end of February, 1932, was estimated at 25·6 to 26·6 milliard marks.[3]

II. The Rigidity of the Interest Charge

During periods of rapid changes in the value of money the burden of debt service is one of the most rigid elements in the

[1] Welter, op. cit., p. 171.
[2] *Wochenbericht* of *I. f. K.*, 1932, No. 20.
[3] *Wirtschaft und Statistik*, 1932, No. 16.

economic system. When fluctuations occur within a narrow range, or the fall in prices is the result of rising productivity, no serious problem is presented. But in the present depression the real burden of short-term, as well as long-term, interest payments has risen enormously.

THE INTEREST CHARGE AND THE NATIONAL INCOME IN GERMANY

	National Income [1] Milliard RM.	Interest Charge			The Interest Charge as % of National Income		
		Long	Short	Total	Long %	Short %	Total %
		Milliard RM.					
1928 .	75·4	3·6	2·7	6·3	4·8	3·6	8·4
1929 .	76·1	4·0	3·2	7·2	5·3	4·2	9·5
1930 .	70·2	4·5	2·4	6·9	6·4	3·4	9·8
1931 .	57·1	4·8	2·8	7·6	8·4	4·9	13·3
1932 .	—	3·5	2·7	6·2	—	—	—

The interest charge as a proportion of the National Income rose from 8·4 per cent in 1928 to 13·4 per cent in 1931. The long-term burden increased uninterruptedly ; whereas the weight of the short-term debt, having fallen in 1930, grew again rapidly in 1931. The nominal sum of interest payable in 1932 was about 1·4 milliard RM. less than in the previous year—the result partly of the reduction of interest by Decree. But, since the national income has declined still further, there has been nothing like an equivalent reduction in the real burden. The State took an important step to reduce interest rates in the Fourth Emergency Decree of 8th December, 1931.

III. THE GROWTH OF MORTGAGE CREDIT [2]

The extent of agricultural and urban mortgage credit in 1931 compared with pre-War may be seen in the following Table :—

[1] Taken from *Das deutsche Volkseinkommen* (*I. f. K. Einzelschrift*, No. 24), p. 60.

[2] The statistics used in the following sections, where not otherwise stated, are taken from the monumental study published by the *Statistisches Reichsamt* entitled " Der Immobiliarkredit " by G. Kokotkiewicz (1932).

CLASSIFICATION OF REAL ESTATE CREDIT

Type of Credit.	*End of* 1913. *Milliard M.*	*End of* 1931. *Milliard M.*
Agricultural Mortgages	13·00	7·65
including Revalorised Mortgages	—	(1·80)
Urban Mortgages	49·20	27·05
including Revalorised Mortgages	—	(5·60)
Total	62·20	34·70
including Revalorised Mortgages		(7·40)

The absolute totals are much smaller than in pre-War times, but, owing to high interest rates, the weight of the indebtedness is relatively much greater. The following table shows the changes that have taken place in the distribution of real estate credit among Bank, private and House Rents Tax mortgages.

	Real Estate Credit.	*Mortgage Banks.*	*Private Mortgages.*	*Rents Tax and Miscellaneous.*	*Mortgage Banks.*	*Private Mortgages.*	*Rents Tax and Miscellaneous.*
	Milliard M.				%		
1913	62·2	37·2	25·0	—	59·8	40·2	—
1928	26·7	16·2	5·9	4·6	60·7	22·1	17·2
1929	29·9	18·2	6·0	5·7	60·9	20·1	19·0
1930	33·3	20·1	6·5	6·7	60·4	19·5	20·1
1931	35·3	21·1	7·0	7·2	59·8	19·8	20·4

This illustrates the relative unpopularity of private mortgages since Stabilization.

In the first few years after 1924 there was a tremendous flow of loans into agriculture. This fell off about the end of 1928 and the stream of loans granted to urban borrowers for house-building rose rapidly. In so far as loans were still being absorbed by agriculture, they were mainly being devoted to debt conversion, either for converting short-term indebtedness into long-term or for the redemption of obligations. After the end of 1930 there was a definite slowing down in the quantity of loans secured on urban property; whereas with the credit crash of 1931 mortgage business was more or less suspended.

One important feature of post-War development may here be noted, viz. the establishment of numerous mortgage institutions carrying on a specialized business. In both the agricultural and urban lines these undertakings have tended to restrict themselves to a certain type of mortgage business, e.g. houses containing small flats. As a result of the crisis and Government interference to protect debtors, many such Institutes find themselves in serious difficulties, as they have not spread their risks.

The following Table gives a picture of the part played by various types of Institution in the Mortgage loan business :—

PART PLAYED BY DIFFERENT TYPES OF INSTITUTION IN THE MORTGAGE LOAN BUSINESS

	Percentages.					
	Agricultural Mortgages.		*Urban Mortgages.*		*Total Mortgage Credit.*	
	1913.	1931.	1913.	1931.	1913.	1931.
Joint Stock Mortgage Banks . . .	7·7	15·0	42·5	37·5	32·6	31·7
Semi-Governmental Institutes . .	45·7	47·8	3·5	10·8	15·5	20·4
Savings Banks . . .	43·4	31·0	34·5	31·8	37·0	31·6
Private Life Assurance Companies . . .	2·3	1·8	17·5	12·0	13·2	9·3
Public Life Assurance Institutes . . .	0·0	1·0	0·0	1·1	0·0	1·1
State Insurance Societies.	0·9	3·4	2·0	6·8	1·7	5·9
	100·0	100·0	100·0	100·0	100·0	100·0

It is worth noticing that semi-Governmental institutions and State Insurance Societies are much more interested in real estate credit than they were before the War.

IV. THE PROBLEM OF AGRICULTURAL DEBTS

The Fourth Emergency Decree was calculated to reduce the load of interest on agriculture, as well as to prevent farms from being sold under distraint. Part III provided that an interested party could prevent the sale of land under distraint if the highest offer was less than seven-tenths of the value of the property, unless the creditor could furnish evidence that this would mean serious loss to him. After this Decree it was virtually impossible for creditors to collect interest arrears, call in loans, or proceed to sell up. Many debtors, who were quite able to pay, naturally took advantage of the general holiday. Later Decrees strengthened the protection of the debtor and the private creditor ceased to risk any new money in agriculture.

Agricultural debtors, in common with others, benefited from the cut in the ratio of 4 : 3 in long-term interest rates introduced by the Fourth Emergency Decree. In a Decree of 27th September, 1932, the Government took a further step to relieve the burden on agriculturists. Rates of interest on agricultural, forestry, and market garden mortgages were reduced by 2 per cent for a period of two years, from 1st October, 1932, to 30th September, 1934 ; but no rate was to go lower than 4 per cent. The Reich undertook to compensate Mortgage Banks for the moratorium by giving them Treasury Bills in return for non-interest bearing Mortgage

bonds which are to be redeemed when the postponed interest is repaid as part of the principal.

The amount of interest payable by agriculture expressed as a percentage of the proceeds from sales rose from 7·3 per cent in 1926–7 to 13·8 per cent in 1931–2.

This was the situation which the State, through the above-mentioned measures, sought to alleviate. It is now necessary to attempt a statistical measurement of the relief which was afforded.

An Estimate[1] *of the Relief received by Agriculture.*

(*a*) If we take the financial year July, 1931–June, 1932, the interest reduction of 8th December, 1931, had hardly any effect on the real interest burden, since in the first half of 1931–2 bank interest rates were very high (the Reichsbank rate touched 15 per cent) and the prices of agricultural products slumped enormously. In 1931–2 the interest charge on agriculture represented no less than 13·8 per cent of the sales proceeds compared with 8·3 per cent in 1927–8 and 6·98 per cent in the calendar year 1913. This was in spite of the fact that the year 1931–2 saw a substantial fall in such items as freight cost and prices of industrial products.

(*b*) For the financial year 1931–2 the total interest charge on agriculture is estimated at 1,005 million marks.

For the calendar year 1932 it is estimated at 795 millions.

If we take into account the fall in the Reichsbank rate to 4 per cent on 22nd September, 1932, and the 2 per cent interest moratorium which took effect as from 1st October, 1932, the annual agricultural interest charge may be put at 640 millions.

(*c*) Assuming a writing off of 10 per cent of short- and middle-term bank credits and 20 per cent floating debts, we can infer from this source a relief of 50 million in the annual interest charge. This brings the estimate down to 590 millions.

On this basis the average rate of interest on the agrarian debt would be 5 per cent compared with 4·3 per cent before the War, and 8·5 per cent in the financial year 1931–2.

(*d*) Assuming an annual interest charge of 590 millions and sales proceeds amounting to 7,000 millions, the proportion works out at 8·4 per cent compared with nearly 14 per cent in the year 1931–2 and 7 per cent before the War.

[1] Based on Kokotkiewicz, op. cit.

Subsequent Measures

It is here only possible to enumerate the most important of the Decrees subsequently dealing with agricultural matters.

11th November, 1932 .	Decree regarding the Maturity of Mortgages.
12th December, 1932 .	Decree regarding sale under distraint.
16th December, 1932 .	Executory Decree following the Decree of 27th September, dealing with agricultural interest.
17th January, 1933 .	Decree regarding protection against sale of property under distraint.
1st June, 1933 . .	Hugenberg's Law dealing with Agricultural Debts.

V. The Compulsory Reduction in the Money Market Rate

The Fourth Emergency Decree empowered the Reich Commissioner for Banking to bring about, by negotiation between banks and finance houses, an agreement by which the rate of interest on deposits and loans to third persons, as well as commissions, should be reduced. If the Association of Credit Institutions could not reach an agreement voluntarily, the Commissioner was instructed to enforce the necessary regulations. After difficult bargaining a solution was reached. It was decided to reduce in January, 1932, the margin between the minimum rate charged by the banks and the Reichsbank discount rate from 2 to 1 per cent.[1]

This helped to give an impetus to the downward trend of money market rates during the early part of 1932; but the main influence at work was the successive reductions in the Reichsbank discount rate which fell from an average of 8·6 per cent in the last six months of 1931 to 4 per cent in the last three months of 1932.[2] This development gave considerable relief to short-term debtors, the extent of which is included in the general statistical computation made below.

VI. The Problem of Urban Rents and Mortgage Credit

Between the peak of 1929 and the last quarter of 1931 the income from wages and salaries fell by 25 per cent, while the nominal rent outlay remained rigid.

[1] *Vierteljahrshefte zur Konjunkturforschung*, 1932, A, i, p. 36.
[2] *Deutschlands wirtschaftliche Lage, Jahreswende*, 1932–3 (*Reichskreditgesellschaft*), p. 51.

The Fourth Decree of 8th December, 1931, faced the problem as follows :—

(*a*) New regulations regarding the House Rents Tax.
(*b*) A reduction in rent as from 1st January, 1932.
(*c*) The cut in mortgage interest.

(*a*) The House Rents Tax had been introduced in February, 1924, partly because housing was one of the few forms of property that had not altogether lost value in the inflation and partly in order to finance the building of new houses. It was meant to be a temporary tax ; but decisions regarding its fate were continually postponed so that it was still in existence when the world depression had greatly damaged the profitability of house ownership. The yield of the tax went into the budgets of the States and Municipalities. The critical condition of those budgets, as well as the exigencies of housing policy, made it impossible to consider a sudden abolition of this tax.

It was therefore decreed that the reduction of 20 per cent in the House Rents Tax (on the basis of the Decree of 6th October, 1931) should come into force from April, 1932, to April, 1935. For three years following 1st April, 1935, it should be reduced by 25 per cent : for three years following 1st April, 1937, by a half : and as from 1st April, 1940, it should disappear altogether.

Arrangements were also made for the possible compounding of the payment of the tax.

(*b*) A reduction of 10 per cent in rent of old houses, which was to take effect on 1st January, 1932.

This represented a cut of 500 million marks, or 7·7 per cent. Since some owners probably reduced still further, we may estimate the fall at 550 millions, or 8·5 per cent. If account is taken of the houses and flats that are unoccupied, the reduction in the income of house owners in 1932 was about 600 millions, compared with 1931.

In the case of new houses (including those built between 1918 and the end of 1923) the lowering of the rent was to correspond to the extent of the relief received by the owner from the reduction in mortgage interest brought about by the same Decree, i.e. about 150 millions. Here, again, this figure can be increased to 200 millions. This represents a fall in the total rent obtained from new houses from 1·8 to 1·6 milliards, or about 11 per cent.

Thus the extent of the lowering of the rents of old and new

houses was about 800 million marks, or 10 per cent of the amount of rent due in 1931.

This relief to the tenant, however, was smaller than the fall in general incomes. As a result of successive wage cuts, unemployment, and short time the income from wages and salaries was about one-fourth less in the first quarter of 1932 than it was in the first quarter of 1931. It is estimated that this income was 26·2 milliards in 1932, compared with 33·1 milliards in 1931, viz a decline of about 20 per cent.[1]

It may thus be argued that, in spite of the rent cut, the proportion of rent to total income was still higher than it was in 1931. Rent arrears grew from 2½ per cent of the total amount payable in mid-1931 to 5 per cent in mid-1932. Many tenants took advantage of the right given to them in the Emergency Decree of 8th December, 1931, to give notice of termination in the case of tenancy agreements concluded before 15th July, 1931. There was thus a strong tendency for many large and expensive houses to become empty, while the demand concentrated more on middle-sized and less expensive houses.

New Houses.—In the case of new houses which were not mortgaged, and therefore received no interest relief, there was no provision for reduction of rent.

In view of the fact that many creditors charged substantial administration fees, the extent of the interest reduction obtained by the owners of new houses may be estimated at 150 millions, whereas the corresponding diminution of rent enjoyed by the tenants amounted to about 200 millions.

Old Houses.—The annual interest charge on old houses in 1931 amounted to 150 million marks. The Revalorization Law[2] had decreed that Revalorized Mortgages carrying interest of 5 per cent to the end of 1931 (about 5·3 milliards) were to bear interest of 7½ per cent as from 1st January, 1932. If this provision had been carried out, the mortgage interest on old urban houses during 1932 would have amounted to 900 millions. But since the Fourth Emergency Decree fixed the interest on Revalorized Mortgages at 6 per cent, we may estimate the annual interest burden on old houses at about 730 millions. This was 170 millions less than it would have been otherwise, but only 20 millions or 3 per cent less than the previous year's interest charge.

Owners of old dwellings got relief from the reduction of the House Rents Tax (by 20 per cent of the amount due in 1930)

[1] *Statistisches Jahrbuch für das deutsche Reich*, 1933, p. 495.
[2] See Hargreaves, *Restoring Currency Standards* (1926), chap. iv.

to the extent of 400 millions. It came into force on 1st April, 1932, while the lowering of rent began on 1st January, 1932. Thus for the first three months of the year the house owner bore the full burden of the reduction in the tenant's rent and he could only partially reimburse himself through the fall in his mortgage interest. Taking the year 1932 as a whole, and allowing for the fall in mortgage interest and in the House Rents Tax, the total relief to house owners was 420 millions. This was well below the aggregate reduction which they had to make in the rent charge, which, as we have seen above, was in the neighbourhood of 550 million marks.

The measures outlined above were only partially successful in compulsorily adjusting the rent paid by the tenant and the interest and taxes paid by the house owner to the slump in the basic factor, viz. the income of the tenant.

The shrinkage in income (wages and salaries) went appreciably further than the reduction in the rent burden ; whereas the cut in the rent payable was in turn greater than the relief which the house owner got in the way of lower mortgage interest and House Rents Tax.

VII. A Summary of the Total Reduction in the Interest Charge in Germany in 1932 [1]

The following Table summarizes the course of the German interest charge up to the middle of 1932 :—

Interest Charge (in milliard Marks).

	1928.	1929.	1930.	1932.	1932 (*mid-year*).
Agriculture	0·92	0·95	0·95	1·01	0·85
House Ownership	1·48	1·63	1·75	1·83	1·51
Public Administration	1·10	1·36	1·52	1·43	1·43
Public Undertakings and Admin. Unions	0·20	0·28	0·33	0·34	0·34
Industry, Trade, and Transport	2·60	2·98	2·35	3·00	2·10
	6·30	7·20	6·90	7·61	6·23

In interpreting this Table, it is to be noted that the 1932 figures are arrived at by reckoning the mid-1932 interest charge on the basis of the indebtedness at the end of 1931. Moreover, " financial year " means 1st July–30th June in the case of agriculture, and 1st April–31st March in the case of Public

[1] Based on G. Kokotkiewicz, *Der Immobiliarkredit.*

Undertakings and Administrative Unions and Public Administrative Bodies.

Agriculture.—The interest charge for 1931–2 is 160 millions less than in 1930–1. Most of this was the result of the long-term interest cut enacted by the Fourth Decree: the rest was the effect of lower short-term (personal credit) rates.

Housing Credit.—Here the fall was 320 millions. We have already seen that 140 millions of this was the direct result of the Fourth Emergency Decree.

Public Authorities.—Since the financial year in this case runs from 1st April to 31st March the fall in the interest charge is seen by comparing the 1930–1 with the 1931–2 figure, i.e. a difference of 90 millions.

Industry, Trade, and Transport.—In this sphere there was a substantial decline from 3 milliards to 2·1 milliards. This was for the most part the consequence of cheaper short-term credit.

The total decline in the interest charge between 1930–1 and 1931–2 was in the region of 1·4 milliards.

VIII. Public Discussion of the Interest Decrees

In the controversy which raged in Germany over this interest issue, most of the professional economists, and, in particular, the *Frankfurter Zeitung*, wielded an imposing armoury of arguments which, in so far as they were based on orthodox theory, belonged to an intellectual sphere far removed from that of the supporters of the official policy. The former alleged that the intolerable burden of interest could not be said to exist everywhere. They quoted figures to prove that in agriculture hopelessly overburdened farms which cannot even be saved by a drastic cut in interest are to be found alongside of others which are comparatively free from debt. Furthermore, those who enter into long-term contracts are supposed to take the rough with the smooth: on the well-founded assumption that fluctuations, like the poor, are always with us, creditors and debtors are each taking a risk.

As against the argument of the agriculturists that they were unable to influence the price of their products, the obvious answer was, of course, that the stiff tariff does more for prices in this industry than almost anywhere else (except when Providence is over-generous and bestows on Germany a bounteous harvest !).

The agriculturist's complaint against the unprecedented rise

in the real value of his interest payments—he had to make two pigs grow where one grew before in order to hand over the nominal interest charge—was contrasted by the *Frankfurter Zeitung* with the amiable docility with which the creditors bore the strain of the extraordinary fall in the value of money in the years just before the War. These long-suffering creditors did not ask for an increase in the long-term rate of interest. They were good losers. It was submitted that to grant the agriculturists' claim means logically the establishment of an interest sliding scale, according to which an attempt would be made to let justice reign as between debtor and creditor. Such a proposal was out of the question. At any given time the debts outstanding had been contracted at totally different phases of the trade cycle: the sliding scale idea placed absolutely unwarrantable trust in the efficacy of " index numbers " as a standard of " the movement of purchasing power ". No fruitful conclusions could be hoped for along such lines.

In general it was emphasized that, if the present system is to work at all, the fundamental faith in the security implied in legal agreements must not be undermined. What was apparently necessary to save a small portion of the community in the short run must not be regarded as being good for the community as a whole in the long run.

IX. The Case in Favour

A case can be made out for State interference to break down rigidity in circumstances, when fluctuation is abnormal, when the entrepreneurs, thus assisted, may be regarded as fit to survive or when the reduction in the burden on the Budget is fairly considerable, as in the English conversion scheme, which however differs in the manner of its execution from the German interest reductions. There will be a decided net advantage in bringing about an early adjustment between the swollen interest burden and the reduced proceeds, if one can be certain that the repercussions will not seriously endanger the sources of savings for the future. Moreover, a compulsory fall in the rate of interest in the capital market can help to adjust investment to savings after a long-drawn-out depression which has involved the vicious circle of a secondary deflation. This argument is particularly relevant where public investments highly susceptible to the rate of interest, e.g. housing, normally play an important role.

X. The Demerits of the Policy

A measure of general application must naturally produce many hard cases. Several examples of injustice can be cited as a consequence of the working of the interest-reducing Decrees. The long-term creditor was penalized much more than the short-term. The debtor of a Mortgage Bank was allowed by the Fourth Decree to fulfil his obligations by the tender of Mortgage Bank bonds, which up till the middle of 1932 were at a discount of 30 to 35 per cent; on the other hand, the debtor of an Insurance Company or Savings Society could not avail himself of this method. The Decree of 27th September, 1932, which enacted the agricultural interest moratorium, offers another example of arbitrary discrimination. Under its terms, Mortgage Banks, whose agricultural mortgages represent more than 10 per cent of their total cover, receive treasury bills from the Reich to enable them to make good the interest gap in the next two years. Mortgage Banks whose agricultural business is less than 10 per cent of their total cover must, equally with the private mortgage creditor, insurance companies, and savings societies, bear the burden of the interest deficiency themselves. Most of these latter institutions can doubtless shoulder the loss without harming their position. For example, the Bayerische Vereinsbank had lent 30·3 millions on agricultural mortgages, viz. 7·3 per cent of its total mortgage business; as a result of the Decree it loses in each of the next two years 600,000 marks interest receipts out of a total interest income of 31 millions. But the Decree bears hard on those institutions heavily committed to the agricultural mortgage business as, e.g., Savings Banks, which in some cases in the provinces are very specialized: their equilibrium was hopelessly upset and they certainly deserve compensation. Furthermore, even the Mortgage Banks which, as has been pointed out, receive compensation from the Reich in the form of non-interest-bearing treasury bills falling due in 1936–7 are running a risk. For the Reich receives, as security for the treasury bills, mortgage bonds free of interest, which are to be met when the postponed interest is repaid. But if the agricultural debtor in the meantime becomes insolvent, the Bank will still be liable for the mortgage bonds held by the Reich, which must at a later stage recover the sums advanced.

It is relevant here to draw a distinction between the nominal and effective rate of interest. If the result of a compulsory cut in the nominal rate is to bring about a fall of

a proportionately greater extent in the market valuation of, e.g., mortgage bonds, then the effective interest rate instead of falling has, of course, risen. A great deal, thus, depends on the reaction of the capital market to such intervention. The valuation of the bonds of a particular Bank will be greatly influenced by the degree of interest arrears. This is borne out by the course of the quotations of different institutions in 1932. This leads us to a consideration of the effect of these reductions on interest arrears.

There is no ground for assuming that a general cut in interest of necessity diminishes the aggregate of arrears. In order that it should be fully effective in this direction, we must postulate that the interest arrears are evenly distributed over all the farms. For instance, if each mortgagee were in arrears with his interest to the tune of 30 per cent and the Mortgage Bank reduced the interest rate from 6½ per cent to 4½ per cent then, other things being equal, the arrears should disappear. But if we consider a state of affairs much nearer reality, in which there are a large number of farms unable to pay any interest, alongside of others only slightly or not at all in arrears, a given fall in the interest rate will only have a modest effect on the interest arrears. There is reason to believe that the Decrees have been unsuccessful in this direction.

Perhaps the most serious danger of this policy is its effect on the disposition of investors. There can be little doubt that the two Decrees delivered a grave shock to the long-term capital market. This is illustrated by the course of mortgage bonds after the Stock Exchange was re-opened in April, 1932. They fell from about 74 per cent of par to nearly 64 between April and June, 1932. The subsequent improvement was associated with the enactment of a Decree in June giving the creditor the right, under certain conditions, e.g. when interest arrears had accumulated for more than six months, to proceed to have the property sold under distraint. The complete standstill to which the creditor had been brought by the Decree of 8th December, 1931, was slightly changed in his favour. The mortgage bond market reacted accordingly.

The extent to which protection of debtors, irrespective of whether they are fit to survive or not, has been carried in Germany has exercised a very depressing influence on the market. Would-be creditors have cause to fear further invasions of their rights and this state of nervousness leads to a situation where long-term capital needs are dependent more and more on State credits and

subsidies, and less and less on bank and private credit. In the words of the *Frankfurter Zeitung*, " the accumulation of unused funds on the money market must in the long run benefit the capital market and thus through the rise in the price of fixed interest-bearing securities create the possibility of a genuine conversion to lower interest. If there had not been several avoidable shocks to confidence owing to a fallacious State policy, these natural forces would have already brought about a fall in the interest rate. . . . The creditor gave the money. He will give it again if he can be guaranteed legal security." [1]

XI. Political Complications

The position of Germany during the upward swing of the world cycle 1925–9 was a peculiar one. For well-known reasons the internal interest rate was abnormally high: there was an enormous inward flow of capital from abroad. Moreover during that period Germany was paying Reparations according to the Dawes Plan. Full weight must be given to the special features of the problem—the paramount necessity for making up for the ravages of the war and inflation and for providing an export surplus.

The problem is whether the State's interference to break down the " rigidities "—in the present case the interest charge—is compatible with the fundamental necessity of allowing the play of economic forces to correct the lop-sided developments of the previous boom. The Government argued, not without justification, that it could not afford to wait for the latter process to work itself out, and in any case it would probably produce social upheaval. Unfortunately for the protagonists of State intervention in this particular sphere in Germany, agricultural policy has been dominated by sectional interests wielding extraordinary political influence. This statement can be proved only by a detailed history of the *Osthilfe* policy since 1926; but there can be little doubt that it is substantially correct. The Eastern landowners have succeeded in getting the community at large to pay for the cost of propping up agrarian investments in the Eastern provinces; and in so far as the interest reduction coupled with the *Osthilfe* policy simply prolongs this state of affairs, it deserves the most serious condemnation. A reduction of interest, thus tainted, becomes part of a programme of " nationalization of losses ".

[1] " Die andere Seite," *Frankfurter Zeitung*, 20th November, 1932.

The normal path to a new equilibrium, where profitable working is again possible, is the thorny one of liquidations. The Government thought fit to take strong preventive measures against the operation of this process. Whether the Government of the Nazi Revolution will proceed to break up the large, and in many cases, bankrupt estates in order to make way for the settlement of unemployed on the land remains to be seen. The political complications have certainly not been diminished by the establishment of the Hitlerite Dictatorship.

THE DECREE OF 8TH DECEMBER, 1931[1]

REDUCTION OF RATES OF INTEREST

FIRST SECTION

Capital Market

I

(1) The rate of interest on the following shall be reduced to 6 per cent if it amounts to 8 per cent or less but more than 6 per cent, and shall be reduced in the proportion of 8 : 6 if it amounts to more than 8 per cent. Public loans or loans in connection with which partial bonds have been issued (bonds of the Reich, the States, Districts and Municipal Associations), mortgage deeds, municipal and light railway bonds, bonds of private or public credit institutes or institutes dealing with the consolidation of loans, debentures of share companies, limited liability companies, co-operative societies, private individuals.

(2) In so far as the rate of interest amounts to more than 12 per cent the portion in excess of 12 per cent shall be reduced in the proportion of 8 : 4 ; otherwise (1) applies.

(3) If the reduced interest rate results in a figure which cannot be divided into quarters, it shall be made up to the full quarter.

(4) The reduction applies only to interest due for a period following the entering into force of this section.

II

(1) The provisions of Par. I apply correspondingly to interest on claims, including mortgages and debts on landed property, if the latter do not normally fall due until one year after they have arisen.

(2) No reduction shall take place in the contribution towards the costs of administration agreed upon in the case of claims or loans

[1] *Reichsgesetzblatt*, 1931, i, No. 79.

on landed property to which Mortgage Banks and public credit institutes within the meaning of the law of 21st December, 1927 (*R.G.B.*, i, p. 492), are entitled at the time this Decree enters into force. If a contribution towards administration costs has not been specially agreed upon, then a portion of the present interest rate shall be considered as such contribution, subject to the provisions of the executive regulations.

III

The additional interest (revaluation surcharge on interest) in excess of 5 per cent which is payable according to Par. I, Clause I, of the Law concerning the Maturity and Payment of Interest on Revalued Mortgages of 18th July, 1930 (*R.G.B.*, i, p. 301), shall be reduced to 1 per cent.

IV

(1) A creditor cannot give notice of termination before 31st December, 1933, of claims and loans on landed property of the types described in Pars. (1), (2), the interest on which has been reduced in accordance with this section. If notice of termination is by agreement not permissible for a certain period, this period shall be prolonged by two years. By such prolongation the period is not extended beyond 31st December, 1935. If notice of termination is by agreement permissible only at a date subsequent to 31st December, 1935, it shall remain so.

(2) Notices of termination which have already been given shall remain effective.

(3) The present regulation as to the maturity of loans mentioned in Par. I, Clause I, shall remain effective.

(4) The credit institutes of the type described in Par. 2, Clause 2, may alter the schemes of amortization for their mortgage deeds and bonds, if the repayment of the claims or loans on landed property used as cover is postponed owing to the alteration in the dates of maturity set out in (1) above.

(5) Existing arrangements and provisions contained in statutes whereby claims or loans on landed property become prematurely due, as well as the rights of creditors in accord with Pars. 1133 to 1135 of the Civil Code, shall remain unaffected.

(6) The right of notice of the debtor and the owner of the encumbered estate shall not be restricted by the provisions of this section.

(7) The provisions concerning maturity contained in the Law on the Maturity and Payment of Interest on Revalued Mortgages of 18th July, 1920 (*R.G.B.*, i, p. 200), and the regulation of 10th November, 1931 (*R.G.B.*, i, p. 607), shall remain unaffected.

V

The mortgage or loan on landed property covering the interest reduced in accordance with II (1) is cancelled.

VI

(1) After 31st December, 1931, bearer-bonds issued under previous legislation may not be put on the market.

(2) Bearer-bonds issued within the country, within meaning of Par. 795 of Civil Code, or the Law *re* issue of Bonds of 23rd June, 1923 (*R.G.B.*, i, p. 709), may only be put on the market with a permit of Reich Government.

(3) Before such permit is granted consent must be obtained from the supreme authority of the State in the territory in which the issuer resides or has his business.

(4) The remaining provisions of Par. 795 of the Civil Code shall apply correspondingly.

VII

(1) The provisions of Pars. I to VI shall, subject to the provisions of the executive regulation, not be applied to bonds issued abroad.

(2) The same applies, subject to provisions of executive regulation, to inland claims which are used as cover for bonds described under (1).

VIII

Par. 247 of Civil Code shall again be put into force.

IX

(1) The alterations in interest rates and in the conditions as to maturity based on this section need not be entered in the Public Estate Register for the purpose of becoming effective.

(2) The provisions of Par. 796 of Civil Code shall not apply in so far as rates of interest and conditions of maturity are altered in accord with this section.

X

If Credit Institutes of the type described in Par. II, Clause 2, have issued bonds on mortgages or loans on landed property which they have acquired, the debtors of such mortgages and loans on landed property can pay off their debt, subject to the provisions of the executive regulation, by surrendering similar bonds issued by the Credit Institute.

XI

The Ministers of Economic Affairs and of Justice can issue decrees and general administrative regulations necessary for application of this section. They can to this end issue general supplementary provisions.

XII

This section enters into force on 1st January, 1932 : Par. IV on day of Proclamation.

SECOND SECTION

Money Market

I

(1) The Commissioner of the Reich for Banking shall ensure by negotiation with the associations of credit institutes that the associations arrive at an agreement among themselves by 31st December, 1931, as to the rate of interest for deposits and as to rates of interest and commission on loans for third persons. The agreement requires the sanction of the Reich Commissioner for Banking : it shall apply to all undertakings of the type in question, even if the latter are not members of an association.

(2) If the associations of credit institutes do not arrive at an agreement by 31st December, 1931, the Reich Commissioner for Banking shall issue the necessary regulations after having consulted the associations and with the consent of the Board of Directors of the Reichsbank. The same shall apply to credit institutes for which an association does not exist. The Commissioner can exercise the same power if, without his consent, the agreement arrived at is abolished or replaced by another one.

II

Undertakings acting professionally as trustees or administrators of moneys, particularly against payment of interest (deposit business) can, on request of the Commissioner for Banking, be refused permission by the Minister for Economic Affairs to continue carrying on deposit business, if they do not adhere to the agreement arrived at in accord with Par. I or to regulation issued.

III

If a person, after having been forbidden to carry on such business (Par. II), continues transacting deposit business, he shall be punished with imprisonment of up to one year or a fine up to 500,000 RM.

IV

The Minister for Economic Affairs can issue decrees, etc., necessary for applying this section.

PART TWO

Housing

I

Compensation for currency devaluation in the case of land built upon. This tax, commonly known as the House Rents Tax, is to be reduced by 25 per cent from 1st April, 1935, by a further 25 per cent from 1st April, 1937, and to be entirely suspended from 1st April, 1940.

II

Lowering of Rents.—For houses subject to Rent Law of Reich and others which were ready for occupation by 1st July, 1918, rents are reduced by 10 per cent from 1st January, 1932. For houses which were fit for occupation only after 1st July, 1918, rents are reduced to the extent that the land built on is relieved by the lowering of the House Rents Tax in accordance with Par. 1.

III

Extraordinary Termination of Housing Contracts.—Notice to terminate a housing contract entered into before 15th July, 1931, may be given with effect from 31st March, 1932, even if this is not allowed by law or under the contract, unless the rent laid down in the contract has been lowered by 20 per cent by agreement during 1931 or the landlord has carried out at the request of the occupant constructional alterations at considerable expense. These provisions apply also to business premises for which a contract was entered into before 15th July, 1931.

CHAPTER VI

PUBLIC WORKS POLICY

The general policy of State interference, to attempt to bring about by means of public works the employment of labour which would not otherwise have found employment in the private market, has taken several forms in Germany. Confining our survey to the last six years we may conveniently distinguish four lines of activity.

I. PRODUCTIVE UNEMPLOYMENT RELIEF (*wertschaffende Arbeitslosenfürsorge*), including :—
   (*a*) Relief works.
   (*b*) The building of houses for agricultural workers.
II. VOLUNTARY LABOUR SERVICE.
III. SPECIAL GOVERNMENT PROGRAMMES OF PUBLIC WORKS.
IV. MISCELLANEOUS STIMULANTS DESIGNED TO INCREASE EMPLOYMENT.

I. PRODUCTIVE UNEMPLOYMENT RELIEF

It is one of the principles of the post-war German Unemployment Insurance Scheme that it should be part of the aim of the system to provide work for some of the unemployed. The idea was given concrete expression in the Act of 11th July, 1927 (*Gesetz über Arbeitslosenversicherung und Arbeitsvermittlung*) when " productive unemployment relief " was introduced.[1] It enables various works of " productive " and social importance to be financed partly out of the unemployment benefit, which is saved thereby, and partly out of advances and loans provided by the Reich and States. Apart from giving employment, the system is held to be a useful means of testing the capacity and willingness of the unemployed to work.

There are the usual provisions regarding the nature of the projects to be undertaken. They must be works of a " productive " character—this word is not defined, except tautologically as " enhancing the production of goods "—and they should have a good effect on employment through

[1] See clause 139 of the Act (*Reichsgesetzblatt*, 1927), and two Orders issued by the Federal Employment Exchanges and Unemployment Insurance Board and the Federal Ministry of Labour on the 28th and 29th March, 1928, respectively (*Reichsarbeitsblatt*, 1928, i, pp. 87, 90).

repercussions on other industries. Wages cost should be large in proportion to cost of materials, etc., and the new opportunity of work should lead to a more advantageous distribution of labour from a social point of view, as, for instance, when migration of workers from overcrowded towns to the country is encouraged. All Labour Exchanges are to be on the watch for possibilities of this sort.

Finance.[1] The methods of financing are as follows. Financial assistance is provided in two forms, Basic Assistance and Extended Assistance.

Basic Assistance represents the benefit money saved by the fact of so many insured unemployed becoming relief workers. It is forthcoming from the resources of the Federal Unemployment Insurance Board if the relief workers have been drawing standard benefit, and from the funds of the Reich (four-fifths) and the Communes (one-fifth) if the relief workers have been on emergency benefit. In cases where the persons given work are recipients of Poor-Law relief, the basic assistance is contributed by the Municipalities.

For persons taken off standard and emergency benefit, the amount of the Basic Assistance is the sum of benefit thereby saved, which can reach, on an average, a maximum of three marks per man-day.

Extended Assistance is paid only when the project cannot otherwise be carried through, assuming that the maximum Basic Assistance of three marks per man-day has already been obtained. It is paid in equal amounts by the Reich and by the Federal State benefiting by the work, and may consist either of loans or payments of part of the interest on loans. The aggregate of Extended Assistance for any given project must be in a fixed proportion to the amount of unemployment benefit saved. A normal limit of twelve marks per man-day is set for loans from Reich and State funds together ; but in exceptional cases, e.g. where the employing authority is financially weak but the work is important, this limit may be raised to fifteen marks per man-day. The total of Basic plus Extended Assistance must not exceed 80 per cent of the whole cost of the project. The loans are generally granted at a rate of interest of 4 or 5 per cent, with a redemption period of about fifteen years.

[1] See first Report of *Reichsanstalt für Arbeitsvermittlung und Arbeitslosenversicherung* (*Reichstagsdruchsache*, 1928), and J. Richter, "Die Regelung der wertschaffenden Arbeitslosenfürsorge," in *Reichsarbeitsblatt*, 1928, No. 12

Interest grants are designed for relief works involving relatively high material costs, which cannot be executed solely out of loans received in the form of Extended Assistance. In such cases the Reich, or the State, or both, make grants to cheapen the cost of the loans which the employing authority is obliged to raise in the market. These interest grants from Reich and Federal State funds should not exceed three annual contributions of an amount representing 4 per cent of the total cost after subtracting Basic Assistance.

We need not describe in detail the cumbrous machinery by which the two kinds of Assistance were to be voted. The States were unwilling to delegate to the Federal Unemployment Insurance Board power to determine their share of the Extended Assistance, and this led to much complication and delay in the procedure. The Controllers of the Divisional Exchange Offices and the President of the Federal Unemployment Insurance Board were to co-operate with the Federal State Governments in authorizing Extended Assistance. Later this machinery was simplified.

Public Authorities are not to be responsible for actually carrying out the relief-works. Semi-public and private enterprises are recognized for this purpose only when they have been established to execute works of public utility. The vast majority of relief works are put into operation by Municipalities and Unions of Municipalities and a few by semi-public or "mixed" undertakings (*gemischtwirtschaftliche Unternehmungen*). In the selection of the labour force persons who have been unemployed for a long while are to be given preference, and men with families are, whenever possible, to be employed near their homes.

The Extent of Public Works (Notstandsarbeiten) organized as Productive Unemployment Relief

The machinery just outlined was in operation until the 1st August, 1930, when the German Public Works Company was formed. The average number of relief workers covered by the scheme has been as follows [1]:—

Year.	*Monthly Average.*
1928	67,000
1929	55,000
April, 1930–March, 1931	32,000
April, 1931–March, 1932	32,000

[1] Based on the four annual Reports of the *Reichsanstalt für Arbeitsvermittlung und Arbeitslosenversicherung* (1928–1932).

The work undertaken has included waterway improvements, building of embankments, power stations, dams, and gas conduits, road construction, and hydraulic engineering. There has been great seasonal fluctuation in the employment provided, as the work is largely outdoor. The monthly average figures are not very significant ; but, since the average period of employment would be about three or four months, the number of unemployed brought within the orbit of relief work has been correspondingly greater than the monthly averages.

In August, 1930, the *Deutsche Gesellschaft für öffentliche Arbeiten A.G.*—German Public Works Company—was inaugurated. The whole share capital is held by the Reich. Its object is to promote investment in public works, and to raise loans at home and abroad for this purpose. The Reich handed over to the Company its outstanding claims of 372 million marks on account of Productive Unemployment Relief Loans.[1] The Company was thus equipped with a steady income in the form of interest and sinking fund on these loans. One disadvantage of the previous procedure had been a lack of coincidence between the time when Government grants were authorized and the seasonal needs of the labour market. The new Company could now adapt its relief work expenditure to meet varying seasonal conditions and borrowers were enabled to work out their plans beforehand, knowing exactly to what extent they could depend on assistance from public funds. Since the Public Works Company now took the place of the Reich as a contributor to Extended Assistance, the task of voting the loan or grant passed into the hands of one of the Committees of the Company.

The income of the Company, from interest and sinking fund on outstanding loans, during the first eight months of its existence, August, 1930–March, 1931, amounted to 35 million marks. Its efforts to raise further loans in the market did not meet with success : it had to content itself with some provisional credits. Out of its available resources it authorized loans of 50·2 million marks for 530 projects. This represented a quarter of their total cost, which was 233 millions. The contribution of the Unemployment Institute was between 25 and 30 millions and there were further sums forthcoming from the States. The Company's loans generally carried interest at 5 per cent with an amortization period of 20 years. In accordance with the revised procedure, after the Divisional Exchange Office has examined

[1] First Annual Report of the *Deutsche Gesellschaft für öffentliche Arbeiten A.G.*, for 1930.

each contract from the point of view of the labour market, and the Federal and State authorities have looked into the technical and financial aspects and authorized their assistance, the contracts are then sent to the Public Works Company. From the founding of the Company to the 31st March, 1932, a sum of 74·7 millions of loans were authorized of which 40·3 millions were actually paid out.[1]

The Encouragement of Rural Housing

Productive Unemployment Relief also includes the measures taken to encourage the building of houses for agricultural workers. The object is to make the country more attractive for town dwellers and to oust labourers who have come in from foreign countries. The method is to grant loans free of interest, with a redemption period of fifteen years in the case of Company houses and thirty years when a worker builds his own house. The loans are granted half by the Reich and half by the State concerned. If, for example, the cost of a worker's house is 9,000 marks the Productive Unemployment Relief Loans furnish 7,400 marks, or 82 per cent. The remaining 1,600 marks are to be raised in the market as a first mortgage, in so far as the money is not forthcoming from the owner himself. Since this involves a high interest burden—8 or 9 per cent when the scheme was introduced in 1928–9—the Districts—*Kreise*—were encouraged to assist by granting mortgages, carrying low interest, or cheap building land. The Reich has also made grants reducing the interest charge to 3 per cent for the first three years.

From 1921 to 31st March, 1932, 66,656 houses of this type were built, 25,637 company houses and 41,019 belonging to the workers themselves. The number built between October, 1928, and March, 1932, was 19,036.

The Amount Spent on Productive Unemployment Relief between 1st January, 1929, and 31st March, 1932

We may now give a summary [2] of the amounts spent on Productive Unemployment Relief, including Relief Works and Rural Housing, by all the authorities concerned in the period from 1st January, 1929, to 31st March, 1932.

[1] See second Annual Report of *Deutsche Gesellschaft für öffentliche Arbeiten für* 1931, p. 6.

[2] Figures taken from the Annual Reports of the *Reichsanstalt für Arbeitslosenvermittlung und Arbeitslosenversicherung.*

Period.	*Responsible Authority.*	*Amount (Million Marks).*
Jan.–Dec., 1929	Federal Unemployment Insurance Board	35·7
	Reich	75·6
	States	74·3
	Total	185·6
Jan.–Dec., 1930	Federal Unemployment Insurance Board	38·3
	Reich	77·2
	States	74·0
	Total	189·5
Jan., 1931–March, 1932	Basic Assistance	30·4
	Extended Assistance from Reich	36·5
	Public Works Company and the States	37·4
	Total	104·3

Thus from the beginning of 1929 to the end of March, 1932, an aggregate sum of 479·4 million marks was devoted from all sources to Productive Unemployment Relief.

II. Voluntary Labour Service (*Freiwilliger Arbeitsdienst*)

The execution of an elaborate scheme of Voluntary Labour Service provides one of the most interesting examples of recent State activity to alleviate some of the grave evils associated with an abnormal volume of unemployment. It was first introduced in the second Emergency Decree of 5th June, 1931, which placed its organization in the hands of the Federal Unemployment Insurance Board. It came into force in its original form at the beginning of August, 1931, and its first phase lasted exactly twelve months.

First Phase (1st August, 1931, to 31st July, 1932).—The main object was to counter the demoralizing effect of unemployment on young persons. The Unemployment Insurance Board has always emphasized considerations of labour welfare and discipline rather than the effect it can exercise on the labour market. Projects were chosen which were not attractive to private enterprise, nor suitable for elaborate relief works. In the first year the scheme was limited to the recipients of ordinary and emergency unemployment benefit: it was, therefore, almost impossible to include young persons who had never been in work. One exception was made to this rule by the Decree of 25th May,

1932,[1] which provided that Reich grants of two marks per man-day could be paid in respect of volunteers enrolled for work in agricultural colonies, even though they were not qualified for ordinary benefit or were under 21 years of age and, therefore, too young to receive emergency benefit. Moreover, in order to facilitate the settlement of unemployed on the land, it was provided that volunteers who had been employed for twelve weeks in economically useful work could have credited to them in the Reich's Book of Debts—*Reichsschuldbuch*—claims equal to 1·50 marks per day worked. Recipients of Poor-Law relief could be included only if the Municipalities could meet the expenses themselves.

The experiment met with conspicuous success. The number of volunteers rose from 1,450 at the end of October, 1931, to 70,444 at the end of June, 1932 : 55 per cent were under 21 years of age. In this first phase 4,777 projects were authorized, of which 649 were completed. A total of 4,537,120 days work was put in ; 1,784 of the projects were designed to improve the health of the people, e.g. sport and play-grounds, bathing pools, etc. ; 554 represented drainage, and other land improvements. These two types of work employed 56 per cent of the total volunteer force at the end of June, 1932.

Second Phase.—The scheme was somewhat altered by the Decree of 16th July, 1932.[1] The principle of voluntary service and the general character of the projects to be undertaken were maintained. But the area of recruitment was no longer confined to recipients of unemployment benefit. Every German under the age of 25 could henceforth be enrolled and, alongside of manual labour, mental and physical training (*geistige und sportliche Ausbildung*), was given more prominence. The Reich grant was fixed at a maximum sum of 2 marks per person per working-day for twenty weeks within a period of two years, while in the case of economically useful works the maximum grant period could be raised from twenty to forty weeks. This grant sufficed to cover meals and clothes for the volunteers, contributions to social insurance, and pocket money of about 30 pfennigs a day. Thus each volunteer cost the public purse 50 marks a month, or 600 marks a year. The purchase of materials and tools falls on the authority organizing the work and may be estimated at 400 marks per volunteer per annum. Thus the total annual cost of Voluntary Labour Service works out at 1,000 marks per person. Dr. Syrup, the Labour Minister

[1] *Reichsgesetzblatt*, 1932, i, p. 251.

in the Schleicher Government, in an address on this subject,[1] argued that a Compulsory Labour Service scheme including 500,000 young persons would cost roughly 500 million marks per annum. He was of the opinion that such an ambitious plan would imply an expansion of credit.

The authorities carrying out the work were chiefly States, Provinces, and Districts: private companies could only be recognized if their profits are devoted wholly or chiefly to the public benefit. Alongside of the employment of the labour, there was the organization of the volunteers' social life. The scheme worked best when all the workers lived continuously in camps, and the various youth organizations were encouraged to supply good leaders who would imbue the young men with ideas of comradeship, loyalty, and discipline. The moral value springing from the voluntary character of the service was undoubtedly important. We cannot, however, pursue further this interesting aspect of the experiment, which is already a matter of past history. The Government of the National Revolution has decided to introduce a far-reaching measure of Compulsory Labour Service.

In its second phase Voluntary Labour Service continued to show remarkable expansion, the number of persons enrolled increasing from 100,000 in July, 1932, to 286,000 at the beginning of December, 1932. Out of the 1·4 million (1 million men and 400,000 women) people under 25 years of age who were unemployed at the end of September, 1932, over one-seventh were engaged in projects of a publicly useful character under the auspices of Voluntary Labour Service. It must be admitted that this was no mean achievement. Female volunteers were only 6·2 per cent of the total of 270,000 in November.

The following is a summary of the types of project carried out.

VOLUNTARY LABOUR SERVICE

Type of Project.	*Volunteers employed.* *August,* 1932.	*December,* 1932.
Land Improvements	38,381	88,075
Transport Improvements	24,019	50,578
Forest Work	14,851	17,090
Smallholdings and Allotments	16,330	20,586
Sports Grounds, Playing-fields, etc.	35,562	25,402
Miscellaneous	14,955	40,035
Total number of Man-days	2,998,502	6,752,186

[1] *Der Arbeitgeber*, 1st January, 1933, " Der freiwillige Arbeitsdienst," by Reichsminister Dr. Syrup, pp. 3–8.

On an average between August and December one third of the volunteers were engaged in land improvements and one-tenth on forestry and smallholdings.

Up to December, 1932, the original Reich budget estimate of 50 million marks, together with a supplementary grant of 25 millions, had been spent.

III. Special Government Programmes of Public Works (*Arbeitsbeschaffungsprogramme*)

By far the most important development in the sphere of Public Works is the series of special Government Programmes of Public Works which began in the middle of 1932. Each of these was announced with a great campaign of publicity, and large hopes of a reabsorption of a considerable fraction of the unemployed army were aroused. A summary is contained in the following Table :—

		Type of Work to be undertaken.		
Public Work Scheme.	*Total Million RM.*	*Roads.*	*Canals.*	*General Improvements.*
1932 Brüning Programme .	135	60	50	25
1932 Papen Programme .	182	40	—	26
Jan., 1933 Gereke Programme	500	?	—	?
Federal Institute for Unemployment Insurance, German Public Works Co.	35	10	5	13
Railway Company Scheme .	280	—	—	—
Post Office Scheme . .	60	—	—	—
Total Sums . .	1,222			

This total sum of 1,222 millions represents the aggregate authorized cost of the various Reich schemes for the provision of work initiated between June, 1932, and the beginning of February, 1933. To this must now be added the 1,000 millions contemplated in the Hitler Plan, of June, 1933, together with the other ingenious and varied devices contained in this new Law.

The budget for 1932–3 provided for the expenditure of 135 millions, of which 60 millions were to be devoted to country road building, 50 millions to canal building and 25 millions to general improvements. Later Papen inserted 182 millions into the current budget for further work schemes. It may be added here that the granting of tax vouchers, in accordance

with the so-called Papen Plan, was also designed to give a stimulus to employment. The characteristics of this Plan are fully dealt with elsewhere : it is not included here as an element in the public works programme. The tax vouchers, to a total value of 700 millions, which were to be granted on certain conditions to employers who could show an increase in their labour force, turned out to be a failure. They were, therefore, incorporated in the Gereke Programme of January, 1933, as the basis of the loans to be granted to the Municipalities for the purpose of financing employment projects. 280 millions were planned to be spent by the Railway Company on its own capital renovation and 60 millions by the Post Office on similar objects.

It will be of interest to examine the Gereke programme in some detail. This was set in motion by the short-lived Schleicher Government, and compared with its predecessors—though not with its Hitlerite successor—it was an ambitious plan. By a Decree of 15th December, 1932,[1] von Schleicher created the post of Reich Commissioner for the Provision of Employment " for the purpose of unifying and accelerating all measures in the sphere of the provision of work ". Dr. Gereke received this appointment and his ideas on the subject of public works are supposed to have obtained at least partial blessing in the Schleicher programme, the details of which were published on the 6th of January, 1933.[2] The employing authorities are the Reich, States, Municipalities, Unions of Municipalities and various public Corporations, as well as the so-called " mixed " undertakings. The works should be economically useful and, if possible, capable of completion during 1933 : in particular they should comprise the repair and extension of existing capital and the improvement of the soil. It must be proved that the projects could not be executed out of the funds of the employing authority. Areas with particularly heavy unemployment are to be given preference ; workers are to be employed under the usual legal wage contract conditions and for not more than forty hours a week.

A fairly substantial Public Works programme had been organized in the slump of 1925–6 ; but at that time the Finance Minister had Budget reserves to play with. The problem of the financing of these 1932–3 schemes is worthy of close attention ; for they have been initiated in a period when Budget reserves

[1] See *Reichsgesetzblatt*, 1932, i, p. 543.

[2] *Durchführungsbestimmungen zur Arbeitsbeschaffung* of 6th January, 1933 (*RGB.*, 1933, i).

are non-existent, further taxation increases hardly possible, and the raising of long-period loans temporarily out of the question. An attempt has been made to solve this dilemma by providing the employing authorities with resources in the form of loans from the Public Works Company and the *Rentenbank-Kreditanstalt*. These loans are to have an amortization period of about twenty years, beginning on 1st July, 1935, the actual length of the period and the rate of interest to be adjusted to meet particular cases. Given a redemption period of twenty years, it is arranged that an annuity of 6 per cent of the original loan—embracing interest and sinking fund—shall be paid in forty equal half-yearly instalments. This implies an effective interest rate of only $1\frac{3}{4}$ per cent, and the Reich bears the cost of this concession, which means about 25 to 30 million marks per annum. Capital investments which are expected to give a relatively high yield, such as the extension of electricity works, particularly when undertaken by "mixed" undertakings, must bear the full interest and sinking fund payments; but even in this instance the service, on a 5 per cent basis, is much cheaper than the market rate.

The recipient of the loan, in most cases a public authority, is expected to engage contractors and firms to carry out the actual work rather than undertake it itself. In thus handing out contracts and orders it must give preference to small and middle-sized undertakings. The machinery of financing is as follows. A contractor, or a firm, draws a bill on the Public Works Company (*Öffa*) or the *Rentenbank-Kreditanstalt* (*R.K.A.*): the bill is accepted by the *Öffa* or *R.K.A.*, and endorsed by the responsible Municipality or other employing authority. It may then be discounted at a bank. A consortium of banks has undertaken to discount the bills of the *R.K.A.*, which can be drawn on up to 200 million marks. The *Öffa* is responsible for the remaining 300 millions of the Gereke programme.

The Public Works Company is committed to accept bills up to 504 million marks. Of this total 150 millions are rediscountable by a consortium of the *Reichskreditgesellschaft*, 250 millions under the Gereke Plan by a consortium of the *Reichskreditgesellschaft* and the *Deutsche Bank & Diskontogesellschaft* and the remaining 50 millions of the Gereke commitment by the *Akzept* Bank. Finally the Reichsbank stands behind the whole scheme with its guarantee to rediscount.

The official view regarding this method of financing is that no danger exists of a serious demand being made on the

Reichsbank.[1] It is argued that all this is largely a question of redistributing means of payments within the system. Wages are paid instead of the dole and taxes are forthcoming from the re-employed undertakings and workers. The bank consortium is a very necessary part of the structure : it hinders the possibility of an inconveniently large flow of bills reaching the Reichsbank. The fact that the bills are in the last resort rediscountable at the Central Bank is meant to encourage the other Banks to hold them as liquid resources. The Reichsbank has declared itself ready to prolong the bills until April, 1938 ; and the tax vouchers furnish security for them until they fall due.

The complacency of the official view is justified only on certain assumptions. These credits, which finance public employment at the present time, represent claims on the future earning power of the Reich. They are a part of the aggregate of postponed charges on revenue which has been growing like a snowball at an alarming rate since the credit crisis of 1931. No loan could be floated in January, 1933 : hence a compromise was struck. Liquid short-term bills are created which are allowed to run till 1938. It is, in other words, a gamble on the chance of raising large long-term loans in the near future, which will be used to redeem these and other obligations. Meanwhile, if the work plans succeed, especially indirectly, in stimulating industrial activity, an increase in the ordinary demands on the banks must arise and they will find it necessary to have more frequent recourse to the Reichsbank. If the money market in this way loses its liquidity, then not only will it be difficult for the Reichsbank to avoid an extension of its note issue, but the Finance Minister will find himself losing his advantage of being able to cover his deficit cheaply by means of Treasury Bills. The danger to the Treasury could, of course, be offset by the increased revenue from taxation and public enterprises, which will, by hypothesis, be forthcoming ; and the altered market situation may make it possible to consolidate part of the enormous floating debt. It is not easy to foresee exactly what can happen. It may be that, as soon as the full influence of these Public Works is felt, the Reichsbank will be subject to a strain which may have ugly consequences. If a confidence crisis were to take hold of the money market at an early stage, the whole precarious edifice would suffer a fatal shock.

[1] See *Die Entwicklung der deutschen Bauwirtschaft im Jahre* 1932 (a Report of the *Deutsche Bau- und Bodenbank A.G.* and the *Deutsche Gesellschaft für öffentliche Arbeiten A.G.*), p. 40.

In conclusion, a word may be devoted to the type of works undertaken in these Plans. From published figures it is clear that a large proportion of the funds are invested in road building and soil improvement. Germany has long suffered from a deplorable scarcity of capital, and it may pertinently be asked whether the sinking of these large sums in such a one-sided manner can be advantageous. Even if one accepts the reasoning in Mr. Keynes's recent proposals for England,[1] the corollaries would not be applicable to Germany with its stand-still agreements and lifeless capital market. Within the unavoidable limits imposed upon it, a Government has to choose such things as roads and canals, for emergency works. The question is whether, in view of Germany's peculiar circumstances, a sound business revival can be assisted by deflecting so much of its scarce capital supplies into channels that commend themselves, chiefly because they belong to the category where there is no objection to a public authority as entrepreneur and because they have a large wages cost relatively to the cost of materials.

The Hitler Plan of 1st June, 1933.[2]—An important addition to the series of Public Work Schemes was made by the Law for the Diminution of Unemployment (*Gesetz zur Verminderung der Arbeitslosigkeit*) of 1st June, 1933. This consists of a group of measures tied together in a general scheme comparable to the Papen Plan of September, 1932. The main feature is the issue of one milliard Work Treasury Certificates (*Arbeitsschatzanweisungen*) for the financing of public employment schemes. This will be described first and the accompanying measures, which will operate in practice independently, will be dealt with under the category of miscellaneous stimulants.

Though the offspring of the Government of the National Revolution, this new plan for the " creation " of work differs very little in its conception from its predecessors. Its method of financing is modelled on the Gereke programme. The approved employing authorities, States or Municipalities, are empowered to draw bills on the Public Works Company. The banks then discount the bills and if necessary the paper can be taken to the Reichsbank for rediscount. The Work Treasury Certificates to the extent of one milliard marks constitute the basis of security for the Public Works Company. The maturity of the Treasury Certificates will correspond with that of the bills, so that the

[1] *Means to Prosperity.*

[2] *Gesetz zur Verminderung der Arbeitslosigkeit* of 1st June, 1933, *RGB.*, 2nd June, 1933.

Public Works Company, with the cash received from the Treasury as the Certificates fall due, will be in a position regularly to meet its acceptance obligations. The operation of the Plan is to be under the control of a Commission, with the President of the Reichsbank as Chairman. It has authoritative powers " to supervise all matters appertaining to the money and capital market so as to avoid disturbance due to false measures or interferences from irresponsible quarters ". Dr. Schacht, as head of the Central Bank, is thus given full powers to regulate the pace of the scheme, and the public have been encouraged to believe that in some mysterious way the old stubborn difficulty of the tacit opposition of the Reichsbank to such experiments has been happily surmounted.

The Work Treasury Certificates will be redeemed between 1934 and 1939 at the rate of 200 millions per annum. The Minister of Finance is empowered to enter the necessary amounts in the budget estimates of these years. Meanwhile a special Amortization Fund is to be built up out of four sources :—

(*a*) Annual repayments of the loans granted to States, Municipalities, Municipal Unions, and other Corporations by the Reich.

(*b*) Treasury Certificates, Bonds, and Debt Book Claims (*Schuldbuchforderungen*) which will be paid in as contributions to the Voluntary Fund for the Fostering of National Labour [1] (*Freiwillige Spende zur Förderung der Nationalen Arbeit*).

(*c*) Interest and redemption payments received in virtue of loans granted out of the proceeds of the Voluntary Fund for the Fostering of National Labour.

(*d*) Sums received in repayment of loans granted to married couples.[1]

The type of works to be undertaken are as follows :—

(1) Repair and extension of office buildings and dwelling-houses, bridges, and other property of the States, Municipalities, Municipal Unions, and other Corporations.

(2) Repair of dwelling-houses and offices on agricultural estates, the splitting up of large dwelling-houses and repair of small houses.

[1] The Voluntary Fund for the Fostering of National Labour and the Marriage Loans belong to our category of Miscellaneous Stimulants and will be explained in that connection. They are both characteristic features of the Hitler Plan.

(3) Suburban settlements.
(4) Agricultural settlements.
(5) River embankment work.
(6) Capital equipment for supplying the population with gas, water, and electricity.
(7) Road construction.
(8) Supply of goods to necessitous persons.

The Law states that the works under Nos. (1), (3), (4), (5), and (6) are to be financed by means of loans ; and those under No. (2), (7), (8) by means of grants. These grants will be paid in the case of No. (2) to the house owner,[1] in the case of No. (7) to the States, Municipalities, and Municipal Unions, and in the case of No. (8) to the District Welfare Unions (*Bezirksfürsorgeverbände*).

The conditions attached to the works under No. (7), which consist chiefly of road-building, are worthy of mention. Grants will be made for these projects only when they are of economic value, and if the employing authority is unable to execute them out of its own resources. The maximum scope for the employment of labour is to be guaranteed, except in so far as the use of auxiliary machinery is indispensable and unless such a restriction will unduly raise costs. The labour force is to be recruited exclusively from the unemployed, except in so far as the technical nature of the work demands the services of skilled workers who are not unemployed. The normal legal wages contract is not to apply ; it is replaced by special provisions, which closely resemble the conditions usual in Voluntary Labour Service. The unemployed recruited for these road works are to receive (*a*) the unemployment relief payment, whether insurance benefit, emergency benefit, or public assistance, for which they are qualified ; (*b*) vouchers of the value of 25 marks for every four full weeks' work, these being valid only for the purchase of clothing, linen, and household utensils from special stores ready to accept them ; (*c*) a hot meal per working day given by the employing authority, or the equivalent in cash.

The 400,000 men who, it is hoped, will be absorbed in road schemes will thus receive a remuneration which will be well below the minimum allowed under an ordinary trade union agreement. Assuming that unemployment benefit is on an average 42 marks a month, it is clear that the addition of only

[1] These grants to householders are a continuation of the scheme begun in the autumn of 1932, and further developed in January, 1933.

25 marks in vouchers and a hot meal a day will mean that these men will hardly be financially better off than if they remained unemployed. They cannot buy food with the vouchers, whereas their " maintenance costs " in food, clothes, and travelling fare will be higher than when they were unemployed. This brings into existence a third category of employed workers. Previously there had been two groups—workers under the normal wage contract and relief workers (*Notstandsarbeiter*), who are not employed under a legal wage agreement but fall under the provisions of the Welfare Law (*Fürsorgerecht*). The third group, introduced by the Hitler Plan, belongs to the welfare category, but are not relief workers in the sense of the Welfare Law. The National Socialist Government can take credit for making a vigorous onslaught on the rigidity of the wage structure. It is not too much to say that it will get its new network of roads built in return for the unemployment dole supplemented by some clothes and meat. If wages in German industry generally can be *gleichgeschaltet* to this coolie level, Hitler will have gone a long way to conquer unemployment ; but perhaps the mass of his Storm Troops will not exactly see eye to eye with him on this matter.

Such is the outline of the Public Works provision of the new Law. It is now proposed to examine its financial foundation in more detail. The various programmes already reviewed have been made possible by the issue of Treasury Certificates, which are to be redeemed out of taxation during the years 1934–8. It takes some time to put these contracts into full operation, partly owing to the necessity for preparatory administrative examination and partly for technical reasons. The series of programmes—including the Brüning and Papen instalments of 1932, the Gereke-Schleicher Plan of January, 1932, the Federal Unemployment Insurance Institute, Public Works Company, Post Office, and Railway Company programmes—comprised authorizations totalling 1,230 million RM. Of this sum only about 325 millions had been actually spent up to 27th May, 1933. The details are exhibited below.[1] And now comes the Hitler Plan with a further 1,000 millions, together with the resources which will be made available from the Voluntary Fund for the Fostering of National Labour. The comments already made on the underlying assumptions and lurking dangers of the methods by which these plans are financed apply with greatly increased force to this latest development.

[1] See Appendix.

Doubtless this artificially swollen stream of public works will give a much-needed support to the labour market in the autumn of 1933, when the favourable seasonal influences of the spring months have worn off. The Government, of course, emphasizes the benefit that will be derived from the indirect stimulus to industry. But in the early stage of such a revival the normal demands on the banks' resources will increase and this will lessen the fluidity of the money market. In view of the magnitude of the emergency schemes now under way, it is clear that Dr. Schacht will have by no means an easy task to ensure that the Reichsbank is not lured on to the slippery slope.[1] Other things being equal, it is fairly certain that the money market cannot out of its own resources finance the load of bills which this pyramid of emergency works implies. But for some time, at any rate, other things will not be equal. Under the Transfer Moratorium Agreement of July, 1933, 50 per cent of the 800 millions of annual foreign interest obligations are to be paid into a newly-created account (*Konversionskasse*) in the Reichsbank.[2] The presumption is that the foreign creditors will not be content with seeing their money lying idle and earning no interest ; on the other hand they will hardly wish to reinvest it on long-term. There is, therefore, the strong possibility that the money market will be maintained very fluid by this welcome supply of short-period money.[3] Such a prospect led a German newspaper, with unconscious humour, to publish an article under the engaging title *Grundlagen des Aufstiegs: Arbeitsbeschaffung und Transfer Moratorium* (Foundations of Recovery: Emergency Works and Transfer Moratorium). If this happy conjuncture of events turns out properly, Dr. Schacht will be able to provide a Hitler holiday without butchering the Reichsbank. The Nazi Leader will be in a position—at least in the short run—to cash some of his extravagant promises with foreigners' money—a really instructive example of the Awakened Germany applying its virile native powers to setting its own house in order.

[1] In September, 1933, the Reichsbank was given authority to operate open market policy with a view to placing fresh resources at the disposal of the capital market. Its first step was to take up 200 million RM. worth of Tax Vouchers.

[2] In the first half of 1934 the creditors will get only 30 per cent. They can realize their " scrip " in foreign exchange only when it is used to finance additional German exports.

[3] This is openly discussed in an article entitled " Die Arbeits-Milliarde " in the *Vossische Zeitung*, 2nd June, 1933.

IV. Miscellaneous Stimulants Designed to Increase Employment

Besides the large-scale plans already described, there are a number of ingenious little devices of a varied character introduced now and then to " create " employment. Worthy to rank in this category is that part of the Papen Plan of September, 1932, which provided for the granting of tax vouchers to employers who could show an increase in their average labour force, calculated on a three-monthly average basis.[1] Other examples may here be noted in a little more detail.

Assistance for House Repairs and Renovation.—Von Papen included in his famous Decree of September, 1932, for Reviving the Economic System an interesting provision calculated to stimulate employment in house repair. Grants of 50 million marks were to be handed out to owners of houses for the purpose of carrying out repairs and the splitting up of large dwelling-houses, the main condition being that the owner should himself bear four-fifths of the cost. The intention was to use this bait of 50 millions to call into existence new orders for labour and material of the value of 250 millions. The money was to come from budget sources but, as there was no corresponding estimate, it was perhaps inevitable that it should be raised through the issue of Treasury bills.

Moreover, as an extension of a provision of a Decree passed on 14th June, 1932, a new Decree was enacted on 22nd February, 1933, by which a further impetus is to be given to the repair and maintenance of dwelling-houses and agricultural farm buildings, and the Reich Minister of Labour is given power, jointly with the Finance Minister, to undertake guarantees up to a maximum of 100 million marks for loan obligations incurred for these purposes.

Finally, the Hitler Government's Law for the Diminution of Unemployment of 1st June, 1933, bestows further grants on householders to be spent on repairs and renewals. The only point of difference is that it does not include the Papen condition that the owner himself must supply four-fifths of the total cost of the work. One may gather that this healthy provision prevented the former scheme from producing spectacular results.

Grants to Farmers for increased employment of labourers. One of the early remedial measures passed by the Government of the National Revolution has the object of stimulating farmers

[1] See Chapter IV above.

to employ more labour.[1] For each additional person employed the farmer receives a monthly grant from the Government amounting to 25 marks in the case of men and 20 marks in the case of women workers. Thus practically the whole of the money wages received by these new labourers comes from the Government and the farmer has to meet only the cost of their food and, in some cases, lodging. The subsidy is limited to farms up to a size of 40 hectares. On the assumption that the workers newly taken on have all been previously drawing the dole, this new work-providing plan will cost the Treasury nothing, for it will save an equivalent sum in unemployment relief. But it is notoriously difficult in agriculture to test whether the farmers are really employing additional labour or not. In so far as new jobs are introduced, for which wage-agreement rates would otherwise have to be paid, then obviously part of the burden will be pushed on to public funds. The difficulty of inspection in agriculture is so great that it is inconceivable that such a scheme can be worked without abuses. The anomalies arising out of the unemployment insurance system, in so far as it applies to agriculture, and the fatal reactions of the employers to the " employment premium " device in the Papen Plan, are not very reassuring precedents.

Measures Contained in the Hitler Plan of 1st June, 1933

In addition to the Emergency Work programme already dealt with, the Hitler Plan introduces several measures calculated to expand employment. They can be briefly considered in this connection as miscellaneous stimulants ; for they are more or less independent of one another, and do not constitute parts of a unified coherent whole.[2] Reference has already been made to the Voluntary Fund for the Fostering of National Labour.[3] The Government lays emphasis on the desirability that all citizens should contribute to this Fund, in order that the resources for the " creation " of work should be further augmented. In addition to cash, the Government is prepared to accept such claims on the Reich as Treasury Certificates or Debt Book claims. Certain advantages to taxpayers are offered by way of encouragement. The receipt for the contribution, plus the Government premium, will be recognized by the Revenue

[1] See *Der deutsche Volkswirt*, 10th March, 1933, pp. 720–1.
[2] See " Neue Arbeitsbeschaffung," *Der deutsche Volkswirt*, 9th June, 1933, p. 1019.
[3] Section III of the Law for the Diminution of Unemployment.

Authorities as reducing the taxation liability of the contributor in the period in which it is made. Moreover, these receipts will be accepted in payment of tax arrears and no interest will be charged. In cases where the taxpayer has in the past, i.e. before 1st June, 1933, evaded his obligations, he will escape punishment if he presents a Voluntary Fund receipt which covers at least half the defrauded amount: he will, however, still be liable for the remainder. The Government adds to each contribution a premium of 25 per cent, if it is paid before 1st October, 1933, 20 per cent if it is paid in the first quarter of 1933, and 15 per cent if it is paid between 1st January and 1st April, 1934. The cash entering this Fund will be administered by the Public Works Company as trustee for the Reich: the Treasury Certificates, etc., will be transferred to the special Amortization Fund. The above-mentioned uses to which the receipts can be put are not valid in the case of inheritance tax, customs duties, and consumption taxes.

Writers on public finance sometimes emphasize the weakening of the " morality " of taxpayers which sets in during depression and affects the " susceptibility " of certain revenues.[1] The Hitler Plan tries to meet this evil by making it comparatively easy for the lawbreakers to escape the wages of sin. This is not the first of such amnesties in the recent financial history of Germany: the Railway Loan issued in 1931 had a similar bait attached to it. As a non-recurring expedient there may be something to be said for it, but, if such a policy comes to be regarded as a stand-by of a harassed Government, it will only foster the evil which it seeks to exploit. The Hitler Government is making strenuous efforts to ensure that the Fund will be a substantial one. For instance, it has appealed to all officials, salaried employees, and wage-earners to instruct their employers to deduct the contribution at the source.[2] It does not seem to realize that the money accumulating in such a Fund represents a mere transfer within the system. The demand for consumers' goods will diminish in the interests of extensive road-building. The mass of workers employed by private enterprise will lose a portion of their purchasing power, but this sacrifice will not correspondingly reduce costs in private industry, for the sums released are to be used by public authorities to produce capital goods, for which there is no " economic " demand.

[1] F. Neumark, *Konjunktur und Steuern* (1930).

[2] See the wireless appeal of Reinhardt, Under-Secretary of State in the Finance Ministry (*Börsenzeitung*, 30th June, 1933). This is the case with most of the Nazi " voluntary " funds.

Tax Immunity for the Purchase of New Machinery.—Section II of the Law of 1st June aims at encouraging employers to renew their fixed capital. A firm which incurs an outlay on improving or replacing its machinery or other instruments of production can obtain exemption, to the extent of the sum thus spent, from the income, corporation income, and industrial profits taxes due between 30th June, 1933, and 1st January, 1935. The following four conditions must be fulfilled :—

(*a*) The new machinery must be made in Germany.
(*b*) It must be acquired between 30th June, 1933, and 1st January, 1935.
(*c*) The new instrument must replace a similar one in use previously.
(*d*) Proof must be forthcoming that the introduction of the new machine does not diminish the labour force employed in the factory.

Encouraging the Demand for Domestic Servants.—The Hitler Government has, on the one hand, suspended the obligation of householders to pay unemployment insurance contributions in virtue of domestic servants and, on the other, has allowed the householder to count domestic servants, up to a maximum of three, as his own children in filling up his income tax returns.

The Marriage Loans.—The Government of the National Revolution prides itself on killing two birds with one stone by introducing its scheme of marriage loans. Not only is it said to be vital for Germany to raise the marriage-rate and, therefore, the birth-rate : it is also possible at the same time to find extra employment for men. Any woman who has been in employment for six months during the last two years, and decides to get married, may obtain a loan free of interest up to 1,000 marks. She must not re-enter the labour market as long as her husband earns at least 125 marks per month. The loan is given in the form of vouchers, which are valid only for the purchase of furniture and other household requisites. The advance is to be paid back at the rate of 1 per cent per month ; but every time a live-born child arrives the outstanding liability will be reduced by 25 per cent. It is intended to enable men to be taken on in the jobs vacated by women. Nothing is said regarding wage-rates ; presumably the unemployed men are to be reabsorbed at the same pay as the women previously received.

The economic policy of the new Government is inspired by a strong, but naïve, determination to " create " employment.

All sorts of measures have been introduced to increase the number at work. Generally speaking, the success of such crude expedients can only be bought at the price of misdirection of capital, or of the compulsory forcing down of wages. There is no doubt that the Hitler Government is sincere in its onslaught on the unemployment problem; but it will

APPENDIX: FUNDS FOR EMERGENCY WORKS AUTHORIZED AND ACTUALLY SPENT UP TO 27th MAY, 1933.

Sources of Funds.	*Amounts Authorized. Million RM.*	*Purpose of Expenditure.*	*Sums actually paid out. Million RM.*	
Reich				
(*a*) Public Works Programme, 1932, Section I	135	Roads	42·7	
		Waterways	24·1	
		Improvements	16·05	
				82·85
(*b*) Public Works Programme, 1932, Section II	182	Roads	3·5	
		Underground work	3·9	
		Improvements	3·7	
		Houses	8·4	
				19·5
(*c*) Public Works Programme, 1933	500	Renovation of roads, bridges, etc.	5·4	
		Improvements	5·7	
				11·1
Federal Unemployment Insurance Institute	38	Country Roads	8·3	
		Waterways	2·35	
		Towns	0·29	
		Underground	0·16	
		Rest programme, 1932	0·05	11·15[1]
		Improvements		10·4
Public Works Company	35			26
Railway Company	280			130[2]
Post Office	60			34[3]
	1,230	*circa*		325

[1] The figures belong to the Public Works Programme of 1932.

[2] Bills to the amount of 130 millions have been presented to the *Deutsche Verkehrskreditbank*.

[3] The amount of the payments actually made cannot be determined because the contracts are administered through the District authorities (*Bezirksbehörden*).

On the basis of the Work Programmes of the Government in 1932 and 1933, a total sum of 1,230 millions has been authorized (including contributions from the Unemployment Insurance Institute of 38 millions). Up to the 27th of May, 1933, the actual amount used (i.e. bills presented for discount) equals at the most 325 millions. Thus over 900 millions are yet to be drawn on and will be utilized during subsequent months.

probably discover that political forms are much more easily revolutionized than economic realities.[1]

[1] In judging the number registered as unemployed under the Nazi regime the following facts, *inter alia*, have to be borne in mind: (*a*) domestic servants, agricultural workers, gardeners, and transport workers on rivers and canals are no longer insured; (*b*) the 250,000 enrolled in Compulsory Labour Service are excluded; (*c*) the Miscellaneous Stimulants which we have described amount in most cases to a colossal spread-over, whereby employers are forced to take on men whether they can afford it or not; (*d*) no less than 250,000 have been billetted on the farmers in exchange for the dole money; (*e*) since the State and Nazi Party are now a unity, and since one of the special levies on industry goes to the Party funds, it is impossible to know how many industrially unemployed Storm Troopers are being fed and clothed in return for other services rendered. The unemployment figures are obviously not comparable with those of 1932.

CHAPTER VII

SUBSIDIES, LOANS, AND GUARANTEES

I. What is a Subsidy ?
II. The Subsidizing of Agriculture.
III. Support for Industry.
IV. Loans.
V. Guarantees.

I. WHAT IS A SUBSIDY ?

Assistance granted to private and semi-public concerns from public funds takes a variety of forms in Germany. A broad distinction may be drawn between " direct " support in the shape of grants, low interest rates on loans, or guarantees, and " indirect " support afforded by artificial price maintenance by means of tariffs. The extent of the sums granted under the first category cannot always be exactly ascertained even from the Finance Accounts of the Reich [1] ; whereas it is even more difficult to determine what the States and Municipalities accomplish in this field. As for the second category, one must be content with rough guesses based on a comparison between the internal and world price level in the branches of production concerned.

The simple subsidy can further be considered from various points of view.[2] Its economic significance will depend to some extent on the sources from which the money is obtained : it may come from the general fund of taxation or from an ear-marked source. For instance, in the last two years, the yield of the industrial charge, formerly for Reparations, has been transferred via the *Bank für Industrie-Obligationen* to agriculture. Moreover the question of " incidence " arises in this field. In the words of Dr. Dalton, " a grant is direct when the whole benefit accrues to the persons to whom it is made, indirect if it is passed on to some other person owing to a consequential change in the terms

[1] See *Verhandlungen und Berichte des Unterausschusses für Landwirtschaft*, Band 13 : *Die Förderung der Landwirtschaft durch öffentliche Mittel* (1930), pp. 3–5.

[2] See M. Palyi, " Subventionen," *Die Wirtschaftskurve*, ii, 1930, pp. 153–4.

of some bargain between them." [1] The recipient of the subsidy may not be the person who enjoys its full benefit; and the question of the "ability to receive" grants may usefully be discussed. This makes the analysis of the precise effects of a given subsidy rather complicated. A subsidy may be open, in which case there is the possibility of Parliamentary or public discussion of its extent, or it may be hidden and perhaps a counter in a game of corrupt bargaining. An important distinction is whether any conditions, e.g. the necessity for rationalizing production, accompany the grant of public money. There is also the division between recurring and non-recurring subventions. Finally, some subsidies may be introduced to counteract the effects of protective measures already in existence. Even Professor Palyi is prepared to admit that a subsidy may in certain circumstances be economically sound, e.g. "productive unemployment relief" which employs capital which would otherwise have had to be content with a less productive field of investment owing to real wages being held artificially high.[2]

The peculiar character of the subsidy problem in Germany may best be illustrated by referring to the subsequent history of Part IV, Chapter V, of the Emergency Decree of 4th September, 1932, the object of which was to adjust salaries of directors and higher officials in subsidized undertakings down to the level of corresponding employees in the public service. The Decree's definition of a subsidized concern was "undertakings, institutes, offices, companies as well as public corporations to which the Reich, a State, a Municipality, or Union of Municipalities has granted financial assistance".[3]

But the Papen Government must have been aware that such an attempt at definition raises far more problems that it settles. A few examples culled from Germany's rich and variegated subsidy experience will serve to indicate the many-sidedness of this development.

The execution of this part of the Decree of 4th September proved a thorny problem, because it was necessary to draw an exact dividing line between subsidized and non-subsidized concerns, which would not offend against the principle of equality before the law. The practice of well-meaning Governments has produced a bewildering, heterogeneous crop of paternal measures,

[1] Hugh Dalton, *Public Finance* (1929), chapter xvii, "Grants and Purchase Prices."

[2] See Palyi, "Subventionen," *Wirtschaftskurve*, op. cit., p. 154.

[3] See *Verordnung zur Belebung der Wirtschaft*, part iv, chap. v (*R.G.B.*, 1932, p. 431).

and the most skilful draughtsman may well feel baffled. In 1932 the zinc ore mine owners, Stohlberg and Giesche, applied to the Government for a tariff. The Government recognized the necessity, but on grounds of policy was obliged to refuse. Instead it offered a grant from the Reich Treasury ; and, since the mine owners were loath to suffer the odium of being subsidy-fed, the Government particularly emphasized the point that exactly the same purpose would be achieved whether they gave a grant or introduced a duty. When the Reich later approached these mine owners with a view to an adjustment of fees and salaries, they naturally argued that either, on the Government's own assumptions, all concerns receiving protection through customs duties should be included within the law's scope or they themselves should be left out, on the ground that they had been obliged against their will to accept a subsidy instead of a tariff.[1]

A special exception made for such cases would, however, create further disturbing complications. The assistance granted to the *Mansfeld A.-G. für Bergbau und Hüttenbetrieb* (*Eisleben*) is typical. The year 1930 brought a ruinous decline in prices—copper 41 per cent, silver 33¼ per cent, lead 30 per cent, and zinc 22 per cent. The price of copper fell from 18·3 to 9·8 cents and even at 18·3 cents profits had vanished. Severe wage cuts and economies were imposed, but it was impossible to keep up with the progressive fall in receipts.[2] The Company saw no alternative to closing down the mines. This spelt disaster for the workers ; consequently the trade union leaders appealed to the Government and a subsidy was authorized. The employers then organized the subsidized mines as a special department with its own balance-sheet, and in the year ending 1932 it showed a total loss of 13½ millions, of which 9 millions were covered by the Reich subsidy. The Mansfeld Company could accordingly argue that, far from receiving State assistance, they are actually giving a subsidy of 4½ millions to keep in existence copper mines which the Reich regards as important from the social point of view. Without pausing to examine the validity of this argument, we may merely point out that the Government would find it difficult logically to reject it, if at the same time it recognized the claim of the Stohlberg and Giesche zinc ore owners to special treatment.

[1] See *Frankfurter Zeitung*, 11th November, 1932. "Was ist eine Subvention ?" and the Stohlberg Company's 1933 Annual Report (*Berliner Tageblatt*, 29th June, 1933).

[2] See *Frankfurter Zeitung*, 7th June, 1931, "Mansfeld unter Subvention."

If the tangled web of Reich assistance is difficult to resolve into an ordered pattern, the activities of the Municipalities in this sphere defy such an attempt altogether. The precise quantitative importance of Communal subsidies is impossible to assess; but it is known that they constitute a considerable fraction of the expenditure of the Financial System under this head. The detrimental effects which can be imputed to subsidies, as such, are here gravely enhanced by the pernicious competition which often takes place between different municipalities. There are many instances of towns, particularly in Western Germany, which have endeavoured in various ways to outbid one another in order to influence the location of factories. Such a form of public interference, even when pursued by a central national authority like the Reich Government, is open to objections; but, when local authorities engage in a sort of civil war in which success is determined by the degree of willingness to grant concessions to private entrepreneurs, the consequences cannot fail to be disastrous. The weapons used in this contest are many and some are ingenious.[1] They include the time-honoured method of granting guarantees and credits, tax concessions, the sale of land at very low prices, or purchase at excessive prices, the provision of special transport facilities, the taking over of shares in a company at a price well above the market valuation, postponing the service of loans, etc. Entrepreneurs are, of course, well versed in the art of playing off one municipality against another and squeezing out the maximum advantage. For instance, the town of Hagen in the Ruhr bestowed upon *Gebr. Elbers A.-G.* a grant of 800,000 RM. partly in exchange for land and partly shares; moreover, it gave the firm *Schmiedag* a subsidy of 80,000 RM. and also undertook the interest payment and guarantee on a loan of 600,000 RM. This encouraged the *Gebr. Dörken A.-G.* to approach the town of Gevelsberg in the same area with a similar request, viz. for a ten-year period loan, free of interest, accompanied by the threat that otherwise the factory would have to be transferred to the site of the Hoesch concern in Dortmund. Needless to say the "enterprise" of the brothers Dörken met with success. It is also worth mentioning that local taxation concessions played a part in the balance of advantages which lured a Ford factory to the city of Cologne in 1929.[2] This led the *Städtetag* (the Association of German

[1] For a number of concrete examples see L. Miksch, "Subventionen in der Industrie," *Wirtschaftskurve*, iii, 1930, pp. 270–1.

[2] See L. Miksch, *Wirtschaftskurve*, op. cit.

Municipalities) to circularize the town councils warning them against weighting the scales against German firms.

If a private Board of Directors has fulfilled its duty to its shareholders by making the most of advantages offered to it by a municipality, should the company be regarded as " subsidized " in the sense of the *Reichsgesetzblatt* ? It could pertinently retort that many undertakings owe their very existence to public contracts and others to tax concessions ; but both the latter sources of public assistance appear to be excluded by the wording of the text in the Decree of 4th September, 1932.

With the colossal reorganization of the Banks in 1932 the subsidized fraternity has received into their midst some distinguished members. But here again a strong element of doubt exists as to the credentials of one or two of them. No one would deny the right of the Dresdner, Commerz, and Adca Banks to be admitted. However, the Deutsche Bank, not being enthusiastic for the honour of becoming a member, has reiterated with pride that it accomplished its reorganization out of its own resources, though it has to admit that 35 per cent of its share capital was provided by the Gold Discount Bank. In this case must the boundary line be drawn to differentiate money coming from the Reichsbank, via its auxiliary, from money flowing from the Reich ? Or are we to regard the Deutsche Bank as a recipient of " transitional payments " rather than public assistance, since it sounds better ?

As one proceeds with an examination of the banking complex, the shadows darkening the path of logic become even thicker. One comes across a very awkward border-line case in the shape of the *Bank für Industrie-Obligationen*.[1] The shares of this bank are privately owned. Its function is to transfer, under public control, the yield of the charge on industry, which used to flow into the Reparations pool, to the assistance of agriculture. Though it is obviously a wheel within the complicated Reich subsidy machine, the spokesman of its shareholders could develop the thesis that the Bank is by no means a recipient of subsidies, but rather performs the function of a middleman transferring tax revenue to a group of agricultural customers. In its own books the business would be represented by items appearing on both sides of the account. Assuming the Government recognized such an argument, then the Joint Stock Banks could take up the refrain and declare that they could no longer remain members of the subsidy fraternity on the ground that, as the

[1] See *Frankfurter Zeitung*, 11th November, 1932.

Government has so often emphasized, the reorganization of 1932 was executed above all in the interests of the German economic system, namely, their own customers. The two cases are not exactly on all fours: on the one hand public money is given to a bank and then handed out to customers, while on the other hand private money which has been lost is replaced from public funds. This offers the alarming possibility of further border-line cases.

These few examples will suffice to show the sort of problems facing the legislator, who would draw a clear and logical distinction between a subsidized and a non-subsidized undertaking. Five months after the enactment of the original Decree the Executory Provisions were finally published as a separate Decree.[1] This probably represents the best answer that the Government can give to the question " what is a subsidy ? " First, subsidized undertakings include companies and legal " persons " in private or public law, institutions, and private enterprises which have received out of public funds credits, grants, or advances, outside normal business transactions. When a concern has obtained a private credit which is protected by public guarantee, it is to be regarded as equivalent to a direct public credit. The use of public money for acquisition of, or investment in, private shares counts as a subsidy. By " public funds " are to be understood the funds of the Reich, a Federal State, a Municipality (or Union of Municipalities), the German Railway Company, or of any legal " person ", institution, or corporation, under public or private law, whose capital to the extent of at least one-half has been supplied separately or jointly by the Reich, the German Railway Company, the Reichsbank, a Federal State, or a Municipality (Union of Municipalities), or whose policy is under such public domination, e.g. through majority voting rights. Assistance from public funds is so defined as to exclude the following: (*a*) The holding of credits in banks or other financial houses as an ordinary business transaction, (*b*) grants of permission to postpone payment of taxes, duties, fees, or other obligations unless such respite is expressly characterized as financial assistance in the sense of the Decree, (*c*) the issue of Tax Vouchers under the provision of the Decree of 4th September, (*d*) provisions of insurance against payment of premiums, (*e*) the bestowal of credits or grants which exclusively fall to

[1] *Verordnung zur Ergänzung und Durchführung des Kapital V der Verordnung zur Belebung der Wirtschaft vom* 4. *September* 1932. 27. February 1933. *R.G.B.*, 1933, i, p. 89.

the benefit of a third party, particularly credits which are directed entirely to the furtherance of housing, public works for the unemployed, or Voluntary Labour Service, (*f*) measures inserted in the Reich budget for assisting foreign trade, (*g*) the allocation of Treasury Certificates or cash grants by the Reich according to the Decree of 27th September, 1932, for the relief of interest on agricultural real estate debts.

Having thus made a gallant attempt to provide a workable foundation, the Decree goes on to declare that, wherever " public financial assistance " exceeds the minimum, as measured by 5 per cent of the capital of the undertaking, the fees or salaries of directors, higher officials, and salaried officials earning more than 12,000 marks per annum must not exceed those of corresponding grades of the public service. We are not here concerned with the interesting question of the merits of this enactment. It is an eloquent commentary on the jungle of subsidies which has flourished in Germany that, in the effort to achieve this deceptively easy goal, such a mass of complications and contradictions were encountered. Thanks to a commendable adherence to the principle that it is better to travel hopefully than to arrive, the episode has thrown an instructive light on the infinite variety which characterizes this important chapter of recent German development. As might be expected, the definition leaves unsolved most of the tricky puzzles mentioned above. It is, admittedly, made clear that, for instance, the Deutsche Bank, partly owned by the Gold Discount Bank, must put up with the odium of belonging to the subsidized fraternity. The facts, however, remain : it is out of the question to expect the wild and luxuriant growth of the last few years to yield to the zeal for tidiness which is displayed in this recent specimen of Reich policy.

II. The Subsidizing of Agriculture

The innumerable ways by which assistance is rendered to agriculture makes it impossible to arrive at an exact total of subsidies. It will be useful at the outset to describe some of the channels through which direct grants flow.[1] At the source stands the Reich Ministry of Food and Agriculture, whose functions have developed to such an extent that, according to the Audit Office, 82 per cent of its expenditure in 1930 was devoted

[1] See Dr. K. Bloch, " Subventionen in der Landwirtschaft," *Wirtschaftskurve*, Heft ii, 1930, pp. 157–167.

to subsidies. To-day it wields important powers as a consequence of the strong protectionist development of the last few years. Apart from special measures of assistance, there are three Funds out of which money is regularly granted. First, the Agricultural Emergency Programme Fund, originating in 1927 and 1928; second, the Fund for the financing of the grain harvest; and third, the Fund for the support of the slaughtered cattle market. These three together supply an annual outlay of about 40 million marks. The Ministry also deals with the surpluses of the Reich Maize Board, while the agricultural tariff policy has naturally extended the scope of its operations.

Other Departments also co-operate. For example, the War Ministry does its duty by placing ample means at the disposal of the Army to be used for purchasing horses at excessive prices. The building of agricultural workers' houses as a part of productive unemployment relief, financed partly by the Federal Institute for Unemployment Insurance and partly by grants from the Reich, is also a veiled subsidy. Public or semi-public Institutes also play their part, e.g. the *Rentenbank-Kreditanstalt*, established in 1925 to take over the property of the old *Deutsche Rentenbank*. This gives credit to farmers at very low interest rates and has also helped to secure large foreign loans for agriculture. No attempt is here made to enumerate all the different measures which have been introduced in the interests of the agrarian community. Special attention can be given only to the evolution of the last two or three years.

Not only are reliable statistics very scarce, but those that exist are very difficult to interpret. One is forced to fall back upon the class of budget expenditure entitled *Wirtschaftliche Zwecke* (Economic Purposes) and select the items which appear to fall into the category of subsidies. It must be emphasized that too much significance cannot be attached to the absolute amounts, for it is impossible to guarantee that every figure included represents a pure subsidy or that every subsidy is included. Many grants devoted to " economic purposes ", e.g. the building and maintenance of bridges, canals, air services, etc., are really of the same character as expenditure on education or social services: they can be regarded as being within the normal activities of the State.

The classification of Reich expenditure published in the *Finanzieller Überblick über den Haushalt*, 1932, contains two items which throw some light on Reich grants to agriculture, viz. *Osthilfe* and *Förderung der Landwirtschaft*. These appear

under the general rubric " Expenditure on Economic Objects ". The figures are as follows [1] :—

	1926. *Actual.*	1928. *Actual.*	1930. *Actual.*	1931. *Estimate.*	1932. *Estimate.*
Assistance to Eastern Agriculture for debt consolidation (*Osthilfe : Umschuldung*)	41·0	65·5	142·7	89·3	115·8
Fostering of Agriculture :—					
(*a*) Recurring	8·4	7·9	6·2	6·3	5·7
(*b*) Non-recurring	119·8	72·1	97·3	21·0	77·75
Participation in *Deutsche Boden Kultur A.G.*	—	—	16·0	—	—
Gross Total	169·2	145·5	262·2	116·6	200·3
Income	—	—	16·5	0·9	0·9
Net Total	169·2	145·5	245·7	115·7	199·4

Public money is spent on agriculture in order to achieve a quantitative increase in production, qualitative improvement (through standardization, breeding, etc.), the promotion of more rational marketing methods and education.[2] It is impossible to ascertain how much assistance in the form of pure subsidy is received by agriculture. The *Osthilfe* credits have always aroused deep suspicion and, if the true facts could be published, a bottomless pit, into which public money has been indiscriminately thrown, would probably be revealed. Even under the Nazi regime the Junkers are still powerful enough to prevent any interference with this very questionable form of public assistance.

III. Support for Industry

Many businesses have been threatened to their very foundations owing to the unparalleled circumstances of the last two or three years. It would require very diligent examination to discover what amounts the Reich has spent on direct subsidies to industry. Very little official information is available. One must be content with incomplete scraps of information derived from newspapers and trade journals. But a few striking instances may be mentioned. Allusion has already been made to the Mansfeld Company, whose copper mines were kept open

[1] *Finanzieller Überblick*, 1932, Supplement No. 10, pp. 8 and 14.

[2] See *Die Förderung der Landwirtschaft durch öffentliche Mittel : Verhandlungen & Berichte des Unterausschusses für Landwirtschaft*, vol. 13 (1930), p. 11.

by a Reich subsidy of no less than 9 millions in 1932. A new arrangement has now been made, by which the Mansfeld Company itself ceases to be subsidy-fed and the copper mines are taken over by a new company, whose share capital of 6 million marks is held by Mansfeld. Since the Hitler Government came into power, agreements have been concluded which make it possible to open a further copper mine which was threatened with complete closing down at the end of 1932. It is provided that, whenever the cost of production of copper exceeds a stated amount, the Mansfeld Company must pay a certain sum per ton ; if the cost of production is reduced below this limit, the Reich and Prussia undertake to grant a premium. This is supposed to give the Mansfeld Company an incentive to work the mines as economically as possible Various interests have combined to enable these copper mines to continue working : the Railway Company has given a reduction in freight rates, the local municipality a remission of taxes, and certain firms a reduced rate of interest on outstanding building credits. Finally the Reich and the State of Prussia have also given concessions. Under previous subsidy agreements these two authorities had the right to participate in the future profits of Mansfeld. The company is now permitted to fulfil this obligation in a lump sum payment of 1·75 million marks to be made within two years of signing the agreement. There was a loss of 1·61 million marks on the working of the Mansfeld copper mines in 1932, although it received 11·26 millions as subsidy from the Reich and the State of Prussia and 1·07 millions as investment grants from the Treasury.[1]

Shipping has suffered very heavily in the depression. The Reich Government and the banks carried through an extensive reconstruction of the two big enterprises *Hapag* and *Norddeutscher Lloyd* in March, 1932. Their share capital was written down from 160 to 48 million marks. The banks advanced a credit of 46·4 millions, which the Reich guaranteed. In these " cleansing operations " the Government must always be prepared to see loans becoming irrecoverable and thus written off as bad debts. It is often only a matter of time before a credit takes on its real character as a subsidy.

One of the most impressive and mysterious examples of Government assistance to industry was the well-known *Gelsenkirche* affair, which came to light in June, 1932. Space does not allow a description of the details of this transaction. Suffice

[1] See " Mansfeld Zunkunft gesichert ", *Vossische Zeitung*, 5th July, 1933.

it to say that, shortly before the resignation of the Brüning Cabinet, the Finance Minister, Dietrich, signed an agreement, whereby the Reich acquired shares to the nominal value of 110 million marks at 90 in *Gelsenkirchener Bergwerks A.G.* The Reich made further purchases in the open market, which gave it a majority-holding in this large coal-mining concern with a total share capital of 250 million marks. The Government paid four times the market value of the shares at the time. The deal implied majority control over the *Vereinigte Stahlwerke.* A loud volume of criticism was provoked and the Papen Government was obliged to appoint a committee of inquiry into the affair. The suggestion that the owner, the industrial magnet Flick, was about to accept offers made by foreign interests, could not be substantiated. Another excuse was that the collapse of the undertaking would have imperilled the recovery of the banks—and the Dresdner Bank, owned by the Reich, was one of Flick's principal creditors. But in this case there is no reason why the banks should not have granted a moratorium. Whatever the real motives—and several incidents in this episode need a great deal of explaining—the transaction was of unquestionable importance, for it plunged the Government right into the centre of the coal and steel industries. It is an extension of the scope of the " Public Hand " which raises serious problems. The Social Democrats at the time roundly criticized it as a gratuitous subsidy to a bankrupt concern. It is too early to say whether this step is likely to accelerate or retard a policy of socialization in this key industry.

The crisis of 1931 shook the banking system, and the Government was obliged to come to the rescue. The method and extent of the assistance in this sphere are fully described in the next chapter.

It is impossible to obtain anything like a complete account of the direct assistance given to private enterprise by Reich, States, and Municipalities ; but from the few known facts we can only surmise that the aggregate must be enormous.

Indirect Subsidies through Tariffs

An attempt has been made by Professor Dessauer to calculate the extent of the indirect subsidy to agriculture by multiplying the volume of home production (minus that part of it used as fodder, seed, etc.) by the average difference between the home

and world price.[1] He took the price differences for the year July, 1930, to June, 1931, and arrived at a figure of 2·5 milliard marks. A similar calculation for industry, in which output figures for 1928–9 are combined with the tariff duties in force in 1931, results in a total of 1,200 millions. Such a statistical exercise is open to various objections and the figures should not be taken too seriously. The important point is that in Germany, where in 1932 the average price of wheat was 250 per cent, of rye 233 per cent, and of maize 327 per cent above the world level, an indirect subsidy of considerable magnitude is given to agriculture. The same is true of many branches of industry.

IV. Loans

The claims credited to the Reich in respect of the loans which it has granted represent assets in the national balance-sheet. But, in judging the real value of such assets, it must be remembered that many Government loans have special features. Thus a Government often finds it necessary to grant a loan in cases where the private lender would not dare to do business. Again, the period of redemption may stretch over a very long period of years. In Germany no special legislative sanction to borrow is necessary so long as an estimate for the purpose has been included in the budget, and the object on which the money is to be spent accords with this.

Fortunately official figures regarding the Reich's outstanding loans up to 31st March, 1932, are available.[2] On 1st October, 1930, the total stood at 989·6 million marks. Between 1st October, 1930, and 30th September, 1931, 67·2 millions were repaid and 223·9 millions transformed into material assets (e.g. in *Siedlungsbank* and *Bau- und Bodenbank*) and 5·2 millions written off. Meanwhile, 163·2 millions of new loans were granted. Thus on 1st October, 1931, the figure was 856·5 millions. In the period 1st October, 1931, to 31st March, 1932, 12·0 millions were repaid and 1·6 millions written off, whereas fresh loans of the value of 46·6 millions were made. The loans outstanding on 31st March, 1932, amounted to 889·5 millions, of which 527·1 millions had been voted in the Ordinary Budget and 362·4 millions in the Extraordinary.

[1] For the details of the calculation see Dessauer, " Landwirtschaftliche und industrielle Subvention," *Der deutsche Volkswirt*, 13th November, 1931.
[2] See *Finanzieller Überblick über den Haushalt*, 1932, pp. 21–2.

The accompanying Table shows the distribution of the loaned money over various industries and fields of public expenditure.

LOANS GRANTED BY REICH 1928–1932.[1] TOTAL OUTSTANDING AT EACH DATE (IN MILLION MARKS)

	1st July, 1928.	*1st Oct.*, 1929.	*1st Oct.*, 1930.	*1st Oct.*, 1931.	*1st April*, 1932.
Agriculture and Food	117·0	149·0	221·4	225·9	237·0
Trade and Industry .	58·0	47·0	43·6	43·2	44·9
Shipping . .	49·0	51·0	13·1	9·0	8·5
Transport . .	9·0	10·0	88·7	100·4	105·4
Unemployment Relief	330·0	734·0	114·4	140·0	144·9
Housing and Settlement . .	373·0	397·0	380·7	232·8	246·2
Territory formerly occupied . .	71·0	76·0	83·6	76·6	76·5
Miscellaneous . .	151·0	43·0	44·1	28·6	26·1
Total . .	1,158·0	1,507·0	989·6	856·5	889·5

The decline from 1,507·0 in October, 1929, to 889·5 millions in April, 1932, is due chiefly to the drastic cutting down of the loans for the relief of unemployment. From being almost a half of the total at the former date these are now only about one-sixth. The policy of propping up agriculture expresses itself in the considerable increase in loans since 1929: they constitute over one-quarter of the aggregate in 1932. The Reich has also been increasingly generous to transport; but housing and settlement has a smaller debt than previously.

V. GUARANTEES

Nowhere is the severity of the depression reflected more clearly than in the enormous rise in the guarantees undertaken by the Reich. Governments, having been first empowered by special legislation, have undertaken guarantees of a magnitude which the Finance Minister can no longer afford to overlook.

The Table on p. 174 shows the position as it has developed since January, 1930.

In addition there are guarantees of (*a*) an annual dividend of 51·629 millions on 737·6 millions 7 per cent preference shares of the German Railway Company, and (*b*) an annual dividend of 0·045 millions on 900,000 5 per cent preference shares of the *Rhein-Main-Donau, A.G.*

As compared with the position on 1st October, 1930, the

[1] *Finanzieller Überblick.*

REICH GUARANTEES 1930–1932[1] (POSITION AT EACH DATE)

	1st Jan., 1930.	1st Oct., 1930.	1st Oct., 1931.	1st Oct., 1932.
	(in Million RM.)			
Agriculture	103·5	109·1	93·3	268·8
Trade and Industry	184·9	309·1	730·8	689·2
Shipping and Transport	57·1	55·6	51·7	75·7
Housing and Settlement	164·8	199·3	220·9	175·9
Formerly occupied Territory	7·6	7·7	2·4	2·3
Banks	—	—	147·2	348·5
Miscellaneous	3·6	3·3	3·0	3·5
Total	521·5	684·1	1,249·1	1,563·9

guarantee obligations of the Reich have increased by 880 millions. The factors responsible for this increase are :—

	Millions.
Bank Guarantees	348
Increase in Guarantee of Russian Trade	273
Increase in various export guarantees	103
Increase in guarantees of Debt consolidation credits	100
Increase in credit guarantees	56

From the year 1927 to 1931–2 the Government had to meet its obligations under guarantees to the extent of 80·076 million marks. Deducting 6·6 millions obtained as premiums, we have a net liability of 73·472 millions which had to be actually met. It was distributed as follows :—

	Millions.
Agriculture	54·7
Trade and Industry	16·9
Occupied Territories	1·5
Miscellaneous	0·4
Total	73·5

There is reason to believe that since 1st April, 1932, there has been a further addition to the guarantees undertaken, bringing the total to nearly 2 milliards.

The amounts entered in the budgets to meet possible demands on the Reich from this quarter have been as follows :—

	Millions.
Budget of 1927	15
Budget of 1928	12
Budgets of 1929, 1930, and 1931 (13 millions each)	39
Budget of 1932	20
Budget of 1933	35

These sums are not large in themselves ; but it is the negation of financial prudence to shelter private enterprise at the risk of unbalancing the budget.

[1] *Finanzieller Überblick*, loc. cit., pp. 24–5.

CHAPTER VIII

THE REORGANIZATION OF THE BANKING SYSTEM AND FOREIGN EXCHANGE CONTROL

I. The Gathering Storm and the Crash.
II. The Reorganization of the Banks in February, 1932.
III. The Second Stage of the Reorganization.
IV. The State and the Banking System.
V. Foreign Exchange Control and Transfer Moratorium.

I. THE GATHERING STORM AND THE CRASH

The progressive loss of confidence in the soundness of the German system, which set in during the months before July, 1931, had its roots in a complex of economic and political factors. The alarm created abroad by the results of the election of September, 1930, the abortive project for a Customs Union with Austria, and the impossibility of bearing the burden of the Young Plan annuities, gave a renewed impetus to a deep-seated disposition to withdraw credits. The instability and obscurity of the internal political situation added to the general feeling of uncertainty. The consequences of the rapid fall in world prices made themselves particularly felt in Germany. With the collapse of the Austrian *Kreditanstalt* in May, panic spread like wild fire among bank creditors. During the first seven months of 1931 no less than 2,900 million marks of short-term credits were withdrawn from Germany, the pressure being most severe in June and July.[1] The Return of the Reichsbank for the end of June revealed that the desperate effort to retain the 40 per cent cover had exhausted three-quarters of the Rediscount Credit of 100 million dollars granted to it by the Bank of England, the Federal Reserve Board, the Bank of France, and the Bank for International Settlements. Internal creditors were now contributing increasingly to the demand for exchange.

Early in July came the sensational news of the failure of the *Norddeutsche Wollkämmerei*, Bremen, the largest textile concern

[1] See " Report of Young Plan Advisory Committee ", *Economist Supplement*, 2nd January, 1932. Germany parted with about 2 milliards of gold and foreign exchange between May and the middle of July.

in the country. It had a share capital of 75 million RM. and open reserves of 22½ millions. Its total assets, including its subsidiary companies, amounted to 140 millions, but its aggregate debts were 240 millions. Not only were share capital and reserves lost, but the concern failed to meet half its liabilities. This proved to be the last straw in an already desperate situation. Not even the offer of a credit guarantee of 500 million RM. by a group of the largest German firms, with the object of " strengthening the effectiveness of the Gold Discount Bank ", could stem the ever-flowing tide of withdrawals.

Collapse of the Danatbank.—On 13th July, the Darmstädter and National Bank was compelled to close its doors. Since May it had had to meet withdrawals to the extent of 650 million R.M., which was actually one-third of the country's total loss in that period. There had been continuous rumours appearing in the Press regarding its position and it was known that the *Nordwolle* affair had inflicted upon it a loss of well over half its share capital of 60 millions. The head of the Danat, Jakob Goldschmidt, had a reputation for recklessness and excessive optimism, and the recent policy of the bank laid it open to be one of the first victims in a general wave of distrust. The accompanying Table [1] exhibits the growth of the " Creditors " of the four chief banks in the 2½ years preceding the crisis.

CREDITORS

	31*st Dec.*, 1928.	31*st Dec.*, 1929.	30*th Aug.*, 1930.	31*st Dec.*, 1930.	30*th May*, 1931.
			Million RM.		
Deutsche Bank	4,643 [2]	4,729	4,494	4,137	3,921
Danat . .	2,083	2,384	2,426	2,291	2,070
Dresdner .	2,113	2,276	2,344	2,220	2,033
Commerz .	1,487 [3]	1,586	1,511	1,489	1,393

These figures show how rapidly the Danat went on increasing its indebtedness, whereas the Deutsche Bank repaid 300 millions of foreign credits in July and August, 1930, before there was any fear of a withdrawal crisis. Goldschmidt had been the means of selling more German shares abroad than any other bank chairman ; and he was himself a member of the Supervisory Boards of 134 industrial concerns. Moreover the Danat was loath to liquidate its debtors. In his report for 1930 Goldschmidt gave expression to the opinion that, in the existing circumstances,

[1] See G. Katona, " Danat Bank," *Der deutsche Volkswirt*, 17th July, 1931.
[2] Addition before fusion.
[3] After fusion with *Mitteldeutschen*.

the German banks should avoid inflicting the hardships involved in the liquidation of frozen credits. Finally he had been led by a false conception of prestige to keep the bank's share capital ludicrously low, believing that a high quotation—it was for a time 300 per cent—was a more reliable guardian of credit than a high share-capital.

The Government granted the Danat a moratorium until 1st July, and meanwhile bankruptcy proceedings were to be instituted. It was, however, inevitable that a serious run on the other banks should follow and the Government had to close the banks for two days. To meet the gravity of the position a partial bank moratorium had to be prolonged, and even these rigid restrictions did not suffice to prevent the failure of yet another important financial house, the Schröder Bank of Bremen.

Devisen Control.—This stage in the crisis evoked two important acts of Government interference. On 18th July, 1931, a Decree was enacted demanding the surrender to the Reichsbank of all kinds of foreign exchange—currency, cheques, bills, etc.—held by people liable to German property tax. An exception was made of foreign securities not repayable within three months, unless they had been acquired with foreign exchange after 12th July, 1931. All holdings of foreign exchange were to be notified to the taxation authorities. Henceforth all dealings in foreign payments were only to take place through the Reichsbank. This was the beginning of the far-reaching system of Devisen Control. The first Standstill Agreement was reached on 19th August, and came into force on 17th September.

The Establishment of the Acceptance and Guarantee Bank.—The second event was the establishment of a new Bank with a share capital of 200 million RM., to which particular emergency functions were entrusted. Two-fifths of the capital was supplied by the Government, and eleven large banks, including the Gold Discount Bank, took up the remainder. This new institution owed its birth to the severe crisis which had befallen the other banks. It provided machinery, by which a dangerous run on any single bank could be neutralized and the incidence of the pressure evened out over them all. Among its subsidiary powers was the right to discount the bills of small banks and have them rediscounted at the Reichsbank. It is important to note the origin of the Acceptance Bank, for it has outlived the abnormal conditions which brought it into existence and has become part of that unique banking structure which is the legacy of the crisis.

The ban on ordinary banking transactions could not be raised

until strong safeguards against a renewal of the run had been erected. With this end in view the Reichsbank rate of discount was raised on 31st July from 10 to 15 per cent and the lombard rate from 15 to 20 per cent. Further, a Decree of 1st August tightened the devisen regulations by making a written permit necessary for the acquisition of foreign exchange. Foreign securities not quoted on a German stock exchange could no longer be bought or sold without a permit, and dealings were only to be allowed at the official rate. A slight modification was later introduced in favour of firms regularly engaged in foreign business and in the case of contracts originating before 4th August. The service of long-term loans was definitely secured.

The other necessary task was the rehabilitation of the banks which had fallen victims to the crisis, and the bolstering up of others which were in difficulties. The Danat Bank was allowed to remain a private institution. As a *Kommanditgesellschaft*, i.e. a company in which some partners or shareholders are liable only to the extent of their holding while the liability of others is unlimited, its capital had been owned partly by itself and partly by directors and personally responsible managers (*Geschäftsinhaber*). The latter handed over their holdings gratis and a group of industrial concerns including the largest in Germany—the A.E.G., Siemens, I.G.-Farben, and others—took over 35 million marks' worth of shares at 125, that is to say, for 43 million marks. This impressive group of enterprises did not, however, supply the cash themselves, but had it advanced to them by the Reich in the form of a credit to be repaid after five years. Goldschmidt was the only one of the managers who retained his position. This scheme, which included the adoption of limited liability, sufficed to enable the Bank to reopen its doors without fear; but its existence in its new form was destined to prove a short one, for in the elaborate Bank Reorganization of February, 1932, the Danat disappeared, without even leaving the trace of its name.

The fact that the Dresdner Bank had also to receive Government assistance was a great surprise at the time. But the strain of continued withdrawals had been considerable and it had been extensively involved in the *Nordwolle* failure.[1] The foreign

[1] The inquiry showed that the unsecured bank debt of the *Norddeutsche Wollkämmerei* was distributed as follows: Danat Bank, 34·7 millions; Dresdner, 25·0 millions; Commerz, 10·4 millions; Deutsche Bank, 9 millions; Schröder of Bremen, 6·3 millions.

advisors of the Government, Dr. Sprague and Marcus Wallenberg, going upon experience of similar cases in other countries, such as Denmark and Sweden, took the line that the bank's weakness could be met only by strengthening its capital foundation. The Reich took over 300 millions of preferred stock and paid for them in Treasury Certificates which the Bank was to cash with the assistance of the Acceptance Bank. No responsibility for debts was incurred. Of the 134 millions of share capital only 84 millions remained in existence. It has been argued that Reich assistance for the Dresdner Bank was not really necessary and that the analogy of foreign bank crises, such as that of Landsmann's Bank in Copenhagen, was not sound.[1] This would, however, be an unprofitable discussion, for, in the light of after-events, these measures taken by the Reich immediately after the July crisis were merely the first stage in an unavoidable extension of Government participation in the banking system.

Some rescue work had also to be done in the provinces. In the State of Saxony, badly hit by the depression, the State Bank and the *Allgemeine Deutsche Kreditanstalt* were fused under the joint guarantee of the State. The State Bank had been rather too active in assisting industrial concerns, including the Horch motor car works and the Döhlen steel works, and was thus burdened with unduly large frozen assets. The Schröder Bank of Bremen was also completely reorganized under the new name of *Norddeutsche Vereinsbank, A.-G.* Its losses amounted to 43 millions. The method of " rectification " was similar to that of the Danat : the new capital was 12 millions, of which the State of Bremen took 7 millions, a group of industrialists in the State 3 millions, and the *Reichskreditgesellschaft* and the *Berliner Handelsgesellschaft* one million each. In this case again the contribution of the industrialists came indirectly from the Reich in the form of a credit of 5 millions for three years.

Ordinary banking operations were resumed on 5th August without any difficulties ; but the status of the banks had been thrown into the melting-pot. The Government appointed a Committee of nine experts to examine the problem. It also placed three nominees on the Supervisory Board of the Dresdner Bank to consider desirable changes in the personnel of the Board of Directors. On 19th September a Decree for the supervision of private banks was passed.

A Reich Commissioner for Banking was appointed as well as

[1] G. Stolper, " Staat und Banken," *Der deutsche Volkswirt*, 7th August, 1931.

a Banking Board of Control. The Commissioner is an independent official responsible to the Minister of Economic Affairs: the Board merely lays down general lines of policy and its five members comprise the Commissioner himself, the President of the Reichsbank, a Bank Director nominated by the latter, and the Secretaries of the Ministries of Finance and Economics respectively. The scope of their activity was not very precisely laid down. There are only general phrases, such as " influencing banking policy in the economic interest of the community ". The Commissioner has the right to demand any information he requires from the banks and the Board of Control may decide general principles for the conduct of banking business including " the conditions under which the banks may exercise the voting rights carried by the securities deposited with them for safe keeping ". The actual power wielded by the Commissioner depends largely, in practice, on the personality of the President of the Reichsbank.

II. The Reorganization of the Banks in February, 1932

On 23rd February, 1932, the full details of the tremendous reorganization agreements were published.[1] It is only possible here to give a very brief survey of the cleansing operations carried through in the case of each bank.

The Dresdner-Danat Fusion.—The Dresdner Bank absorbed the Danat without changing its name. The Reich guarantee for the internal creditors of the latter lapsed, but remained in force as far as external creditors were concerned. 321·5 millions of losses were written off out of previous profits and 100 millions were borne by the Reich. The Danat formerly had a share capital of 60 millions, of which 35 millions were held by the Bank itself, and open reserves of 60 millions. The latter were altogether lost, while the 35 millions of shares were to be handed over to industry. The remaining 25 millions of shares were written down in the proportion of 10 : 3, i.e. to 7½ millions, and exchanged for new Dresdner shares. The Dresdner Bank had a share capital of 100 millions before the crisis; of this the Bank itself held 34 millions and the Reich 22 millions. The Bank's own holding disappeared and the rest of the shares were written down in the proportion of 10 : 3. The Reich relinquished its own shares, so that all that was left of the ordinary share capital was 12½ millions. Moreover, the 300 millions of Preferred shares

[1] See *Frankfurter Zeitung*, 23rd February, 1932.

issued to the Reich in the 1931 crisis were now written down to 200 millions. Thus the total share capital of the Dresdner Bank now amounted to 220 millions. To this must be added 30 millions reserve and 60 millions in the form of Treasury certificates to constitute a secret reserve : these were provided by the Reich. It is interesting to note that the Reich also furnished 20 million marks as a compensation fund for employees dismissed on account of the merger.

Deutsche Bank and Diskontogesellschaft.—The readjustment process was here carried through by using the Bank's own resources. It held 105 millions of its own shares and 33 millions of these were eliminated. The 180 million shares in the hands of the public were reduced, in the ratio of 5 : 2, to 72 millions. What was left of the Bank's own shares, namely, 72 millions, were to be issued at 115 and a portion of them was taken over temporarily by the Gold Discount Bank. Total losses of 276·8 millions were written off by taking 23 millions of the 1931 profit, 146 millions from reserve, and 108 millions book profit from reduction of capital. These transactions left the Deutsche Bank with a share capital of 144 millions and reserves of 25·2 millions.

Commerz and Privat Bank.—The 37·2 million shares held by the Bank were sold to the Gold Discount Bank at par and the total capital of 75·0 millions was written down to 22½ millions. Forty-five million shares issued at 115 were taken by the Gold Discount Bank, and a further 12½ millions were added, representing the capital of the Barmer Bankverein which was absorbed. The total capital of the Commerz thus stood at 80 millions. Furthermore, it received 23½ millions in Treasury certificates from the Reich to build up a reserve of 30 millions.

Allgemeine Deutsche Kreditanstalt (*Adca*), Leipzig.—Its capital was 40 millions. Twenty-two millions were cancelled and the remainder written down to 6 millions. The Gold Discount Bank took over 13 million shares at 115, so that the capital amounted to 19 millions. The *Adca* was equipped by the Reich with a reserve of 6 millions and a guarantee fund of 12 millions.[1]

[1] These February Reform measures were revised in April, 1932. The original intention of merging the Adca with the Saxon State Bank was dropped and the Saxon State's guarantee for the deposits lapsed. The Adca's losses were covered by the receipt of Treasury bills redeemable out of profits. Its capital was written down from 40 millions to 20 millions with 6 millions reserve instead of 19 million. The Gold Discount Bank took up 14 millions of the new share capital. Thus the Adca remained only nominally a private enterprise. Its reorganization resembles that of the Commerz—a majority of shares held by the Gold Discount Bank,

These were the main lines of the reorganization, as it affected the chief banks. Further consideration is necessary to show clearly the part played by the Reich and the extent to which it now participates in the banking system. The whole operation implied writing off losses, the securing of liquidity, and the establishment of a sound capital basis for future profitability. Let us turn our attention to the first stage—the writing off of losses. The total sum which had to be made available for this purpose, including the rebuilding of reserves, in the four banks embraced by the Reorganization Plan have been estimated at 940 millions.[1]

AMOUNTS FOR WRITING OFF LOSSES AND FOR INTERNAL RESERVES

	Million RM.
Deutsche Bank & Diskontogesellschaft	291
Dresdner-Danat Bank	491·20
Commerz & Privat Bank	123·35
Allgemeine Deutsche Kreditanstalt	35·08
Total	940·63

An estimate may be given of the proportion of this total sum which the banks supplied out of their own resources, or at the expense of the private shareholders, by drawing on reserves and by using the book profit arising out of the writing down of the values of shares, apart from those belonging to the Reich.

AMOUNTS SUPPLIED BY THE BANKS OUT OF THEIR OWN RESOURCES

	Million RM.
D.D. Bank	291
Dresdner-Danat Bank	150·4
Commerz & Privat Bank	80·7
Adca Bank	25·08
Total	547·18

The Deutsche Bank bore the whole cost of the cleansing operation itself. The Dresdner supplied 94 millions from the reserves of the two merging banks, 17·2 millions from profit and 51·7 millions from book capital gain: the whole of the remainder, namely 340 millions, constituted Reich assistance.

the Reich's claim on future profits, representatives of the Reich, Reichsbank, and in this case the Saxon State on its Supervisory Board. See *Der deutsche Volkswirt*, 22nd April, 1932.

[1] See Dr. Felix Pinner, "Hinter dem Zahlenschleier," *Berliner Tageblatt, Abend-Ausgabe*, 27th February, 1932.

The Commerz contributed two-thirds of the required sums, the difference being accounted for by the purchase by the Reich of 37·2 million shares and the grant of Treasury Bills of the value of 16·75 millions as a guarantee fund. A Reich advance of 10 millions for a guarantee fund explains the disparity in the case of the Adca.

The Reich's Contribution.—The Reich handed over Treasury certificates of the value of 388·5 million RM. to these four banks for covering losses, building up reserves, and as liquidity credits. The details are as follows :—

REICH TREASURY CERTIFICATES GRANTED FOR THE COVERING OF LOSSES AND BUILDING OF RESERVES [1]

	Total Amount made available.	*Amount to be repaid.*
	Million RM.	
Dresdner Bank	270·0	115·0
Commerz Bank	40·0	40·0
Adca Bank	16·0	16·0
Liquidity credits to Darmstädter and National Bank	62·5	62·5 [2]
Total	388·5	233·5

This shows that the Reich provided about 40 per cent of the means necessary to make up for the losses and the disappearance of the reserves of the four large banks — Dresdner, Danat, Commerz, and Adca—the bulk of which was absorbed by the Dresdner-Danat. The total of 178·7 millions to be repaid, out of 388·5 millions, represents the position in the middle of 1932 : needless to say this must be revised in the light of subsequent developments.

It is convenient at this point to extend the above table to include the sums spent by the Reich on other banks.

REICH TREASURY CERTIFICATES GRANTED FOR COVERING LOSSES AND BUILDING UP RESERVES (OTHER BANKS) [3]

	Total made available.	*Amount to be repaid.*
Norddeutsche Kreditbank	10·0	—
Norddeutsche Kreditbank (not in form of Certificates)	1·5	—
Liquidity Credits to the Landesbank der Rheinprovinz	64·0	64·0
Total	75·5	64·0

[1] Particulars given in the *Finanzieller Überblick über den Haushalt*, 1932, p. 17.

[2] This sum has already been repaid.

[3] Particulars given in the *Finanzieller Überblick über den Haushalt*, 1932, p. 17.

Having re-established a bedrock foundation for the banks by writing off losses and creating new reserves, the Reich completed the rationalization plan by re-forming their capitalization. In these tasks the Reichsbank, working through its subsidiary, the Gold Discount Bank, co-operated in an important degree with the Reich. Since the new shares that were taken over were purchased at a premium of 15 per cent (5 per cent in the case of the Dresdner) a contribution was made to the strengthening of the banks' open reserves. The following table [1] gives some interesting details of the participation of the Reich and the Gold Discount Bank in the share capital and reserve of the four chief banks.

	Total		*Participation of Reich in*		*Participation of Gold Discount Bank in*		*Private Participation in*	
	Capital.	*Reserves.*	*Capital.*	*Reserves.*	*Capital.*	*Reserves.*	*Capital.*	*Reserves.*
	(In million RM.)							
Deutsche B.	144	25·2	—	—	50·0	7·5	94	17·7
Dresdner B.	220	30·0	152	30·0	48·0	2·4 (?)	20	—
Commerz B.	80	30·0	11·16	23·25	45·0	6·75	23·84	—
Adca [2] .	20	6·0	—	4·05	14·0	1·95	6·0	—

	Participation of the Reich and Gold Discount Bank as % of Share Capital. % [3]
Deutsche Bank	35
Dresdner Bank	91
Commerz Bank	70
Adca	70

In regard to the 50 millions of shares held by the Gold Discount Bank in the Deutsche Bank, the latter created for itself cover in the books of the former. The Deutsche Bank intended at a later date to issue the whole of the new 72 millions of shares on the market and then free itself from public participation. Towards the end of April, 1932, it had to close the application lists without success.[4] In February the Bank had been able to announce that 22 millions of the 72 million new shares had been taken up by its industrial friends: the new issue in April at 115 could only raise the quota of privately held new shares to 27 millions, so that the Gold Discount Bank still possessed 45 millions, or 31 per cent, of the total share capital. This failure was an eloquent proof of the fact that investors were suspicious of bank shares. The issue price of 115 savoured of undue

[1] Pinner, "Hinter dem Zahlenschleier," *Berliner Tageblatt*, 27th February, 1932.

[2] The figures given for Total Capital and Gold Discount Bank participation therein are those resulting from the revised reorganization in April, 1932.

[3] This was the position in February, when the scheme was passed.

[4] See *Der deutsche Volkswirt*, 29th April, 1932, p. 1008.

optimism : the bank will have to content itself with low dividends for some time in order to repair the ravages of the crisis on its reserves.

Sixty-nine per cent of the capital of the Dresdner Bank is held by the Reich and 22 per cent by the Gold Discount Bank ; whereas in the Commerz the Gold Discount Bank holds 56 per cent and the Reich 14 per cent. It is clear that the influence of the Government on the Dresdner is much stronger than on the Commerz. None of the shares of the Adca are in the possession of the Reich, but part of the reserve has come from the Government. The Gold Discount Bank holds about two-thirds of the capital.

How Public Money was Provided.—Three sources were drawn upon : the Reich budget receipts from seigniorage on the coinage, the yield of the tax on excess note issue which was ear-marked for use by the Reichsbank instead of going to the Treasury, and the profits of the Reichsbank. For the rest the Reich added to its short-term debt by handing over Treasury Bills. In view of the fact that the Treasury normally takes a graduated proportion of the profits of the Central Bank, as well as the yield of the tax on excessive note issue, it is clear that the assistance granted through the Gold Discount Bank was really borne by the Reich finances. The participation of the Gold Discount Bank in the share capital of the four reorganized banks amounted to 174·60 million marks. To enable it to do this the Reichsbank increased its subsidiary's capital by 200 million marks, thus leaving it a margin of 25 million marks for possible future participations. The Reichsbank had made considerable profits during the crisis year of 1931, since the withdrawal of short money made recourse to the Central Bank much more necessary and the high interest rate ruling in a stringent market added substantially to the profitability of its discount and advances business. As the Reichsbank had prospered on the strength of conditions which had meant the collapse of other banks, it was only fair that it should disgorge some of its gains in order to put these banks on their feet again. It was not necessary to extend the note issue : it was simply a matter of book transfers. If the banks were to experience further losses and had to cover them from their Guarantee Funds, or if there were further withdrawals of deposits, they might find it necessary to lombard the Treasury Bills granted to them and a sudden demand for notes might then be felt by the Central Bank.

The Banks' Capital and Liabilities after the Crisis.—A clear view of the effect of the crisis and of the rationalization plan may be obtained from the following summary table [1]:—

	Share Capital		Reserves		Liabilities		Capital plus Reserves as % of Liabilities	
	1930	1931	1930	1931	1930	1931	1930	1931
	(Million RM.)							
Deutsche Bank	250 [2]	144	160	25·2	4,484	3,371	9·1	4·9
Dresdner Bank	100	220	34	30	2,385	3,173	5·6	7·9
Danat Bank	60		60		2,417		4·0	
Commerz Bank	75	80	40·5	30	1,682	1,202	6·9	8·6
Reichskredit	40	40	20	20	627	504	9·6	11·9
Berliner Handelsgesellschaft	28	28	15	10	423	329	10·2	11·6

The Deutsche Bank comes out with the lowest proportion of resources to " creditors ", viz. 5 per cent. The merger of the Dresdner and Danat shows an improvement in the percentage. The two centralized Government owned banks—the *Reichskreditgesellschaft* and the *Berliner Handelsgesellschaft*—went through the crisis without having to reduce their capital and they paid their usual dividend. They naturally experienced a fall in creditors, so that the proportion of their resources to liabilities improved in both cases. This decline in creditors was moderate compared with that of the other banks. These two centralized institutions benefited from the crisis, inasmuch as funds flowed to them from other banks owing to the relative security offered by the fact of Government ownership.

The Reorganization of Provincial Banks. — The need for rescue operations was by no means confined to the Berlin banks. We have already described the methods adopted to set the Adca of Leipzig on its feet. The full range of the Government's interference would not be adequately appreciated, if reference were not made to one or two other schemes to assist provincial houses. The *Norddeutsche Kreditbank A.-G.*, Bremen—formerly I. J. Schröder Bank—was assisted partly by the Reich and partly by the City of Bremen. The Basle " standstill " negotiations and the claims of foreign creditors made it necessary for the Free City of Bremen to guarantee 168·8 millions of assets and for the Reich to add its own guarantee to half this sum. The Reich placed 35 millions of interest-bearing Treasury Certificates, falling due on 1st October, 1934, at the disposal of the Bank. Of this 20 millions were used to make up for

[1] See Pinner, op. cit.
[2] After writing off 35 millions of its own shares.

losses, 10 millions being borne by the City of Bremen, and 15 millions were applied as working credits and were to be repaid to the Reich. Up to 31st March, 1932, 31 millions of these Certificates had been utilized.

The Reich granted the *Landesbank der Rheinprovinz*, Düsseldorf, Treasury Certificates, non-interest bearing, to the amount of 120 millions,[1] while the State of Prussia joined in the assistance to the same degree. By the middle of 1932, 64 millions had been used, namely :—

25	millions	falling	due	on 15th October, 1932.
37·5	,,	,,	,,	,, 15th January, 1934.
0·5	,,	,,	,,	,, 15th November, 1936.
0·9	,,	,,	,,	,, 15th March, 1937.

Finally, 20 millions of Reich funds were applied to the rationalization of the co-operative credit societies (*gewerbliche Genossenschaften*).[2]

Reich Guarantees for Banks.—The Bank Reorganization Scheme added a great deal to the ever-growing burden of guarantee obligations taken over by the Reich. The details are set out in the following table :—

REICH ASSISTANCE TO BANKS IN THE FORM OF GUARANTEES. POSITION ON 1ST APRIL, 1932[3] (Million RM.)

	Amount of Guarantee.
Norddeutsche Kredit Bank (Bremen)	88·0
Deutsche Orient Bank	7·7
Acceptance Bank	66·0
Reichszentralkasse der deutschen Beamtenbanken	1·3
Co-operative Credit Societies	47·6
Central Association of Communal Savings Banks	100·0
Consumers' Co-operative Societies	8·5
Handelsbank, Berlin	0·5
Berliner Bank für Handel und Grundbesitz	20·5
Gewerbebank Trier A.-G.	0·5
Miscellaneous banks	7·9
Total	348·5

The Acceptance Bank.—In a period of abnormal crisis in the German credit system it is not surprising that several Governmental institutions should have been created to execute emergency measures of assistance. One of the most interesting of these is the Acceptance Bank. As we have seen, it was established immediately after the Credit Crisis of 13th July, two-fifths of its capital of 200 millions being provided by the Government and the rest by eleven banks. In the first stage

[1] See *Finanzieller Überblick*, p. 15.
[2] Ibid., p. 16.
[3] Ibid., p. 25.

of its existence it was preoccupied with facilitating the reorganization process.

Early in March, 1932, it was decided to extend the scope of its operations to include the granting of credits, but only to banks, financial houses, and credit institutions. The object was to improve the facilities for the granting of self-liquidating credits, in cases where the banks were not prepared to undertake the business at their own risk. The *Akzeptbank, A.-G.*—as it was called—was in no way to compete with other banks for ordinary business: the development was conceived merely as a further extension of its original function of rendering assistance. It is not allowed to receive deposits, and it must confine itself to sound bills. The reluctance of the credit banks to undertake new business may be illustrated by the fact that between November, 1931, and the end of February, 1932, the banks' " debtors " diminished by 681 million marks—a decrease greater than in the whole of 1931.[1] This was partly due to the calling in of outstanding credits and partly to the writing off which accompanied the reorganization scheme of February.

During the crisis of July and August, 1931, special support had had to be furnished for the Savings Banks. The withdrawals had been so heavy that the Reichsbank had to grant a special lombard credit of 175 millions and the Acceptance Bank a credit quota of 500 millions at the maximum. In the first few days after reopening, the Savings Banks had to avail themselves of 150 millions of Acceptance Bank credits. For several months renewed support had to be given to these important institutions. It became part of the task of the Acceptance Bank in 1932 to secure as rapidly as possible the winding-up of these credits. The internal political uncertainty in May and June resulted in further withdrawals which had to be offset in the usual way by further resort to the Acceptance Bank and Reichsbank.[2]

Another important task accomplished by the Acceptance Bank was the granting of relief to small and middle-sized banks. According to an agreement arrived at early in August, 1932, for easier facilities for the financing of new business resulting from industrial production, the Reichsbank co-operated by giving the Acceptance Bank the right to re-discount up to 50 million marks.[3]

[1] See *Wirtschaftskurve*, 1932, i, p. 20.
[2] Ibid., ii, p. 169.
[3] *Frankfurter Zeitung*, " Akzeptbankunterstützung für Privatbankiers," 7th August, 1932.

III. The Second Stage of the Reorganization

The comprehensive plan for the reorganization of the Banks, which was carried through in February, 1932, was inevitably based to some extent on assumptions regarding the future. All the assets had been carefully examined and losses written off, whereas reserves were created as a safeguard against possible contingencies. Economic conditions, however, worsened during the late spring and summer, and what had seemed secure credits in February looked doubtful later; moreover, it turned out that many of the securities held by the banks had been valued too high. Further, the fact that the public had become shy of holding bank shares, as we have seen in the case of the Deutsche Bank issue, did not improve the banks' situation. The immediate cause of the second major interference of the Government sprang from the dangerous development which was taking place as a result of the various schemes of industrial reconstruction. Since February, 1932, *Sanierung* had been the order of the day, and several important concerns had to go through the process which the ravages of the depression had made inevitable. These schemes were built up on a more or less uniform pattern. Besides the reduction of interest and the foregoing of claims, the creditors were obliged to see the bulk of their credits turned into shares and new resources were procured by the issue of new shares, or the taking of credits to be transformed into shares at a later date. In this way the concern would be put on its feet by turning part of its debts into shares, by allowing another part to remain as long-period obligations, and by eliminating the remainder.

Such schemes led to the creation of shares of questionable value and, since the banks were in many cases substantial creditors of these weak undertakings, the process meant a perilous piling-up of such shares in the hands of the banks.[1] This exchange of frozen assets for dubious shares threatened to produce a cramping lack of liquidity. The banks might have been able, with time, to neutralize these dangers, if the Papen Government had not conceived its ambitious scheme for reviving economic activity. The September Plan, calculated to stimulate private capitalism through the medium of 2·2 milliards of tax vouchers, assumed active co-operation on the part of the banking system. Having interfered in February to put

[1] See Dr. Paul Silverberg, "Sanierung," *Der deutsche Volkswirt*, 16th September, 1932, p. 1665, and Gustav Stolper, "Der zweite Akt," *Der deutsche Volkswirt*, 23rd September, 1932, p. 1695.

Humpty-Dumpty back on the wall, the Government had now to step in again to make certain that Humpty-Dumpty could stay there without undue strain. Papen's decision to apply artificial respiration, instead of further deflation, could never have fruitful effects unless the banks could be in a position to grant credits to the reviving system. Hence the creation of two new organs by the Government, the *Industrie-Finanzierungs-Institut* (*Ifi*) and the *Amortisationskasse* (*Amok*). This represented the second important step in the direction of strengthening Government influence over the banks.

The *Industrie-Finanzierungs-Institut*[1] was intended, not as its name implies, directly to finance industry but to place liquid resources at the disposal of banks and banking-houses. Its share capital was fixed at 30 millions, consisting of 10 millions of preference shares taken up by the Gold Discount Bank, the Acceptance Bank, and the *Bank für Industrie-Obligationen*, and 20 millions of ordinary shares to be acquired by all the banks which intended to take advantage of the services of *Ifi*. At first only 25 per cent of these shares were to be paid up. Not only the large banks, but also the small, middle-sized, and private banking firms were to participate. The Institute was authorized to take over from the banks securities and claims which they had acquired as a result of the reconstruction of various industrial concerns. Each bank was permitted to transfer such securities to an amount equal to ten times the capital which it had paid in. On the basis of a 25 per cent paid-up capital, this meant that *Ifi's* absorbing power would be limited to 50 million marks. The criterion was, however, relaxed by making the whole nominal ordinary capital of 20 millions the basis, thereby expanding the scope of *Ifi's* operations to 200 millions. This was justifiable only on the condition of a rigid adherence to the principle that only sound securities should be taken over. Up to 75 per cent of the nominal value of the securities handed over could be mobilized by the banks in the form of bills which they could either stock in their portfolios or realize in the market. The remaining 25 per cent remained credited to the banks. This enabled the credit needs of the business world to be more easily met, since the load of unrealizable securities was thus taken off the banks' shoulders.

[1] See Professor W. Salzbach, " Industriefinanzierungs A.G. und Amortisationskasse," *Frankfurter Zeitung*, 29th September, 1932. " Fortschritte bei den Bank-Projekten," *Berliner Tageblatt*, 29th September, 1932. " Der Fortgang der Sanierung," 2ter Artikel, *Frankfurter Zeitung*, 19th October, 1932.

Ifi is to continue in existence for five years, within which period it is hoped that improved market conditions will allow the shares to be placed. In the event of one of the banks suspending payments, or if a reorganized undertaking goes on making losses for two years, then *Ifi* can demand that the bank takes back the transferred securities. At the end of five years the latter are returned automatically to the banks. The Institute receives the dividends and interest and is, if possible, to pay 4 per cent to the banks.

The Amortisation Institute (*Amok*) was a special organ designed to relieve the banks of a mass of frozen " debtors " and to facilitate their gradual writing off. *Amok* credited the banks with the equivalent of the face value of these claims, which could then appear in the banks' balance sheets instead of " debtors ". Each bank must pay an annual sum of 1 per cent of the claim into a general redemption fund, together with amortisation at the rate of at least 4 per cent. No bank is allowed to declare a dividend, until it has fulfilled its redemption obligations. The limit to the operations of *Amok* was fixed at 20 per cent of the capital of all the banks availing themselves of its services : this worked out at 292 millions.[1] Alongside the general redemption fund to be assembled out of the annual 1 per cent payments, a guarantee fund of about 30 millions was formed as a safeguard against deficiencies due to bank failures. A group of industrialists were to act as guarantors to this amount and thus the grant of further Government assistance was avoided.

Through the creation of these two new organs the balance-sheets of the banks were relieved of 500 millions of unrealizable securities and doubtful " debtors ". The scheme involved no extension of credit nor expenditure of public money. What happened was simply a reshuffle in the banks' books : bills appear instead of part of the securities originally held, whereas in the place of frozen " debtors " the banks now possess bills, in so far as the " debtors " are sound, and a claim on the Amortisation Institute, in so far as they are dubious.

The function of the Amortisation Institute may be described as the provision of an omnibus capital depreciation account for all the banks. It would have been possible without this interference for each bank, given the necessary legislation, to run a special capital depreciation account of its own. But there

[1] See " Der Fortgang der Sanierung, iii, Verein Amortisationskasse," *Frankfurter Zeitung*, 23rd October, 1932.

were two insurmountable objections: this procedure would mean legalizing the presentation of false balance-sheets and would have compelled each bank to publish the full extent of its losses, which, of course, varies considerably from bank to bank.[1] Criticism may certainly be levelled against such balance-sheet "window dressing". It has, for example, been suggested that the real reason for the initiation of this second stage of reorganization was not so much the burden of the banks derived from the past, as the part which the banks were chosen to play in the impending Papen programme for the revival of industry.[2] Moreover, the *Amortisationskasse* is not accountable either to the general public or to the bank shareholders. This is probably meant to hide the further depreciation, which may possibly have to be undertaken, and to prevent the newly reorganized banks from losing respectability.

This second stage was a logical corollary of the first. The German banks have certainly the possibility of making considerable profits; but meanwhile the huge losses of the crisis year 1931–2 had to be dealt with in such a way as to enable the banks to operate freely. If they could thus be put in a position to yield good profits in the next few years, though these will be lean years for the shareholders, the crisis will have been systematically and safely liquidated.

Certain difficulties were encountered in the process of launching the *Amortisationskasse*.[3] They arose out of differences between the banks and industrial interests regarding the formation of the guarantee fund of 30 million marks. The industrialists wished to incorporate this guarantee within the framework of the 500 million guarantee fund of industry for the "standstill" obligations of the Gold Discount Bank. This would be justified by the fact that 100 millions of these debts would be repaid during the first half of 1933. Moreover, the industrialists demanded further security. They argued that the sum to be built up out of the compulsory 1 per cent contributions of the banks would only accumulate slowly, whereas it would be during the first few years that the risk of bank failures would be greatest. They, therefore, requested that the future incomes of this amortisation fund should be mortgaged to meet possible outgoings in the first few years. The bankers objected that this plan would shift most of the risk on to their shoulders and that such an arrangement

[1] See G. Stolper, "Der zweite Akt," op. cit.
[2] See Professor W. Salzbach, op. cit.
[3] See "Amok im Werden", *Berliner Tageblatt*, 25th October, 1932.

did not correspond to the interest which the industrial concerns had in facilitating the reorganization of undertakings.

The two Institutes—*Industrie-Finanzierungs-Institut, A.-G.*, and *Tilgungskasse für gewerbliche Kredite* (*Tilka*)—were finally established on the 23rd December, 1932.[1] The negotiations which had been going on since September effected no material change in the constitution of *Ifi*; but its twin Institute the *Amortisationskasse*, under a new name, underwent some modifications during its pre-natal existence. The industrialists got their way and the guarantee fund of 30 millions was created by reducing the industrial guarantee for the "standstill" obligations of the Gold Discount Bank from 500 to 470 millions.[2]

The balance-sheets of the credit banks for 1932, which were late in appearing owing to negotiations with *Tilka* and *Ifi*, reveal a development which stands in notable contrast to that of the public banks. The Deutsche and the Commerz banks both took advantage of the Amortisation Institute (*Tilka*) and handed over a part of their frozen "debtors" to an extent only approximately published in their reports. The Dresdner Bank accomplished a further *Sanierung* out of its own resources by writing down its capital from 220 to 150 millions, thus avoiding the necessity of resorting to *Tilka*. Recent figures show that the decline in debtors as well as creditors which was experienced in 1932 has been still going on.[3] Between November, 1932, and February, 1933, creditors fell as follows: Deutsche, 80 millions; Dresdner, 31 millions; Commerz, 24 millions. The *Reichskredit* had a small increase. Debtors decreased as follows: Deutsche, 115 millions; Dresdner, 32 millions; Commerz, 18 millions. It is significant to note that the various measures designed to extend credit during these months, namely, tax vouchers and the Public Works bills, did not suffice to counteract the underlying forces making for contraction. Doubtless the shrinkage would have been greater but for these attempts at revival. The work schemes were, for technical reasons, slow in getting under way. The public banks showed signs of renewed strength and liquidity. The Savings Banks consolidated their position in the second half of 1932 and were able to reduce their obligations to the Acceptance Bank and Reichsbank, on account of Crisis assistance, from the peak of 1,100 millions in the summer of

[1] See Dr. Karl Friedrich, "Finanzierungsinstitut und Tilgungskasse," *Bankarchiv*, 1st January, 1933.

[2] *Verordnung über Wirtschaft und Finanzen*, 23rd December, 1932 *R.G.B.*

[3] See "Gegensätzliche Entwicklung bei privaten und öffentlichen Banken", *Frankfurter Zeitung*, 28th March, 1933.

1932 to 520 millions at the end of February, 1933, and later to 480 millions. The State banks increased their creditors by 78 millions, of which the Bank for Overseas Trade accounted for 29 millions. The Association of Communal Savings Banks also exhibited a rise of 110 millions in these three months.

The annual reports of the Deutsche and Commerz Banks do not specify the amounts of doubtful debtors transferred to *Tilka*: it is estimated unofficially that it was 20–25 millions for the Commerz, and 34 millions for the Deutsche, or about 20 per cent of the capital and reserves in each case.[1] This afforded much-needed relief to their balance-sheets; but the regular payment of redemption quotas to *Tilka* will be a standing charge on future earning power. The Dresdner Bank effected the required " rectification " in another way, by reducing its capital from 220 to 150 millions, and its open reserves from 30 to 15 millions. In this way it avoids burdening its future profits with *Tilka* obligations. The Report points out that the industrial and security holdings of the two merged banks, Dresdner and Danat, suffered serious depreciation in value on account of the worsening of the depression. With this second *Sanierung* the total outlay of the Reich on the Dresdner and Danat amounts to 520 millions,[2] while it holds only 100 millions of shares. In other words, the Reich has parted with 420 millions in the long process of rehabilitating the two banks and only a fraction of this sum is recoverable. Since the liquidity problem was not a pressing one for the banks in the spring of 1933, they were not in any haste to use the facilities offered by the *Industrie-Finanzierungs-Institut*. The immediate necessity was relief for their balance-sheets.

There is reason to believe that Dr. Schacht, the President of the Reichsbank, does not look with favour upon the two new Institutes founded in December, 1932.[3] The course adopted by the Dresdner Bank probably reflects his views, namely, that the banks should " cleanse " their balance-sheets as far as possible without further outside assistance. If this is true, his opinion stands in opposition to that of Geheimrat Karl Friedrich, a director of the Reichsbank, who has given the plan

[1] See " D.D. Bank-Ersparnisse decken Abschreibungen ", *Frankfurter Zeitung*, 6th May, 1933, and " Die Bilanz der Commerzbank ", ibid., 5th May, 1933.

[2] See " Die zweite Sanierung der Dresdner Bank ", *Frankfurter Zeitung*, 18th June, 1933.

[3] See " Neue Wendung in der Bankfrage ", *Frankfurter Zeitung*, 13th April, 1933.

his blessing. He stated that the two Institutes have been formed to enable the losses of the immediate past to be distributed over a series of years, so that the weakened economic system can cover them out of its own resources. It is thus not a repetition of the scheme of State assistance which marked the first stage of the Banking Reorganization in February, 1932.[1]

IV. The State and the Banking System

The reorganization of the banking system in Germany has been so far-reaching that it may pertinently be asked whether the banks are not already socialized. It would be difficult to find a parallel for the tremendous inroad into the Holy of Holies of private enterprise which took place in Germany in February, 1932. The relation of the Reich to the banks cannot, however, be discussed as a separate problem: it is intertwined with the other abnormal developments of the last two years, such as the stringent Devisen Regulations, the Standstill Agreements, and the Transfer Moratorium. These measures strike at the very roots of banking and of private capitalism. Instead of the ordinary personal relationship between debtor and creditor, there now exists a temporary legal relationship between a consortium of creditors and a whole nation of debtors. The extent of the individual debtor's assets is a matter of minor importance.[2] It is, therefore, essential to bear in mind that the problem of "semi-nationalized" banks is a part of the unprecedented and complicated web of State interference, which has been forced on Germany by the severity of the depression.

The first fact of importance is that, after the credit crisis, the deposit business of the banks rested more and more on the guarantee of the State. Even banks that still remained nominally private concerns were only able to maintain the confidence of depositors, because there was a latent State guarantee which may legitimately be looked upon as a substitute for part of their capital. Thus, if it is the promise of the State to cover losses or the fact that the State is the chief shareholder that makes it possible for the banks to continue to receive deposits, is it reasonable to expect the State to refrain from exercising an influence over the utilization of that money? An illogical and untenable situation arises if the chairmen of the banks are

[1] Karl Friedrich in *Bankarchiv*, loc. cit.

[2] See F. Somary, "Kreditbanken und Reich," *Der deutsche Volkswirt*, 4th September, 1931.

allowed to pursue their business as independent private capitalists, when they would have no resources to administer were it not for the State's guarantee.

A great deal of interest attaches to the question of the exact relations existing between the Reich and the reorganized banks. The large extension of Government ownership of banks was the child of dire necessity; but it would be an illusion to think that the Reich has been content to remain a passive shareholder. The setting up of a Banking Board of Control and a Commissioner for Banking on 19th September, 1931, was a potentially significant step on the road to " socialization ". In the words of the Decree " the Reich Commissioner for Banking shall keep himself continually informed of the state of German banking and credit, especially in their relation to other countries, and shall influence general banking policy in the economic interest of the community. . . . The Board of Control shall decide what general principles, if any, are to be laid down for the banks in the conduct of their business ". Such general phrases are of course open to many interpretations. But, whatever the motive and long-run intentions of the Government were, the Board and the Commissioner have been too busy up to the present in clearing up the débris of the credit collapse to exercise any systematic form of State control over the banking system.

Let us recapitulate the weighty operations which have been carried through under their supervision. They were, as we have already described :—

(1) The February, 1932, Reconstruction of the Banks.

(2) The Reorganization of the Industrial Co-operatives (*gewerbliche Genossenschaften*) and the Savings Banks.

(3) Support of numerous provincial banks, e.g. in Westphalia, Oldenburg, Schleswig-Holstein.

(4) Assistance for private banking houses through the Acceptance Bank.

(5) The Second Stage of the Reorganization of the Banks—the establishment of *Industrie-Finanzierungsinstitut A. G.* (*Ifi*) and *Tilgungskasse für gewerbliche Kredite* (*Tilka*).

Besides these tasks the Commissioner co-operated in the measures taken to reduce Bank interest rates under the Decree of 8th December, 1931, and in the reconstruction of large industrial concerns, such as Ewald, Karstadt, Schultheiss, König Ludwig, and others.

Meanwhile the Reich was making itself felt within the framework of the existing banking structure. Possessing, either itself

or through the Gold Discount Bank, 90 per cent of the shares of the Dresdner, and 70 per cent of those of the Commerz and Adca, it has been content to allow the old forms to remain unchanged, while altering their practical significance. Outwardly, these banks are still run as private enterprises: but there can be little doubt that the Reich has taken over the real substance of authority. It is well known that changes were made in the personnel of the directorate of each of the reconstructed banks.

But it is not so much through the directorate that the will of the Government is exercised. The following sketch based on personal inquiry will give some idea of the change in the centre of gravity. In a bank in which the Government is chief shareholder considerable importance attaches to the Executive Committee of the Supervisory Board. This smaller body is composed of Government nominees, who include civil servants, industrialists, and one or two private bankers. It is supposed to give expression to the general business point of view. Whereas the Supervisory Board itself meets only two or three times a year, the Executive Committee meets every ten days in conjunction with the Board of Directors. In practice, therefore, the Executive Committee may be said to act independently of its parent body.

Furthermore, the Executive Committee of the Supervisory Board has the power of vetoing the decisions of the Board of Directors. It receives its instructions on points of policy from the Reich Minister for Economic Affairs: the Finance Minister is also interested, inasmuch as the Treasury has supplied the banks with resources. The Executive Committee meets the Board of Directors about three times a month. It can assert the will of the Minister for Economic Affairs in two ways, either by vetoing a proposal emanating from the Board or by conveying to the latter the views of the Economics Minister on a particular item of policy. It may be assumed that the Board generally gives its assent to the wishes of the Reich Minister thus expressed. The Executive Committee has accordingly the twofold power of veto and initiative. The old forms remain: but the introduction of new checks and balances gives the Government the whip-hand. It is a provisional empirical device which is in many ways unsatisfactory, for the machine of private banking is partially put out of action, without being replaced by a constructively-built organ of State control. Like many other examples of the temporary half-way house, it must sooner or later give way either to a reintroduction of private responsibility

or to the establishment of newly-conceived organs of State operation.

In the days when the National Socialist Party was carrying on its vigorous campaign in opposition, the fact that it had " the socialization of the banks " in its programme did not cause German bankers to suffer sleepless nights. The first few months of the Hitlerite dictatorship have, however, exhibited such an incredible destructive zeal that it would cause no surprise if the turn of the banks to be *gleichgeschaltet* came pretty soon.

However, if we are to judge by the appointment of Herr Schmitt to succeed Hugenberg as Minister for Economic Affairs, the Hitlerite Government seems to be in favour of encouraging private enterprise. There is a school of thought in the Nazi movement which regards the socialization of the banks as the key to the solution of Germany's most pressing economic problems ; but such an interpretation of their " Socialism " is not to the taste of the leaders. Hitler has taken a leaf out of the book of British experience and has set up a Commission of Inquiry into the whole Banking problem. A Committee has been formed under the chairmanship of the President of the Reichsbank and including representatives of the Central Bank, the Ministry for Economic Affairs, Finance Ministry, and other experts. After a preliminary examination of the main questions has been undertaken, partly by selected people outside the Reichsbank, the main inquiry will be conducted in conjunction with these experts in the autumn of this year (1933).

Among the important matters to be examined are the desirability of decentralization as a means of satisfying the demand for regional banks, the division of the spheres of public and private banks and a stricter regulation of the interest margin which will not imperil profitability. The trend of Nazi economic ideas is against the large concern, whether in industry or in banking. They evidently wish to confine the methods of mass production to the sphere of politics. It may be assumed that, as a result of this comprehensive inquiry, large concessions will be made to the demands of small middle-class bank creditors and to the strong movement in the provinces in favour of regionalism. Ways and means will also, no doubt, be devised to get rid of the numerous bankers of non-Aryan extraction. It will be interesting to observe what adjustments will be made in the organization of those banks which are now largely owned by the Reich. The structure and the policy of the Banking System will doubtless be modified ; but the fundamental principle

of private profit or *Rentabilität* will remain. The Nazis have neither the capacity nor the inclination to achieve anything revolutionary in this sphere.

V. Foreign Exchange Control and Transfer Moratorium

The credit crisis of 1931 and its repercussions called for a severe measure of interference with foreign trade operations and with all kinds of dealings in foreign exchange. It is not proposed here to describe the mechanism set up for this purpose nor the special problems involved: there is by this time a considerable body of literature on the subject.[1] A whole series of regulations have been issued covering the Standstill Agreements, the surrender to the Reichsbank of foreign assets, and the purchase and sale of exchange. The Decrees dealing with the latter have brought into existence a network of Exchange Control Offices to which exporters and importers must supply regular information concerning their devisen receipts and requirements. Permits are issued to importers laying down the maximum of exchange that may be remitted each month. In common with other countries practising exchange regulation, Germany has been led to conclude "clearing" treaties with some of her neighbours — an extension of State activity calculated to rationalize the instrument of control and minimize the evils implied by it.

A glance at German foreign trade figures will reveal the extent of the shrinkage. Germany normally has an export surplus in her European trade and an import surplus in her overseas trade. In 1930 and 1931 a fall in the overseas import surplus and a rise in the European export surplus combined to strengthen her favourable balance. The decline in the overseas import surplus, compared with the previous year, was 763 million RM. in 1931 and 67 million RM. in 1932; whereas the European export surplus which had risen by 462 million RM. in 1931 underwent a serious fall of 1,867 millions in 1932. Germany's total "active" balance declined from 1·8 to 1·2 milliards. The figures may be summarized as follows:—

[1] e.g. Prion, "Die Praxis der Devisenbewirtschaftung und ihre Ergebnisse," *Zeitschrift für Betriebswirtschaft*, June 1932. "Clearing-verträge," *Währung und Wirtschaft*, Sept.–Oct., 1932. The recent Reports of the British Commercial Counsellor in Berlin give an excellent short survey.

GERMANY'S FOREIGN TRADE BALANCE[1]

Import Surplus (−) or Export Surplus (+)

	1931.	1932.
	Million RM.	
Europe	+ 4014·3	+ 2147·1
America	− 647·2	− 622·5
Asia	− 193·6	− 189·6
Africa	− 160·4	− 145·3
Australia	− 108·9	− 85·8
Total	+ 2,871·6	+ 1,072·6
Europe	+ 4,014·3	+ 2,147·1
Overseas	− 1,110·1	− 1,042·9
Others	− 32·6	− 31·6

Rigorous control of foreign exchange has been accompanied by an attempt to prevent the export surplus reaped from European trade from falling too low. The clearing system may be illustrated with reference to the German-Italian Agreement. Over and above the payments sanctioned by the rationing system, further trade can be financed by the creation of two accounts, one in the Reichsbank and the other in the Banca d'Italia. In respect of German imports from Italy marks are paid into the Reichsbank account, and for Italian imports from Germany lire will be placed in the Italian account. The two accounts are then set off one against the other. It is usually a condition that the trader receiving payment must be prepared to wait until the opposite account shows sufficient items to warrant it.

The difficulties of Germany's position are demonstrated by the history of this agreement with Italy. It was denounced by Germany on the ground that it made it impossible for her to maintain her export surplus in her Italian trade. Italy's answer was a total embargo on exchange dealings. The matter was finally settled by making the proportion of imports to exports in this extra trade in 1931 the basis for the future. The agreements with Sweden, Austria, and Hungary, though varying in detail, are on the same general pattern.[2] The problem is vital for Germany, for her very existence as an industrial country implies having a "passive" balance with overseas countries.

The average monthly export surplus of Germany in 1932 was 89·0 million RM.: in the first four months of 1933 it fell to 44·0 millions. The interest on her external debts involves a

[1] See *Wirtschaft und Statistik*, 1933, No. 4, pp. 105–6.

[2] See "Die deutsche Aussenhandelsfinanzierung in der Kreditkrise, 1931–2," *Forschungsstelle für den Handel*, Berlin.

sum of over 1,300 million RM. This is covered to the extent of a net sum of 100 million RM. of interest and 350 million of services.[1] Thus, if debt service is to be fulfilled, there must be a favourable visible balance of 850–900 million RM. This leaves out of account the necessity for redeeming the capital.

In the first few months of 1933 the situation worsened rapidly.[2]

1933.	*Stock of Gold and Devisen.*	*Loss of Devisen*		*Export Surplus.*
		Special Purpose.	*Current.*	
		Million RM.		
January	923	0	+ 3	+ 23
February	921	0	− 2	+ 27
March	836	− 67	− 18	+ 64
April	510	− 294	− 32	+ 61
May	449	0	− 61	+ 89
June (1st half)	349	− 60	− 40	
		− 421	− 151	

In March the Reichsbank repaid 16 million dollars and, in April, 70 million dollars of the Central Bank credit received in the summer of 1931. In June, the Gold Discount Bank credit of 45 million dollars was also being repaid (at the then equivalent of 150 million RM.).

It must be explained, in passing, that there are certain factors which produce a disparity between the amount of Germany's export surplus and the quantity of devisen received. First, the special characteristics of trade with Russia and some South American countries must be considered. The State has interfered to foster trade, particularly with Russia, by guaranteeing long-term credits. Since January, 1933, however, this factor has not had a very serious effect for more bills have matured than have been created or renewed. Secondly, the proceeds of exports often reach Germany only some time after the goods have been sent out. Thirdly, there is the flight of capital, both legal and illegal. There is reason to believe that the latter has been an important feature since the Nazi Revolution. For instance, German exporters may arrange for their proceeds to accumulate abroad in the form, say, of sterling balances, rather than receive cash which they must hand over to the Reichsbank. Finally, we may mention the effect of a scheme designed to foster "additional" exports, by which the exporter was empowered to receive payment in the form of the firm's stock held abroad.

[1] *I.f.K. Vierteljahrsheft*, 1933, A i, p. 14.
[2] See *Der deutsche Volkswirt*, 23rd June, 1933, p. 1074.

This proved very profitable for those concerns whose stock was valued at, say, 50, and entered in the books at 100.

The rapid depletion of the Reichsbank's gold and devisen resources led to a crisis and Dr. Schacht cut the knot by declaring a Transfer Moratorium, which came into force as from 1st July, 1933. In the form originally proposed it was sweeping in its scope, for it did not even exclude the service of the Dawes and Young loans. After negotiations with the creditors, an agreement was reached, which was much less drastic. The Dawes and Young loan and Standstill creditors received their interest in full, and the other foreign creditors 50 per cent in their own currency. The remainder is paid into the newly-formed Conversion Bureau in the Reichsbank by the German debtors and, in respect of it, negotiable non-interest-bearing scrip is handed to the creditors.[1]

Dr. Schacht is exploiting to the utmost Germany's strong tactical position as a large debtor. The unfortunate creditor finds himself between the devil and the deep. He can either get some of his money back by taking advantage of the use of the scrip, at a very unfavourable rate to himself, to finance additional German exports, or comfort himself with the thought that his abstinence is helping Dr. Schacht to bring about internal recovery.

The Moratorium constitutes a grave interference with normal economic relationships. The extreme economic nationalism which animates Germany's new rulers, and the loss of goodwill abroad since the Nazi Revolution, are factors unlikely to aid a solution in the near future. There is irony in the fact that the Nazi Revolution was enacted on a stage propped up by the Standstill Agreements. The second act of this melodramatic performance will proceed without a hitch, thanks to the extra props furnished by the drastic Transfer Moratorium.

[1] A new Transfer Moratorium arrangement is to be in force for the first half of 1934. According to its terms, the interest and amortization of the Dawes Loan and the interest of the Young Loan will continue to be paid, but only 30 per cent of the claims of the remaining creditors will be met in foreign exchange instead of 50 per cent as hitherto. As the scrip in terms of foreign exchange fetches only half its nominal value, the creditors can now at the best realize 65 per cent of their claims. See the *Economist*, 23rd December, 1933, p. 1230.

Chapter IX

CONCLUSIONS

I. Capital Consumption

The indications are that an appreciable amount of capital consumption has taken place in Germany since 1931. The *Institut für Konjunkturforschung* in Berlin has provided statistical tools for estimating this phenomenon.[1]

Some of the features of capital accumulation in the boom years leading up to 1929 have been referred to in a previous chapter. Investment, both public and private, proceeded at a phenomenal pace, made possible by the enormous importation of foreign capital. The gaps due to the War, the Treaty, and the inflation had to be filled : a rising price level encouraged business men to sink resources in long-term processes. Public Authorities devoted a large part of their means to building houses, public utilities, roads, canals, and other means of transport. The following table gives the estimated amounts applied to new investment, replacement, and stocks in the period 1924–9.

Investments in Germany, 1924–29[2]

New Investment	*Milliard RM.*
I. *Private Sources.*	
Industry	3·93
Transport	1·08
Agriculture[3]	2·55
Small Workshops	·81
Trade (wholesale and retail)	1·16
Miscellaneous	·95
Total of I	10·48

[1] See Keiser and Benning, *Kapitalbildung und Investitionen in der deutschen Volkswirtschaft (Institut für Konjunkturforschung, Sonderheft* 22).

[2] Figures taken from B. Benning, "Private and öffentliche Investitionstätigkeit sowie der Umfang der Spartätigkeit," in *Das Wirtschaftsjahr*, 1932–3 (Leipzig, 1933), edited by F. Raab, pp. 182–3.

[3] Including Dairies, Allotments, and Forestry.

II. *Public Sources.*

Administrative Departments[1]	2·95	
Assistance to the Economic System[2]	1·39	
Transport	7·34	
including:—Railways, Post Office, and Public Transport		4·05
Roads and Canals		3·29
Electricity, Gas, and Water	3·34	
Housing	7·42	
Total of II	22·44	
Total of I and II	32·92	

Maintenance and Replacement.

Private Sources	18·18
Public Sources	19·58
Total	37·76

Stocks.

Industry and Small Workshops	5·55
Trade	5·93
Miscellaneous	·11
Total Stocks of Goods	11·59
Gold	1·83
Total stocks of all kinds	13·42

These figures bring out the extraordinary importance of public investment in Germany. Over two-thirds of the volume of new investment in this period was undertaken by Public Authorities and undertakings under their influence, and almost the whole of this was devoted to transport, public utilities, and housing. It is true that, after the War and the years immediately following it, there was much leeway to make up. Yet this enormous capital expenditure entailed serious misdirection of resources. This was especially true in the case of housing and public utilities. In a country suffering from grave capital scarcity, money borrowed at 8 to 10 per cent was indiscriminately poured into fixed assets involving a relatively large capital cost.

Private entrepreneurs were equally led to extremes and made a fetish of American rationalization methods irrespective of their suitability to German conditions. Though they undoubtedly based their calculations on an estimate of future profitability, the inflationary character of the boom was destined to render this basis illusory.

[1] General administration, police, defence, education, and welfare.
[2] Including institutions like slaughter-houses, market-halls, etc.

There is justification for regarding the public demand for capital as less elastic than the private. Public authorities often proceed with their capital programmes without sufficient regard to the rate of interest. This demand of low elasticity exercised by the " public hand " in Germany was almost as great as the whole internal supply of savings in the pre-1929 boom.[1] The situation was aggravated by the voracious appetite for credits shown by agriculture and the practice of " intra-mural " saving by large concerns. If the undistributed profits invested within the firms concerned had appeared as capital supply on the open market, the danger of misdirection would have been smaller [2] and the rate of interest would probably have been lower. In 1928–9 there would have been hardly any supply to meet the elastic demand of the private market had there not been capital flowing in from abroad. This has led to the further suggestion that, if the inelastic public and semi-public demand had been directed to foreign capital sources so as to give the elastic demand a chance to be satisfied out of the domestic supply, the rate of interest would have been lower and the wastage less serious.[3]

The effect of the subsequent slump on the process of investment and replacement has been disastrous. Estimates of the trend are set out in the following table :—

NEW INVESTMENT, REPLACEMENT AND STOCKS, 1928–1932[4]

(*in Milliard RM.*)

	New Investment.	*Maintenance and Replacement.*	*Total Investment.*	*Change in Value of Stocks (including Agriculture).*	*Gold Holding.*
1928 .	+ 7·3	+ 7·0	+ 14·3	+ 2·7	+ 0·9
1929 .	+ 6·1	+ 7·0	+ 13·1	− 1·0	− 0·5
1930 .	+ 4·0	+ 6·9	+ 10·9	− 3·9	− 0·1
1931 .	—	+ 6·5	+ 6·5	− 5·1	− 1·2
1932 .	—	+ 3·5	+ 3·5	− 4·5	− 0·2

Difficulties in the realm of theory and of statistics complicate the task of measuring capital consumption. But this is not the place to discuss precisely what is meant by keeping capital intact. Herr Benning makes allowance for the diminution in

[1] See Neisser, " Die Zukunft des Kapitalmarkts," *Magazin der Wirtschaft*, 28th March, 1930, pp. 952–6.

[2] W. Prion, " Selbstfinanzierung und Dividendpolitik," *Die Bank*, 1929, p. 10.

[3] See Neisser, loc. cit.

[4] B. Benning, loc. cit., p. 190.

the cost of investment with the fall in prices, and concludes that the volume of investment in Germany in 1931 was only just sufficient to "maintain capital".[1] There were distinct variations over the whole field of industry. In public utilities, housing, and Administrative Departments fresh investment on a smaller scale was undertaken, whereas in several branches of industry and agriculture even necessary reinvestment was neglected. He points out that in 1932 the total investment, public and private, was about 1·5 to 2·0 milliards below the amount which should have been reinvested.[2]

Separate indices point unmistakably in this direction. The following figures show the sudden decline in building activity in 1931 and 1932.

GROSS BUILDING OUTPUT (MILLIARD RM.)[3]

	Housing.	*Industrial Building.*	*Public (including roads, etc.)*	*Total.*
1929 . .	3·5	2·7	2·7	8·9
1930 . .	3·0	2·4	1·7	7·1
1931 . .	1·7	1·3	1·0	4·0
1932 . .	0·6	0·6	0·9	2·1

Moreover, the investment outlay in the Financial System, viz. new building, purchase of land, etc., has shrunk from 1·77 milliards in 1929–1930 to 0·65 milliards in 1932. Even in 1930–1 the amount of building in agriculture is estimated to have been ¼ milliard RM. below the necessary depreciation.

New investment in Public Utilities—electricity, gas, and water—fell off very sharply in 1931, but provision was made for full replacement. When the figures for 1932 become available they will almost certainly reveal a serious decline in reinvestment.[4]

There has been a general tendency for the value of capital to be written down. According to a sample analysis undertaken by the *Statistisches Reichsamt*[5] the book value of the assets of industrial companies was reduced by 608 million RM. in the years 1929–1931, one-half of which fell within the year 1931. This was over 6 per cent of the value at the end of 1931.

[1] For another valuable study based on German statistics see J. Marschak, "Substanzverluste," *Archiv. für Sozialwissenschaft und Sozialpolitik*, 1932, pp. 129–45.

[2] B. Benning, loc. cit., p. 191.

[3] Ibid., p. 187.

[4] "Die Investitionen der Elektrizitäts-, Gas- und Wasserersorgung, 1928 bis 1931," *Wirtschaft und Statistik*, 1933, No. 13, pp. 411–13.

[5] See "Die Entwertungen in der deutschen Industrie 1929–1931," *Wirtschaft und Statistik*, 1933, No. 15, pp. 474–6.

The analysis distinguishes industries making production goods and consumption goods respectively, and it is interesting to notice that the former had already adjusted their valuation to a substantial extent during the years 1924–8.

Industry Group	No.	Share-Capital	Total Value of Capital	Amounts written down (in million RM.), as shown in balance-sheets				
		Million RM.		1924–28	1929	1930	1931	1929–31
		Position at end of 1931						
Production Goods	915	9,078	7,591	462	88	110	192	390
Consumption Goods	1,055	3,030	2,322	76	24	53	141	218

The adjustment was proportionately greater in the industries making consumption goods than in those making production goods in the period 1929–1931, viz. 9 per cent compared with 5 per cent. A wave of capital reconstructions set in during 1932, and some idea of its effect is given by the following figures of the annual diminution in the total share capital of German joint-stock companies, due to writing-down, or dissolution through liquidations, and bankruptcy.

	Amount of Diminution in Share Capital of German Companies.[1]
	Million RM.
1929	292
1930	380
1931	455
1932	1,300

A provision of a Decree of 5th October, 1931, made it easier for limited liability companies to " cleanse " their balance-sheets by adapting the book value of their assets to the fall in prices.[2] The way was thus opened for a drastic writing-down of book values and the " cleansing " process which followed was accompanied by a catastrophic slump in share valuations. The trend already visible in 1930–1 has, therefore, gone much further in 1932–3.

Serious Shrinkage in Savings.

Another important indication is afforded by the data representing savings. There was a decline of 3 milliard marks

[1] *Wirtschaft und Statistik*, 1933, No. 15, loc. cit.
[2] See Dr. F. Kreil, " Sanierungen," *Die Bank*, 28th September, 1932.

in the amount of money capital available for long- and short-term investment in each of the years 1931 and 1932. The Savings Banks experienced an excess of withdrawals over receipts to the extent of 1·39 milliards in 1931 and 0·63 milliards in 1932.[1] The chief causes of this retrogression were the withdrawal of foreign funds, the losses made by industrial concerns and the financing of consumption through relief measures and subsidies. The finance of Unemployment Relief may be summed up in the following table :—

UNEMPLOYMENT RELIEF IN GERMANY [2]

Financial Year	Total	Amount covered by	
		Contributions	Treasury Grants
	(Milliard RM.)		
1928–29 . .	1·42	0·83	0·59
1929–30 . .	1·78	0·90	0·88
1930–31 . .	2·77	1·19	1·58
1931–32 . .	3·11	1·28	1·83
1932–33 . .	3·03	1·48	1·55

The Significance of Capital Consumption.

Sufficient evidence has been cited to prove that Germany has for the last two years been making inroads into her capital substance. The significance to be attached to this development depends on whether these are symptoms of a disagreeable, but not serious, malady which recurs after each cyclical crisis, or whether they are the visible signs of a dangerous wasting disease. Dr. Hayek has called attention to the possibility of the latter being mistaken for the former.[3]

The fact that an investment is misdirected can only be discovered some time after the event. If it is such that an early change in the conditions of demand will suffice to restore its profitability, the entrepreneur is faced with the problem of balancing the loss of tiding over the temporary unprofitable period while maintaining the investment against the loss which would be incurred by winding it up and re-starting later. Where the latter is much heavier than the former, there appears to be a

[1] B. Benning in *Das Wirtschaftsjahr*, 1932–3, pp. 196–7.
[2] Benning, loc. cit., p. 201.
[3] Dr. F. A. von Hayek, " Kapitalaufzehrung," *Weltwirtschaftliches Archiv.*, 1932, pp. 86–108.

justification for temporary State assistance.[1] But if the resources transferred to the weakened undertaking are thereby prevented from finding their way into more profitable investments, the policy will mean a secondary misdirection of capital.

The misdirections of capital, which are associated with the upward swing of the trade cycle, involve losses, if consumers refuse, immediately after the crisis, to restrict their consumption drastically. Since experience shows quite clearly that it is impossible to expect such a curtailment of consumption, the excesses of the boom must be paid for in liquidations—nature's way of effecting a cure. This is the judgment of certain theorists.[2]

In Germany the Government's Emergency Decrees, reducing wages and salaries, could be interpreted as an attempt to reduce consumption; but the effect was partially offset by an inroad into savings. There is a strong correlation (0·97) between the movement of the net inflow or outflow of Savings Banks deposits and the estimated aggregate income of labour.[3] From the beginning of 1930 to the middle of June, 1932, the production goods index fell by 48·5 per cent and the consumption goods index by only 23·5 per cent.[4] In other words, the mass of consumers retaliated against the restrictionist policy by consuming savings. The practical implications of maintaining the community's capital stock intact were much more than human flesh and blood could bear.

Some gloomy prophets appear to think that certain countries are entering on a period of "secular capital consumption". Hardly any quantitative evidence has been advanced to support this view. It may be true that the phenomenon in Germany has gone further than the necessary and unavoidable process which follows every boom. But that can be put down to the cumulative shrinkage, involved in a secondary deflation, which was mainly the result of the policy of compulsorily restricting consumption. The disturbing practices of the Nazis are doubtless inimical to capital accumulation. But, in future, even more than in the past, the State in Germany will exercise a paramount influence on saving and investment. If the State, in wielding its

[1] Beckerath, "Technischer Fortschritt und Kapital-verschleiss in freier Konkurrenzwirtschaft und gebundener Wirtschaft," *Kapital und Kapitalismus* (1931), vol. ii, p. 339.

[2] e.g. E. Schiff, *Kapitalbildung und Kapitalaufzehrung im Konjunkturverlauf* (Vienna, 1933).

[3] *Vierteljahrshefte zur Konjunkturforschung*, 1932, A, 2, p. 104.

[4] Ibid. 3, p. 45.

powers, pays consistent regard to certain basic economic necessities, there is no essential reason why Germany should go on living on her capital.

II. State Policy and the Trade Cycle

It is generally admitted that the growth in the relative importance of public expenditure has made national and local budgets much more susceptible to economic changes. According to Professor Wagemann, total public expenditure, as a proportion of the national income in the chief countries, increased between 1913 and 1928 as follows[1]:—

		%	%
Great Britain	from	12	to 25
France .	,,	18	,, 24
Italy . .	,,	16	,, 31
U.S.A. .	,,	8	,, 15
Germany .	,,	16	,, 28

To meet the problem it has been suggested that the Finance Minister should put more weight on sources of revenue which tend to be crisis-resistant, e.g. taxes on inheritance, property, and certain consumption goods, so as to avoid being too dependent on those whose yields fluctuate considerably.[2] This is actually what he is forced to do in the downward phase of the trade cycle. The proportion of the total tax revenue got from the Customs Duties, Turnover, and Consumption taxes in the German Reich budget increased from 43 per cent in 1929–1930 to 60 per cent in 1932–3. There seems to be no alternative to adjusting the budget with as little friction as possible. This unpopular task fell on Dr. Brüning in Germany and it could not have been carried out more thoroughly.

Some of the lessons derived from the "deflationist" finance policy may be summarized under four headings.[3]

(1) The decrease in the productivity of some revenues could not be offset even by drastically scaling up the rates of tax and the prices charged, e.g. the Assessed Income Tax, taxes on capital transactions, and the income from publicly-owned undertakings.

[1] E. Wagemann, "Steuerwirtschaft und Wirtschaftsteuerung," *Berliner Börsencourier*, 6th December, 1932.

[2] F. Neumark, *Konjunktur und Steuern.*

[3] See H. Ritschl, "Der Staatshaushalt in der Depression," *Archiv für Sozialwissenschaft*, June, 1933, p. 311.

(2) Other receipts were less affected by the slump, so that their relative contribution to the smaller total revenue increased. Prominent in this category are the taxes on Land and Buildings, Trade Profits, and House Rents, on which the States largely depend.

(3) The yield of another group of taxes could be substantially raised through increases in the rates of tax, e.g. import duties, Turnover, and Consumption taxes.

(4) Finally, important structural changes took place within the Federal Finance System. The Reich strengthened its position as a recipient of tax revenue, as compared with the States and Communes; and it was obliged to make large grants to the Municipalities to finance Emergency Unemployment Relief. The depression, even apart from the political Revolution, has made the old system of revenue transfers a complete anachronism.

State interference to force down the prices of proprietory articles and sheltered wage rates can undoubtedly help to shorten the depression. The problem of sticky interest rates is more difficult. Here the complex of factors affecting the future supply of capital must be borne in mind. No community can afford to ruin the confidence of the creditor, which is so vital to its capital market, in order to alleviate the difficult circumstances of debtors, many of whom are guilty of misdirecting resources. If, however, the goal of German policy is the restoration of agriculture, the compulsory reduction of mortgage interest rates may be regarded as part of the price which has to be paid by the economic system.

The slump has inspired some German economists to pay attention to the relation between public finance policy and the trade cycle.[1] The indifferent quality of this literature emphasizes the vital necessity for a well-founded theory of trade fluctuation. Most of the contributions seek to establish generalizations regarding the imprint which changes in business activity may be expected to leave on the economic area in which the State is directly interested. It is almost inevitable that these generalizations should be mostly truisms. One or two authors have taken the other approach and have discussed the effect of various Governmental measures on the

[1] e.g. E. Munzer, *Dynamischer Staatshaushalt?* (1931). H. Fick, *Finanzwirtschaft und Konjunktur* (1932). F. Neumark, *Konjunktur und Steuern* (1930). von Mering, "Neue Untersuchungen über öffentliche Einnahmen und Konjunktur," *Finanz-Archiv.*, 1932, pp. 274–287. "Finanzen und Konjunktur," *Vierteljahrshefte zur Konjunkturforschung*, 1932, Teil A.

course of the trade cycle.[1] The fruitfulness of this latter type of theoretical inquiry depends on a satisfactory interpretation of industrial fluctuation. The phenomena of the later phase of depression and early stage of recovery have still to be adequately explained. When this has been done, it will be profitable to pronounce on the merits of various specimens of State policy applied at different phases of the cycle.

During general business fluctuation relative prices are subjected to two different kinds of disturbance. The first is due to the fundamental fact that deflation, like inflation, does not affect all prices at once. The process of contraction, like the previous expansion, works gradually by stages through the system. This carries with it an important redistribution in the ownership of income, arising out of differential gains and losses. The other disturbing element is the existence of contracts, institutional rigidities, and monopolistic interferences. The economic system can be divided into various categories of producers, ranging from those whose prices are most rigid to the other extreme where prices are most flexible.[2] Obviously deflation will involve differential gains and losses from this source as well.

The theoretical importance of relative prices, rather than the general price-level, has no essential connection with contract frictions. But any discussion of State policy aimed at influencing the course of the business cycle must take both sources of distortion into account. The increasing market significance of State enterprise, public expenditure, and taxation adds to the importance of the second type of disturbance. Here is a fruitful field of study which will bear directly on the central problems of economic policy.

Our study of Germany shows at least one thing. Government interference to reduce rigidity is not only feasible, but can be carried out with such thoroughness that the Government may even forget the conditions of its own self-preservation. It was no mere coincidence that the phenomenal advance of the Nazi Party was contemporaneous with Dr. Brüning's "heroic" Emergency Decrees and that its electoral strength began to ebb in November, 1932, with a loss of two million votes, when the policy of extreme deflation had been followed by mild expansion.

[1] An important contribution in this field has recently been made by Professor Gunnar Myrdal, of Stockholm. See his *Konjunktur och offentlig Hushållning* (1933) and *Finanspolitikens Ekonomiska Verkningar* (1934).

[2] Cf. V. Bloch, *Krise und Einkommen* (Vienna, 1932).

Brüning staked everything on the chance that a prompt application of the surgeon's knife would enable the patient to recover in a short space of time. He over-estimated both the efficacy of the operation and the resisting power of the patient. If he could have foreseen what has subsequently happened to himself and to the unfortunate patient, it is doubtful whether he would have insisted on the necessity for such a serious operation.

Previous chapters have shown how the Government's policy to counteract the effects of the slump was vitiated by a confusion of ends. The immediate object was to balance the budget. From a purely financial point of view the Emergency Decrees were inevitable. At the same time an attempt was made to achieve two other contradictory aims: to increase the country's competitive power by driving down prices, and to restore a better relationship between costs and prices. The supremely important factor was the determination to keep the currency linked to gold. If the Government had concentrated on reducing rigid costs so as to quicken adjustment between costs and prices, the outcome might have been different. But a uniform cut in the level of costs, prices, and incomes could not restore equilibrium. On the contrary it led to a further shrinkage and a secondary deflation,[1] which increased the unemployed army to over six millions and brought the volume of current investment to a very low level. The slump thus reached a depth which was lower than was necessary to eliminate the disproportions of the previous boom.

The factors in the German problem are so complicated that it is very difficult even to be wise after the event. If the par value of the mark was to be protected at all costs, there was no alternative to a stiff restrictionist policy. Three months after Britain left the gold standard Germany had to submit to the agony of the Fourth Emergency Decree which, with one blow, reduced nominal purchasing-power by 3·5 milliard RM. Being a large debtor country, no longer possessing the confidence of her creditors, she had no option but to seek to make both ends meet by rigorous economy and mortgaging the future. In emphasizing the risks implicit in this policy, let us not forget that Dr. Brüning had to face a problem of unprecedented complexity. It is to his eternal credit that he threw popularity to the winds and

[1] See W. Röpke, *Krise und Konjunktur* (1932), pp. 90 and 115–21; *Die Theorie der Kapitalbildung* (1929); and "Trends in German Business Cycle Policy", *Economic Journal*, September, 1933.

courageously carried out the policy which he sincerely believed to be in the true interests of his country.

The new regime has been able to call forth some degree of industrial recovery, even though the private capital market is still, at the end of 1933, paralysed by lack of confidence. An increase in physical production and a diminution in unemployment have not been accompanied by a resumption of long-period, private investment. Moreover, it was not till late in the year 1933 that the aggregate income from wages and salaries began to exhibit a slow increase. This means that the expansion in the number employed is the result chiefly of a " spread-over " which must imply a sustantial reduction in the average weekly wage per man. The grim facts of the underlying situation remain. The material prosperity and the peace of Europe are closely bound up with the economic destiny of the New Germany.

PART III

ITALY

By T. J. Hughes

Chapter I

RECENT BUDGETARY HISTORY OF ITALY

Preliminary Survey

The period from 1913–14 to 1929–1930 in Italian Budgetary History falls into three distinct periods :—

(1) The war-time years, in which the influence of the World War upon revenue and expenditure can be easily traced.

(2) The years immediately after the war, in which the problems of the war period were even more acutely felt and in which the lira depreciated rapidly.

(3) Then a period of financial and economic recovery, during which budgetary equilibrium was attained, the system of taxation was completely revised, expenditure reduced, and the lira finally stabilized in December, 1927.

The course of revenue and expenditure has been as follows :—

	Revenue.	*Expenditure.*	*Surplus + or Deficit —.*
		(*Millions of lire.*)	
1913–14	2,524	2,688	— 164
1914–15	2,560	5,395	— 2,835
1915–16	3,734	10,625	— 6,891
1916–17	5,345	17,595	— 12,250
1917–18	7,533	25,299	— 17,766
1918–19	9,676	32,452	— 22,776
1919–20	15,207	23,093	— 7,886
1920–21	18,820	36,229	— 17,409
1921–22	19,701	35,461	— 15,760
1922–23	18,803	21,832	— 3,029
1923–24	20,582	21,000	— 418
1924–25	20,440	20,023	+ 417
1925–26	21,043	20,575	+ 468
1926–27	21,450	21,014	+ 436
1927–28	20,072	19,575	+ 497
1928–29	20,201	19,646	+ 555
1929–30	19,838	19,668	+ 170

(1) The World War necessitated extraordinary expenditure and brought in its train charges of an exceptional character, as well as the damage caused to persons and to property. Some of these charges are perpetual, such as the interest charges on the funded debt, while others have a long course to run—such

as War Pensions and the interest on loans floated for the reconstruction of territory invaded during the war.

The increase in taxation in a country like Italy, of limited resources and wealth, contributed towards the economic difficulties of the period. The necessities of the time also made necessary the floating of internal loans, the offering of Treasury Bonds, and the printing of paper money on a large scale. Foreign loans were almost exclusively used for the purpose of provisioning the country during the war years.

Deficits increased annually in the national budget, and interest charges on war loans amounted almost to a quarter of the national revenue during the war years.

Such phenomena were not, of course, peculiar to Italy. The increase in public debt, the general rise in prices, the growth of public expenditure, and the depreciation of the currency were all direct results of the war and were experienced in many other countries.

In 1922–3 began the work of reconstruction of State finances, with a programme of reform consisting of the following objects : (*a*) revision of the system of taxation ; (*b*) the attainment of budgetary equilibrium ; (*c*) the funding of debts ; and (*d*) the re-establishment of sound monetary conditions.

The revision of the system of taxation has proved to be one of the most difficult tasks undertaken. The main ends in view were the grading down of certain taxes which had attained exorbitant proportions : the simplification of the existing scheme with a view to reducing the number of separate taxes, the elimination of evasion, and the encouragement of savings.

Budgetary equilibrium was to be brought about by the reduction of public expenditure and by the revision of taxation. Since 1924–5 the budgets have shown a series of surpluses.

Claims against Germany were dealt with under the Dawes and then the Young Plans. The internal " Lictorial Loan " was floated in 1926–7, and all powers of note issue were concentrated in one central bank, the Banca d'Italia. The stabilization of the lira, at the rate of 92·46 to the pound sterling, on the 21st December, 1927, marked the completion of a long and difficult undertaking.

Meanwhile, alongside of drastic economies in other forms of expenditure, the execution of public works on a large scale was steadily maintained, and these may be said to have culminated in the *battaglia del grano* and in the undertakings of the *bonifica* and other schemes for agricultural improvement,

to which further reference is made below. The economies included the reduction in Government staffs, the simplification of the administrative machine, the transfer of certain State enterprises to private undertakings and the constitution of certain State services as autonomous bodies, improved financial control, and its centralization under the Ministry of Finance.

Analysis of Revenue, 1913–14 to 1929–1930

The amounts entered under the heading of "*entrate effettive*" in the budgetary statements were in 1913–14 only L. 2,524 million. They reached their maximum in the financial year 1926–7 with L. 21,450 million, and in 1929–1930 were L. 19,838 million.

Principal factors in this increase as compared with the pre-war period were the increase of existing taxes, the imposition of new taxes, and the growth of State monopolies.

Public revenue increased steadily during the war, and rather more rapidly in the years immediately following it.

After an increase in the financial years 1920–1 and 1921–2 revenue showed a decrease in the period 1922–3, consequent upon the revision in the system of taxation and the abolition of the extraordinary taxes of the war period.

The increase in the following years is to be attributed to the effectiveness of the new scheme of taxation, the discovery of new sources of revenue, and the success of the campaign against evasion.

Expenditure

In the financial years 1914–15 to 1918–19 the public expenditure of Italy increased, as a direct result of the war, to about fifteen times its pre-war proportions, to reach, during that period, a sum of L. 91,635 million. In 1919–1920 it fell to L. 23,093 million, but 1920–1 represented the highest expenditure after the war with the sum of L. 36,229 million; this was reduced to L. 35,461 million in 1921–2, and to L. 21,832 million in 1922–3. The series of deficits ended in 1923–4, and the financial year 1924–5 was able to show a surplus of L. 417 million.

The surplus of 1925–6 was used, to the extent of L. 1,800 million for special purposes of defence and economic

development, while allowing the Treasury a residual benefit of L. 468 million.

A new policy of caution was made necessary by the stabilization of the lira in December, 1927, so that in 1927–8 expenditure was reduced to L. 19,575 million in contrast with L. 21,014 million in 1925–6. In the financial year 1927–8, the sum of L. 24,521 million, entered under *entrate* in the section *movimento di capitali*, is due almost entirely to the proceeds of the Lictorial Loan, which was floated as a prelude to financial reform.

The effect of this general improvement in the Italian financial situation was not only apparent within Italy, but inspired, particularly after the stabilization of the lira in December, 1927, more confidence abroad in Italy's economic future. Proofs of this were the loans floated in foreign countries during 1927, which in the New York market totalled nearly 300 million dollars, of which 100 millions were an Italian Government Loan.

The Consolidation of the Floating Debt and the Lictorial Loan

The funding of the floating debt in Italy was an emergency measure, necessitated by the serious position with regard to Treasury bills in the autumn of 1926. Nearly 30 per cent of the National Debt consisted at this time of Treasury bills, and Count Volpi, in his address in the Senate on 9th December, 1926, compared the situation to that of an industrial concern in which 30 per cent of the liabilities consisted of short-dated bills, with a resultant continual danger of bankruptcy.

The new currency regulation, too, had had its effect in the constriction of credit, which increased the difficulties of the Treasury. In the summer of 1926 the Treasury had had to meet the repayment of bills to the amount of nearly L. 3,000 million, while the situation promised to become yet more serious with the maturing of still larger sums : L. 1,358 million in November, L 1,379 million in December, L. 2,322 million in January, 1927, L. 1,900 million in February, L. 1,299 million in March, and L. 1,213 million in April : a grand total of about L. 10,000 million in the course of six months. The Government found itself unable to meet these obligations, and the funding of the floating debt became imperative.

Count Volpi pointed out that " the consolidation of the floating debt will not make the total public debt heavier than it was at the beginning of the financial year, nor will it burden

the budget with heavier debt charges than those which it would have had to meet had this step not been taken ".

The Government, therefore, decided upon a compulsory conversion of the short-term bills, and of the five- and seven-year bonds, into a new consolidated loan. This was the Lictorial Loan, which (the Minister stated) " will not be used to meet a deficit on the Budget ; and therefore that part of it which consists of cash subscriptions will find a counterpart in the current account with the Bank of Italy and in advances made on the respective securities ; that portion of the loan represented by the conversion of Treasury bills and bonds will stand for a change in the form of the debt, increasing it by some L. 3,000 million, the difference between the conversion price of the bonds and the issue price of the new security. This amount is accounted for, as regards L. 2,509 million, by Treasury bills, and as regards L. 178 and L. 520 million respectively by the five- and seven-year bonds. Altogether the increase will only partially absorb the decrease of L. 6,545 million which has occurred since the beginning of the financial year, and the interest cost will be less than that which would have been entailed by a higher rate of interest on the total amount of the bills and bonds thus converted ".

The Loan was thus described by Senator Luigi Luzzatti :—

" The purpose of the present Loan is to improve the conditions of national economy by collecting existing bank-notes, drawing them out from their hiding-places, and allowing the Bank of Italy to put them into circulation. The Loan is made for a specific productive purpose, and while it affords, for a fixed term of years without risk of change, a good rate of interest to the subscribers, it saves our economic life from the dilemma of either inflating the currency or else persistently reducing available funds, discounts, and all credit activities."

Unification of Bank-note Issue and Currency Deflation

Between May and September of 1926, the Government passed decrees for (1) the unification of bank-note issue, (2) the quantitative control of bank-notes and currency circulation, and (3) the protection of public savings in banks and other institutions.

The unification of bank-note issue has been a long-deferred problem in Italian financial history. The centralizing of the power of note issue in the Bank of Italy was effected by the

Royal Decree of 6th May, 1926—made a Law of the Kingdom on 25th June, 1926 (Act No. 1362).[1]

The Government's plan of currency deflation, designed to safeguard the exchange value of the lira, provided for—

(1) A reduction of the Government's debt to the Bank of Issue consisting of bank-notes borrowed by the Treasury to meet war and post-war needs.

(2) Increase of the metallic reserve against the bank-notes in circulation.

(3) Limitation of the Banca d'Italia's commercial credits.

(4) Reduction of Treasury currency in circulation and conversion of the notes of smaller denominations.[2]

Note on the Structure of the Italian Budget.—Until 1926 the budget was composed of four parts, or chapters. The first contained all revenue and expenditure, ordinary and extraordinary; the second dealt with financial operations connected with the construction of railways; the third with loans and expenditure for the amortization of the public debt; and the fourth with transfers of capital and funds received by the Central Government on account of certain local organizations and autonomous bodies. These were the categories which constituted the budget or *conto di bilancio.*

[1] The following is a summary of the provisions:—

(1) Transfer to the Banca d'Italia of the specie, bullion reserve, and foreign currencies equivalent to gold carried by the Banca di Napoli and the Banca di Sicilia as security for their paper currency.

(2) Transfer to the debit of the Banca d'Italia of the notes issued by the Banca di Napoli and the Banca di Sicilia in circulation on 30th June, 1926.

(3) Transfer to the credit of the Banca d'Italia of the moneys owed to the Banca di Sicilia and the Banca di Napoli by the Special Independent Section of the Consortium for Advances on Industrial Securities (Sezione Speciale Autonoma del Consorzio per Sovvenzioni su Valori Industriali), together with their collaterals and accumulated reserves.

(4) Transfer to the Banca d'Italia of the credits of the two banks outstanding on 1st July, 1926, against the Royal Treasury for extraordinary advances and for notes issued on its behalf.

[2] See the Royal Decree of 7th September, 1926, No. 1,506, and the Decree of the Minister of Finance of 9th September, 1926: Under Article 1 of the first Decree the Government has guaranteed repayment of its debt to the Banca d'Italia, which consisted of bank-notes issued for circulation and amounted to L. 6,729,411,855·51 on 20th August, 1926. The first payment on the Government debt was for $90,000,000, consisting of $70,000,000 drawn from the Morgan Loan, and the remainder made by the Treasury from other available funds. These payments were duly made to the Banca d'Italia. The remaining portion of the debt the Government has provided for by appropriations of L. 500 million in the Budget estimates.

Since 1st July, 1926, however, the Italian budgetary statements contain only two categories, as follows :—

(1) Ordinary and extraordinary revenue and expenditure.

(2) The " movement of capital ", which consists of loan receipts and expenditure on capital account.

Although the State railways are now established as an autonomous concern and only appear in the national accounts if they are able to pay over to the Treasury a net surplus, a plan adopted now also with regard to the Postal, Telegraphic, and Telephonic Services, their financial status is still a matter of national concern.

The Period since 1929

The Fall in Prices [1]

In 1929 there was a fall in the level of wholesale prices in Italy. Taking 100 as the index-number for 1913, we have :—

1929.	*In gold.*	*In paper money.*
January . .	134·7	496·3
October . .	127·6	470·2
November .	126·0	464·2
December .	124·6	459·2

The general index-number may be analysed into three series of indexes : (1) Prices of goods produced and consumed entirely in Italy ; (2) Prices of imported goods ; (3) Prices of goods for export.

Taking 100 as 1913 basis and comparing also the prices of 1926, in which year the exchange fluctuated in terms of sterling up to 125, we have :—

	1st category.	*2nd category.*	*3rd category.*	*General Index.*
1913	100	100	100	100
1926	629·04	700·82	623·39	654·40
1929 January .	490·52	506·54	485·38	496·30
December . .	453·55	467·89	422·69	459·20

The effects of this fall in prices will be considered later.

One of the many difficulties of the financial year 1929–1930 was the restriction of credit in all branches of Italian industry. In April, 1930, however, the rate of discount was reduced and the restrictive policy in the granting of credits and in the exchange

[1] See *Bollettino Mensile di Statistica dell'Istituto Centrale di Statistica.*

markets was relaxed. Both these acts were interpreted as confirming the stabilization of the lira, but during 1929 both these influences, that of restriction of credit and an equally restrictive policy in the exchange-markets, had seriously hindered Italian production. On the other hand a definite programme of rationalization of industry in all its branches had been carried out, while the banking institutions of the country had also been more closely linked together.

The effects of this restrictive policy in the granting of credits by the Bank of Italy, which had been pursued for some years with a view to preparing and consolidating monetary stability, were rendered more acute by the general fall in the world level of wholesale prices. From March, 1930, the fall in prices increased with ever greater rapidity, threatening to become one of the major catastrophic disturbances the capitalist system has yet suffered. There was a general decrease in all branches of production, growing unemployment, a fall in profits for every sort of business undertaking, and difficulties in National and Local Finance.

Italy suffered, like other countries, from the dislocation of trade and finance resulting from the world crisis—but her difficulties were not so much internal, as those caused by the repercussions of the crisis on her economy. She suffered, for instance, from lack of foreign capital.

The general fall in the price level in Italy continued during the first three months of 1931 unabated, and reached its lowest point in March.

March, 1930 .	436·49	(1913 = 100)
December, 1930	369·63	
January, 1931	361·86	
February, 1931	357·52	
March, 1931 .	350·18	

The volume of foreign trade diminished considerably. The value of imported goods in the first four months of 1931 was reduced to L. 4,164 million as compared with L. 6,077 million in 1930 and L. 7,723 million in 1929—a percentage contraction of 31·5 per cent compared with 1930, and 46·1 per cent compared with 1929. The value of exported goods, too, from L. 4,674 million in 1929 fell to L. 4,133 million in 1930, and in 1931 to L. 3,181 million, a contraction of 23 per cent compared with 1930, and 32 per cent compared with 1929. It is computed by the Institute of Statistics that the decrease of 21 per cent in 1930, as compared with 1929, was due to the extent of 10 per cent (one-half) to

the fall in prices: and that the 31·5 per cent decrease in 1931, compared with 1930, was due, as to two-thirds, to the fall in prices, and only one-third to an actual contraction in the volume of trade.

Revenue and Expenditure after Stabilization

The revenue of the last few months of the financial year 1926–7 was already showing some signs of weakness. Industrial stagnation and a general slowing-down of economic activity had caused a definite decrease in receipts from taxes, just at the time when the Government was hoping to benefit from its new scheme of taxation. When stabilization had finally been effected, it seemed that the revaluation of the lira had excessively increased the fiscal burden and was going to disturb Budgetary equilibrium.

A study of budgetary equilibrium from 1927-1930 reveals the following (from the *Gazzette Ufficiali*) :—

	(*Millions of lire—paper.*)		
	Revenue.	*Expenditure.*	*Surplus.*
1926–27 . . .	21,449	21,014	+ 435
1927–28 . . .	20,071	19,574	+ 497
1928–29 . . .	20,200	19,645	+ 555
1929–30 . . .	19,890	19,746	+ 150
1930–31 (estimated) .	19,348	19,085	+ 263

The stabilization of the lira was followed by a diminution in receipts from taxes, thus :—

	(*Millions of lire—paper.*)		
Nature of Receipt.	1926–27.	1927–28.	1928–29.
Registration dues	1,054	765	792
Supplementary taxes such as stamp duties	323	303	306
Inheritance duties	111	96	89
Mortgage dues	211	164	172
Special taxes on the exchanges . .	783	642	706

To be noted also is the diminution in the yield of taxes on transactions, which amounted to L. 3,524 million in June, 1927, compared with L. 2,992 million in June, 1928, and L. 3,249 million in June, 1929.

On the other hand the raising of tariffs considerably increased certain portions of revenue.[1] The total of customs receipts

[1] Decrees of 13th September, 1928, and of 24th May, 1929, for duty on imported wheat; decree of 28th September, 1928, for duty on alcoholic drinks; decree of 24th September, 1928, for duty on spirits and tobacco, etc.

increased from L. 5,263 million in 1926–7 to L. 5,782 million in 1928–9, i.e. to a percentage of 27 per cent of revenue as compared with 23 per cent before stabilization.

For example :—

	(*Millions of lire.*)		
	1926–27.	1927–28.	1928–29.
Duties on alcoholic drinks .	302	232	340
Duties on coffee . .	260	356	340
Duties on sale of pure oils .	80	100	113
Customs dues . . .	2,749	2,678	3,087

Receipts from Government monopolies have maintained a fairly constant level.

On the expenditure side the policy of recent years has been one of economy wherever possible. Stabilization of the lira effected automatically a reduction in the expenses of certain Ministries — such as Public Works and War — which in all amounted to some 5 milliards of lire. Thus :—

	(*Millions of lire—paper.*)		
Expenditure.	1926–27.	1927–28.	1928–29.
Service of the Public Debt .	4,746	4,074	4,445
War Pensions . . .	1,153	1,230	1,207
Other pensions . . .	958	929	951
Military expenditure . .	5,105	4,454	4,443
Civil Service . . .	8,732	8,257	8,596

The Fascist State has naturally been able, because of the complete concentration of power in its hands, to reduce expenditure more easily than would have been possible in other countries—particularly as regards the remuneration of its own employees and the revision of its contracts. The remarkably wide powers of the dictatorial regime have made much easier, too, the adaptation of the budget to changes in the purchasing-power of money.

After attaining and maintaining budgetary equilibrium in the period 1926–9 it seemed that Italy was now entering upon a new phase in her national and economic development, due to the new problems caused by the fact that the Italian economy was becoming more highly State-controlled and centralized and due also to decreasing returns from important sources of revenue.

In view of the growing deficit on the budget of 1930–1 (L. 934 million on 31st December), the Government decided by Decree-Law of the 18th November to reduce the salaries of officials by 12 per cent and the wages of employees of the State

by 8 per cent—from which it was hoped to effect an economy of some L. 400 million by 30th June, 1931. Economy was also effected in State expenditure on Public Works, which amounted to L. 2,068 million in 1926–7 and was reduced to L. 1,976 million in 1928–9, while further reductions were made in 1930.

None the less, Italy, like the rest of the world, was now entering a period of budget deficits.

CHAPTER II

THE ATTACK ON RIGIDITIES

WAGES, SALARIES, AND RETAIL PRICES

The movement for the reduction of the burden of fixed money charges was initiated by the Government in a series of measures for lowering rents, wages, retail prices, and other charges, beginning with a press *communiqué* of 18th November, 1930.

The economic depression of 1930 had affected all branches of Italian trade, industry, and commerce. It was reflected in the shrinkage of revenue from the tax on turn-over, from the proceeds of Government monopolies, in particular that of tobacco, and in the extra charges that had to be met by the Treasury on account of Public Works undertaken to relieve unemployment to the amount of L. 359·2 million, together with a fall in the proceeds from income tax and other direct taxation—the general result of which was that during the first four months of the financial year July, 1930–June, 1931, the surplus of L. 150 million on 30th June had become a deficit of L. 729 million by 31st October. There must be noted during this period, however, an additional charge of L. 100 million for reconstruction and general relief work made necessary to repair the damage caused by the earthquake in Southern Italy in July, 1930.

During this year of economic depression one of the major difficulties was found to be the wide differences between the movements of wholesale prices, retail prices, and cost of living.

The Council of Ministers, therefore, on 18th November, 1930, issued a decree lowering by 12 per cent as from 1st December, 1930, " the salaries, wages, and emoluments of all kinds—pensions excepted—of all persons in the employ of the State, municipalities, provinces, public services and utilities, semi-official bodies, and occupational syndicates or unions."

In addition to this decree a press *communiqué* was issued on the same day outlining the scope of the new measure. It stated that the Government had in mind the following three points: (1) That the wages of almost all classes of workers were being substantially reduced ; (2) that it is in the best interests of persons

in public employment that the national budget should be balanced; (3) that the reduction of salaries should and will lead to a more rapid decline in retail prices and in rents.

The Government took the lead by lowering by 10 per cent, on the day of issue of the decree, the prices of food-stuffs sold in the shops open to its employees. Care was taken that the price of bread should be brought into relation with the heavy fall in the price of wheat, while throughout the country the syndical organizations were active in obtaining general observance of price reductions. The *Istituto per le Case Popolari* and the National Fascist Federation of House Owners agreed to lower rents everywhere by 10 per cent. The National Fascist Confederation of Commerce secured reductions in the retail price of bread, macaroni, fish, groceries, meat, etc., and shopkeepers were obliged to lower prices still more by the policy of municipal authorities in opening stalls in markets, where groceries and provisions were sold at the lowest possible prices compatible with present wholesale prices.

" Standard-price " shops, i.e. shops that had agreed to lower their prices to the rates charged by co-operative and other organizations, were authorized to display special notices to that effect, subject to the supervision of the provincial Federations of Traders. Extensive price reductions were also made by retailers of clothing, shoes, and other articles of general consumption.

The Government, in turn, made various reductions in its charges, as, for instance, in the railway rates for goods traffic: a 10 per cent reduction in the cost of electric light was announced, and was followed by a lowering of the price of gas. From 1st December, 1930, tram and motor 'bus fares were reduced, the tariffs for professional services were reduced by their respective syndicates, and notaries' fees, which are controlled by the State, were lowered. The Federation of the Hotel and Tourist Industries determined to make a 10 per cent reduction in charges throughout the country. On account of the lower cost of the staff in their employment several municipalities found themselves in a position to reduce their rates, while farm leases were generally revised downwards.

This general movement of economy spread in the period under review from prices to wages, with the result that on 28th November, 1930, the President of the Confederation of Industries (employers) and of the Confederation of Industrial Workers announced that the two organizations had decided

upon an 8 per cent reduction. This might be specially noted with regard to the query as to whether any discrimination was practised in wage and salary reductions against State employees as compared with persons in private employment. This reduction of 8 per cent did not apply to male workers over 18 whose daily wage did not exceed L. 12 in towns of over 200,000 inhabitants, or L. 8 elsewhere, nor did it apply to workers on short time. In addition, in the case of those workers whose wages had already been reduced in the six months previous to the introduction of the new cut, the lowering of wages would only be applied in so far as it brought the total reduction up to 8 per cent, which figure was not to be exceeded. The salaries of clerical and other business staffs were reduced by 8 per cent for those over L. 300 and not exceeding L. 1,000 a month, and by 10 per cent for those over L. 1,000. In addition the General Fascist Confederation of Industries had asked all joint stock companies to lower by 25 per cent the sums which their presidents, directors, and managing directors were receiving as participation in company profits, and the Board of Directors of the National Fascist Association of Business Managers had decided that the earnings of such managers should be lowered by agreement with their individual firms by not less than 12 per cent. Allowances to which members of Parliament were entitled were reduced by 12 per cent from 1st January, 1931.

While it was not found possible to make price and wage reductions over quite so wide a field as it had been hoped to cover, it was argued that the reductions achieved afforded definite proof of the efficiency of the Corporative machine as a means of obtaining class collaboration, and was a practical example of the insistence placed by Fascist principles upon the necessity for individual and sectional interests being supervised and controlled, and whenever necessary sacrificed, in the interests of the State.

The general movement for the downward revision of prices was in a large measure assisted by the action of the General Fascist Confederation of Commerce, acting through the medium of its provincial Federations, and by the action also of the National Council of Corporations, summoned by Signor Bottai, Minister of Corporations, to examine the situation and to advise upon it. The general reduction in retail prices was to the extent of 10 per cent, but in some instances the reduction has been greater. In the case of standard medicines, for example, the lowering of price was to the extent of 30 per cent. The method

of procedure was as follows: When the prices for food-stuffs, or for any class of commodities, had been agreed upon by the syndicates and other trade and advisory organs, who acted in conjunction with the *podestàs*, prefects, and other political authorities, steps were taken to enforce these prices. Those who charged more were punished by having their shops closed for a given number of days which varied according to the gravity of the offence. It was stated, however, that a much more effective influence on retailers than any measures of reprisal or any definite regulations, was the consciousness of the strength of public opinion which was convinced that such reductions were in the interest of the nation as a whole, and were assisting Italy in her efforts to combat the repercussions of the world depression upon her internal economy.

Thus, in April, 1931, Signor Mussolini in the course of a speech at the annual meeting of the Association of Italian Corporations was able to refer to " the disciplined self-control of workers of all classes, manufacturers, bankers, farmers, and traders, which had made it possible to reduce the disparity between wholesale and retail prices, and make effective the policy, first adopted in Italy, of deflating retail prices by reducing wages and salaries ". It was felt, however, that the limit of such reductions had been reached, and the Minister of Finance stated in the course of a speech on the financial situation on 29th May, 1931, that no further reductions in the salaries of Government officials were contemplated.

Government Bonds, Mortgages, and Industrial Debentures

It had been categorically stated by Signor Mussolini in his speech in the Italian Senate in December, 1930, that many rumours, which were then current, as to the probable lowering by the Government of the stabilized parity of the lira were completely without foundation. He stated that such a policy could only be characterized as one of complete folly, which would plunge Italy again into a state of indescribable confusion. In referring also to the rumour then current that the Government intended to reduce the interest on the national debt, he made an equally emphatic denial. " It can readily be understood," he said, " that, to avoid the danger of failure at the time of stabilizing the lira, we had to fund the debt, but after inflicting that inevitable injury on the holders of government stock we have not even dreamt of inflicting further injury by any curtailment of the interest due to them."

A similar statement was made by Signor Mosconi, then Minister of Finance. He observed that the Government was showing its wish to reduce the national debt through the provision of a sinking fund, which was to be supplied through the extra revenue to be obtained from raising the price of tobacco; but, owing to the smaller consumption which followed immediately upon the raising of prices, and also in part to the existing depression, receipts from this source would not in the current financial year (1930–1) exceed L. 100 million. However, the institution of a sinking fund had already done valuable service in improving the position of government stock. Signor Mosconi then observed: "But while our action is entirely directed towards the improvement of the market in the interest of the stock-holders, malicious rumours are set going to the effect that the Government has under consideration the reduction of the rate of interest on its bonds. This is evidently done to injure Italian credit. It is hardly necessary to say that such rumours are without any foundation whatsoever. The Government knows very well how sensitive credit is and is firmly determined to avoid any action which might disturb the market."

With regard to mortgages, the only reduction yet noted is one from 6 to 5 per cent on mortgage rates by the Credito Fondiario. There have been no marked reductions in the rate of interest on industrial debentures. There has, however, been a definite campaign in favour of cheaper money. In May, 1932, the Governor of the Banca d'Italia, assisted by the President of the Italian Association of Banking Experts and the President of the Savings Banks' Association, entered into negotiations with the joint-stock credit banks to make possible a reduction of the rates of interest allowed on current and deposit accounts. In August it was found possible to reach an agreement by which the maximum rates on current accounts were to be reduced to 2½ and 3 per cent, and on deposit accounts to 3 and 4 per cent, as from 1st October, 1932.

The reduction, which was thus made possible, followed upon the setting up of the *Istituto Mobiliare Italiano* and the *Sofindit*,[1] which relieved the credit banks of the responsibility of financing industry. It was intended to restrain competition between the banks to secure deposits, and to relieve the financial market from the attraction which was exercised on savings by the high rates of interest which were offered on current and deposit accounts. Under the conditions which then prevailed, such accounts partook

[1] See Chapter IV below.

of the nature of permanent investments, and tended to deflect savings from normal business channels.

In pursuance of the cheaper money policy, the Minister of Finance issued a decree dated 27th September, 1932, which provided that the interest on loans allowed and bonds issued by the land credit banks should not exceed 5 per cent as from 1st October, 1932. This measure did not affect loans already contracted before that date.

CHAPTER III

PUBLIC WORKS AND THEIR FINANCE

A. GENERAL SURVEY

The 28th October, 1932, is a convenient date from which to look back upon ten years of Italian history since the Fascist Revolution. So far as Public Works are concerned, the list that could be drawn up of works actually completed, even omitting those already begun or in process of completion, would be an imposing one. It will be most convenient to attempt to summarize, on the basis of information issued by official sources, the whole ramification of activities which could be classified under the heading of " Public Works ", including that particularly important branch of Public Works known generically as *Bonifica*.

The *Mostra della Bonifica*, or Exhibition of Land Reclamation, occurred opportunely at this date. Much progress has undoubtedly been made towards solving the malaria problem which had hitherto rendered unfit for human habitation large tracts of land capable otherwise of being put to agricultural use: the ultimate aim of this scientific campaign against malaria is to make the whole national territory available for agricultural activities: while side by side with the *Mostra della Bonifica*, the *Mostra del Grano*, or Wheat Exhibition, set forth to the public gaze in the autumn of 1932, contemporaneously with the national celebrations of the completion of the first decade of Fascism, what had been done to raise the yield per hectare in Italy of wheat, so that Italy is on the way to making herself independent of wheat imports from foreign sources. It was stated that some 7,500,000 metric tons were harvested during 1932, out of Italy's normal requirements of some 8 million metric tons, and it should be noted that about 600,000 metric tons were ruined by bad weather. Thus the goal of independence with regard to wheat supplies, which has been steadily aimed at, would seem now to be within sight. It is stated also, in the Report of the Association of Italian Corporations, that the yield per hectare has been raised from an average of 10·4 quintals in the pre-war period of

1909–1914, and from 9·9 in the period 1919–1922, to 13·0 in 1926–1932, while during 1932 a record average yield of 15·2 quintals per hectare was attained.

Another department of Italian agricultural life was similarly illustrated. This was the Exhibition of Fruit-Growing, a sphere of economic development with regard to which the Italian climate is particularly well favoured.

A number of important enterprises were opened to public use from 23rd to 26th October, 1932, all of which had been completed during the past twelve months. The inauguration of these large-scale Public Works was an impressive feature of the decennial celebrations.

Among these undertakings may be mentioned the work of irrigation carried out in the Pontine Marshes, where a network of large canals now drains the area and has made possible the establishment of a new township, Littoria, in the centre of what had hitherto been a vast tract unfit for human habitation on account of its fever-breeding, malaria-infested zones; the modern *autostrade*, or roads reserved entirely for fast motor-traffic, which have been established in different parts of the country, noticeable among which are those connecting Turin and Milan, Florence with the sea and Trieste with Fiume, the long bridge built across the Venetian lagoon which joins up the city of Venice with the mainland, and also the aqueducts which serve to bring drinking water to the districts of Monferrato and Schievenin. And perhaps most spectacular of all, in the very heart of Rome itself, is the new road, the Via dell'Impero, which runs straight from the National Monument to the Colosseum, thus linking new with old, and passes through the imposing remains of the Imperial Forums which its construction now exposes to the public gaze: this was opened and made available for traffic on 22nd October, 1932.

This short list serves to summarize the major achievements of 1932. For the ten years, 1922–1932, figures have been given by the Minister of Public Works which state that the total expenditure which has been budgeted for national development and which could be classified under the heading of Public Works amounts to some L. 28,871·9 million, and of that total sum L. 15,292·6 million have already been spent, distributed among the different departments as follows: L. 2,725 million for road development, L. 1,913 million for hydraulic works, L. 1,050·6 million for *Bonifica* or Land Reclamation, L. 1,152 million for the development of Italian harbours and ports, L. 1,172 million for public buildings

and schemes of housing, L. 437 million for works connected with the prevention of floods and landslides and the strengthening of river embankments, L. 1,087 million for works of reparation after volcanic eruptions and earthquakes, L. 111 million for similar works of reparation due to the war, L. 371 million of special expenditure on works of reconstruction in the liberated territories, L. 627 million on subsidies to railways (chiefly on subsidies to railways of narrow gauge) and also on subsidies to tramway and motor car services, L. 2,232 million for building of railways, and L. 527 million for extra charges which could be grouped under the heading of " sundry costs ".

It is stated that during the past ten years the area reclaimed for agricultural purposes is more than 7 million acres, while at the same time permanent employment on the land has been afforded to some 55,000 workers, of whom a large proportion are ex-soldiers who eventually will settle upon the land reclaimed —and in the reclamation of which they have been actively concerned—either as farmers on a crop-sharing basis or as " smallholders " in the English sense.

Another noticeable feature is the special attention which South Italy and the Islands have received. Whereas the North is highly developed industrially and economically in comparison with the regions south of Rome and Naples, it is one of the claims of the present Government that a more balanced national economy is now being built up.

Large-scale enterprises have been carried out in Sicily, which have done much to assure the economic prosperity of the island. A total expenditure of L. 3,607 million has been divided as follows among the varying departments : L. 698 million for reconstruction works at Messina, L. 582 million for the improvement and extension of the railway system, L. 381 million for harbour and port improvements, L. 327 million for the maintenance and reconstruction of existing roads, together with L. 303 million for the building of new roads.

Steps have also been taken to improve water supplies, which had been a grave handicap to the adoption of improved agricultural methods.

The Government has spent L. 320 million on the construction of aqueducts and a further L. 89 million for works of irrigation and the sinking of wells. Another L. 120 million have been spent on hydraulic undertakings, works of reafforestation, and of drainage, and L. 34 million on the building of farms and villages. For the winter of 1932–3 additional sums of L. 38·5 million

for the completion of works already in hand and of L. 186 million for new undertakings connected with the campaign for land reclamation have been allotted.

Sardinia is another interesting field where the policy of Public Works may be studied. There is much similarity between the needs of Sardinia and Sicily.

In Sardinia, as in Sicily, one of the chief handicaps to the economic development of the island had been the lack of efficient water supplies. It is stated that the largest town in the island, Cagliari, had often been obliged in summer to import water in tanks from the mainland. A vigorous policy was initiated for increasing the supply of water, and to this end a big scheme for the reafforestation of mountain slopes was a necessary corollary: the irrigation and reclamation of districts which had hitherto been largely swamp areas, or so liable to floods as to make them unfit for agriculture were undertaken, similar work was carried on within town areas, schools were built as part of a general campaign for the improvement of existing educational facilities, and a large and ambitious programme connected with health services, the chief aim of which was the prevention of malaria, was put in hand. Thus it is stated that 157 aqueducts were constructed between August, 1925, and December, 1931, necessitating an expenditure of L. 103·5 million: the total expenditure on Public Works of all kinds has been L. 613,284,787. At the present moment those undertakings actually in process of completion will mean a further expenditure of L. 586,653,593. These schemes for the general improvement of conditions in the island have also another interesting aspect. Whereas hitherto the density of population in Sardinia has been only 35·9 per square km., compared with an average of 125 per square km. for the rest of Italy, it is now stated that, owing to the success of the various enterprises for the reclamation of land areas and institution of effective water supplies, the island is able to take in elements of surplus population from already overcrowded districts of Emilia and Venetia—the Plan for this absorption of surplus population being supervised and directed by a body known as the Commissariat for Internal Migration.

The campaign against illiteracy is proceeding, and may be included in a general review of Public Works in so far as it covers school building all over the country. Thus in the last ten years the total of new schools which have already been opened amounts to 10,000. The allotment of funds during 1933 will make possible

the construction of another 1,200 schools, of which 378 will be built in Southern Italy and in the Islands.

There are various other spheres which have some relevance to State activities with regard to Public Works. Particularly noticeable among these is the electrification of the Italian State Railways, which is proceeding apace. Whereas in 1922 the length of railway lines already electrified amounted to some 700 kilometres, it stood at the end of 1931 at a total of some 2,000 kilometres ; and this figure will increase to some 5,000 kilometres when undertakings which have already been begun are completed.

Mention should also be made of the development of aviation in Italy, civilian air services having grown steadily in recent years. Thus at the end of 1931 there were twenty-eight lines in regular operation, while the distance flown during 1931 amounted to 4,398,871 kilometres, and the number of passengers carried was 33,650.

Maritime works also occupy a large and important place in the programme of national development, and many enterprises connected with the improvement of harbours and port facilities have been successfully completed. During the past ten years a total sum of L. 1,000 million has been invested in these undertakings—while in Northern Italy particular attention has been paid to the improvement of canals and inland means of water transport.

Roads are another branch of Public Works which deserve mention. The improvement in the surfaces of main highways is very marked, and between its creation in 1928 and 30th June, 1932, the Road Board had entirely reconstructed and resurfaced 7,693 kilometres of roads and had undertaken similar work on other roads to the extent of 1,313 kilometres. It is anticipated that, by the end of 1933, 10,000 kilometres of important national high roads will have been completely reconditioned according to the most modern methods. Another enterprise is the general beautifying of their appearance by the planting of trees (it is stated that some 600,000 have been so planted) along the roads.

In any review of national economic improvement the campaigns of *Bonifica* or Land Reclamation, and of the *Battaglia del Grano* or Wheat Campaign, deserve special notice. The wheat campaign was instituted in an effort to make the country independent of all imports of wheat from abroad ; and this campaign has been widened in scope so as to include, wherever feasible, all types of agricultural and farm products, such as fruits and vegetables, livestock, and silk-cocoons, as well as cereals.

Similar benefits have been secured from a natural advantage which Italy possesses: that is in the control and development of water power in its application to industrial development. The production of energy by hydraulic works has now increased from 1,250,000 horse-power in 1922 to 3,600,000 in 1932, the production of electric current from 3,652,200 k.w.h. in 1922 to 9,665,000, and the length of high-power cable lines from 16,000 kilometres in 1922 to 23,000 in 1932, while the number of mountain reservoirs has increased from 54 to 184 in the same period.

With regard to the progress of Land Reclamation in Italy, it is important to notice the passing in 1928 of the Integral Land Reclamation Law, which was termed " Integral " because it co-ordinated all the hitherto unrelated activities dealing with the general work of *Bonifica* and connected them within one, comprehensive framework. Since its establishment in 1928, the aim which was then delineated of reclaiming some 7½ million acres of land, rendered uninhabitable mainly by the presence of fever-breeding swampy areas and the ever-present danger of malaria, has been prosecuted with great energy. The results so far obtained are as follows: at the end of 1932, 215 *consorzi* or associations formed for the particular end in view, in this case land drainage and irrigation, were occupied with the work of draining some 6,665,000 acres, while at the same time another eighty-eight associations of landed proprietors were dealing similarly with another 585,000 acres. In a different department, that of improving areas which were already cultivable but capable of giving a higher yield per acre under improved and scientific farming methods, some seventy-four *consorzi* were engaged on another 3½ million acres, while the number of associations formed for the general purpose of irrigation, and that of making available constant and efficient water supplies for the areas under treatment, numbered 550: connected with this latter work was that of some nine other associations occupied with the control of mountain torrents, works whose especial object was the prevention of landslides, and also with reafforestation as an aid to improved water supply.

B. Methods of Financing Public Works

Three principal categories of Public Works are distinguished in the *Annuario Statistico*, which gives particulars year by year of the expenditure incurred.

(1) Works both paid for and carried out by the State.

(2) Works largely paid for by the State, but carried out by means of private concessions.

(3) Works paid for and carried out by local bodies, with some financial assistance from the State.

Works in the first category include hydro-electric and drainage schemes of national importance, especially in the mountainous districts; the regulation of river levels and the repair of river banks; the development of facilities for internal navigation on rivers and canals, especially where such developments have military importance; development of State railways and of main roads; and the repair of damage caused by earthquakes, storms, and floods to public buildings, roads, etc.

Works in the second category, in which local groups, private companies, and even private individuals participate, owing to the large degree of local benefit resulting, include hydro-electric and drainage schemes of primarily local importance; works of *bonifica*, or land improvement, which bring benefits both from the economic point of view, and from that of public health; provincial and communal roads; extension of the public railways carried out by private companies, and the improvement of port facilities. In many of the works in this category part of the cost is met by the private concessionaires.

Works in the third category are of the same general character, but the benefit is regarded as being predominantly local.

These, however, are only broad distinctions. Legislation, passed from year to year, lays down, in detailed schedules, the division of administrative and financial responsibility for particular Public Works.

Expenditure on Public Works increased in Italy after the war because the Government found it necessary both to provide against unemployment and also to continue the prosecution of schemes which had been interrupted during the war. To provide the necessary finances one large fund was created, constituting the special budget of the Ministry of Public Works, from which allocations could be made among particular schemes. Immediately after the war it was found necessary to authorize the spending of one milliard (one thousand million) lire for the construction of bridges, ports, roads, etc.; of L. 1,800 million for railway construction; and of L. 500 million for other various undertakings of public utility. A further expenditure of L. 480 million was authorized on Public Works to combat unemployment by the law of 20th August, 1921, under

the heading of " extraordinary expenditure ", and provision for this had to be made in the budget of the Ministry of Public Works.

The method generally followed, previous to the first " consolidations of expenses " made by the Fascist Government, to which reference will be made later, was to authorize for each particular undertaking a sum which was to be inscribed in the column " extraordinary expenditure " in the national budget. When these new Public Works were authorized by legislation, the entire expenditure over a period of years was also authorized, together with the assignment of expenditure for each particular financial year. The first " consolidation of expenditure ", made by the Fascist Government in 1923, authorized the expenditure of L. 6,204,407,165·60 for "extraordinary" Public Works. This expenditure contemplated the prosecution of enterprises over a period of six years and the necessary allocation of funds was made to cover particular assignments for each financial year, while expenditure in each year was not to exceed L. 1,000 million.

A new " consolidation of expenditure " was effected a year later, which authorized the expenditure of L. 15 milliard on " extraordinary " Public Works over a period of twelve years, that is, from the financial year 1924–5 to the financial year 1935–6, the expenditure to be inscribed in the budget of the Ministry of Public Works. This expenditure was authorized to fill definite gaps in the national economic structure, both industrially, and, in the agricultural sphere, with the financing of land reclamation schemes. It was not incurred primarily to deal with unemployment, although it incidentally helped to solve that problem. Its real purpose was to increase productivity, particularly in the hitherto neglected South and the Islands. Thus whereas L. 2,210,750,000 of the 15 milliards was allocated to Northern Italy and L. 1,459,030,000 to Central Italy, for the South and the Islands was reserved the sum of L. 5,243,790,000—the remaining expenditure being distributed among construction of railways (L. 3,052,000,000) and general items of expenditure, housing, irrigation, aqueducts, etc. The chief objects of the expenditure were roads, hydraulic undertakings, port-constructions, expenditure made necessary by the war, provision of public water supplies, schemes of *bonifica*, construction of public buildings, expenditure on the new provinces, reparation after floods, landslips, etc., special works in Rome, reparation after earthquakes, subsidies for irrigation, construction

of aqueducts, subsidies to railways, tramways, etc., and the establishment of reserve funds.

As a result of this method of " consolidation of expenditure ", which grouped an entire block of Public Works of varying character within a single financial allocation, the system of " conceding " various undertakings, of letting them out " in concession " for the purpose of their more effective prosecution, developed contemporaneously, and as a corollary to this the method of " deferred payments " as regards the State contribution. The payments by the State were made in the form of terminable annuities, including both capital and interest, spread over a period of twenty to thirty years. The advantage of this method was that it allowed of the undertaking of a larger number of enterprises, at least in so far as the financial provision was concerned, than would have been possible under the system of " direct payments ", covering the whole cost as it was actually incurred. Under the system of deferred payments, the original provision of funds for the undertakings could be made by those organizations or companies to whom the undertakings had been conceded—which usually meant recourse to banks and to those " parastatal " credit institutions (*istituti di credito parastatali*) to which reference will be made later. These institutions were able to grant credit against State guarantees, reimbursement being made by the State annuities. The financing of these enterprises " in concession " was therefore really made by a recourse to public credit and savings, which lightened the immediate burden on the State by spreading it over a number of years. This method of " conceding " Public Works, of letting them out, that is, to a private contractor, was originally adopted only for certain classes of undertakings, notably railways and *bonifica*, but with the development of a definite legal and administrative system governing the regulation of Public Works, the method was extended to works of all kinds. The more general method of " concession " was to public associations (*enti pubblici e consorzi*) rather than to private contractors.

The principal " parastatal " institutes of credit, to which reference was made above, are five in number :—

(1) *Consorzio di credito per opere pubbliche.* Created by Decree-Law of 2nd September, 1919.

(2) *Cassa nazionale per le Associazioni Sociali.* Created by Law of 17th July, 1898 ; amended by Decree-Law of 21st April, 1919.

(3) *Cassa nazionale per la invalidità degli operai.* Created by Laws of 30th May, 1907 and of 18th November, 1917.

(4) *Istituto nazionale delle assicurazioni.* Created by Law of 4th April, 1912; amended by Royal Decree-Law of 29th April, 1923.

(5) *Istituto di credito per la cooperazione.* Created by Royal Decree-Law of 13th August, 1913.

These institutions differ from ordinary banks in so far as they do not have to avoid the immobilizing of their credits in long-term loans and do not have to meet the calls of depositors. Authorized and capitalized by the State, they are guaranteed by special conditions of privilege and monopoly and can, therefore, specialize in the provision of extended credits and allow their funds to become " frozen " to an extent that ordinary banks would be unable to contemplate. It is not so much that they are enabled to take risks, which is not the case, but that they can lend on a long-term basis; the State guarantee to pay the annuities eliminates all element of risk. The financial burden of a particular undertaking spread over a number of years under this sytem of " deferred payments " is, therefore, in the first instance borne entirely by the credit institute which receives the State annuities issued to the entrepreneurs. During the period of the enterprise, therefore, the credit institute deals with the entrepreneur in the place of the State, and accepts the annuities issued to him by the State under the terms of the concession, providing the actual sums estimated by the entrepreneur as necessary to the prosecution of the work. The State is thus relieved of the immediate, though not of the ultimate, fiscal burden of such undertakings.

This system of " conceding " Public Works, with the proviso for the method of deferred payments on the part of the State, was first authorized by the Decree of 6th February, 1919, when it was restricted to particular kinds of Public Works, and was then, with Royal Decree-Laws of 8th February, 1923, and of 28th August, 1924, extended to Public Works of any description. The last-named Decree fixed the duration of the State contribution, which should not exceed thirty annuities, including interest and cumulative sinking fund.

This method of financing Public Works has led to considerable debate in Italy. On the one hand, it is argued that it has the advantage of elasticity and permits of the carrying out of a larger programme than does the alternative method of direct payments provided for in the old " consolidation of expenditure ". The advantage of the method of deferred payments has been likened, by some of its advocates, to that of instalment buying by private individuals. It is also contended that it

makes possible long-range planning of Public Works and the taking of broad views regarding national requirements. It is claimed, moreover, that the method has been justified by experience, and that the decade 1922–1932 has been full of remarkable successes in this sphere of public policy.

On the other hand, it is argued that this method involves grave risks, particularly if the value of money is unstable over the period of the annuities; that it is more likely to lead to extravagance than the alternative method of paying year by year out of revenue as work proceeds; that it is inferior, also, to the method of financing Public Works by straightforward Government loans, since it tends to camouflage the aggregate of the State's liabilities, and, further, that the elasticity of the method of deferred payments is really less than its supporters allege, since there is a fairly rigid limit to the sums which the credit institutes are able to lend on long term.

In point of fact, Italian policy has compromised between the methods of direct, and of deferred, payments, and has made discriminating use of both. The greater part of the L. 15 milliard authorized for the twelve year period now in progress is being provided by direct payments, charged from year to year on the vote for the Ministry of Public Works. The method of deferred payments is, however, being generally used for the following classes of works :—

(1) Schemes of *bonifica* and various hydraulic undertakings.

(2) Construction of "secondary" railways conceded to private companies.

(3) Construction of tramways similarly conceded to private companies.

(4) Hydro-electric undertakings.

With reference to the method of financing Public Works undertaken by private enterprise should be noted the founding by Royal Decree in 1924 of the *Istituto di Credito per le Imprese di Pubblica Utilità*, which began its operations in 1925, with a view to financing undertakings officially recognized as having a definite public utility. Various banks and insurance companies subscribed the capital of L. 100 million. The method of financing adopted is that of issuing of bonds and the granting of credits to different companies on the security of their fixed plant.

Recent Developments in and Expenditure on Public Works

During the financial year 1925–6 various decrees were issued for the better regulation and control of foreign loans in Italy,

and during 1927 there was a temporary veto upon such loans, which might constitute an element of risk during the period of stabilization. Government sanction is now required for all foreign loans, and is only given on clear proof that it will be for the benefit of production, employment, or the export trade. In addition to the Government 100 million dollar loan of November, 1925, in New York, the following loans were contracted in the United States for the purpose of financing productive undertakings :—

	Million dollars.
Mining industries . .	80
Merchant marine . .	22
Land reclamation . .	5
Electrical industries . .	22
Engineering industries .	5
Chemical industries . .	12
Other industries . .	4
Total . . .	150

Two municipal loans were also raised in America during 1927, each of 30 million dollars, for Rome and Genoa.

In connection with road undertakings should be noted the creation in 1927 of the new Road Board (*Azienda Autonoma Statale della Strada*) which, in its constitution, resembles the State railways and was placed under the supervision of the Minister of Public Works. In addition to the maintenance of the main roads, which hitherto had mainly devolved upon provinces and communes, the Board was also made responsible for future Public Works necessary to improve the existing network of roads, and it was estimated that adequate finances could be obtained by the transfer from the Treasury to the Road Board of half the sum obtained in 1926 from the duty on petrol and the taxes on motor cars, which then amounted to some L. 580 million.

During 1928 much attention was given by the Government to land reclamation and irrigation schemes ; it was then estimated that about 5 million acres would be reclaimed within fourteen years, entailing an expenditure of some L. 7 milliard—of which the Government would contribute half and various proprietors and *consorzi* the other half. In 1928 was drafted the " ' Integral ' Land Reclamation Law " to provide authorization for this scheme and furnish a plan for Public Works in connection with the *bonifica* to be spread over fourteen years, and make the necessary financial provisions. Credits were to be provided

largely by insurance companies and savings banks. Much emphasis was laid on the fact that the Government was enlisting private enterprise for the carrying out of these undertakings. The Government, however, reserved the right to supervise and control the entire scheme, and even to take over any properties on which work had not begun within the time assigned, and work them at the owner's expense.

From November, 1922, to February, 1929, some 855,008 hectares had been reclaimed at a cost of L. 1,054 million, the territorial distribution being as follows :—

	Hectares.	*Cost.* (*Million lire.*)
Emilia and Romagna	362,834	322
Veneto	130,725	191
Lombardy	91,225	121
Calabria	72,854	167
Sardinia	61,842	88
Latium	31,407	35
Campania	28,413	14
New Territories	22,453	25
Tuscany	21,435	35
Apulia	21,320	48
Sicily	10,500	6
	855,008	1,052

During 1928 expenditure on Public Works amounted to L. 1,715 million, of which L. 217·5 million were for railway construction. The value of existing contracts at the beginning of the year was estimated at L. 4,035 million (of which 40 per cent was for road and railway construction), and it was calculated that this amount consisted of L. 2,208 million for direct Government works, L. 1,603 million for works in concession to local bodies, *consortia*, private companies, and individuals, and L. 494 million for other works subsidized by the Government. The magnitude of this sum is accounted for by the fact that a proportion of it was provided specially to meet the unemployment problem, while in September, 1928, a special allocation of L. 235 million was made for the winter of 1928–9 for works of a productive character. To meet this charge various new taxes were introduced. The tax on bachelors was doubled, and there was an increase in the taxes on wheat and the manufacture of spirits and a raising of the price of salt. From these provisions it was hoped to obtain an additional revenue of about L. 600 million.

In the sphere of land reclamation during 1929 should be noted also the replacement of the Ministry of National Economy by

the Ministry of Agriculture and Forests, to which new Ministry an additional Under-Secretary of State was appointed in order to deal with co-ordinated land reclamation, taking over all business relating to this from other Ministries and more particularly from the Ministry of Public Works. In the estimates of 1930–1 a sum of L. 424 million was entered for this new land reclamation department of the Ministry. During 1929 and 1930 Public Works policy continued to be actively pursued and special additional allocations were made in both years in order to deal with the increasing volume of unemployment, the registered unemployed having risen from 332,000 in November, 1929, to 553,000 in November, 1930.

It was estimated that during the period October, 1922, to 31st December, 1930, the Ministry of Public Works and the Road Board had actually paid or authorized payment of the following amounts, under the head of extraordinary expenditure for Public Works :—

	Million Lire.
Hydraulic Works	1,708
Roads	2,428
Maritime Works	1,037
Land Reclamation (until transference to Ministry of Agriculture)	700
Floods and Landslips	393
Buildings (State and workmen's houses)	1,059
Reparation after the War	84
Reparation after earthquakes, etc.	976
Redeemed territories	378
Railway construction	2,123
Railway, tramways, and motor services (until transferred from Ministry)	627
Ordinary expenditure	1,767
General expenditure and sundries	418
Total	13,698

The accounts of the Board of the Consortium, whose special function is the granting of credit for Public Works, showed during 1930 that by the end of the year the total amount of loans sanctioned and granted by it was L. 1,960 million, of which L. 88 million had been sanctioned and granted during 1930. It is stated that the value of bonds issued was L. 1,669 million, and of that sum L. 174 million had already been taken up at the end of the year by banks and private individuals. This Consortium, it should be explained, is composed of the chief credit institutes and insurance companies.

During 1930 work in connection with land reclamation under the Act of 1928 was pursued according to schedule, and steady

progress was made. The financial programme authorized by the Act was as follows :—

Nature of Work.	*Cost (millions of lire).*	*Time required from initial date (years). (1929–30.)*	*Percentage of cost met by Government grants.*	*Cost to Government (millions of lire).*
Drainage and accessory works	4,500	14	68	3,060
Irrigation in S. Italy and Islands . . .	300	14	42·5	204
Irrigation in N. and Central Italy	500	8	40	200
Villages and farm buildings in South and Islands .	500	8	27	340
Rural aqueducts . .	200	7	75	150
Farm Roads and Water Supply . . .	1,000	14	40	400
	7,000			4,354

In August, 1931, were inaugurated the new waterworks at Ravenna, which were begun in 1923 and had cost L. 32 million, comprising a network of land reclamation, drainage, embanking, and harbour construction in the district, on which latter undertakings, apart from the actual waterworks, some L. 50 million had already been spent. These works are transforming the city and developing the prosperity of the surrounding area.

For the winter of 1930–1 schemes of Public Works were considered which entailed an expenditure of L. 3,629 million and were estimated to be capable of giving employment to over 300,000 men. It has already been noted, however, that such large programmes as have been the rule in Italy in recent years are not drawn up primarily with a view to dealing with the unemployment problem ; but rather in order to increase national development and productivity. In other more highly industrialized countries programmes on this scale would perhaps be superfluous and therefore uneconomic. The actual necessity and consequent economic *raison d'être* for such large-scale undertakings become apparent when one examines their general character ;—the reclamation of hundreds of thousands of acres of malarial marsh-land, works of irrigation to prevent the frequent periods of drought which were so often harmful to agricultural production, the building of aqueducts and the institution of town drainage, the betterment of roads and general communications in the South and in the Islands, together with the construction of schools in these territories, the relief of the pressure of

population in certain rural areas by transference to other, and formerly depopulated, districts now made habitable and productive by new works, the general improvement in living conditions, in housing and sanitation, in hitherto neglected provinces, and, finally, the development of Italy's " white coal " resources to act as a basis for whole new series of agricultural and industrial enterprises.

With regard to the financing of certain Public Works in special areas should be noted the operations of the Bank of Naples, for the Southern Provinces, and the *Cassa Depositi e Prestiti* throughout the country. When the Bank of Naples discontinued its functions as a bank of issue in 1926, it was granted a sum equal to its former gold reserves wherewith it might act as a public utility bank, particularly in the sphere of agricultural and land credit. It controls through its twenty-one branches 630 smaller credit banks which thus extend its organization to remote rural areas. It has also assisted in the financing of Public Works and land reclamation through loans granted to municipalities and various *consortia*. The *Cassa Depositi e Prestiti* has also financed many productive enterprises throughout the country, including works of land reclamation, irrigation, drainage and sanitation, and other undertakings of local authorities. Its own resources are derived mainly from Post Office Savings funds and, after an inspection for 1931, its assets were stated to amount to L. 30,700 million against liabilities of L. 21,800 million.

Of special interest during 1931 was the work of reclamation in the Pontine Marshes, of which the principal operations were in course of completion. For purposes of reclamation the area had been divided into two sectors, one of 135,000 acres assigned to the Consortium of Piscinara, the other of 65,000 acres which was assigned to the *Bonifica Pontina*. By November, 1931, some L. 160 million of the estimated total of L. 350 million had been expended on the Piscinara sector.

During 1932 new sums became available for the financing of Public Works as a result of the issue of nine-year Treasury bonds on 9th April, 1932, which was to repay the fifth series of nine-year Treasury bonds due in November, 1932. On the first day of issue the sum of L. 4,353 million was subscribed, whereas L. 1,000 million only was needed for the purpose of meeting repayment. The Government stated that it would accept the additional L. 3,000 million ; and of this amount, L. 1,000 million were assigned to the financing of Public Works, of which L. 750

million will be spent on the completion of important works already undertaken, including drainage of land, building of roads, regulation of watercourses, and the betterment of sanitation in backward areas.

The financing of Public Works from popular savings is an important element in the system. These savings are directed through the Post Office Savings Banks to swell the assets of such institutions as the *Cassa Depositi e Prestiti*, and the Social Insurance and the National Life Insurance Funds, and are thus utilized in the national development policy. This is effected mainly through the undertaking of Public Works subsidized by the State through the method of deferred payments, the method of financing in this case being generally the issue of long-term bonds in which those Institutes mentioned above invest their surplus funds. It is stated that these interest-bearing bonds are held by them and do not come on to the market, and it is claimed, though the claim seems of somewhat doubtful validity, that this fact prevents the occurrence of any " hidden inflation ".

The following table [1] shows the Public Works completed or commenced in 1932 :—

Nature of Work.	*Completed.*	*Begun.*	*Cost (millions of lire).*	*Average daily number of workers employed.*
New roads constructed by Ministry of Public Works .	250	68	301·1	13,934
Roads rebuilt by Road Board	143	37	284·6	15,204
Hydraulic works . .	377	32	378·9	26,331
Harbour works . . .	64	13	207·1	3,244
Public and school buildings .	235	81	205·8	7,110
Integral land reclamation .	389	105	690·3	39,823
Railway construction . .	29	3	137·0	1,377
Reparation after floods and earthquakes . . .	77	50	42·2	2,779
Aqueducts and sanitary works	383	135	332·2	12,497
Total	1,947	524	2,579·2	122,299

[1] From the Report of the General Fascist Confederation of Italian Industries for 1932.

Chapter IV

THE REFORM OF BANKING AND THE USE OF STATE CREDIT

A Decree Law of 7th September, 1926, made an important reform in Italian Banking Law. The necessity for increased central control had been shown by the failure of the Banca Italiana di Sconto and by the serious embarrassment of at least one other important Italian bank. To save the credit structure of the country from complete collapse, it had been necessary for the Treasury to step in and take on its own shoulders a large part of the losses which had been incurred. There had also been a series of failures among smaller banks, largely owing to their speculative and unwise use of their resources.

Existing regulations only applied to Savings Banks and to *Istituti di Credito Fondiario*, that is to say, to credit institutions which make loans against security of real estate. These regulations were exercised by the Ministry of National Economy.

The new regulations are much wider in scope, applying to all banks which accept deposits, including branches of foreign banks operating in Italy. They are exercised jointly by the Ministers of Finance and of National Economy, and by the Bank of Italy. All such banks must be registered at the Ministry of Finance, and power is taken to control the opening of new branches, including branches in the Italian Colonies or abroad ; to require the building up of reserves, equal to at least 40 per cent of the capital ; to secure the submission of periodical returns of information, and of annual balance-sheets, in a prescribed form, to the Bank of Italy ; to conduct an investigation at any time into any bank's affairs, through persons appointed by the Bank of Italy ; to make regulations regarding the proportions to be maintained between capital, reserves, and deposits ; to make any other regulations designed to protect depositors, including the regulation of the risks which may be incurred in various types of advances ; and to prescribe penalties for the breach of any of these regulations. These powers, it will be seen, are very wide. The powers of the State in matters of banking and credit are, indeed, very extensively used in Italy, as will

be further shown in the following study of the use of State credit in Italy in recent years. Two main lines of activity may be distinguished.

(*a*) The use of State credit in the development of home and foreign trade, both in the form of loans, intended to help a particular concern or group of concerns in the tiding over of a difficult period, or in the re-establishment or improvement of their productive capacity: and also in the form of State guarantees of export trade, and of contracts made abroad for the supply of goods outside Italy.

(*b*) The recent development of a group of "Parastatal" Institutions (*Enti Parastatali*) whose function is the supply of credit for particular branches of the national economy, both industrial and commercial, or even purely financial.

Under a third heading, which will be examined in the next chapter, may conveniently be grouped all other instances of State interference or control in the development of Italian industry and commerce, of which some of the most important are concerned with the regulation of new industrial ventures and new capital issues designed to secure a smooth and balanced rhythm in the national economic development, avoiding as far as possible any excessive flotations in the capital market or the establishment of over-large and unwieldy industrial concerns, which may seem "top-heavy" and unsafe.

(*a*) *The Use of State Credit in the Development of Home and Foreign Trade.*

An example of State stimulus to Italian foreign trade was the Trade Agreement signed with the Soviet Government on 2nd August, 1930. In connection with this Agreement the Italian Government increased from 65 to 75 per cent the guarantee under the Exports Credits Scheme, whereby Italian industrialists and manufacturers were enabled to undertake orders for the Soviet Government, which reached a total of some L. 200 million: further orders were placed in connection with a more recent Agreement of 27th April, 1931, for another L. 350 million with the Soviet Government.

In the sphere of home trade aid has been given to a number of enterprises, held to be of national importance. An instance of this was the subsidizing of the *Manifatture Cotoniere Meridionali* of Naples by the Government over a period of four years (1926–1930) to the extent of some 50 per cent of its capital; while the Cogne Iron and Steel works was given a government loan

to the extent of some L. 55 million in 1926, but these works became a State enterprise by Royal Decree Law of 30th December, 1929. Similar loans have been granted to the Adria Company, engaged in the manufacture of chemicals at Monfalcone, and the Safri Fishing Company, but some limitation of this particular form of governmental activity was suggested in the discussion in the Senate of the possibility of a similar loan to the Whitehead Torpedo Factory at Fiume, when it was stated that there was a feeling in both Houses that such loans should be considerably reduced.

Grants, however, continue to be made in many cases. Thus, in September, 1931, in order to improve the existing conditions in the lead and zinc mines of Sardinia, the Government undertook to make loans of a temporary nature to those enterprises employing from 1st May, 1931, to 30th June, 1932, a number of workers equal to that employed on 15th April, 1931. This arrangement was to apply only if the London price of the ores extracted from the mines should fall below £10 per ton. Assistance of a similar nature was given in the case of the lignite and antimony mines.

These instances of the use of State Credit to assist enterprises which are temporarily in embarrassment owing to the prevailing economic depression serve to exemplify the broad lines of industrial policy laid down at a meeting of the governing body of the General Fascist Confederation of Industries in March, 1931. This association represents 131,840 business enterprises employing 2,712,000 persons. The Confederation's policy is to assist, wherever possible, in the maintenance of the steady rhythm of productivity in all spheres of the national economic life, despite the adverse influences of the world-wide depression which was particularly affecting Italian export-trade ; but it was also stated that the Confederation could not countenance any efforts towards the saving of concerns which were fundamentally unsound ; the sooner these particular enterprises were liquidated, the better for the national programme of production as a whole.

At the same meeting, in March, 1931, an important line of policy was also laid down with regard to the tendency towards large-scale industrial mergers, with particular reference to their possible adoption as a method for increasing national productivity. The Governing Body decided that such mergers should be countenanced in Italy only in rare cases, when real benefits, particularly with reference to the possibility of industrial

expansion, might be obtained from a policy of agreements or understandings among enterprises engaged in productive activities of a similar character. They would not be permitted, if they aimed merely at the perpetuation of an already existing order of things in the industrial world—with a view to the maintenance of high profits. It was stated that for a country such as Italy, at her present stage of industrial and economic development, large-scale businesses on the American model could not be considered either suitable or safe, since the tendency of all such enterprises was towards over-capitalization and financial " top-heaviness ". For Italy, particularly with her large agricultural population, it was considered that a better medium for industrial expansion would be by the slower and safer methods of medium-sized business undertakings. This subject will be treated more fully in the next chapter.

In considering the various forms of State activity for the development of home and foreign trade it is necessary to mention the National Export Institute (*Istituto Nazionale per l'Esportazione*), established in 1926–7. Reference has already been made to loans and subsidies granted by the Government to particular enterprises in Italy, which are concrete instances of the use of State credit in the development and stimulation of home trade. The National Export Institute, on the other hand, is an instance of a special organization created to assist Italian export trade. In addition to providing an information service on the widest possible lines, the Institute has also been able to secure the creation of a Company whose special object is the insurance of export credits. The Institute has also obtained a special guarantee from the Government of those credits which might be considered as presenting risks of an exceptional character, whether political or economic. It was understood, on the other hand, that such credits would be forthcoming, where such elements of risk were present, only in cases of particular importance to the development of Italian export trade as a whole.

A recent Decree-Law gave permission to a particular section of the National Insurance Institute to guarantee these risks by policies carrying a premium of 1 to 4 per cent of the total amount guaranteed. Control of these insurance facilities rests in the hands of the National Export Institute, since special application has to be made through the Institute when guarantees of this kind are required.

Particular attention has also been paid to the complete reorganization on modern lines of the export of fruit and

vegetables. These two branches, so closely connected with Italian agricultural activities, have been practically reformed by the National Institute for Export, particularly in the methods of packing, grading and standardization, while special legislation has ensured the adoption of uniform methods. Together with the help of the Bank of Italy and an organization known as the Citrous Fruit Exchange, a complete rationalization of these branches of production has taken place.

The National Institute for Export works in conjunction with the Ministry of Communications, to secure improved shipping facilities and a lowering of railway rates and shipping freights. It is a "parastatal" organization directly financed by the Government, its subsidy amounting to L. 6 million during the first year and to L. 4 million during each subsequent year. This is one of the most obvious and significant examples of the use of State credit for the stimulation of Italian foreign trade. The Institute has played an increasingly important role in fostering Italian commerce abroad since its inception in April, 1926.

The regulation of the supply of export credits is contained in the Decree-Law of June, 1927, which, with some amendments, was passed by Parliament in June, 1928. This was further supplemented and amplified by a Decree of 8th July, 1929. The limitation of State credits to the Italian export trade was placed at L. 200 million within the financial year ending 30th June, 1930—of which sum not more than L. 120 million could be used to guarantee exports to any single country.

Mention should also be made of the subsidies paid annually to various shipping lines. As early as 1925 a scheme was drawn up and approved whereby the Government agreed to assist certain shipping companies: a distinction was drawn between those lines which, running between the mainland and the Italian Colonies—and also the islands—were considered as being absolutely necessary to the proper economic development of the country, and those other lines which connected Italy with the principal ports and markets overseas and were considered to be of economic importance, though not of such prime importance as those in the first class.

During the financial year which ended June, 1925, L. 149,929,000 were spent on such subsidies: later these were increased to L. 192,245,000, corresponding to an increase in mileage covered by the shipping lines from 3,800,000 to over 5½ million.

Subsidies for shipbuilding are another important item in the use of State credit in Italy. As early as 1924–5 the total of these grants was L. 80,700,000. The scheme for the application of such credits was drawn up and approved in a Decree of February, 1923, and continues in force.

Under a Decree of 14th November, 1926, a complete programme was drawn up for subsidies to various shipping lines during a period which should cover the financial years 1925–6 to 1945–6 —the total of such expenditure amounting to L. 3,204,779,500. This sum is allotted between the different shipping companies, according to their classification, as either " absolutely necessary " or " useful ", as follows :—

Class 1 (" absolutely necessary ") . .	L. 2,600,050,000
Class 2 (" useful ") . . .	L. 507,300,000
Class 3 (" useful "—with 5-year contracts)	L. 97,429,000

The differentiation between Class 2 and Class 3 is determined by the length of the contract undertaken. Class 1 consists of contracts of twenty years; Class 2 of contracts of ten years; Class 3 of contracts of five years.

It should be noted that among those shipping lines classed under the heading of " absolutely indispensable " are those running between the principal Italian ports and East and South Africa, the Adriatic, the Mediterranean ports, and the Red Sea.

Grants to shipbuilding were continued under the Decree-Law of 16th May, 1926, along the same lines as those laid down by a Decree-Law of February, 1923, which lapsed on 30th June, 1926. Such subsidies consist of a financial grant, usually based on production, together with the allowing of various materials needed for constructional purposes into the country duty-free, and also certain exemptions from taxation. Subsidies were paid on similar lines to the Italian iron and steel industry in 1926, and for this purpose a total sum of L. 684 million was supplied, the payment of the amount to be spread over a period of twelve years.

The subsidizing of shipping services continued to receive regular attention at the hands of the Government, and the total sums authorized as expenditure on such grants were advanced by L. 4,322,500 to take effect during the financial years 1927–8 to 1930–1. This additional expenditure was to be used as an extra grant to the shipping line known as the *Navigazione Libera Triestina,* which covers an area including the North Pacific and the coastal towns of Africa.

A further grant was made by Decree-Law of 13th December,

1928, which advanced the total sums to be expended by the Italian Government on such subsidies to shipping lines from L. 3,360 to L. 3,817 million, payable between the years 1925 and 1947.

Mention may also be made here of the creation in 1928–9 of an Institute which is concerned with the granting of credits to shipping lines and the development by financial subsidies of naval activities generally. This was founded with a capital of L. 100 million which had been derived from the subscription of different public institutions, mainly of a semi-Governmental character. A fixed rate of interest on loans made by the Institute is furnished by the Government itself—at a rate of 1 per cent when the ships or vessels under consideration are bought abroad and at 2½ per cent when the vessels are constructed in Italy.

Special insurance policies are issued as security against loans, and these, consisting of a mortgage on the ship itself, can be supplied up to 60 per cent of the actual value on the market of the completed vessel.

Permission was given for the issue by the Institute of registered bonds, which could be discounted at the Bank of Italy.

Subsidies to shipping continued to be given by the Government, and during the financial year 1929–1930 it was estimated that such grants and special allocations amounted to L. 190 million. Similarly the cost of grants to shipbuilding was calculated at about L. 34 million annually, in addition to the allowing of material which would be used in connection with such constructional work duty-free into Italy, up to a total amount of some L. 26 million annually.

Companies which receive financial assistance from the Government include the *Lloyd Triestino*, which maintains passenger and Transport services between Italy and Palestine, India, and the Far East ; and the *Società Veneziana di Navigazione a Vapore*, which operates a fortnightly service between Italy and Calcutta. In this particular case the Government made an agreement which covers a period of ten years, undertaking to pay L. 2½ million during the first eight years and L. 1¾ million during the last two years.

Another Decree of 8th June, 1929, granted a special subsidy for shipbuilding, in the form of special assistance for the construction of vessels completed and launched before 30th June, 1938, and granted exemption from income tax during the first ten years after the ship has been put into active operation.

The contract between the Government and the *Società Italiana*

di Servizi Marittimi (the Sitmar line), which operates services between Italy, Egypt, the Levant, and the Near East, including sailings to the principal ports of the Black Sea, has been amended. The annual subsidy now payable to this company is L. 12¾ million —and this sum, granted in 1931, will be paid for the ensuing six years. Similar amendments of contract were made with the *Lloyd Triestino* shipping company, and also with the *Società Anonima Navigazione Toscana*—which in this latter case advanced the special grant allotted annually to the company from nearly L. 3 million to slightly over L. 4 million: an increase was also allowed in the subsidy payable to another shipping line (the *Società Anonima di Navigazione La Meridionale*) engaged in the operation of passenger and transport services to the islands around the coast of Sicily.

It was estimated that the total sum spent by the Government on subsidies to shipping companies amounted during the financial year 1930–1 to L. 223 million. To this sum should be added an additional expenditure of L. 1½ million in connection with the fulfilment of mail contracts.

Similarly, expenditure during the financial year 1930–1 in the form of grants and subsidies to shipbuilding amounted to L. 57 million, in addition to the duty-free importation of shipbuilding materials to the value of L. 108 million.

(*b*) *Other Forms of State Credit; the "Parastatal" Credit Institutes*

The Italian word *parastatale* is nearly, but not exactly, equivalent to the English "semi-official". It will, therefore, be left in its Italian form and rendered as "parastatal". Many "parastatal" institutes of various kinds exist in Italy, of which the credit institutes are only one group.

Reference has already been made, in the previous chapter, to five such credit institutes, and to the way in which they mobilize credit and direct savings into Public Works programmes.

There are, however, some more recently created credit institutes of this type on which we should now concentrate our attention.

The *Istituto Mobiliare Italiano* is one of the latest creations of the Italian Government in this field. Its general function is to finance industrial production. It was described, at its inception, as a "new, semi-official, public-utility corporation". Its capital was to be not less than L. 500 million, of which half was to be provided by the *Cassa Depositi e Prestiti*, and the

remainder by the various bodies included in the Consortium for Subventions on Industrial Securities.

The *Istituto Mobiliare Italiano* may make advances, for a period of not more than ten years, to Italian business enterprises on the security of their stocks, shares, and debentures; it may also hold and take up shares in enterprises to which it has made advances. It has also power to issue bonds and debentures of its own up to a total amount of ten times its own subscribed capital. The bonds will carry a fixed rate of interest, but will not be secured on any particular assets of the Institute; the debentures, on the other hand, will be secured on shares and debentures held by the Institute, or pledged with the Institute against advances made by it to various enterprises. Bonds and debentures issued by the Institute are to enjoy special privileges as regards exemption from taxation; they are to be trustee securities; the Bank of Italy is to accept them as collateral for advances; and the Government may, in suitable cases, guarantee the interest upon them. The Institute is regarded primarily as an investment institute; it is not to accept deposits, or run current accounts, or compete with the savings banks.

Its Board of Directors is to contain representatives both of the Ministry of Finance and of the Ministry of Corporations, together with ten persons nominated by the various bodies which have provided the initial capital. The President and Vice-President of the Institute are to be appointed by the Head of the Government, after consultation with the Ministers of Finance and of Corporations. The first appointments have now been made, and Senator Mayer, Chairman of the Budget Committee of the Senate, has been nominated as President, and Signor Tumidei, Chairman of the Budget Committee of the Chamber of Deputies, as Vice-President.

The Institute is designed to assist the development of Italian industry and to enable the Italian deposit banks to restrict their activities to commercial credits and short-term advances only. Through the issue of its own bonds and debentures the Institute will grant long-term credits to industry, but will discriminate, in the granting of credit, in favour of concerns which are of national importance and efficiently conducted. It is no part of its duty to bolster up insolvent undertakings. These, in the national interest, should be liquidated and not kept alive.

The Institute was founded, and the initial capital was over-subscribed, in December, 1931. It came into being within fourteen days of its authorized creation by the Council of

Ministers. Signor Mussolini, in his speech in opening the Institute, expressed the belief that it would play an important part in guiding Italian industrial organization towards the corporative structure and in exercising the supervisory and directive activity of the State over the play of private interests. He added, however, that changes in the organization of Italian joint-stock companies must be brought about gradually, and that the immediate object of the Institute must be to assist enterprises which were essentially sound but were suffering from the effects of the world depression. Senator Mayer, the first President of the Institute, stated on the same occasion that it was not part of his intention to use the Institute as an instrument for the nationalization of industry, and emphasized its importance in relieving the deposit banks from the risks of financing industry on the old lines.

In October, 1932, the Institute made its first issue, in the form of L. 100 million of three-year bonds, bearing interest at 5 per cent with a net return of 5¼ per cent. This issue was fully subscribed without any appeal being made to the public, but it was stated that a further issue of ten-year bonds would shortly be made, and that these would be offered to public subscription.

Mention should also be made here of a number of other credit institutions similar in their general character and constitution to the *Istituto Mobiliare Italiano*. Chief among these are the following: the Credit Institute for Public Utilities, the Credit Consortium for Public Works, the Naval Credit Institute, and the recently-founded *Sofindit*—an abbreviation of *Società Finanziaria Industriale*.

The organization of this series of special financial institutions, semi-public or "parastatal" in character, has proceeded apace in Italy within the last few years and is part of a comprehensive plan for reorganizing the national financial and banking activities. By relieving the banks of the onus of supplying credits for industrial production, that is by strictly demarcating the functions of the banks and these new institutions, it has been possible to bring about a more complete mobility of the assets of the deposit banks and to maintain their liquidity at a high and safe level.

The special function of all the "parastatal" institutes, on the other hand, is the supply of long-term and medium-term credit for business and industrial enterprises of a definitely national importance. It is stated that the *Istituto Mobiliare Italiano* will concern itself particularly with the supply of

medium-term credits, acting as an agency whereby the investing public, and especially the small investor, can avail themselves of its semi-official character to invest with full confidence as to the security of their funds.

These new institutions are closely interlinked, the *Sofindit*, for example, being given the right to borrow, on the security of first-class collateral, from the *Istituto Mobiliare Italiano*. The Naval Credit Institute, among others, is expanding its activities, and in the early part of 1932 made an issue which was heavily over-subscribed.

CHAPTER V

STATE CONTROL OF ITALIAN INDUSTRY, COMMERCE, AND FINANCE

We may conclude this study by considering certain other forms of State control of Italian industry, commerce, and finance. An interesting and recent example is the creation, on 21st January, 1933, of a new institution known as the Institute for Industrial Reconstruction. It is organized as a public corporation, on similar lines to the other " parastatal " institutions already described. It is organized in two sections, one of which is concerned with the supply of credit to sound business enterprises and the other with the more difficult task of winding-up, or liquidating, enterprises which are considered unable to cope with existing competitive conditions. These two sections are separately organized, each having its own budget and its own capital. The President is appointed by the Head of the Government, after consultation with the Ministers of Finance and Corporations, and the first President to be appointed is Signor Beneduce, formerly President of the Credit Institute for Public Utilities and at present Vice-President of the Bank for International Settlements at Basle. The Board of Directors is composed of six persons, nominated by the Ministers of Finance and Corporations jointly ; out of these six, three are chosen by the Ministers from a panel of names submitted by the *Cassa Depositi e Prestiti*, the National Social Insurance Fund, and the National Insurance Institute, these three bodies having subscribed the capital, amounting to L. 100 million, of the Institute for Industrial Reconstruction.

Like the *Istituto Mobiliare Italiano*, the Institute for Industrial Reconstruction may make loans, on suitable security, to Italian business enterprises, and may also issue its own debentures, repayable in fifteen to twenty years. Those debentures may, in suitable cases, be guaranteed by the State. A first issue of L. 1,000 million 4½ per cent twenty-year debentures was announced early in 1933.

The need for the creation of this new Institute, alongside the *Istituto Mobiliare*, has been questioned in some quarters.

But the intended difference of function appears to be twofold. In the first place, the Institute for Industrial Reconstruction will generally grant longer credits than the *Istituto Mobiliare*; in the second place, as its name and constitution suggest, it will be more directly concerned with actual reorganization and reconstruction, as distinct from the provision of credit in appropriate cases. Its second section, known as the section for Industrial Liquidation (*Sezione Smobilizzi Industriali*), is the successor to a previously existing *Istituto di Liquidazione*, whose assets and liabilities it has taken over. It has been granted a special fund of L. 85 million, to be spread over twenty years, for use in the liquidation of unfit concerns. The Government holds the view that such concerns should not be allowed to die a lingering death, but should be disposed of as quickly as possible, so as to remove a danger to the proper development of Italian industry as a whole.

Another striking example of State interference is the provision that no new factory may be opened in Italy, nor any existing factory substantially extended, nor any new capital issue made, without the permission of the Government. This proviso is designed to prevent over-production and the relative over-development of particular branches of industry, and also to secure some control over the geographical distribution of industry within the Peninsula.

Other examples are more stringent control of municipal borrowing; a closer control of business amalgamations, which are authorized only where they seem likely to increase the efficiency of production; and the development of trade associations, membership of which is often made compulsory by Government Decree, to promote concerted policies in particular branches of trade and to avoid all unnecessary duplication of business activities.

It is claimed that State control of Italian industry and trade has succeeded in infusing a new sense of harmony and unity into all departments of the national economic life; that, in the Corporative scheme of thought, the State no longer stands apart from the nation as an outside force arbitrarily imposing its will upon various groups, but that it is now more closely identified with the people in their daily pursuits than it has ever been before, and more closely, it is claimed, than in any other national State at the present time. The State exercises its control of production through continual, and not merely spasmodic, collaboration with the organizations of employer and worker,

on which it has conferred legal status within the Corporative System. This is further illustrated by the operation of the well-known Labour Charter of 1926, an examination of which would transcend the limits of this study. It may be noticed, however, that supporters of the present regime claim that the continuous consultation between employers' and workers' representatives under this Charter, together with the presence at such discussions of representatives of the Ministry of Corporations, and the legal prohibition of strikes and lock-outs has done much to dissipate the atmosphere of mutual mistrust and lack of understanding between capital and labour which prevails in other countries.

The principle has been laid down that no private monopolies, free from State control, shall be established in Italy and that, more generally, the unregulated competition and haphazard co-operation of the past is now to be replaced by a definite and co-ordinated planning activity. All problems of industry, agriculture, and national economic life generally are to be approached, and solved, in the light of the collective interest, and not in that of sectional interests. Opposition to the collective interest on the part of groups or minorities within the State will not be countenanced. As to how far these principles have been beneficially applied in Italy under the present regime there will, of course, be differences of opinion among foreign observers.

NOTE ON BIBLIOGRAPHY

There is a plentiful literature in Italian on Fascism in all its aspects—political, philosophical, economic, and financial. As yet there is little of value in English. A series of volumes of Mussolini's speeches, entitled *Discorsi*, has been published from 1925 onwards by Alpes of Milan. These, together with Professor L. Amoroso's *Dal Liberalismo al Fascismo* (Rome: Castellani, 1929), and some of the writings of Professor G. Bottai may serve as a starting-point for the study of the Italian experiment and its mentality. From Professor Bottai's writings the following might be selected: *La Carta del Lavoro*, annotated by Bottai (Rome: Diritto del Lavoro, 1928), *L'Economia Fascista* (Rome: Tipografia Arte della Stampa, 1930), and *Le Corporazioni* (Rome: Mondadori, 1932).

A simple and well-written textbook on the Corporative State is

Elementi di Ordinamento Corporativo (*ad uso delle Scuole Medie Superiori*) (Rome: Diritto del Lavoro, 1928). Good descriptive accounts of Corporative institutions are Rosario Purpura's *Il Consiglio Nazionale delle Corporazioni* (Bologna: Cappelli, 1932) and an official publication, also issued in French, *L'Organisation Syndicale et Corporative Italienne* (Rome: Camera dei Deputati, 1930). A book both theoretical and descriptive is L. Gangemi's *Lineamenti di Politica Economica Corporativa* (Catania: Studio Editoriale Moderno, 1932). More theoretical and semi-philosophical is U. Spirito's *Fondamenti della Economia Corporativa* (Milan: Treves, 1932).

The standard textbook on Italian financial administration is A. De Stefani's *Manuale di Finanza* (Bologna: Zanichelli, 1931). On the theory of Public Finance there is a large Italian literature, but this falls outside the scope of this note. On some of the questions discussed in the preceding chapters the following may be consulted: T. Colonna, *Teoria e Problemi della Economia Finanziaria Corporativa* (Alessandria: Colombari, 1932); F. Danesi, *Gli Istituti di Credito Parastatali* (Bologna: Zanichelli, 1933), and N. Muratore, *La Finanza delle Opere Pubbliche* (Milan: Treves, 1928). A charming book, well illustrated and very cheap at the price of 8 lire, dealing with Fascist policy in afforestation, is Lino Vaccari's *Difendiamo i Nostri Boschi* (Milan: Tipografia del Popolo d'Italia, 1932). Worthy of note also is an interesting report on *Economic Conditions in Italy*, published by the Department of Overseas Trade (H.M. Stationery Office, 1932).

PART IV

FRANCE

By J. N. Reedman

CHAPTER I

THE FORM OF THE FRENCH BUDGET

"All citizens have the right, either themselves, or through their representatives, to ascertain the necessity for a public tax, to assent to it freely, to follow the uses to which it is put, and to determine its amount, assessment, and yield."—*Declaration of the Rights of Man*, Art. 14.

It is doubtful whether anyone would be found in France to challenge this excellent democratic principle. But it is certain that only a few experts and specialized students have sufficient knowledge and leisure to pick their way through the complications of French public finances. These complications are partly due to the effects of the Great War, but, more fundamentally, to the traditional methods by which the public accounts are kept and the budget is voted. A brief account both of the principles which govern the French budget and of the complexities introduced by war-time and post-war financing is, therefore, necessary to an understanding of recent French budgetary history.

The draft budget is drawn up several months before the opening of the financial year by the various administrative departments and by the Ministers of Finance and of the Budget. It is brought before the Chamber as a project of law, prefaced with a general *exposé*. When it has received the assent of the Chamber, the budget goes to the Senate, which may propose amendments before voting and sending it back to the Chamber. As every deputy and senator has the same right as the Government to propose expenditure, the budget debates may be very prolonged. Moreover, in case of disagreement between the Chamber and the Senate, the budget may pass to and fro many times between the two representative bodies before agreement is finally reached. Unlike the British, the French budget does not operate until finally voted and, as the debates generally extend beyond the beginning of the financial year, some arrangement has to be made to cover the period between the opening of the budgetary year and the voting of the budget. This is done by the traditional method of voting monthly credits, *douzièmes provisoires*, on the demand of the Minister of Finance.

It is not unusual for six or seven *douzièmes provisoires* to be required before the budget comes into force.

As in a number of other countries—Belgium and Holland for example—the accounts are kept on the principle of the *exercice*; that is to say, they are kept open for the collection of revenue and the adjustment of expenditure for a supplementary period of several months beyond the nominal twelve months of the financial year. Expenditure may be passed for payment during three months, actual payments are made up to the end of the fourth month, and book-keeping adjustments are made up to the end of the seventh month after the close of the financial year. Credits are granted for a period of twelve months only. Accounts are also kept by *gestion*, which shows credits voted and expenditure undertaken during the twelve months up to the close of the financial year. But these are regarded as only provisional, and it is the accounts by *exercice* which are treated as authoritative, since they include the adjustments made during the supplementary period. The law of 25th January, 1899, declares that these final accounts shall be published for the opening of the ordinary session of the Chamber following the close of the *exercice*, that is to say, about twenty-four months after the end of the financial year to which they relate. In recent years even this legal limit has been exceeded, and the latest closed accounts published are those for 1924. It follows that our study of French budgets must be based—so far as expenditure is concerned—on the accounts *par gestion*. These are, however, a sufficiently reliable guide, particularly over a series of years, though the closed accounts will show slight differences in detail. What is true of expenditure applies equally to revenue. The yield of the latter is published monthly, and thus the cash revenues of a given budgetary year are stated at the end of the twelve months' period as the revenues collected on budgetary account. In the accounts by *exercice*, however, the revenue of a given year is the revenue for the budget of that year, irrespective of the time of its collection.

The French Government finances were complicated during the war by the creation of special budgets and funds. Since the end of the war, and particularly since 1925, some progress has been made towards unification. As, however, more than fifty special funds were created at the Treasury either during or after the war, the Treasury accounts, as distinct from the budgetary accounts, are still extraordinarily complicated. In addition to the general budget, with its group of annexed budgets,

we have the special Treasury funds and also the autonomous fund for the redemption of the debt (*Caisse autonome d'amortissement*). It is the first and third of these sections which more particularly concern us.

The general budget shows on the revenue side the yield of taxes and fees, of monopolies, of public undertakings, and of various miscellaneous activities such as the sale of war stores and other property. The proceeds of loans are excluded, but various sums on reparation account from Germany have appeared in the budget. On the expenditure side the form of the budget has undergone important changes since 1925. Until that year temporary expenditure for the repair of war damage was separately shown in a Budget of Recoverable Expenditure. This expenditure was merged in the general budget after 1925 as one of the measures for controlling expenditure in order to secure budgetary equilibrium, and because it was realized that large expenditures, based on the assumption that the bill would eventually be paid by Germany, were financially unsound. Until 1928 expenditure within the general budget was distinguished as (*a*) ordinary, (*b*) extraordinary, and (*c*) temporary expenditure for the repair of war damage. The distinction between ordinary and extraordinary expenditure was not a distinction between "current" and "capital" expenditure such as exists in the budgets of the Scandinavian countries, and especially that of Denmark. Extraordinary expenditure in the French budget consisted of War Pensions and certain other expenditure attributable to the war period. Since 1928 these expenditures have appeared in the general budget without distinction. There are seven separate budgets annexed to the general budget, with a total expenditure of little more than one-tenth of the general budget. The most important of these are the budgets of Posts and Telegraphs and of the manufacture of coins.

The *Caisse autonome d'amortissement* was established by the law of 7th August, 1926, in order to take over the National Defence Bonds. These represented a huge short-term debt, the conversion of which was at that time an essential condition for the stabilization of the budget and of the currency. It is a Sinking Fund which is separately administered, deriving its income from the proceeds of the Tobacco Monopoly, which are earmarked for this purpose, and from a certain percentage of the Succession Duties. Any deficit on the operations of the *Caisse* was to be a charge on the general budget. Up to the

present, however, the fund has annually shown a surplus. Though at first only concerned with the amortization of the Defence Bonds and certain classes of Treasury Bonds, the powers of the *Caisse* have since been extended to the repayment of other portions of the public debt.

Further complications in the study of recent French budgets are introduced by the changes made in the dates of the opening and closing of the financial year. Until 1930 the financial year coincided with the calendar year. In 1929, with a view to lengthening the period for debate and thus facilitating the voting of the budget in good time, the financial year was changed so as to open on 1st April and close on 31st March. To achieve this end the *exercice* of 1929 was lengthened by three months and thus ran from 1st January, 1929, to 31st March, 1930. But after two years' experience of this change it was decided to revert to the old practice, since the desired results of lengthening the period of discussion were not achieved, and because certain administrative difficulties were encountered. Thus the budget for 1932 ran only for nine months, from 1st April to 31st December, and the current budget for 1933 runs from 1st January to 31st December. These changes complicate comparisons of recent budgets.

CHAPTER II

THE STABILIZATION OF THE BUDGET AND OF THE FRANC

The stabilization of the French currency after the post-war inflation was finally achieved in 1928. It was, however, two years earlier, in 1926, that the most important steps towards this end were taken by the Government, of which M. Poincaré was the head. The main problem was that of balancing the budget, for, whether or not unbalanced budgets were the original cause of inflation, they were the chief cause of its continuance. Until expenditure was covered without recourse to printing more notes, the vicious circle of inflation could not be broken. It was partly the failure to realize this fact which led to a new inflation and a rapid depreciation of the franc in the early summer of 1926, despite earlier tentative efforts at stabilization. In the late summer and autumn of 1926 the Poincaré Government passed a series of measures which assured the equilibrium of the budget and made complete stabilization of the currency possible in 1928. To examine in detail the history of these efforts is beyond the scope of the present study. But, since this is our starting-point, we may recall briefly the main events.

Two problems of outstanding importance faced the Poincaré Government in 1926. First, it was necessary to secure the equilibrium of the State budget, and second, a huge amount of war debt, falling due within a few months, had to be converted into long-term obligations, if further inflation was to be prevented. When both these ends had been achieved, the other problems of stabilization become comparatively simple. Clearly only one or both of two methods are possible to balance an unbalanced budget, namely, an increase of revenue and economies in expenditure. M. Poincaré made use of both these methods. His economies, however, consisted, for the most part, in preventing further increases in expenditure. Extensive reductions were impossible. The rapid depreciation of the franc had not only reduced the real incomes of the State employees, but had also increased the nominal requirements of the State services. Allowance being made for the rise in prices, the cost of the ordinary public services was hardly more in 1925 than in 1913. Only the debt service, which from the nature of the

case it was impossible to reduce, had greatly increased. Moreover, increased military expenditure was inevitable in 1925 and 1926 on account of the campaign in Morocco. The few administrative economies obtained by temporarily reducing the number of Ministries were negligible, and even if the psychological effects of such economy gestures were seen in increased confidence, there was never any hope of balancing the budget by these means.

The only alternative was to increase the normal revenue of the State. Politically, the time was ripe for this, when the Poincaré Cabinet was formed in the late summer of 1926. A Committee of experts appointed earlier in the year to examine the financial situation had reported in favour of increasing taxation to produce an additional 8,000 million francs. M. Caillaux, as Minister of Finance, adopted most of the recommendations of the Committee, but made some concessions for political reasons. He proposed new taxes to the extent of 5,000 million francs. The necessity for new taxation was already well understood and had impressive support. Moreover, the entry into force of the Dawes Plan in 1924 had the same effect in France as in Belgium ; it brought the realization that Germany's capacity to pay was limited, and that the legal right to reparations was a foolish excuse for an insolvent Treasury. Thus though, with a more attractive programme than that of the Committee of experts, the Briand-Caillaux Ministry had come to grief, the Poincaré Ministry of " National Concentration " was able successfully to carry a demand for an increase of taxes by no less than 11,000 million francs. By this means the budget of 1926 was balanced with a surplus, and the Treasury was relieved of one of the chief items of uncovered expenditure which in the past had led to inflation. It would be wrong, however, to regard the budgetary measures of the Poincaré Government as a single and isolated effort. Certainly this was the most far-reaching and decisive event in the post-war budgetary history of France, but a series of developments had since 1920 prepared the way for the climax.

During and after the war the many special funds opened at the Treasury were not covered by ordinary budgetary receipts, but almost entirely by loans. Immediately after the war no attempt was made to cover certain expenditures within the budget by ordinary revenue. Apart from the special funds, there were, in fact, three budgets—the ordinary budget, covered mainly by revenue from taxes, etc.; the extraordinary budget of special expenditure, covered mainly by loans; and the budget

of recoverable expenditure for the repair of war damage, based on future reparation payments, and also covered mainly by loans. In 1923 the extraordinary budget was discontinued, but the distinction between ordinary and extraordinary expenditure was made in the general budget until 1928. In 1925 the budget of recoverable expenditure was also discontinued, the expenditure being included in the general budget. This movement towards unification was approved by the Committee of experts in 1926, who argued that the demands made on the Treasury in virtue of the special funds were a source of continual embarrassment and should, strictly speaking, be made against the budget and met by ordinary revenue. The degree of unification already carried out by 1926 had, indeed, caused the importance of the budgetary deficit to be generally realized.

The loss of confidence in the French franc, both at home and abroad, and the veritable "flight from the franc" in the first half of 1926, set the French Treasury a more immediate problem than that of budgetary equilibrium. The floating debt, in the form chiefly of National Defence Bonds, had assumed immense proportions. These bonds, falling due at periods of one month to one year, were constantly being tendered for repayment. So long as the Government could induce either the actual holders or new buyers to take new issues of bonds as the old ones fell due, the problem was not acute. The British Government was able to do this with its Treasury Bills, and so experienced no embarrassing demands for repayment. But in France, where the Defence Bonds were more widely diffused among individual holders, the loss of confidence in the currency was disastrous. Demands for repayment were far more numerous than the possibility of new issues on the old terms and, failing some arrangement which would restore confidence, the only alternative was direct inflation. The Government had to face this problem immediately, and by a special law of 7th August, 1926, created a separate fund, the *Caisse autonome d'amortissement*, as described above.

The amount of bonds taken over by the *Caisse* in 1926 was as follows :—

34,196	million	francs	Bonds	of	National Defence	of 1 year.
4,337	,,	,,	,,	,,	,,	6 months.
3,454	,,	,,	,,	,,	,,	3 ,,
4,986	,,	,,	,,	,,	,,	1 month.
46,973	,,	,,	,,	,,	,,	in total.

1,312 million francs Treasury Bonds of less than 1 year.

The *Caisse* had to provide for repayments demanded and at the same time proceed to conversions. Everything depended on the confidence that the Government could inspire by its policy, and on the success of the conversions. Fortunately confidence was sufficiently restored by the fact that the bonds were guaranteed by the tobacco monopoly for the *Caisse* to issue an internal conversion loan of 3 milliards of francs. Gradually Defence Bonds of very short duration were suppressed, no new issues being made. In their place two-year bonds were issued. These in turn were gradually redeemed by amortization or replaced by conversion. We shall consider the operations of the *Caisse* later. For the moment it is sufficient to remark that the problem of the floating debt was satisfactorily solved and presented no further obstacles to effective stabilization. By the end of 1929 the total amount of Defence Bonds outstanding was only 28,491 million francs, as against 46,973 million francs in 1926, and no bonds of less than two years' duration remained in existence.

With the situation of the Treasury thus improved and with confidence restored, all danger of further inflation was definitely ended. There were, however, some disadvantages. A sharp rise in the external value of the franc caused a slackening of economic activity and an increase in unemployment. Fortunately these effects were only temporary. Had they persisted, the stabilization would have been jeopardized by the possibility of a new inflation, for on the one hand continued depression would have upset the calculations of the Government with regard to the yield of new taxes, and on the other political opposition to the Government by industrialists might have broken up the cabinet of " national concentration ". In fact, after this temporary crisis conditions of prosperity reigned in France until the world depression began to make itself felt in 1930. Two circumstances enabled France to share in the relative prosperity enjoyed by a number of countries between 1927 and 1929. In the first place, with a much more self-contained economy than any other industrialized country, France was less dependent upon her export trade than were, for example, Great Britain and Germany. Secondly, there was no question of deliberate deflation in France, as there had been in Great Britain, in the Scandinavian countries, and in Czecho-Slovakia. The temporary setback was the inevitable result of checking the process of inflation. But, once this was accomplished, the franc found its own external level at a rate which corresponded with the

internal price-level. No effort was made to raise the value of the currency to a level which demanded serious internal adjustments of a deflationary character, as in Great Britain. The franc, having found its external value after 1926, was not, like the pound, overvalued.

The relative prosperity which followed the temporary depression removed the fear of budgetary deficits. We need not look further for a witness to this prosperity than the facts which directly concern our present study—namely the progress, after the new taxation, of the Government revenues. The provisional results of the budgets of 1926–9 were as follows :—

SUMMARY OF BUDGETS, 1926–9 (MILLION FRANCS)

	1926.	1927.	1928.	1929–30 (15 *months*).
Expenditure . .	39,745	41,682	44,063	59,059
Revenue . .	41,336	42,296	47,293	62,678
Surplus . . .	1,591	614	3,230	3,871

Thus from 1926–8 budgetary revenue rose from 41,336 million francs to 47,290 million, or about 14 per cent. The greatest increase took place in 1928, when the effects of the brief depression had passed. As the budgetary *exercice* of 1929–1930 was one of fifteen months, the results are not directly comparable with the preceding years. Nevertheless it is clear that the results were highly satisfactory. Allowing for the additional three months the tendency for the revenue to increase was maintained, and the surplus was equal to more than 5 per cent of the total expenditure of the budget.

Relieved of the danger of excessive demands for repayment of short-term bonds, and with the budgetary surpluses to enter on the credit side of its accounts, the Treasury was in very easy circumstances in 1928 and in 1929 and accumulated considerable cash balances. The accounts are extraordinarily complicated, and it is difficult to arrive at a precise understanding of the significance of the Treasury operations. Some approximate figures, however, quoted by a Committee of experts set up to inquire into the financial situation and presenting their report in January, 1933, leave no doubt as to the improvement during the period under review. According to the report of this Committee, the active balance of the Treasury on 30th June, 1926, was 2,687 million francs ; on 31st December, 1928, the active balance was 18,594 million francs, an increase in $2\frac{1}{2}$ years

of 15,907 million. The passive balance on the first of these dates was 100,542 million francs, and on the second date was only 9,529 millions, a reduction in the $2\frac{1}{2}$ years of 91,013 million. Thus though heavily a debtor on balance in 1926, on 31st December, 1928, the available credits of the Treasury were 18,594 million francs, against debits of 9,529 millions.

CHAPTER III

A STUDY OF FRENCH BUDGETS SINCE 1926

We are now in a position to proceed to a more detailed examination of French budgets since 1926. We shall analyse first the revenue and then the expenditure. Finally, we shall pass on to the outstanding problems of French public finance, particularly as regards the world depression.

In the Table which follows are set out the budgetary receipts, including certain exceptional receipts, classified according to their nature. The Table has been built up from the monthly returns in the *Journal Officiel*. All the figures relate to the calendar year, and the changes made in the budgetary year have been ignored in order to make comparisons possible and to show the progression of revenues from 1926 to 1932. These figures cannot be directly related to the figures of budgetary expenditure given below for two reasons, first, because they are cash returns of a twelve-months' period, while in the French system the correlation between revenue and expenditure is not made on the cash principle, and second, because no notice has been taken of the changes in the budgetary year. On the other hand they provide a basis to compare the progress of revenues year by year and give a clear idea of the effects on the revenue of the periods of prosperity following 1926 and of the depression beginning in 1930.

THE YIELD OF DIFFERENT SOURCES OF BUDGETARY REVENUE, CLASSIFIED ACCORDING TO THEIR NATURE. (CALENDAR YEARS, BASED ON MONTHLY RETURNS)

(Million Francs)

	1926.	1927.	1928.	1929.	1930.	1931.	1932.
1. Direct taxes on revenues and fortunes (including taxes *cedulaire* and land tax)	11,192	13,981	13,248	14,670	14,514	13,619	10,061
2. Taxes on successions and stamp duties, etc.	8,064	5,941	7,221	7,966	7,650	6,565	5,757
3. Sumptuary taxes (including 10 per cent supplementary turnover tax)	1,589	1,678	1,879	2,062	1,676	1,469	1,476
4. Taxes on luxury products	4,129	2,036	2,343	2,564	2,687	2,642	2,372
5. Taxes on consumption (including :— (*a*) Customs (*b*) Turnover tax. (*c*) Indirect contributions)	12,882	16,153	17,728	19,385	18,583	19,304	17,168
6. Domains of State	489	399	469	451	424	278	299
Total	38,347	40,191	42,890	47,101	45,534	43,877	37,133

A glance at the totals in the above table brings out clearly the elastic nature of the revenues. From 38 milliards in 1926 they rise gradually to 47 milliards in 1929. Thereafter they fall slightly in 1930 but very heavily in 1932, when the returns are more than a milliard less than at the beginning of the period in 1926. The figures suggest, in accordance with other statistical evidence, that the depression was very much milder in France, particularly in the first two years, than in many other countries. This is more clearly brought out in the present instance, if we take into account the fact that reductions in taxation after 1928 only had their full effect in 1930 and 1931, and this in itself partly accounts for the fall in revenue in those years compared with 1929. On the other hand the heavy fall in 1932 took place in spite of increased taxes applied in the latter half of the year.

The classification in the table, which is that of the French authorities in the official returns, gives rise to certain reflections on the tax structure of France, and also raises the question of the changes in taxes over the period. With regard to the form of taxation in France some remarks of a general nature which bring into prominence the accepted French view on this aspect of public finance, and also make possible a brief comparison with taxation systems of other countries, suggest themselves. It is difficult to arrive at a satisfactory classification of taxes which meets theoretical demands and at the same time takes account of administrative peculiarities and necessities. The old classical distinction between direct and indirect taxation may be objected to on theoretical grounds. On practical grounds it is even less easily defended, especially where comparisons between different countries are concerned, since the terms frequently bear different meanings. Account being taken of these points, we shall consider the French taxation structure according to the following classification: (1) Direct taxes on income and property, (2) taxes on special transactions and transmission of property, (3) taxes on consumption.

Referring back to the previous table the three divisions will be made up as follows:—

(1) *Direct Taxes on Income and Property.*—The whole of section 1 in the table which includes the schedular income tax, the tax on income from capital and the land and property taxes.

(2) *Taxes on Transactions.*—The whole of section 2 in the table, which is made up of the various stamp duties, and taxes on the transfer of property and on various services of a legal nature performed by the State.

(3) *Taxes on Consumption.*—These include all the remaining items in the table, with the exception of the yield of State Domains, which is not, properly speaking, a fiscal charge. There remains under this head, therefore, the proceeds of customs duties, the turnover tax, and the various indirect taxes on a number of products, such as beer, coffee, sugar, etc.

As there have been no important changes in the form of taxation since 1926, we may take any subsequent year in order to examine the taxation structure. Let us take the year 1930, which was a year of fairly normal trade in France. The yield of taxes according to our classification was as follows :—

	Amount in million francs.	*Percentage of total.*
1. Direct taxes on income and property . .	14,514	32·2
2. Taxes on transactions .	7,650	17.1
3. Taxes on consumption .	22,946	50·7
	44,710	100·0

Thus one-half of the total tax revenue is derived from taxes on consumption, and one-third from direct taxes on income and property. Though direct taxation has increased in France since the War and was greatly increased in 1926, it still occupies in France a less important place than in Great Britain and the Scandinavian countries, where it accounts for 40 to 50 per cent of the revenue. Indirect forms of taxation are traditionally preferred in France to direct forms.

While there have been no fundamental changes in taxation since 1926, there have been up to 1931 a number of reductions, a fact which brings into prominence the large yields of 1929 and 1930 due to the extraordinary prosperity of the years 1928 and 1929. These reductions, while affording relief to certain classes of tax-payers, considerably affected the budget revenues, especially when prosperity gave way to depression in 1931. Some of the taxes were restored as part of the measures to restore budgetary equilibrium in July, 1932. In presenting the budget for 1931–2 the Minister of Finance estimated the total cost to the budget of the reductions in taxation at 5,036 million francs, of which 2,557 millions were due to direct taxes, 2,131 millions to indirect taxes, and 348 millions to stamp duties. The most extensive reductions took place in 1929 and 1930. The reductions in direct taxes began in 1928 when the amount of income exempt from the tax was raised from 7,000 to 10,000 francs, and was carried further in 1929 with the

extension of exemptions for family charges and with a reduction from 12 to 10 per cent of the tax on salaries. So far as indirect taxes are concerned the chief changes were the reduction of the sugar duty in 1929, the suppression of the transport taxes on certain perishable goods, and the reduction of the turnover tax.

Undoubtedly the outstanding feature of French budgetary history since 1926 is the steady increase in expenditure, only brought to a halt in the budget voted for 1933. A clear impression, though not an exact statistical measure, of this development was given by M. Germain Martin in his *exposé* of the budget presented for 1933. The budgets voted each year since 1926, supplementary credits voted during the course of the budget not being included, are compared as follows :—

1926	37,338 million francs.		
1927	39,541 ,, ,,		
1928	42,445 ,, ,,		
1929	45,366 ,, ,,		(on the assumption of a budgetary year of 12 months).
1930–1	50,398 ,, ,,		
1931–2	50,640 ,, ,,		
1932	53,467 ,, ,,		(assuming a budgetary year of 12 months, and calculated on an actual budget voted for 9 months).

It should be added that since 1928, and even more since 1930, the *Caisse d'amortissement* has taken over from the budget extensive obligations for the redemption of debt. The explanation of this remarkable increase is to be found in two causes. First, the existence of large Treasury balances, and of budget surpluses in 1927, 1928, and 1929, provided the conditions in which new expenditures were easily accepted. Secondly, it must be remembered that the budget of 1926 represented a minimum of expenditure on various services which are regarded as the normal function of a modern state. Moreover, many services of a social nature, as for example various forms of social insurance, and the organization of public health, were less developed in France than in Great Britain and the Scandinavian countries. We shall proceed to a more detailed analysis of these expenditures.

Budgetary expenditures may be conveniently distinguished under three heads, namely (1) the expenditure on the Public Debt, (2) expenditure on National Defence, and (3) all other civil expenditure. The last of these may be further subdivided into social expenditure, expenditure on economic services, expenditure on public works and national development schemes, etc. Following this plan the budgetary expenditures of France

BUDGET EXPENDITURE IN FRANCE SINCE 1927

(Million Francs)

Type of Expenditure	1927		1928		1929–30 (15 months)		1930–31		1931–32		1932 (9 months)		1933	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1. Debt—														
(*a*) " Dette Viagère "	7,195	16·0	7,757	17·2	10,445	17·0	9,153	16·5	9,593	18·3	7,195	17·3	9,365	18·7
(*b*) Debt Proper	14,981	33·2	14,814	31·0	15,981	26·0	13,227	23·5	11,152	19·7	9,196	22·4	10,067	19·8
Total Debt . .	22,076	49·2	21,571	48·0	26,426	43·0	22,380	40·0	20,745	38·0	16,364	39·7	19,432	38·5
2. Defence . .	9,069	19·4	9,901	22·0	15,833	25·9	14,132	25·4	14,267	26·8	9,963	24·2	11,445	22·6
3. Civil . . .	13,866	31·4	13,468	30·0	19,111	31·1	18,902	35·6	18,234	35·2	14,770	36·1	20,609	38·9
Total . .	44,830	100	44,958	100	61,370	100	55,414	100	53,246	100	41,097	100	50,486	100

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since 1926 are shown in the table on p. 283. As no details of closed accounts are available the table is based on actual expenditures up to the last day of the financial year in question, and for 1932 and 1933 on the credits voted by Parliament. As we have already seen, there is no reason to suppose that these will greatly diverge from the closed accounts. In an appendix to this chapter will be found a similar table giving a more detailed analysis, to which reference must be made for the complete statistics supporting the statements in the text.

In considering the figures in the above table it should be remembered that those for 1929–1930 cover a period of fifteen months, and those for 1932 a period of nine months. All the others refer to a normal budgetary year of twelve months. Total expenditure in 1928 was only very slightly in excess of that for 1927. A slight fall in the debt charge and in the civil expenditure was offset by an increase in military expenditure. After 1928 total expenditures increased rapidly and in 1930–1, a normal year of twelve months, were 10 milliards greater than in 1928. This increase is in spite of the fact that the debt charge in the budget had steadily diminished over the same period. It is almost equally divided between the Defence service and the Civil services. The apparent break in this progression for the year 1931–2 is explained by the fact that in that year the *Caisse d'amortissement* relieved the budget of considerable charges for the redemption of debt. Similarly in 1932, regard being had to the fact that the budget covers a period of nine months, the level of expenditures was at least maintained in the budget as voted. Indeed, in introducing the budget of 1932 the Finance Minister remarked that increased expenditure was necessary on certain social services, as the result of laws recently voted. This is reflected in the rise in relative importance, from 35·2 to 36·1 per cent, of civil expenditure as a whole. The changes in relative importance of the different groups of expenditure, as reflected in the percentages of the total, are no less interesting than a study of the absolute amounts. The debt charge has steadily diminished in importance, a fact which is more striking if we exclude the *dette viagère*, which represents pensions. The charge of the debt proper has fallen from 33·2 per cent of the total in 1927 to 19·8 per cent in 1933, partly owing to the relief of the budget after 1930 of important redemption charges. Defence expenditure, which was 19·4 per cent of the total in 1927, had risen to 26·8 per cent in 1931–2, but has fallen again to 20·9 per cent in the budget for 1933.

Civil expenditure on the other hand, which was stable at about 31 per cent of the total between 1927 and 1930, has gradually increased in importance since the latter date and stands at 40·6 per cent of the total in 1933. This is partly explained by the fact that the chief economies achieved, apart from savings on the debt charge, under the influence of the depression, have been in the Defence services. Finally it is worthy of notice that, whilst increases in the Defence services occurred in the earlier period, from 1927–1930, the greatest increases in the Civil services, due to the extension of various social services, increases in pensions and social insurances, took place after 1930. We shall now consider separately the three classes of expenditure distinguished above.

(*1*) *The Public Debt*

The greatest single item in the French budget is the service of the public debt. Although the devaluation of the currency after the stabilization automatically destroyed a large part of the internal debt contracted during and after the War, the debt burden is nevertheless considerably greater than in 1913. However, even before the War the debt charge was relatively high in France and the increase in the debt charge in the post-War budgets, as compared with that of 1913, is less striking than in the case of Great Britain, where a policy of deflation was pursued. Thus, while the debt charge increased in France from 28 per cent of the budget expenditure in 1913 to 40 per cent in 1929, the increase in Great Britain was from 12 per cent in 1913–14 to over 40 per cent in 1929–1930. Inflation and currency devaluation in France may have reduced the burden of the debt from what it would otherwise have been, but they have not prevented it from assuming a dominant place in the budget.

In the years immediately following the War the debt problem received little serious attention. It was generally assumed that the payments from Germany would eventually liquidate many of the huge Treasury expenditures covered entirely by new additions to the public debt. Slowly and painfully this was seen to be a vain hope and, when the great effort towards monetary restoration came in 1926, a vigorous solution of the debt problem was a vital condition of success. Up to 1926 no important redemption of the debt had been carried out. On the contrary the debt was continually increased. In 1926 no further increases by the ordinary means were possible, the

credit of the Government being too low, and the choice lay between controlling and reducing the debt and resorting to direct currency inflation. We have already explained, in describing the machinery of French public finance, how the *Caisse d'amortissement* came into existence, and how it achieved its primary object. It remains to discuss the management of the debt in the budget, and by the *Caisse d'amortissement*, since 1926.

Until 1930–1 the debt charges in the budget were distinguished under three main heads, namely, (1) the consolidated debt (*dette perpetuelle*), (2) the repayable debt, and (3) Pensions (*dette viagère*). This classification was extended in the budget for 1930–1, since which time six types of debt have been recognized. These are (1) the consolidated debt, (2) the repayable debt, (3) debt at medium term, (4) floating debt, (5) external debt, and (6) *dette viagère*. As has been pointed out, the last of these items is not a true debt charge, but consists of life pensions which are obligations of the State. Thus, in speaking of the debt charge proper, we shall not take it into account. The other items are more or less self-explanatory. The repayable, or *amortissable*, debt represents loans the repayment of which is effected by annuities which are a contractual obligation of the loan. Until 1931 both the interest and the amortization represented in the annuities of this part of the debt were charged against the budget. Since 1931 the budget has only borne the interest charges, the amortization being taken over by the *Caisse d'amortissement*. Only a portion of the floating debt is charged against the budget, since the major part of the floating debt was also taken over by the *Caisse d'amortissement* in 1926.

The complete administration of the debt has been divided between this body and the budget, and it is meaningless to study one without the other. What has been achieved since 1926 is indicated by comparing the composition of the debt at different dates. On 31st March, 1926, the total internal debt was 297,241 million francs; on 31st March, 1930, it was 279,573 million. The reduction is not in itself remarkable. What is remarkable is the change in the composition of the debt, which is as follows:—

	31*st March*, 1926.	31*st March*, 1930.
Long-term debt	163,897 million francs.	228,100 million francs.
Short-term debt	39,910 ,, ,,	17,403 ,, ,,
Floating debt	93,434 ,, ,,	34,070 ,, ,,
Total	297,241 ,, ,,	279,573 ,, ,,

These facts expressed as percentages and quoted by M. Larrieu in his study of the French internal debt bring out the significance of this change even more strikingly. It is worth while to reproduce them.

DIFFERENT ITEMS OF THE FRENCH INTERNAL DEBT EXPRESSED AS PERCENTAGES OF THE TOTAL

	1913.	1919.	1925.	1930.
	%	%	%	%
Consolidated . . .	78	50	45	43·7
Long-term *amortissable* .	12	7	7	37·5
Short term . . .	3	0·6	13·4	6·25
Floating . . .	7	42·4	31·6	12·5

This table brings out very clearly the tremendous growth of the floating debt after the War, and shows also that between 1919 and 1925 very little had been done to restore the pre-War relation between it and the long-term debt. Between 1925 and 1930, however, the floating debt was reduced to 12·3 per cent of the total, being only slightly greater in relative importance than in 1913. On the other hand the growth in importance of the long-term *amortissable* debt shows the extent to which the floating debt has been converted into long-term obligations.

This represents in sum the achievement, by no means inconsiderable, of the debt policy from 1926 until the depression. Since 1931 the effect of deficits in the budget has led to an increase in the public debt, which was commented upon, in striking terms, by the Committee of experts which presented a report on the financial situation in January, 1933. This Committee pointed out that from the beginning of 1931 to the end of 1932 the total of the debt had risen by 23 milliard francs, from 269 to 292 milliards. This latter figure is contrasted with the total debt in 1926 of 305 milliards, and it is pointed out that, if from the latter figure 15 milliards, representing an amortization due to the revaluation of the *encaissements* of the Bank of France in 1926, is subtracted, the debt shows practically no reduction and the effect of four years' amortization is wiped out. On the other hand, while these bare facts are true, and while there has been a marked tendency of the floating debt to increase since the end of 1930, the beneficial results of the policy followed since 1926, which has secured substantial reductions in the debt charge and brought the floating debt to manageable proportions, have by no means been forfeited. It is, nevertheless, to be remarked that, while conversions of portions of the short-term and floating debt to long-term obligations at reduced rates of interest provide a possible saving to the budget in times of depression, the

immediate benefit of these operations is always liable to be offset by the necessity of borrowing to meet budget deficits.

Ignoring the *dette viagère*, the charge of the debt proper has fallen in the budget from 14,981 million francs in 1927 to 10,067 million in 1933. If this represented a saving in interest charges due to redemption and conversion, the achievement would be extraordinary. In fact, however, a large part of this reduction of debt charge in the budget is due to the transfer of charges for redemption from the budget to the *Caisse*. To appreciate the true position we must now consider briefly the operations of the *Caisse d'amortissement*.

When the *Caisse* was first created in 1926, it merely took over the administration of a part of the floating debt, consisting chiefly of National Defence Bonds. By a series of laws and conventions the functions of the *Caisse* have been gradually extended, until by 1931 it had relieved the budget of practically all the charges for redemption of debt. These extensions of its powers mark three stages in the history of the *Caisse*; first, from 1926 to 1928 when it was concerned with the redemption of the National Defence Bonds; second, from January, 1929, to the end of 1930, when it was authorized by a law of 30th December, 1928, to proceed to the redemption of the public debt by repurchases of securities on the market; third, 1931 and after, regulated by a convention of 12th September, 1930, by which it became responsible, after 1st April, 1931, for the contractual redemption of the debt previously charged against the budget, and by a law of 31st March, 1931, by which the redemption of the debt at medium term was transferred from the budget to the *Caisse*. The *Caisse* has thus become the administrator of a sinking fund applied to the reduction of the capital of practically the whole of the public debt. But it is nevertheless an autonomous institution, independent of the general budget with fixed privileges of its own, of which the chief is the exploitation of the tobacco monopoly. Indeed it may be said to perform three tasks, the exploitation of the tobacco monopoly, the administration of the National Defence Bonds, and the redemption of the public debt in general. From its inception in 1926 to the end of 1931 the total amount of redemption effected by the *Caisse* was 19,760 million francs, of which 5,523 million are to be attributed to Bonds of National Defence, and 14,237 million to the public debt in general. Its operations since the end of 1928 are shown in the following tables. It should be noted that the revenues consist not only

in the produce of the tobacco monopoly, but also of the two other taxes named, together with any realized budget surplus, which is thus applied to debt redemption. For convenience we distinguish two periods coinciding with the extensions of its powers. From 1926 to the end of 1928 it was concerned entirely with the administration of the Bonds of National Defence.

OPERATION OF THE "CAISSE D'AMORTISSEMENT", 1928–32

A. Amortization and saving in interest in the Yearly Budget

(Million Francs)

	Net Amortization of Bonds of National Defence	Amortization of Public Debt		Annual saving in interest charges of budget
		(*a*) Contractual	(*b*) Other	
First Period. January, 1929–January, 1931				
1929	2,342	Not taken	5,626	274
1930	553	over until 1931	3,947	215
Second Period 1931–33				
1931	453 (Repayment of Treasury obligations)	1,094	3,981	212
1932	3,400	2,100	2,350	—

B. Revenue of the Caisse d'amortissement, 1928–32

(Available for amortization of the public debt, after paying interest charges, etc., on the Nat. Def. Bonds)

Items of Revenue.	1929.	1930.	1931.
Tax on *première Mutation* .	755·0	519·0	324·0
Succession Duties . .	2,727·0	2,389·0	2,220·0
Voluntary Contributions .	·6	·1	·06
Stamp Surcharges . .	·4	1·0	0·5
Budget Surplus . . .	1,500·0	2,000·0[1]	—
German Annuities . .		2,251·0	
Excess of tobacco monopoly after administration of N. D. Bonds . .	1,097·0	1,403·0	1,762·0
	6,080·0	8,563·1	4,306·6

[1] Budget surpluses in respect of budgets of previous years, which have been paid to the *Caisse* are :—

1928 . 490 million francs.
1929 . 1,500 ,, ,,
1930 . 2,000 ,, ,,

Thus, apart from the actual relief to the budget by the transfer of the contractual redemption charges to the *Caisse*, there has been a considerable real saving in annual interest charges, and a consequent reduction of the burden of the debt. This has been achieved as a result of the direct redemption shown in the table above, of the operations of the *Caisse* in converting the floating debt, and of a fall in the rates of interest since 1926. To the reduction in the annual charges for interest in the budget we should also add the reduction in interest charges of that part of the floating debt administered by the *Caisse*. This annual charge had fallen from 2,700 million francs for 1926 to 1,735 million in 1931, due first to conversions of the floating debt and secondly to reductions in the rate of interest on the two-year National Defence Bonds. The rate of interest on National Defence Bonds has fallen successively from 6 per cent in 1926 to 5 per cent in 1927, 4½ and 3½ per cent in 1928 and 1929, and finally to 3 per cent in 1932. For a short period in 1932 the rate was lowered to 2½ per cent, but was subsequently again raised to 3 per cent. Naturally there was at the same time a rise in the price of Government securities and a consequent fall in the long-term rate of interest at which the Government could borrow. In these conditions conversions of the floating debt were possible and the success of the *Caisse* in reducing the National Defence Bonds from 47 to 28 milliards between 1926 and 1928 is sufficient witness to the improvement in the credit of the Government. Nevertheless the rate of interest on the long-term debt remained fairly high up to 1930, at 6 to 5 per cent, and, apart from the conversions carried out before the end of 1930, most of the effort was applied to redemption. This is natural in view of the general economic prosperity in France in 1928 and 1929, but the policy of the *Caisse* between 1928 and 1931 paved the way for future conversion by improving the credit of the Government. Also, of course, depressed economic conditions are particularly favourable to conversions.

No conversion approaching the magnitude of the British conversion of War Loan in 1932 has been achieved, nor have reductions in rates of interest been so favourable to the French Government. But a conversion of considerable importance was undertaken in conformity with a Law of 17th September, 1932, which authorized the Government to proceed to the conversion of a series of loans, namely, the 5 per cent loan of 1920, 6 per cent of 1927, 5 per cent of 1928, and Treasury Bonds of 1927 at 7 per cent. The Government was authorized to repay

these obligations or to convert them into new Rentes at 4½ per cent. These new securities are repayable in sixty-five years and they carry all the privileges of the 3 per cent consolidated debt, being exempted from special taxes on capital. The capital involved in this operation was about 85 milliard francs, and practically the whole amount was converted. In March, 1933, a consolidation loan was issued to the amount of 5 milliards in the form of long-term bonds repayable in sixty years, and carrying interest at 4½ per cent. The purpose of the loan was to consolidate part of the floating debt which had resulted from budgetary deficits. These deficits are now, therefore, for the most part incorporated in the long-term debt. The loan was issued, however, at an inopportune moment and brought a fall in the price of the 4½ per cent conversion securities issued in September, 1932, from 100 to 85. This indicated a rise in the rate of interest for the State from 4½ to 5⅓ per cent. Thus with the floating debt reduced to relatively small proportions, and with somewhat uncertain conditions in the capital market, the possibility of further reductions in the debt charge by the way of conversions is very doubtful.

Since the end of 1930 the debt has tended to increase and this discussion may be concluded by quoting the following figures from the report presented in January, 1933, by the Committee on the financial situation.

PROGRESS OF THE FRENCH PUBLIC DEBT, 1926–33
(Million francs)

Item of Debt.	1926.	1928.	1930.	1933.
External . .	14,259	7,107	4,906	4,307
Perpetual . .	101,668	101,788	95,778	94,944
Amortissable . .	50,738	104,466	106,324	120,044
Medium Term . .	37,282	22,077	22,075	16,606
Floating . . .	101,309	44,565	37,560	46,170
Posts and Telegraphs	—	2,244	2,704	5,432
Total . .	305,256	282,247	267,347	287,496

These figures do not call for much comment. Looking at the total debt the striking fact is the gradual decrease between 1926 and 1931 from 305 to 267 milliard francs, and the increase again to 287 milliards in 1933. However, the composition of the debt has not significantly altered since 1931 to upset the great achievement of the cut in the floating debt from 101 milliards in 1926 to 37 milliards in 1930. A portion of the new floating debt was converted into long-term obligations in March, 1933. The long-term debt has increased from 106 milliards in 1930

to 120 milliards in 1933, reflecting the effect of these conversions. The consolidated debt has fallen from 101 milliards in 1926 and 95·7 milliards in 1930 to 94·9 milliards in 1933, which represents the net result of repurchases of securities on the market by the *Caisse*.

The external debt is relatively unimportant. It has been reduced from 14 milliards in 1926 to 4·3 milliards in 1933, some external loans having been completely repaid and others considerably reduced. These debts are of two types, commercial and political. The commercial debts are loans which have been raised in a number of countries, while the political debts are due to the British and United States Governments. A definite settlement of the political debts was part of the general plan for stabilization, and agreement was eventually reached on the American debt in the Beranger-Mellon agreement, and on the British debt in the Churchill-Caillaux agreement. These political debt payments were effected under the Young Plan by the Bank for International Settlements, and were covered by the German annuities to France. When the Young Plan finally broke down and the Lausanne settlement was made in 1931, the British debt was, in effect, wiped out and the American debt alone was left undetermined. So far this has been met by default on the part of France as a matter of political principle German reparations having ceased. Only the commercial external debt enters into the budget.

It may be asked what real purpose is served by the *Caisse d'amortissement* operating outside the general budget ? In theory there are objections to this procedure. An important part of the revenues are taken from the budget and earmarked for a particular purpose, contrary to the principle of the universality of revenues, which condemns such application of specific revenues. Moreover, the redemption of the debt is really a budgetary question, and the amount of redemption can only ideally be determined in relation to the total needs and income of the budget and the state of the capital market. An independent sinking fund with an assured revenue might result in repayment of a low interest-bearing debt, while new loans were being raised for budgetary purposes at a higher rate in an unfavourable market. If the revenues assigned to redemption had been available for the general budget, this expensive procedure would have been avoided. To urge such theoretical objections is not to say that the French debt policy has, in fact, had such results. On the contrary, the annual interest charge has been

successfully reduced and, in view of this success, two replies may be made to theoretical criticisms. First, the peculiar situation of 1926 and the necessity for vigorous action with regard to the floating debt were favourable to the formation of an autonomous sinking fund, at any rate temporarily. Its formation was a dramatic move, quite rightly calculated to restore waning confidence. Secondly, the French system, whereby the individual member of Parliament has the same right as the Executive to propose new expenditure, may lead to irresponsibility in undertaking new obligations, especially when the Treasury is in easy circumstances. Thus political motives might lead the Government to neglect favourable opportunities for debt redemption. The existence of the *Caisse d'amortissement* acts as a check on this possible abuse, particularly since the extension of its powers. On the other hand, the first task of the *Caisse* having been performed, it is questionable whether the extension of its powers is, on balance, justifiable. This further break with the principle of the universality of the budget is in itself to be deprecated. As Professor Jèze argues, no *Caisse d'amortissement* will automatically solve the problem of redemption, which depends in the long run on the fiscal capacity of the country and the willingness of the citizens to face economic realities.

Expenditure on Defence Services

The economic problems raised by the expenditure on the defence services are less complicated than those relating to the debt, and can, therefore, be more briefly disposed of. The chief difficulty lies in determining what is, and what is not, defence expenditure. Certain items in the expenditure of other Ministries, as for example certain of the items under " physical education ", may, strictly speaking, be military expenditure, certain physical education centres being related to military service. A study of the budget shows the following items to be undeniably military expenditures, (*a*) the Ministry of War, (*b*) the Ministry of Marine, (*c*) the Ministry of Air, and (*d*) expenditure on military services under the Ministry of the Colonies. We ignore other items, which are very small in amount or of doubtful classification, and also War Pensions under the Ministry of Finance and the Ministry of Pensions. On the other hand there is included under the rubrics named above, expenditure on personnel, on material and on new constructions, including fortifications.

Defence expenditure thus defined increased gradually from 9,069 million francs in 1927 to 14,267 million in 1931–2, but has fallen again in the budget as voted in 1933 to 10,445 million. The expenditure of 15,833 million francs in 1929–1930 cannot be compared, as it applies to a period of fifteen months. In 1926 defence expenditure was 19·4 per cent of the total, in 1928 22 per cent, in 1929–1930 25·9 per cent, in 1930–1 25·4 per cent, in 1931–2 26·8 per cent, in 1932 24·2 per cent, and in 1933 22·6 per cent. These fluctuations, both relatively and absolutely, show a considerable degree of elasticity in this item of expenditure, and divide the period 1926–1933 into two parts, the first, extending to the end of the year 1931–2, being a period of gradual increase; and the second, beginning in 1932, when considerable reductions were made. The reversal of policy in 1932 is explained by special efforts to balance the budget, as a result of which a reduction in defence expenditure of about 1,548 million in a full year was authorized by a law of 15th July, 1932.

An important administrative change was made by the creation in 1929 of a separate Ministry of Air. Previously the expenditure on the Air Force had been incorporated in the expenditure of the Ministries of War and of Marine. This change makes comparisons of earlier budgetary expenditures with later ones a little difficult, but it is clear that a large proportion of the increase is accounted for by the development of the Air service. The expenditures, classified by Ministries, since 1927 have been as follows:—

(*Million Francs*)

Ministry.	1927.	1928.	1929–30.[1]	1930–31.	1931–32.	1932.[2]	1933.
1. War	6,410	6,846	9,765	8,181	8,099	5,218	6,080
2. Marine	2,277	2,633	3,532	3,039	3,355	2,411	2,712
3. Air	—	—	1,974	2,377	2,190	1,826	1,996
4. Colonies	372	422	562	535	673	508	657
Total	9,069	9,901	15,833	14,132	14,267	9,963	11,445

The chief increases in expenditure are in the Ministries of War and of the Air. The increase in total budget expenditure between 1927 and 1930–1 was a little more than 10 milliards, of which about half was due to defence expenditures. On the other hand the reduction in total expenditure between 1930–1 and the budget voted for 1933 is about 5 milliards, of which roughly 3 milliards, or 60 per cent, is due to reductions in defence expenditure.

[1] Budgetary year of fifteen months.
[2] Budgetary year of nine months.

Civil Expenditure

If we include the expenditure on the *dette viagère* in the debt expenditure, then the debt and defence expenditures taken together account for from 60 to 70 per cent of the total budget. The remaining 30 to 40 per cent covers all expenditure for social, judicial or political purposes, including national education, public works, social insurance and assistance, and a large part of the expenditure on pensions, which we have grouped together under the heading "civil expenditure". This category has grown, both in relative and absolute importance in the budget, since 1927. From 13,866 million francs, or 31 per cent of the total, in 1927 it has increased to 20,609 million, or 38·9 per cent, in the budget voted for 1933. Most of the increase has taken place since the end of 1929, up to which time the civil expenditure varied between 30 and 31·4 per cent of the total. In 1930–1, however, there was a sharp rise in this expenditure to 34·2 per cent of the total, the actual credits involved being only slightly less for the twelve months 1930–1 than for the fifteen months 1929–1930. In 1931–2 they remained stable at roughly the same figure, but allowing for the fact that the budget of 1932 covers a period of only nine months, civil expenditure had again an upward tendency. In spite of a 5 per cent cut in administrative costs in the budget for 1933, there is nevertheless a further increase in civil expenditure in that budget.

These increases are due to three main causes, namely (1) increases in the pay of State employees, and in practically all classes of pensions after 1927, (2) the extension of social services, and (3) the application of credits to schemes for national development. The increases in pay and pensions, which of course affected also the personnel of the defence services, was the result of the adjustments of these incomes to the conditions prevailing after the stabilization. During the inflation prices had always raced ahead of the increases in salaries and wages, and, when internal prices became fairly stable, it was inevitable that rates of pay should increase. This process was common to every country which stabilized its currency after inflation without retracing its steps by way of deflation. The extension of social services of various kinds is a development of more fundamental importance. New legislation, which was no doubt partly influenced by the prosperity of 1928 and 1929, has involved the State in new expenditures which have gone on increasing even after the tide has turned, and which, moreover, in present

circumstances show themselves particularly rigid in resisting demands for reduction. As for schemes of national development, many have been discussed, but most are still "such stuff as dreams are made of", though the discussions have led to a certain number of credits being voted for specific projects.

We can best obtain a picture of the extension of these services by comparing the expenditures on the chief items since 1927. In the table below, taking those items of expenditure which are relatively the most important, civil expenditure is classed in four groups, as follows: (1) Social services, consisting of the expenditures of the Ministries of Education, Labour and Social Insurance, and Public Health; (2) Ministry of Pensions; (3) Ministry of Public Works, consisting of expenditure on public works proper, roads, bridges, ports, etc., and on liberated regions, and (4) other civil expenditure, including, for example, the Ministries of Justice, of the Interior, and of Foreign Affairs. This classification makes it possible to see at a glance the effect on the budget of social legislation since 1926.

"CIVIL" EXPENDITURE IN THE FRENCH BUDGET SINCE 1927
(Million Francs)

Item of Expenditure	1927	1928	15 months 1929–30	1930–31	1931–32	9 months 1932	1933	Percentages of Total 1927	Percentages of Total 1933
1. *Social Services.*									
(*a*) Education .	2,575	3,062	4,048	3,806	4,077	3,099	4,148		
(*b*) Labour and Social . .	980	1,288	1,664	968	1,299	1,378	1,664		
(*c*) Public Health	—	—	—	1,262	1,173	1,056	1,324		
Total . .	3,555	4,350	5,712	6,036	6,549	5,533	7,136		
2. *Pensions.* Total . .	1,573	1,012	1,518	2,723	2,307	1,870	2,620		
3. *Public Works.*									
(*a*) Public Works	1,704	1,721	3,048	2,564	2,763	2,029	2,721		
(*b*) Liberated Areas	172	677	803	187	127	95	104		
Total . .	1,876	2,398	3,851	2,751	2,890	2,124	2,825		
4. *Other* Total . .	7,362	5,708	8,030	7,392	6,488	5,243	8,030		
Grand Total .	13,866	13,468	19,111	18,902	18,234	14,770	20,609	31·4	38·9

THE SOCIAL SERVICES

From the preceding table it appears that by far the greater part of the increase in civil expenditure since 1927 is due to the social services, expenditure on which has grown from

3,555 million francs in the 1927 budget to 7,136 million in 1933. Until 1930 public health expenditure was included without special distinction under the Ministry of Labour, Social Insurance and Health, but the budget of 1930–1 incorporates an administrative change by which public health expenditure is recorded in a separate section under a newly-formed Ministry of Public Health. In 1930–1, the first year of the new Ministry's independent existence, the expenditure on public health alone was almost as great as expenditure in 1928 by the Ministry of Labour, Social Insurance and Health combined. A large increase is also revealed in the expenditure of the Ministry of Labour and Social Insurance since the public health expenditures were placed in a separate section. From 968 million francs in 1930–1 it has grown to 1,664 millions voted for 1933.

The Minister of Health, in presenting his budget for 1931–2, gave a summary of the principal directions in which the State had undertaken new obligations. First, the housing policy of the Government had involved new expenditure in the increase of housing subsidies to builders, particularly to increase the construction of artisans' dwellings to let at low rents, and also by the application of a law of 8th June, 1930, giving facilities to war invalids to obtain small properties. Secondly, much attention had been given to the falling birth-rate, and various measures to encourage larger families and to reduce the infant mortality rate had been taken in the form of assistance to large families, the establishment of clinics and medical services for pre-natal and post-natal advice and treatment, and the development of various agencies for child welfare. Finally, increased facilities had been provided for treating tuberculosis, venereal, and other diseases. Social insurances have been increased, first by increases in individual benefits, and secondly by extensions of insurance to new classes of workers. Both directly and indirectly the growth in unemployment has caused these allocations to increase, but it must be remembered that there is no general State insurance against unemployment in France, and unemployment insurance is only a small proportion of the social insurances administered by the Ministry of Labour. The most important extension of insurance services was that which came into force in the budget of 1932, extending the various social services to agriculturists, resulting in an additional charge of 300 million francs in a full year. Subventions to "Mutual Aid Societies of ex-Servicemen" were increased by 74 million francs in 1932. The increase of expenditure in 1932,

directly due to unemployment assistance, was only 3½ million francs, which by no means reflects the real state of unemployment, and the smallness of which is due to the absence of an unemployment insurance system. The indirect effects of unemployment, though not measurable, are to increase the amounts spent on assistance of various kinds, whether by the Ministry of Public Health or the Ministry of Labour and Social Insurance.

Public Works and National Development

The expenditure of the Ministry of Public Works has grown from 1,876 million francs in 1927 to 2,825 in 1933. This is not expenditure of an order which suggests a large development scheme. It is significant, however, for the trend of public works expenditure has been upward over the whole period since 1927, an increase which is regularly provided for in the budget. For though some of the credits administered by the Ministry of Public Works are new capital outlay in the strictest sense of the term, many of them are applied to the maintenance of an increasing number of capital assets which come under the care of the State, and the maintenance charges may become heavier on account of more rapid depreciation of capital assets. Roads and bridges illustrate this point. We should not, indeed, expect to find an extensive scheme of capital development provided for out of the ordinary resources of the budget. The capital required for such a project could only be obtained by a loan.

The budget of the Ministry of Public Works is divided into a number of sections, following the nature of the expenditures. The expenditure on the "liberated regions", which is also separately distinguished, is a legacy of the War and has become of such relatively small importance that we may ignore it. As for the expenditure on public works proper, the following main sections are distinguished in the budget: (1) Expenditure of the Minister and personnel, (2) roads, (3) navigation, (4) water power and electrification, (5) mines, and (6) railways. Of these items the most important is roads and bridges, and it has shown by far the greatest increase, from 516 million francs in 1927 to 1,257 million in 1933. The item "railways" does not represent constructional work or even maintenance, but obligations of the State towards the railways, largely in the form of annuities for the service of the loan covering railway deficits before 1926. The increase of expenditure on roads is an inevitable result of the development of road transport. In 1929 a report on

national development was completed by the National Economic Council, and on the basis of this report a scheme involving a capital expenditure of 17 milliard francs, over a period of four years, was envisaged by the Government of which M. Tardieu was the head. The scheme was not put into operation, but certain proposals for specific works were adopted. These were mainly for canal constructions and improvements in the north, for protection against floods in the Seine area, and for the erection of hydro-electric plants. Half the expenditure of the scheme was to be borne by the Government and half by the local authorities, so that their execution depended in part upon the initiative of the latter. Beyond this the Government did not commit the budget to new expenditures, and in fact declared that the financial situation did not allow the administration to proceed with the construction of new roads at the expense of the Treasury.

The question of public works and schemes of national development have, however, a significance beyond the immediate budget, since any extensive scheme must find the necessary capital outside ordinary budgetary resources. In recent years the problem has been much discussed in France and several schemes have been put forward as practical possibilities. All these schemes provide for the expenditure of a large capital sum over a period of years on constructional works of public utility such as roads, canals, and water supply. Their difference lies mainly in the magnitude of the capital sum involved and in the extent of the works to be undertaken. We have already referred above to the schemes of the National Economic Council and M. Tardieu. Two alternative schemes were put forward, one, by M. Bedouce, visualizing a capital expenditure of 50 milliard francs over a period of five years; the other, that of M. Chabrun, involving a capital expenditure of 65 milliard. It was considered in 1929 that the capital for these schemes could be raised internally on the security of the Government. The Economic Council proposed that the capital should be provided by the *Caisse des dépôts et consignations*, a guaranteed Treasury fund. This proposal was criticized in certain quarters on the ground that this particular fund is guaranteed by the Government and that a large capital issue in the home market on the security of a special fund might damage the national credit. Alternatively it was argued that the foreign capital market should not be closed to a well-considered scheme of national development. The rate of interest at which the

Government could borrow had fallen considerably by 1929 and, in fact, the capital could probably have been raised without difficulty.

But though they were much discussed, nothing was done to bring these schemes to fruition beyond the modest increase in expenditure on public works in the budget, which we have already mentioned. In 1930, and still more in 1931, the economic depression caused the schemes to be abandoned or at least postponed. If those who argue for public works to be timed to smooth out fluctuations are right, the time for such a scheme to be launched in France was in 1930 or 1931. It should have been no more difficult to raise the capital in 1931 than in 1929, provided the loan was not made an excuse for an unbalanced budget. If an effort had been made to meet current expenditure out of current revenue, that was the chief technical condition necessary to carrying out successfully a large scheme of capital development. For France was a creditor country and had a relatively large margin for independent internal development without endangering the foreign exchange. It would, however, have been a bad financial policy to use a scheme of national development to cover an unsound budget, and any project of capital development of public works ought to maintain a clear distinction between current expenditure in the budget and capital outlay on new public works. This is precisely what the scheme presented to the Chamber by M. Herriot in 1932 failed to do. The object of this plan was to balance the budget and at the same time develop certain public works by raising a loan of 35 milliard francs. This amounted in part to covering the budget deficit directly by a loan and calling the result "public works expenditure", and though a large part of the plan provided definite capital development over a period of six years, the confusion of the issues exposed the scheme to severe criticism.

None of these schemes has, however, been undertaken. The monetary policy of France has been deflationist rather than otherwise since the abandonment of the gold standard by Great Britain and other countries. A considerable body of opinion, therefore, is either directly hostile to, or nervous of, a scheme of internal development by capital expenditure guaranteed by the Government, quite apart from the usual prejudices against increased State activity in the economic sphere. Moreover, the technical conditions necessary to the success of such a plan have not been sufficiently explored. The Minister of Finance

has, however, declared in the budget of 1933 that the present time of depression is not a time in which to reduce expenditure on public works.

The effect of the depression on the public finances of France is sufficiently clear from what has already been said to make a repetition unnecessary. Expenditures have continued to increase even after revenues had begun to diminish in 1930, owing to the extension of social services. As a result the budget surpluses have given place to deficits, considerable balances which had accumulated at the Treasury have disappeared, and the debt has increased. The precise amounts of the budget deficits since 1930 are estimated by the Finance Committee of the Senate as follows :—

BUDGET DEFICITS SINCE 1930–31

1930–31	.	2,642 million francs.
1931–32	.	4,748 ,, ,,
1932	.	4,500 ,, ,,

To these figures must be added about 3,800 million francs which is the estimated deficit for 1933.

The problem of balancing the budget has occupied the attention of the Government since 1931, but it was not until July, 1932, that any active measures were taken. A plan by which economies in defence expenditures, a general 5 per cent cut in all administrative expenditures, and some increases in taxation were to be secured, was adopted by both chambers. The total saving in the budget of 1933 by means of these economies was estimated at nearly 1,200 million francs on defence expenditures and 700 millions on general administration. The taxation changes consisted of slight increases in the income tax, the suppression of exemptions from various taxes, and improvements in methods of assessment designed to prevent evasions. These fiscal changes were estimated to increase revenue in 1933 by nearly 2,000 million francs.

In some quarters a vigorous campaign has been waged for drastic economies in public expenditure, and the relative smallness of the results so far achieved are but a measure of the rigidity, in present social circumstances, of these expenditures. The sharp clash of interests, which has come with the raising of this question, was clearly demonstrated in the prolonged and often bitter discussion before the budget for 1933 was finally passed, after six *douzièmes provisoires* had been necessary and three successive Governments had tackled the problem. In addition to the plans of each of these Governments a Committee

FRENCH BUDGET EXPENDITURES, 1927-33

Sources.—Published accounts of expenditures (*dépenses engagées*) to close of financial year.

Item of Expenditure	1927		1928		1929–30 [1]		1930–31		1931–32		1932 [2]		1933	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1. DEBT.														
(*a*) Consolidated	4,705		4,681		5,408		4,404		4,089		3,475		1,879	
(*b*) Amortissable	10,517		9,133		10,517		6,849		5,282		4,581		6,694	
(*c*) Short Term	Not separately distinguished.						1,296		1,190		712		852	
(*d*) Floating	"		"		"		71		60		111		375	
(*e*) External	7,195		7,757		10,446		533		322		287		269	
(*f*) "Dette Viagere"							9,153		9,593		7,195		9,365	
Total Debt	22,076	49·2	21,571	48·0	26,426	43·0	22,380	40·4	20,745	38·9	16,364	39·7	19,432	38·5
2. DEFENCE MINISTRIES.														
(*a*) Ministry of War	6,411		6,864		9,765		8,181		6,250		5,218		5,080	
(*b*) Ministry of Marine	2,277		2,634		3,532		3,039		3,305		2,411		2,712	
(*c*) Ministry of Air	Not separately distinguished.				1,974		2,377		2,190		1,862		1,916	
(*d*) Ministry of Colonies	"		"		562		535		673		508		657	
Total Defence	8,688	19·4	9,487	22·0	15,833	25·9	14,132	25·4	14,267	26·8	9,963	24·2	11,445	22·6
3. CIVIL MINISTRIES.														
Ministry of Finance	3,405		2,789		3,606		3,397		4,768		-2,321		3,117	
" Justice	314		298		430				478		322		411	
" Foreign Affairs	202		239		408		299		299		238		290	
" Interior	816		1,022		1,718		1,704		1,351		1,177		1,420	
" Education	2,805		3,062		4,263		3,806		3,405		3,099		4,148	
" Commerce	279		334		84		61		55		71		96	
" Public Works	2,821		2,690		4,401		2,970		2,413		2,555		2,721	
" Labour and Social Insurance	980		1,288		1,644		968		930		1,378		1,664	
" Health	Created in 1930.						1,262		1,173		1,056		1,324	
" Agriculture	439		584		836		927		642		590		1,012	
" Pensions	1,573		1,013		1,518		2,723		1,987		1,870		2,620	
Total Civil [3]	14,066	31·4	13,970	31·0	19,111	31·1	18,902	34·2	18,234	34·3	14,770	36·1	19,609	38·9
Grand Total	44,830	100	44,958	100	61,370	100	55,414	100	53,246	100	41,097	100	50,486	100

[1] Fifteen months, 1st January, 1929, to 31st March, 1930.
[2] Nine months, 1st April, 1932, to 31st December, 1932.
[3] Including certain credits not detailed above.

of experts appointed in the latter half of 1932 had presented a plan of their own for balancing the budget. This Committee estimated that, if no measures were taken, the deficit in 1933 would be about 10 milliards. It was therefore proposed to meet the situation by increased taxation to yield an additional 5 milliards and by economies in expenditure of an equal amount. Apart from any question of the economic desirability or otherwise of this plan, no Government could have carried it out, and the plan has therefore only an academic interest. Indeed the proposals of M. Cheron in the early part of 1933 were practically the same as those of the Committee and they failed to obtain the approval of Parliament. The opposition to a reduction in the salaries of civil servants has been successfully maintained.[1] When the budget for 1933 finally became law the economies were practically limited to those already imposed in 1932. There were no extensive cuts in social services, no reductions of public works schemes, or of the salaries of civil servants. The economies so far achieved are not inconsiderable, but a glance at the table of budget expenditures which we have analysed above will show that there are very sharp limits to a policy of budgetary deflation. The two items of expenditure "debt" and "defence" alone amount to 70 per cent of the total expenditure. The debt service in the budget proper is impossible of reduction, since redemption is undertaken by the *Caisse d'amortissement.* It is true that, if the amortization by the *Caisse* were suspended, the deficit for 1933 would be practically met, a fact which should be taken into account when speaking of the budget deficit. On the other hand it should be remembered that of the 3,200 millions for the redemption of the debt in 1933 nearly 2,000 millions is contractual. So far as defence expenditures are concerned, we have seen that they have already suffered considerable reductions, and in present

[1] Now, in December, 1933, an Act "for the restoration of budgetary equilibrium" has at last made small reductions in civil service salaries, rising gradually from a 2 per cent cut on salaries betwen 12,000 frs. and 15,000 frs. to an 8 per cent cut on salaries above 100,000 frs. The resultant economy is expected to amount to 271 million frs. This Act aims at wiping out 4,476 million of the deficit of 6,100 million in the 1933 *exercice* by means of economies to the extent of 1,291 million; exceptional resources (lottery, profits on new silver and nickel coinage) of 1,598 million; fiscal modifications (reimposition of 50 per cent of the tax reductions made between 1928 and 1930 and the imposition of a few new taxes) bringing in 1,087 million; and measures for the prevention of fraud yielding 500 million. The balance of the deficit is to be provided for by measures taken under the law relating to the 1934 votes. The budget for the new *exercice* (1934) is again late and two *douzièmes provisoires* have already been voted.

political circumstances the possibilities of further reductions are very slight. Of the 30 per cent of remaining expenditures a large proportion is in any case fixed by necessity, and even the most drastic reductions in the residue of expenditure which is theoretically flexible would not result in very impressive economies.

If extensive deflationary measures have been successfully resisted, the policy of the Government is nevertheless not expansionist. It is stability rather than expansion which has been the main object of French public finance policy since 1931, and this attitude is conditioned by monetary policy. Anxious to maintain the gold standard, France has so far been able to do this, without the tremendous deflation that was necessary in Poland and other gold standard countries. The depression came later and less severely in France than in America, where a desperate situation has produced desperate remedies; the French franc was not, like the British pound, overvalued after stabilization; France is a creditor country, and is less dependent on export trade than most other industrial countries of Europe. She has, therefore, suffered less from the disorganization of world markets; finally, when the gold standard has ceased to exist as an international standard, its maintenance by a few countries only does not imply for them the same adjustments of internal prices to world prices as when gold was an international standard. These factors have enabled France to maintain the gold standard without deflation. Otherwise there would have been two alternatives, a severe deflation or abandonment of the gold standard. In the former event the chief battles would have been fought in the field of public finance, and the history of the budget of 1933 suggests that a policy of extensive deflation has little present chance of success.

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PART V

NINE OTHER EUROPEAN COUNTRIES

By J. N. Reedman

CHAPTER I

GENERAL SURVEY

The student who sets out to make a comparative study of the public finances of a number of countries soon finds himself in a maze from which there is no clear escape. Even the signposts often give a false sense of direction. Terms which may have a particular meaning, when applied to the public finance of one country, may assume quite a different significance when applied to another. Thus the terms " budget surplus " and " budget deficit " have no uniform definition. An application of the accounting methods of one country to the budget of another would sometimes change a deficit into a surplus, or conversely. The pitfalls are many and, even to the wary, obscurely placed. It is well, therefore, to begin by considering the dangers against which we must be on our guard and by a statement of the limitations for comparative purposes of the facts and figures upon which this study is based.

A complete study of the public finances of any country would include the accounts of both the central government and the local authorities. But this would be a colossal task, even in the case of a single country of which the student had an intimate first-hand knowledge. The present study is confined to the budgets of the central governments. This limits the comparability of national expenditures on particular objects. In Poland, Czechoslovakia, and Finland, for example, the local authorities play a smaller, and the central authorities a relatively greater, part in the administration of social services than in Denmark, Sweden, and Switzerland. Any generalizations as to the importance of social services in different countries, based only on the expenditures of national budgets, would be obviously misleading without this qualification. Even with defence expenditures, which are always entirely borne by the national budget, international comparisons are not always simple, since the relative importance of defence in the budget will be influenced by the relationships which exist between central and local authorities in respect of other expenditures. What is true of comparisons of expenditure is equally true of any attempts to compare the relative tax burdens of different countries.

Less obvious but equally serious pitfalls lie in the multiplicity of methods by which budgets are operated and accounts regulated. At the outset it is necessary to distinguish between " closed accounts " and " budget estimates ". Some countries, where the accounts are regulated on the principle of cash accounting, publish closed accounts almost immediately a financial year has ended. Others, which like France and Belgium regulate their accounts *par exercice*—a system whereby the accounts are kept open for a period after the nominal close of the financial year—frequently do not publish closed accounts for several years. If the principle of cash accounting is in use, closed accounts approximate to a statement of the cash received and expended by the Treasury on budget account during the twelve months of a given financial year. Such results are not directly comparable with those provided by the French system. Suppose, for example, that it is desired to compare the revenue of country A, which uses the method of cash accounting, with that of country B, which regulates its accounts by *exercice*. The closed accounts of A will show for any given year the revenue collected in that year irrespective of the year to which it belongs, while that of B will show, for any given year, the revenue collected in respect of the assessments for that year, a supplementary period of several months in addition to the nominal twelve months of the financial year being allowed for adjustment. Again, where government enterprises and monopolies are included in the national budget, the figures appear in some budgets as gross and in others as net figures. In some budgets both principles operate, some enterprises being subject to gross and others to net accounting.

Further complications arise from the existence of special Treasury funds outside the budget. Items which in some countries enter into the general budget are in others kept in distinct accounts. Extreme cases are represented by Finland, which has few special funds outside the budget, and France which has a great many. French finances, indeed, as explained in the preceding Part, provide an excellent example of the sort of error into which one may fall through not taking account of this factor. The repayment of the French debt is now provided for by a special fund distinct from the budget. But the transfer of this part of the debt charge from the budget has only been made in recent years by a gradual process. The present French budget is charged only with the interest on the public debt, while recent ones have also been charged with

various amounts for repayment. Since most other countries include repayment of debt, together with interest charges, in the general budget, we have in the two cases different meanings attached to a budget surplus or a budget deficit. We have the important question raised whether or not a realized budget deficit is to include debt repayment. If we adopt the view, which in theory has much to recommend it, that a net reduction of debt should be subtracted before the real deficit is determined, it is by no means easy to reduce the budget statements of a number of countries to a comparable basis in this respect.

We are thus led to the conclusion that any attempt to make a comparative study of public finances on a purely statistical basis would not yield results worthy of the effort, owing to the diversity of the methods by which national finances are regulated, and the inadequacy of the information. I have here examined the public finances of a number of European countries since the post-War stabilization of the various currencies, and particularly in relation to the economic depression which has cast its shadow over the world since 1930. The only method of presenting the results in an intelligible manner is to treat each country separately. Certain general conclusions and common problems do, however, emerge, and these I shall now set out.

The stabilization of currencies was begun in some countries as early as 1919, but was not generally completed until 1928. It took place under varying conditions. In most cases the attainment of stabilization was dependent on a reorganization of the public finances and the balancing of the budget. This was especially true of those countries where currency inflation had assumed serious proportions. While the ending of uncontrolled budget deficits was everywhere important, budgetary equilibrium was more urgent in some cases than others. Between 1919 and 1928 strenuous efforts were being made in most countries of Europe to ensure that government expenditures were met out of normal revenues, that the various public debts were so administered as to improve the credit of governments, and that the danger of inflation due to unprovided budget outlays was definitely removed. But the budgetary problem was not everywhere equally pressing. In some cases a balanced budget was an essential preliminary to any plan of financial reorganization; in others it was merely an incident in the general scheme of policy. Thus Great Britain and Sweden succeeded in balancing their budgets without much difficulty soon after the War. On the other hand, Austria and Hungary, which were rescued from

financial collapse by the League of Nations in 1923 and 1924, had to submit to strict budgetary control as an essential part of the scheme for reorganization. Czechoslovakia, with economic resources greater than her Central European neighbours, carried out her own scheme of stabilization, in which the reorganization of the public finances and budget equilibrium were finally achieved in 1926, though a substantial beginning was made in 1919. France and Belgium both continued on the dangerous road of inflation until 1926, but then found themselves faced with the alternative of going on to complete collapse or calling an immediate halt. In such circumstances the questions of the budget and of the control of the public debt became of paramount importance, and very severe measures for the restoration of budgetary equilibrium were required.

Budgetary policy was also variously affected by the general aim of the currency policies. In some countries this policy was definitely deflationary, in others the currency was merely devalued and no deflationary adjustments were necessary. The Scandinavian countries, which like Great Britain had not indulged in more than a mild inflation during and after the War, and Czechoslovakia, which used its new independence to establish a new currency, proceeded by the way of deflation. France and Belgium stabilized by devaluation. Austria, Hungary, Poland, and most of the Balkan States, by means of external aid following upon orgies of inflation, replaced debauched and ruined currencies by new ones. Deflation naturally increased the burden of fixed charges, such as interest on public debt, while extreme inflation, which ended in the complete destruction of currencies or in a drastic devaluation, automatically wiped out the whole or large portions of the internal debt. It is not, however, to be assumed that the countries which were subject to the latter influences have now no appreciable debt burden, for most of these have since accumulated considerable new public debts, while those which devalued were still left with considerable internal debts after devaluation. These facts are set out in detail below in the studies of particular countries.

Although there has been no uniformity in the dates and methods of the reorganization of public finances in the general movement towards stable currencies, it is a safe generalization that 1927 saw the budgets of most European countries in a relatively healthy condition ; for by that time most Governments had succeeded either in balancing their budgets or in reducing the deficits to proportions sufficiently small to remove the

danger of inflation. The years 1927 and 1928 were relatively prosperous in Europe as well as in the United States. There were, indeed, some divergences from the normal timetable. Thus Denmark did not enjoy her prosperity until about a year and a half later, when most other countries were already feeling the effects of the new depression. The strong resistance to wage reductions and similar adjustments demanded by a deflationary policy had a retarding effect in Great Britain and the Scandinavian countries. In Czechoslovakia, on the other hand, the effects of the deflation had practically disappeared by 1927. Despite these individual divergences there is no mistaking the general trend, of which the indices of industrial production published by the Economic Section of the League of Nations give some indication. Taking 1928 as the base year, these are as follows :—

	Poland.	*Germany.*	*Austria.*	*Belgium.*	*France.*	*G.B.*	*Sweden.*
1926	70·8	76·6	80·6	86·3	99·2	—	85·2
1927	88·3	97·3	91·4	94·1	86·6	101·2	88·9
1928	100	100	100	100	100	100	100
1929	99·7	101·3	102·5	100·1	109·4	106	100·9

This growing prosperity is reflected in the public finances in a number of ways. In the first place, following upon the currency stabilization, it was favourable to the maintenance of balanced national accounts without necessitating great sacrifices on the part of taxpayers or the public services, which might have resulted in political disturbances in the various countries. If we examine the results of national budgets in a number of European countries for 1928 and 1929 we find that surpluses are more frequent than deficits. This may be clearly seen from the table on p. 314, which shows the budget surpluses or deficits of the countries which are the special subject of our study.

Only three of these ten countries ended each of the two years with a deficit, and of these Sweden would show surpluses if expenditure on capital account were deducted. What is, perhaps, more remarkable is the fact that substantial surpluses were realized by practically all those countries which had either experienced, or been on the verge of, financial chaos. This is no doubt explained by the special measures which were dictated by sheer necessity, but it is none the less evidence of the remarkable recovery which had taken place.

There can be no doubt that this development in public finance was largely dependent on the economic prosperity of the period 1927 to 1929, and while general currency stabilization did much

to foster this prosperity, yet without it this happy state of national finances could never have been realized, and grave currency disorders might once more have descended upon the world. Budget revenues increased in practically all countries and it was chiefly this increase which provided the surpluses, for the possibilities of economy in expenditure were limited. In part, of course, the upward trend of revenue yields is explained by increases in taxation which played an important part in various stabilization plans. But to set it down entirely to this cause is to miss the significance of the general increase in economic

BUDGET SURPLUSES AND DEFICITS, 1928 AND 1929

Year.	*Country.*	*Surplus.*	*Deficit.*	*Currency Unit.*
		Millions		
1928	Austria	77	—	Schilling.
1929	,,	132	—	
1928	Belgium	1,394	—	Franc.
1929	,,	1,314	—	
1928	Czechoslovakia	—	112	Crown (Kc.)
1929	,,	169	—	
1928–29	Denmark	—	271	Crown.
1929–30	,,	7·8	—	
1928	France	3,230	—	Franc.
1929–30	,,	3,871	—	
1928	Finland	—	504	Mark.
1929	,,	—	166	
1928	Holland	—	—	Florin.
1929	,,	—	12	
1928–29	Poland	167	—	Zloty.
1929–30	,,	59	—	
1928	Switzerland	23	—	Franc.
1929	,,	23	—	
1928–29	Sweden	—	27	Crown.
1929–30	,,	—	32	

activity. Though no very extensive changes in taxation were made in any of the countries included in our study between 1927 and 1930, the general tendency was to reduce taxes once the stability of budgets seemed assured. In France, for example, a series of important reductions were begun in 1928, but despite these the total revenues continued to increase until 1930, and were still considerably greater in 1931 than they had been in 1927 when rates of taxation were at their highest. Practically all classes of taxes and all other sources of revenue provided increased returns in every country. Trade taxes such as the

turnover tax, the luxury taxes, and customs and excise, and Government monopolies and enterprises, were most responsive to the growth of economic activity. Thus Poland, Czechoslovakia, Austria, and, to a lesser extent, France and Belgium, in whose systems these sources of revenue play an important part, experienced, more immediately and more markedly than others, the satisfaction of buoyant revenues.

One further generalization may be made concerning the period between the general achievement of currency stabilization and the onset of the world depression in 1929. This is that, under the influence of rising revenues, expenditures had also risen. That this was a widespread phenomenon is brought out clearly in the facts presented below in regard to particular countries. Of these, only Czechoslovakia definitely followed a policy of stabilizing expenditures. In all the others, though the extent and importance of the movement varied, the trend was upward. This fact is important, since it has frequently been asserted that the growth of Government expenditure, particularly on social services, by introducing a greater inflexibility into economic life, retards adjustments to new influences and is an obstacle to recovery from the present depression. That the direct responsibilities of Governments in economic and social life have greatly increased since 1914 is a commonplace, and is adequately attested by the increase in national budgets of to-day over those of 1914, after due allowance has been made for differences in price levels and in the annual burden of public debts. We are here concerned, however, only with the period from the post-War stabilization of currencies to the beginning of the world depression. With regard to the ten countries which are the object of our study it will be seen that the upward trend of budget expenditure is most marked in those which suffered a severe inflation. This is largely explained by the fact that in these countries balanced budgets were a necessary part of financial recovery, and to this end expenditure had been reduced to a minimum. Immediately circumstances were easier expenditure was certain to increase. Moreover, in France, Poland, Belgium, and Austria stabilization did not imply deflation, which would have retarded expansion. It is not without significance that in Czechoslovakia, which deliberately checked the tendency for public expenditure to increase, the monetary policy had been deflationary. Beyond this, however, it cannot be said that the increase in expenditure was due to any single class of budget charges. Most Governments granted

increases of salaries and wages to their employees, but this again applies more particularly to countries which had experienced inflation, where salaries and wages had lagged behind the rise in prices and where in some cases, as in Poland and Czechoslovakia, Government employees had been asked to make temporary sacrifices. Increases of expenditure on social services were fairly general, but for reasons explained above it is impossible to base close comparisons upon these figures. In some cases, notably in France and Poland, defence expenditure increased. In the newly-created countries—Poland, Czechoslovakia, and Finland—capital development has naturally played an important part, and expenditure for economic purposes, either directly or indirectly remunerative, has been among those items which show increases. Debt expenditure has, of course, been variously affected in different countries and in different years by the amount of repayment. But taking only the interest charges into consideration, the general tendency was for this item to decrease in the period under review.

The effects of the world depression, which began to be widely felt in 1929, were everywhere manifest in the following year. Not the least important of these was the extent to which nearly all Governments became involved in budgetary difficulties. Industrial depression acts upon national finances in two ways: revenues automatically decrease, and expenditures, in the face of growing unemployment, tend to be heavier. The fall in revenues is not, indeed, immediately felt, but it has imposed itself on budgets which, the depression not having been foreseen, were planned on the assumption of continuing prosperity. Thus a heavy fall in revenue has come to some Governments which were committed to budget expenditures greater than in previous years. The extent to which revenues have actually fallen in different countries may be studied in greater detail in the chapters which follow. It will be seen that, while no country has escaped this fate, it has appeared later in some than in others and has varied in its intensity. In some countries special circumstances are found. Thus in France the depression developed later and has been less intense. Likewise in Switzerland. Nevertheless, allowing for the existence of special circumstances, it is evident that some tax systems are more sensitive than others to industrial fluctuations. On the whole, those countries which depend most on indirect taxation, and particularly on taxes on trade and on income from Government monopolies and enterprises, have suffered most seriously from falling revenue. For these are

the sources of revenue which first show the effects of industrial fluctuations and are most affected by them. Direct taxes are influenced, as a rule, to a less extent, since in the case of income taxes the effects are longer delayed, while taxes on property are in some degree independent of the incomes or trading activities of the owners, and a fall in interest rates, which is a usual feature of the depression, raises many capital values. Thus Poland and Czechoslovakia, where direct taxation plays a relatively unimportant part, have suffered very severe losses in revenue, while the Scandinavian countries, dependent to a great extent on direct taxation, have been less unfortunate in this respect. To some extent, however, the effects of depression on the revenues of these latter countries are merely delayed, as is shown by the fact that the decrease in the yield of revenue has been more marked in the later stages of the depression.

If revenues are elastic in the face of industrial fluctuations, expenditures are highly inelastic. The breakdown of the gold standard in 1931, together with the appearance of budget deficits, revived in many quarters the fear of currency inflation. In such circumstances fresh efforts were made to balance budgets. Since the possibility of increasing revenues was obviously limited, much attention was given to the reduction of expenditures by various economy measures. These efforts have had their political aspect in the formation of " national " Governments, the granting of special powers to the Government for a limited period, as in Belgium, or the establishment of special commissions and parliamentary committees, as in Czechoslovakia and elsewhere. Naturally, these attempts at economy have led to strong political opposition, which in some cases has been successful. In Denmark, Holland, Sweden, and France, where parties of the Left have either been in power, or held the balance of power in Parliament, economies aimed at the social services have, for the most part, been successfully resisted. In other countries political resistance to such economies has not been sufficiently strong to carry the day. The relative political strength of different interests is, of course, a factor determining to some extent the flexibility of budget expenditures. But this is a subject rather for the student of political institutions. It may be surmised that a more fundamental question is involved than that of cutting the coat to a cloth which is temporarily in short supply. Either consciously or unconsciously the whole problem of the sphere of the State in economic and social life is raised and the attack is probably in no small measure directed against what the

French, with a touch of contempt, call *étatisme*. But these speculations, fascinating as they are, lie outside the limits of this study. The economist must accept political conditions as he finds them, and we can do no more than note the fact that these may affect the extent to which it is possible to reduce budget expenditures to compensate for shrunken revenue.

Budget expenditures are, by their nature, much more rigid than revenues. We have considered them under three heads, namely expenditures on national defence, social services, and public debt. This is not a perfect classification, as it leaves some items of expenditure in an ambiguous position. Nevertheless, it has the virtue of simplicity, covers most expenditure, and can be used as a basis for approximate comparisons. With this classification in mind one or two conclusions of a general nature emerge from our study and deserve our attention.

Defence Expenditure.—With the possible exception of more or less veiled expenditures, relatively small in amount, which may be made by local authorities for such purposes as military training, defence expenditures are always an affair of the central authority, and are charged against the national budget. Sometimes special Treasury funds, operated outside the budget, may include expenditure which is strictly speaking for national defence, as for example, subsidies to firms making armaments. But these are always difficult to ascertain and are sometimes deliberately hidden. In comparison with the total visible expenditure in the national budgets they are small. We have, therefore confined ourselves to the budgetary statements.

In each of the ten countries under review expenditure for national defence is a considerable proportion of the total, though there is a good deal of variation from country to country. The variation is between 12 to 15 per cent and 25 to 30 per cent of the total. But no great importance must be attached to these percentages for comparative purposes, since the budgets themselves are not directly comparable documents. Thus, Switzerland, with a simple and relatively cheap military system, has a defence expenditure in the budget amounting to about one quarter of the total, due to the fact that a great deal of the social expenditure is an affair of the Cantons, and not of the Federal Government. What may be undeniably inferred from the figures is that, given present political circumstances and national ideals, a budget

expenditure which may vary from 12 to 30 per cent of the total is relatively fixed.

It has, of course, been possible for certain administrative economies, and in some cases for reductions in capital outlay, to be secured under this head. The economy measures adopted by all the countries, whose budgets are studied below, have included defence expenditures, whether as a part of general administrative reductions or with special reference to this item. In France the only considerable reductions in expenditure have been those which have affected the Defence Ministries, and these reductions, considered merely as a measure to balance the budget, have been greater in that country than in any other. It should be borne in mind, however, that between 1926 and 1930 defence expenditure had greatly increased in France and was, for that reason, probably more elastic than elsewhere. At the most, defence expenditure in the French budget for 1933 has been reduced by 8 or 9 per cent, as against that for 1931–2. In other countries the proportionate reduction has been less, even though in Poland, and to a lesser extent in Czechoslovakia, Finland, and Belgium, military expenditures increased between 1926 and 1930. It is clear that in present circumstances defence expenditure is not only a substantial proportion of the total budgets, but is highly inflexible against reductions, though less inflexible against increases.

Social Expenditure.—It is not intended to make a comparison, as between various national budgets, of the expenditure under this head. Such an attempt would only lead to error, since on the one hand the items included under this rubric are not the same in every case and on the other hand we are not able to take into account the part played by local authorities. It can be shown, however, that expenditure which may be regarded as belonging to this class is in some budgets as much as 40 per cent of the total, and in others not more than about 18 per cent. From the point of view of giving elasticity to budget expenditure, it may be supposed that this wide divergence has some importance. While, as we have seen, the flexibility of budgetary expenditure on social services depends on political conditions, those countries in which these services are most highly developed are likely to find the greatest difficulty in cutting them down. Thus, where such expenditure is something like 40 per cent of the total, we may expect the budget to show great rigidity. This is, in fact, suggested by our studies. Denmark, Sweden, and Holland, in which countries social services are highly developed and are

a relatively greater charge on the budget, have not found it possible to reduce this expenditure in any appreciable degree. Poland, on the other hand, has greatly compressed the budget, chiefly at the expense of the civil service, social services, and public investments. Generally speaking, however, it will be found that economies in social services have not brought great relief to budgets, but have resolved themselves into checks on further development and general administrative economies. This is so, first, because of the importance of these services in the social life and, secondly, because expenditure for relief of various kinds is increased during the depression.

The Public Debt.—The annual charge on the public debt is by its nature fixed. It may be reduced by repayment or by conversion, but the effect is not immediate, and in either case must wait a favourable opportunity. In so far as the annual debt charge is a high proportion of the total budget expenditure, the latter will be rigid. Moreover, the fall in prices, which has been very marked in the present depression, has increased the real burden of public debt. There is, however, great divergence in the amount of debt charge in the annual budgets. In 1930 it was less than 10 per cent of the total expenditure in Sweden, but was 33 per cent in Belgium. On the whole the proportion of the debt charge to the total budget has decreased since 1927. This is fairly general, though Austria is an exception, the debt charge having increased in relative importance, especially since 1929. This does not, however, necessarily mean that debts have been generally reduced, the decrease in the relative importance of the debt charges being partly explained by increases in other types of expenditure. Moreover, the only really striking changes in this respect are shown in the French and Belgian budgets, where the debt charges have fallen from over 40 per cent of the total in 1927 to about 30 per cent. Both countries were faced in 1926 with the necessity of setting about a systematic reduction of the debt and both have succeeded in reducing their debt charges by means of repayments and conversions, which represent a not inconsiderable achievement. On the other hand, in both cases the decline in the relative importance of the debt charges in the budget is largely explained by the rapid increase of other expenditures, and in the case of France also by the removal of amortization charges from the budget to a special fund. The variation of the relative importance of debt charges in budgets is shown in the following table :—

COMPOSITION OF PUBLIC DEBTS AND INTEREST CHARGES

(In millions of currency unit of each country)

Country	Year	Internal		External	Total	Interest [1]	
		Funded	Floating			Amount	% of Budget Expenditure
Austria	1931	136·8	—	1,955·3	2,092·1	131·6	5·6
Belgium [2]	1931	25,749·1	1·1	27,766·1	52,516·3	—	—
Czechoslovakia	1931	23,882·1	3,130·2	6,341·9	33,354·2	1,685·9	15·2
Denmark	1930–31	634·1	9·5	717·9	1,358·8	61·0	19·0
Finland	1931	408·6	—	3,391·7	3,800·3	212·1	5·8
France [3]	1930–31	245,503·1	34,370·4	202,305·6	482,179·1	13,194·9 [3]	24·2
Holland [3]	1930	2,461·8	293·1	—	2,754·9	109·5	18·0
Poland	1930–31	359·6	25·2	3,694·4	4,079·2	181·6	6·4
Sweden	1930–31	1,800·6	0·3	—	1,800·9	82·4	10·0
Switzerland	1930	1,608·9	187·4	276·3	2,072·6	109·9	28·8

While it is true that the debt charge is at any given moment a rigid item of expenditure, conversions of maturing debt to lower rates of interest can generally be most favourably made when industry is slack. No conversions of the magnitude of the British conversion of 1932 have been made on the Continent. In France and Holland, however, conversions have been carried out in 1932 and 1933 on a very much smaller scale and on less favourable terms. There has also, of course, been a fall in the rate of interest, though in countries like Poland with limited capital resources the fall has been less than elsewhere. Finally, it must be remembered that the suspension of sinking funds offers a temporary respite and practically every Government has reduced its provision for amortization since the depression began.

Having gained a general idea of the rigidity of budget expenditures in the countries under consideration, we may ask to what extent and by what means expenditures as a whole have been reduced. For an answer to this question the reader must be referred to the studies which follow, but one or two points are worth notice in a general review. First, with the exception of Sweden, which has launched a budgetary programme of public works expenditure, every country has adopted economy schemes and more or less deflationary policies. A common feature of such schemes has been reductions in the salaries of government employees. Generally speaking, these

[1] Interest charges only are included. The percentages in the column may differ therefore from figures quoted in later tables, which include also amortization. Also the total debt includes some items which are outside the general budget.

[2] Based on budget estimates.

[3] Including some contractual amortization.

reductions have varied from 5 to 15 per cent and have not been greatly out of proportion to the fall in the cost of living. In Poland, however, they have been particularly drastic, amounting in some cases to 35 per cent. It has been a common practice to impose percentage cuts in the expenditure of various departments, and this has inevitably checked new investment and development schemes. Sometimes this has led to a contradictory policy, as in Czechoslovakia where in 1931 a loan of 1,300 million crowns was raised for public works to provide employment, while in other directions the budgetary policy was definitely deflationary. Except in Poland, the actual results in the reduction of expenditure will be seen to be relatively small. Doubtless the effect of these budget economies is very much greater than is measured by the actual reduction of budgets. Apart from a general world expansion, particularly in creditor countries, debtor countries have no option but to follow a deflationary course, if the risk of currency inflation is to be avoided. The report presented to the Stresa Conference on the condition of the countries of Central Europe shows clearly that these had no margin within which to pursue an expansionist course, though it has been possible for Sweden to do this with some confidence. The extent to which currency restrictions have been imposed is sufficient indication of this.

In all countries the fall in revenues has been met by increased taxation. All classes of taxation have shared in the increase. Naturally expediency has determined the specific measures in each country. In most cases the increases have resolved themselves into increases of existing taxes and the removal of special exemptions. Regulations for the collection of taxes have been generally tightened up, a move which is of considerable importance in Poland and Czechoslovakia, where the administrative machinery for the assessment and collection of taxes is comparatively undeveloped, and also in France and Belgium, where the traditional dislike of direct taxation has retarded its development and hindered the evolution of technical efficiency in its assessment and collection. In these countries evasions and arrears of taxes are a larger element than in most others. Though in almost all the countries some new taxes have been imposed, such as the inclusion of hitherto untaxed products in customs and excise, or the extension of profits taxes to industries previously exempt, no important new sources of taxation have been tapped and in no case has the taxation structure been substantially changed.

Despite the diversity of the budgetary systems, this brief review shows clearly that during the period of prosperity and high revenue returns Governments have increased their budget expenditure, and have sought to decrease it during the depression. That is to say, budgetary policy has been expansionist on the upward sweep of industrial activity and deflationist during the decline. Of the ten countries under consideration only two, Sweden and Czechoslovakia, are in any sense an exception to this, Sweden on account of having adopted a deliberately-planned expansion in the 1934 budget as a means of escaping from the depression, and Czechoslovakia in having prevented expenditure from increasing during the prosperous period between 1927 and 1929. This is of interest, in view of the argument that industrial fluctuations could be greatly reduced, if Governments were to plan public finance policy so as to be expansionist when economic activity is on the wane and deflationist when it is increasing. We have seen that, while expenditures rapidly increased between 1927 and 1930, the reductions subsequently achieved by economy measures have been small in comparison. The deflationary effect, however, is greater than is measured by the actual reductions in budget expenditure, for not only is the capital expenditure of central and local authorities restricted, with the corresponding economic consequences, but the psychological effect on economic society as a whole is itself deflationary and by no means inconsiderable.

Similar considerations underlie the various and much-discussed proposals for the launching of public works schemes as a means of escaping the present depression, including the scheme for international public works sponsored by the late M. Albert Thomas and the International Labour Office. The latter is for the moment relegated to a technical sub-committee of the League of Nations Transit Commission, where its materialization is effectively postponed. Now these schemes, which are concerned with capital investment, imply budgetary planning. This is particularly important, in so far as they visualize the timing of development schemes to coincide with particular phases in trade fluctuations. As we have shown, however, not only does no such planning at present exist, but public finance policies tend to follow industrial fluctuations, rather than to move in the opposite direction. Though it is beyond the scope of the present work to discuss these theories, several facts, which are revealed by our study, are apposite. The first of these relates to the confusion and diversity of budgetary methods in different

countries, and especially to the absence in most instances of any adequate distinction between capital and current expenditure. The budgets of Denmark, Sweden, and Holland have long maintained this distinction, which has also been introduced in Finland in the budget for 1933–4. The distinction is most complete in Denmark, where it is possible to follow clearly in the budget accounts the development both of current and capital expenditures. Moreover, capital depreciation and interest on capital invested in Government departments is charged against the current accounts. In Sweden and Holland there is not the same precision in accounting, but the principle of differentiating between capital and current accounts is explicitly recognized. It is, of course, by no means easy to find a criterion by which to determine what is capital expenditure and what is not. Even if we adopt the view that all expenditure, which is not "productive", is current expenditure and should be met out of current revenue, it still remains to determine the meaning of "productive". On the other hand, while the dividing line is hard to draw, the broad distinction between expenditure for capital and for consumption is clear enough, and no great headway can be made in the direction of planning public expenditures, before such a distinction is introduced into national budgets. It is interesting to note, for example, that part of the public works expenditure in the Swedish budget for 1933–4 is regarded as expenditure for consumption and, though it is not possible to meet it out of current revenue for the year, a portion of the loan is made repayable in five years out of a special tax.

It would appear also that Government enterprises run on commercial lines should, in the interests of the clarity of public accounts, have separate budgets, outside the ordinary budget. Though this is frequently done, it is far from being general. The Polish budget includes government enterprises and in many others the line of demarcation is very uncertain. One of the small, yet nevertheless promising, results of the League of Nations restoration schemes in Central Europe has been to secure a certain measure of budgetary reform by insisting on the separation of the accounts of certain Government enterprises from the ordinary budgets.

The conception of budgetary equilibrium is hardly less important in regard to budget planning. All budgets normally cover a period of one year and, by whatever means the accounts are regulated, the deficits or surpluses are struck annually.

This is in keeping with well-established business conventions, and is a practice too widely established to be disturbed, but it might be asked whether there is any particular virtue in giving the yearly budget accounts any greater importance from the point of view of the period to which they refer, than is given to the yearly balance-sheet of a commercial firm. Why should not the period in which the accumulated deficit or surplus is allowed to affect the trend of budgetary policy be longer than one year ? Budget planning implies tacitly that it will be so. But we are far from this ideal and it must be admitted that, the control of public accounts being very much more difficult than the control of accounts by a private corporation, the inefficiency resulting from the present system is the price which must be paid, in existing political circumstances, to escape still greater errors. Nevertheless, the point is of great theoretical, and may be of great practical, importance. There is nothing sacrosanct about a year as a financial period. This has been recognized in a number of schemes for stabilization in which the budgetary period has been shortened. Thus the League of Nations plans for reorganization in Austria and Hungary instituted monthly budgets, and the monthly publication of accounts. The same plan was adopted in Poland as a means of correlating expenditure more closely with revenue, and is still in operation.

Budget deficits, which have accompanied the depression, mean for the most part increases in the public debts, particularly floating debts, and the suspension or reduction of sinking funds. Not all Governments have as yet found it necessary, however, to float new loans to meet budgetary deficits. So far, Czechoslovakia and Poland have been able to cover the deficits out of cash reserves accumulated by their respective Treasuries during the period between 1927 and 1930. France acquired considerable Treasury reserves at the same time, but these were applied to debt redemption and to increased expenditures, so that they had practically disappeared when the depression began. These facts are of great interest, since it is suggested that Governments might follow the precedent of industrial firms and build up reserve funds in good years to meet the necessities of less prosperous times. There are great, though not insuperable, difficulties in the way of this procedure. In some countries the position of the Treasury and budgetary practice are such that there would be no constitutional or impressive administrative obstacles. In others, France for example, the

position of the Treasury is so ambiguous, and the budgetary procedure is such, as to make the practice difficult. The theoretical objection is made that reserve funds so accumulated would find their way into the central banks, swelling the reserves and providing the basis for further credit expansion, which it is the object of the Government policy to prevent. To this objection two replies may be suggested. First, while in a perfectly free economy those results might accrue, there is no *prima facie* reason why they should do so under modern conditions. Sterilized bank reserves have been common enough in recent years. The fact that both Czechoslovakia and Poland have carried over Treasury reserves, though of modest proportions, is noteworthy. Secondly, it would appear that the objection does not sufficiently distinguish between the long-term and the short-term capital market. But to pursue this argument further would carry us beyond the scope of this work.

In bringing this introductory survey to a close we may remark on the lack of clarity and promptness in publishing budget accounts. There is here great scope for reform and an international conference would not be ill employed, which secured a greater measure of precision and uniformity in this respect. Where cash accounting is in vogue, closed accounts are generally published within a few months of the end of the financial year. Countries which regulate their accounts on the French system are much later in publishing results. Some countries do not publish regular accounts at all. Even where accounting *par exercice* on the French model is employed, a yearly account based on cash accounting would be in the interests of clarity and, ultimately one may hope, of greater efficiency. Czechoslovakia publishes both a cash account and an administrative account of the budget. The question, however, is not merely one of publishing facts, but of publishing, promptly and intelligibly, closed accounts.

Note on Public Works

(*a*) *Magnitude.*

The lack of co-ordination between various departments in most countries makes it difficult to estimate the part played by various Public Works' programmes. Side by side with special schemes for promoting Public Works to absorb the unemployed, there is often a policy of reducing capital expenditure, through the budget, being carried out at the same time. Nevertheless,

some Public Works of considerable magnitude have been promoted in some countries.

In Poland since 1926 a systematic development of Public Works has been promulgated under the control of the Ministry of Labour and Social Affairs. In Czechoslovakia, Denmark, and Austria, Public Works are linked with Unemployment Insurance schemes. In Denmark, a law was passed in 1930 embracing a five-year scheme of road construction, mainly with a view to relieving unemployment. This involves an expenditure rising every year from the equivalent of 1·3 million dollars in 1930 to 2·7 million in 1935. In Czechoslovakia, a loan of 1,300 million crowns was raised internally to finance certain Public Works, namely, building, roads, railway construction, etc.

In Belgium a loan of 1½ milliard francs was raised chiefly for the execution of Public Works in 1931.

In Sweden, a large scheme, to which reference has already been made, is provided for in the 1933–4 Budget.

(*b*) *Character.*

The character of the Public Works, undertaken as crisis measures, varies from country to country. Road construction is probably the chief single type. In countries where State enterprises of a productive type exist, as for example, Czechoslovakia and Poland, railway construction and building programmes are important. In many countries drainage of various kinds has been undertaken, and in this regard the reclamation work of the Zuyder Zee in Holland is most important, but this ambitious work has recently been to some extent retarded.

(*c*) *Financing.*

Financing is carried out partly by direct subsidies on current budget account, but to a greater extent by loans. In Poland local authorities may borrow from the Bank of National Economy for works approved by a special committee of the Ministry of Labour and Social Welfare. In Czechoslovakia and Austria loans are connected directly with Unemployment Insurance. Special road funds exist in certain countries for road development, special taxes being earmarked, Holland is a case in point. Finally, certain works are directly financed by special loans.

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Chapter II

DENMARK, SWEDEN, AND HOLLAND

I

Denmark

Owing to important changes in the methods of accounting, adopted in 1926, the Danish budgets before and after that year are not comparable. The new methods carry the principle of cash accounting to a completeness not to be found in any other national budget. A clear and consistent distinction is maintained between current and capital revenues and expenditures presented in two accounts, the current account and the capital account. All the ordinary expenditures of government, apart from capital movements, appear in the current account which shows on the revenue side the proceeds of all taxes and the interest received on capital invested. The capital account shows strictly capital movements. The proceeds of the sale of property and any decrease in stocks or working capital are shown as revenue, while capital investment and repayment of debt appear as expenditure. No debt redemption is entered in the current account. It is a peculiarity of the Danish system that interest on the public debt does not appear directly as expenditure in the current account, but as a reduction in the current amount of interest received of which only the net balance, either positive or negative, is shown on the revenue side of the current account. All government departments and undertakings are charged interest at 5 per cent on the capital invested in them, whether this capital is producing revenue or not. This interest charge represents part of the current expenditure. Capital depreciation is charged against the current account, but it is also entered as revenue in the capital account.

Though we cannot strictly compare the results of the budgets before and after 1926, it is worth while to summarize briefly the general trend of developments since the War. In 1913 the deficit on the capital account was rather more than offset by a surplus on the current account, including nearly 2 million kroner for debt redemption. The current expenditure was

114 million kroner of which 28 millions, or 24·5 per cent, was defence expenditure and 12 millions, or 10·5 per cent, was interest on the debt. The capital expenditure was 12·2 millions and the total revenue, current and capital, was 128 millions. In the year 1921–2 expenditure in the current account was 499 million kroner and the deficit, excluding the capital account, amounted to 90 millions. Expenditure was gradually reduced to 416 millions in 1924–5, when the current account showed a surplus of 14 millions. During these years, however, the deficit on the capital account more than offset any surplus on the current account, even when the amount of the debt repayment is subtracted, as it should be, from the gross deficit. There is, however, no principle of sound finance which requires capital expenditure to be covered by current revenue, rather than by loans, and in considering the question of deficits or surpluses it is more important to study the current accounts. This is particularly true of the budgets since 1926, in which a strict distinction is maintained between current, and capital, expenditures and revenues.

The summarized results of the Danish budgets since 1928–9 are as follows :—

SUMMARY OF DANISH BUDGETS 1928–29 TO 1932–33
(Million Kroner)

	1928–29.	1929–30.	1930–31.	1931–32.	1932–33.
A. *Current Account.*					
Revenue .	312·1	336·1	343·1	333·1	309·3
Expenditure .	323·0	324·1	317·4	332·2	290·2
Balance .	− 10·9	+ 12·0	+ 25·7	+ 0·9	+ 19·1
B. *Capital Account.*					
Revenue .	432·5	59·9	68·6	114·6	46·9
Expenditure .	403·2	64·1	92·8	155·7	64·6
Balance .	+ 29·3	− 4·2	− 24·2	− 41·1	− 17·7

Current expenditure has thus been fairly stable, until, as a result of the depression, the budget estimates for 1932–3 provided for considerable economies. In 1928–9 current expenditure was in excess of current revenue by over 10 million kroner, but in the following years surpluses were realized on current account, despite the fact that expenditure showed a slight tendency to rise. Revenue rose from 312 million kroner in 1928 to 343 millions in 1930, falling again to 333 millions in the following year. These fluctuations in revenue are chiefly due to changes in general trade conditions, which in Denmark have not run exactly parallel with those of the more industrial countries of Europe. In Denmark, 1926 and 1927 were years of depression

the effect of which—allowing for the time lag important in a country which relies to a great extent on direct taxation—affected the revenue yield of the budget of 1928–9. The prosperity which prevailed in certain industrial countries of Europe in 1927 and 1928 appeared rather later in Denmark, where on the other hand the first effects of the world depression were somewhat deferred. There were thus two causes which tended to maintain a fairly high revenue yield in the budgetary year 1931–2, the delay in the appearance of the depression, and the time lag, already mentioned, between the decrease in economic activity and its full reflection in decreased revenue from direct taxation.

The chief items of expenditure in recent Danish budgets are set out in the table below. For the years 1929–1930 and 1930–1 the figures are those of the closed accounts, while for the two following years they are the expenditures approved by the Danish Parliament. Only the expenditures of the current accounts are considered.

BUDGET EXPENDITURE 1929–30 TO 1932–33
(Million Kroner)

Item	1929–30		1930–31		1931–32		1932–33	
	Amount	%	Amount	%	Amount	%	Amount	%
Defence .	55·0	17·0	51·0	16·1	50·2	15·0	55·2	18·6
Social .	145·3	44·8	143·7	45·3	147·3	44·1	137·8	46·2
Debt .	62·5	19·3	61·0	19·2	59·4	17·7	58·5	19·6
Other .	61·3	18·9	61·7	19·4	78·0	23·2	46·5	15·6
Total .	324·1	100	317·4	100·0	334·9	100	298·0	100·0

The classification in the above table does not itself call for much comment. The debt service does not include any amortization, but only the interest and some very small administrative expenses. " Social Expenditure " is composed of three separate items, namely, Social insurance of various kinds, Education and Public health. Civil and military pensions are included in " Other Expenditure " or in " Defence Expenditure ", and the apparent increase in the latter in 1932–3 is due to the transfer of the charge for certain military pensions from the Ministry of Pensions to the Ministries of Defence, and is not to be interpreted, therefore, as an increase in military expenditure.

It is interesting, on the basis of this classification, to consider

the relative importance of the different types of expenditure. Over 40 per cent of the total expenditure is due to the services of social insurance, education, and public health. Defence expenditure, which has varied between 15 and 18 per cent of the total, is not high in comparison with the proportion of such expenditure in the budgets of most other countries. Similarly the debt charge, accounting for under 20 per cent of the total, is comparatively light. The absolute expenditures on each of the items "Defence", "Social", and "Debt", show a remarkable stability, the fluctuations in the total being mainly due to changes in "other" expenditure.

The effect of the depression on Danish public finances has been to reduce the yield of taxation and to make it increasingly difficult to balance even the budget of current expenditure and revenue. Even so the decline in revenue is less marked than in many other countries and, though it may be true that the full effects of the depression have not yet made themselves felt, the budgetary situation is relatively good. Expenditures, however, are very rigid and, in a country where social services play so important a part as in Denmark, may even be increased by the depression, whether this be in the capital budget in the form of aid to agriculture or in the current budget in the form of heavier charges for unemployment relief and insurance. To meet the situation created by the depression there have been some economies and some increases in taxation, but the possibilities of both are somewhat limited. In 1931 the original expenditure voted for the capital budget was increased by 93 million crowns as a result of a supplementary vote which increased the sum for the amortization of the debt and extended financial aid to agriculture. The revenue was increased by 72 million crowns, of which 19 millions was to be raised by a supplementary tax on income and most of the remainder was to be obtained by borrowing.

Economies in expenditure have been restricted to administrative savings which, though not unimportant, are small. The deflationary policies which have been pursued in Poland, Czechoslovakia, and some other countries have had no acceptance in Denmark, where attempts to reduce wages and social standards in order to bring down costs have been defeated. Indeed the Government has entered into an agreement to maintain the level of wages. This rigidity of wages and of social standards made it inevitable that Denmark should immediately follow the example of Great Britain in abandoning

the gold standard in 1931, a move which has made the continuance of the policy of maintaining public expenditures possible. Given these conditions of rigidity it must be admitted that a reduction in budgetary expenditures is hardly possible. Social expenditures, as we have seen, account for about 45 per cent of the current expenditure. Defence expenditure, amounting to only about 18 per cent of the total, is relatively light and could not in any case be much reduced. The debt expenditure in the current account is purely interest and is therefore an essential charge. Moreover, of a total internal debt of 586 million crowns at the end of 1931 only 8 millions was floating debt. There are thus no considerable savings to be obtained by conversions. It is true that the abandonment of the gold standard has increased the burden of the external debt, so that the total debt service is increased by 4½ per cent over what it would otherwise have been. The adjustment of this item, however, depends very largely upon the future of international exchange rates. Nevertheless the situation of the Danish public finances may be considered as highly satisfactory. Nowhere have the revenues of Governments escaped the effects of the depression, but in Denmark they have fallen less heavily than in many other countries. The public accounts are admirably regulated and nothing is obscurely hidden either from the wise or the unwise. Since the debt is relatively small, capital expenditure could without difficulty be increased, the more so as the full significance of capital expenditure is clearly expressed in the Danish budget system.

II

Sweden

Sweden was the first country to return to the gold standard after the War, which had affected Swedish public finances less adversely than those of almost any other country. The public debt had been kept small, and none of the circumstances which seriously endangered the stability of the currency in other countries were present in Sweden. Thus the question of budgetary stability was not raised in an acute form, and the national budget was able to follow a more or less normal development.

Like the Danish budget, that of Sweden is in two parts, an

administrative account and a capital account. The distinction between the two types of revenue and expenditure is based largely upon the accountant's distinction between " current " and " capital " income and outlay, but it is neither so logical nor so complete as in the Danish system, for it is determined partly on historical grounds. Nevertheless all strictly capital expenditure is shown in the capital account together with certain expenditure, on State enterprises for example, which would not normally be considered as capital outlay. But the distinction maintained in the Swedish, if not so clear as in the Danish, finance accounts is important, and makes for that precision and clarity which is so desirable, yet so rare, in the presentation of national budgets. On the expenditure side of the capital account are shown expenditure on State enterprises, including new investments in such enterprises, investments in the purchase of shares outside State enterprises, sums for the amortization of the debt, and some small miscellaneous items. The administrative expenditures consist of the ordinary expenditures of the various Ministries, and the interest on the State debt. The revenue is distinguished as revenue from taxation of all kinds, income of the State enterprises, income from investments in shares, and the proceeds of loans.

The recent trend of expenditure of Swedish budgets has been upward both in the administrative accounts and in the administrative and capital accounts taken together. Thus administrative expenditures have risen from 664 million crowns in 1928–9 to 765 millions in 1931–2, while total expenditures have increased from 791 to 893 million crowns in the same period. At the same time revenues, excluding the proceeds of loans, have increased from 758 to 805 million crowns. In each of the four years 1928–9 to 1931–2 total expenditure (administrative and capital) has been in excess of revenue, excluding loans, making a total deficit over the four years of 176 million crowns. Against this, however, must be set 132 millions for the amortization of the debt included in the expenditure. It should also be remarked that in the expenditure is included capital investment, and that the administrative outlay is easily covered by ordinary revenues. The depression has naturally resulted in falling revenues, though it was only in the budget of 1931–2 that a decline began to show itself, and not until the following budget that it became really serious. Expenditure for 1932–3 was originally estimated at practically the same as that of the previous year, but in consequence of the fall in revenue it is now estimated that the

deficit will be about 143 million crowns. The yield of the various sources of revenue and the summarized results of the budgets of the last four years for which closed accounts are available are shown in the table below.

SUMMARY OF SWEDISH BUDGETS, 1928–29 TO 1931–32

	1928–29	1929–30	1930–31	1931–32
Taxes	572	598	598	594
Productive Enterprises	153·3	148·3	144·6	102·8
Loans	49·9	34·4	49·8	72·8
Total Revenue	808·2	829·3	840·4	872·7
Total Expenditure	791·6	811·0	818·5	893·8

The yield of taxes has thus increased from 572 million crowns in 1928–9 to 598 millions in 1930–1, but fell very slightly to 594 millions in 1931–2. An examination of the individual taxes shows, as we might expect, that direct taxes on income and property maintained a high yield, being only slightly less productive in 1931–2 than in the previous year, while customs duties on the other hand began to decline with the beginning of the depression in 1930. The fluctuations in the returns from the State's productive enterprises reflect directly the general economic conditions.

Expenditures are shown in the following table.

EXPENDITURES OF SWEDISH BUDGETS, 1928–29 TO 1931–32

Item	1928–29		1929–30		1930–31		1931–32	
	Amount	%	Amount	%	Amount	%	Amount	%
Defence	133·4	20	138·0	19·6	129·2	17·6	125	16·3
Debt	86·6	13	86·0	12·4	82·0	11·1	81	10·6
Social	235·0	35·4	249·0	35·7	270·4	36·9	281·8	36·8
Other	209·0	31·6	229·0	32·3	252·0	34·4	278	36·3
Total	664	100	702	100	733	100	765	100

The expenditure shown in the above table is administrative expenditure only. It will be noticed that the trend of the total has been definitely upward, but that this does not apply to all the individual items. Both the defence expenditure and the interest charges on the debt have been reduced while social expenditure (i.e. education and the Ministry of Social Affairs)

and other expenditure have considerably increased. The proportion of the individual items to the total as represented by the percentages is an interesting study. The most remarkable feature of the budget, in comparison with those of many other countries, is the extremely low debt charge which in 1932 was only about 10 per cent of the total. Hardly less striking is the relatively low charge for the defence services which have fallen from 20 per cent of the total to 16·3 per cent. Thus these two items together account for less than 30 per cent of the total expenditure, Social expenditure for about 36 per cent of the total, and " other " expenditure for a similar proportion. It should be pointed out that a good deal of expenditure included in the rubric " other " is properly speaking social expenditure, as for example, much of the expenditure under the Ministry of Pensions. Thus about 70 per cent of the expenditure is directly for social, economic, or general administrative purposes.

Though the world depression has seriously affected economic activity in Sweden, the public finances appear to be better placed to weather the storm than those of other countries. Although the fixed debt charge is relatively small, the expenditures in the budget are nevertheless rigid on account of the social and political opposition to any suggestion to reduce the social services. Like Denmark, Sweden immediately followed Great Britain in abandoning the gold standard in 1931. Indeed, not only is a deflationary policy in public finance definitely opposed in Sweden, but it is the only European country in which expansionist ideas have been incorporated in a determined policy. In this respect the budget approved by Parliament for 1933–4 marks an important step in budget history and should receive the careful consideration of all who are interested in present-day problems of public finance.

The principle on which the budget for 1933–4 is based is that of extending schemes of public works during depression, in order to absorb unemployed workers and to give a general stimulus to industrial enterprise. Whereas the budget of 1932–3 provided for an expenditure of 896 million crowns the new budget for 1933–4 is increased to 1,029 millions. On the basis of the previous year's revenue, excluding loans, there would be a deficit on the year of about 380 million crowns. This is to be covered in two ways, first by a loan of 240 millions, and second by economies and increased taxation. Increases in the beer, alcohol, tobacco, and malt duties and in the income tax are expected to yield an additional revenue of 69 million crowns.

Economies in administrative expenditures to the extent of 74 millions will also be obtained. Of these the most important is in the defence services, which will be reduced by 20 millions to a total of 102 millions, or less than one-eighth of the total administrative expenditures and about one-tenth of the total budget. Expenditure of the Ministry of Agriculture will be reduced by 11 millions and of the Ministry of Education by 7 millions. Other economies will apply to the general administrative departments.

The most important part of the scheme is the provision in the budget for 300 million crowns to be devoted to schemes of employment, 240 millions of which is to be devoted to public works such as the electrification of railways, the construction of roads and bridges, and similar works of economic and social value. These schemes are financed by a Government loan, but there are some critics who would argue that some at any rate of the expenditure under the scheme is not itself productive and should not, therefore, be regarded as capital outlay, but should be met out of current income. Whatever justice there may be in such criticism, it is largely answered by the terms of the loan, a large part of which is entirely repayable within four years. What is still more important, however, is that it is to be paid off by means of an increase in the death duties, imposed and earmarked for that special purpose. It is pointed out that, even thus increased, the scale of the death duties is lower than in Great Britain.

The importance of this scheme to the student lies in the fact that it is a definite attempt to put into practice the expansionist theory as a means of escaping from the depression. It has been prepared by the joint labours of practical men and of theoretical economists. The limitations of an isolated attempt by one country to restore prosperity by these means is fully realized. But, as Professor Myrdal points out in his defence of the plan, there are limits within which even an isolated expansion may bring beneficial results without the evils of currency inflation and consequent exchange depreciation and, provided those limits are not overstepped, the social evil of unemployment may be substantially diminished. It is true that those limits must vary with different countries and different circumstances. What is possible for Sweden may not be possible for Poland. Sweden is, no doubt, admirably situated for the attempt since the burden of the public debt is light and the credit of the Government, both at home and abroad, is high.

III

HOLLAND

The financial year 1913 closed in Holland with an expenditure of 219 million florins in the ordinary, and 19·4 million florins in the extraordinary, budget. The revenue in the two budgets amounted to 227·4 million florins, giving a deficit of 11 millions. In 1922 the expenditure, including the " crisis expenditure " and the loan fund, both legacies of War-time conditions, amounted to 1,179 million florins. Taking into account the rise in the price level, the expenditure on a gold basis in 1922 was 470 compared with 100 in 1913. The deficit in 1922 was 399 million florins, but this is unduly swollen by an accounting operation whereby 178 million florins were debited against the budget of 1922 for losses on the food supply service, though the payments had been made in previous years. This summary comparison shows, however, that public expenditure had greatly increased during this period, even after allowing for the rise in the price level, and that the public finances were less satisfactory in the early post-War years than they had been in 1913.

In Holland, as in countries whose finances were more violently disturbed by the War, there was an effort in subsequent years to attain economic stability, of which budgetary stability was considered an indispensable part. Budgetary expenditure was at its highest peak in 1922 and thereafter until 1926 gradually declined. The increase since 1927 is mainly due to amortization of the debt, and only very slight increases are in respect of administrative services. However, the actual post-War situation of the Netherlands Government finances was much better than the large deficits suggest. Although a series of such deficits during and after the War were covered by loans, thus increasing the public debt, the current expenditure—namely, expenditure in the ordinary budget, the " crisis budget ", and the loan fund account—was met out of current revenue between 1920 and 1926, even after including in the expenditure amortization of the debt amounting to about 295 million florins. The deficits were almost entirely due to the extraordinary budget, the expenditure in which was for the most part capital investment. In 1925, 1926, and 1927, however, there were substantial surpluses ; the " crisis budget ", introduced during the War, had been discontinued, and expenditure in the ordinary budget

had been made to conform more closely to the principle that capital expenditure, properly so-called, should be for productive purposes only.

We may, therefore, regard the years 1922 to 1925 as a period during which an effort was made to achieve stability in the public finances of Holland, though with far less drastic methods than those applied in countries suffering from violent inflation. The general budgetary policy between 1922 and 1925, and especially from 1924 when Mr. Colyn became Minister of Finance, was to reduce expenditure and to increase taxation. The price level had been falling, but became stable in 1924, and the budgetary policy was adjusted to deflationary conditions, and was in a certain measure itself deflationary. Among the measures adopted in 1924 was a reduction of 20 per cent in the salaries of employees of the Government, a step made possible by the fall in prices. Certain changes were also made in the form of the budget. In 1925 the " crisis budget " was discontinued, the so-called " crisis " expenditure being included in the ordinary budget, and the State mines have been excluded from the budget since 1926 except for the net surplus or deficit. Capital expenditure was defined by the Dutch Treasury to mean " investment which in the economic sense can be considered as productive ", and this definition was more rigorously applied than in previous years, certain items of expenditure being transferred from the extraordinary or capital budget to the ordinary budget.

The budget is now presented in two parts, the ordinary budget, of current expenditure and revenue, and the extraordinary or capital account. The capital account covers the service of loans to municipalities and advances to various Government enterprises, and also special amortizations of the public debt. In addition there are several special funds outside the budget, of which the most important are the Loan Fund, created in 1914 to meet expenses of interest and repayment of " crisis loans ", and drawing its revenue from additional percentages on existing taxes, and the Road Fund, created in 1927 for the reconstruction and maintenance of roads.

In 1925, after a period of deflation, the external value of the paper florin reached gold parity, and the gold standard was resumed. The adjustment of the budget to these conditions resulted in reductions in the expenditure on National Defence, Education, and various social services. The salaries of officials were reduced, as were the wages of workers in sheltered industries.

The general progress of current expenditure and income up to 1924 is as follows :—

CURRENT RECEIPTS AND EXPENDITURE, 1920–24[1]

(Million Florins)

	1920	1921	1922	1923	1924
Revenue . .	907	842·7	763·8	738·9	680·5
Expenditure .	800	806·1	989·3	743·2	697·5
Balance . .	+ 107	+ 36·6	− 225·5	− 4·3	− 17·0

The wholesale price index, on a basis of 1913, was at its highest (292) in 1920, had fallen to 182 in 1921, to 160 in 1922, and to 156 in 1924. Thus the reduction in current expenditure from the high level of 1922 to that of 1924 represents a heavy fall in real expenditure. In 1922, however, we must allow, as explained above, for an item in expenditure of 178 millions which is merely an accounting entry, the payments it represents having been made in previous years. Even so we are left with a fall in expenditure from 1922 to 1924 of over 100 million florins, or about 13 per cent.

Expenditure on capital account was also greatly reduced from 289 millions in 1921 to 96 millions in 1924, and the total expenditure in the general budget and the loan fund, which had been 1,095 million florins in 1921, was only 794 millions in 1924.

The year 1925 marks the end of the period of deflation, and the achievement of budgetary stability. Between 1925 and 1929 the budget expenditures steadily increased, but revenues increased even faster. In each of these years the ordinary budget produced a surplus, which in 1925, 1926, and 1927 more than offset the deficit on the extraordinary budget. In 1928 and 1929 large repayments of debt were included in the extraordinary expenditure, and the budgets in these two years closed with deficits which, however, were considerably less than the amounts of amortization. In each year the estimates of revenue proved to be very conservative, and actual revenue substantially exceeded anticipations. One result of this regular under-estimation of the revenue-producing capacity of the country was that the growth in expenditure was held in check, the high income receipts appearing as unexpected surpluses rather than as supporting new expenditures. The expenditures,

[1] This includes receipts and expenditure of the ordinary account, the Crisis Account, and the Loan Fund, but excludes the extraordinary or capital account.

including the ordinary and extraordinary budgets and the loan fund, between 1925 and 1929 were as follows :—

TOTAL EXPENDITURE OF BUDGETS IN HOLLAND, 1925–29
(Million Florins)

	1925	1926	1927	1928	1929
Total Expenditure .	746·1	767·4	700·9	926·8	913·6
Amortization included in total Expenditure .	46·4	79·0	57·6	233·5	161·9

The fluctuations in total expenditure are largely explained, therefore, by fluctuations in the extraordinary budget, chiefly in respect of repayment of the debt. The removal of the gross accounts of the State mines from the ordinary budget after 1926 makes strict comparison of the ordinary budget before and after that year impossible. But it is clear that current expenditure on the administrative services has shown a tendency, though not very marked, to increase. The ordinary expenditure for 1930 was 610 million florins, as against 598 millions in 1929 and 574 millions in 1928.

Analysing the expenditure in the ordinary budget the chief items are those of the Ministry of Education, the Ministry of National Defence, the service of the debt, and the Ministry of Labour, Commerce, and Industry. Each of these departments has shown increasing expenditures since 1925, with the exception of the National Debt service which, following the large amortizations and conversions, required slightly less in 1930 than in 1925. The relative importance of these expenditures in the ordinary budget are as follows :—

CHIEF EXPENDITURES IN THE ORDINARY BUDGET

	1913	1928		1929	
	% of Total	Amount	%	Amount	%
Debt Service . . .	12	88·4	15	82·0	13·7
Education and Arts . .	15	145·6	25	152·2	25·6
National Defence . .	17½	93·6	16	95·0	16·0
Labour, Commerce, and Industry	—	71·7	14	79·6	13·3
Public Works . . .	—	47·0	9	59·3	10·0

These expenditures, it should be noted, are those within the ordinary budget only, and do not include the special repayments of debt in the extraordinary budgets of 1928 and 1929. It is

largely in virtue of these repayments that the debt service (mainly interest) in the ordinary budget shows a slight reduction in recent years, from slightly over 20 per cent of total ordinary expenditure in 1926 to 13·7 per cent in 1929. The Ministry of Education is responsible for the highest expenditure, absorbing in 1929 about 25 per cent; the Ministry of National Defence comes next with 16 per cent, and then the Ministry of Labour, Commerce, and Industry with 13 per cent. It is interesting to compare these expenditures with the budget of 1913. The group of services which are generally referred to as the "social services" has greatly increased in importance and is the chief source of the increase in total expenditures. National Defence occupies relatively about the same position in 1929 as in 1913, which, taking into account the increase in total expenditure, means that actual expenditure on national defence has increased by more than the increase in the price level. The national debt service is a greater burden on the present than on the pre-War budgets.

The budgets of 1925 to 1929 represented stable and relatively prosperous conditions. As we have seen, expenditure expanded slightly, though the upward tendency was held in check by cautious estimates of revenue. The depression of 1930, however, changed these favourable conditions. The yield of taxation began to fall, leaving the Government with the prospect of heavy deficits which would have to be met by an increase in the national debt. Ordinary receipts, which in 1929 had been 649 millions, fell to 632 millions in 1930 and 556 millions in 1931. The accounts for 1930 closed with a surplus in the ordinary budget of 27 millions, but this was offset by a deficit in the extraordinary budget, the result of the two budgets being a deficit of 15 millions. The provisional results for 1931 show a deficit on the ordinary budget of 49·5 million florins and on the extraordinary budget of 96·5 millions, a total deficit of 146 millions.

In order to meet this situation the Government has both looked for new revenue and made an attack on expenditure. Taxation in Holland is, however, very high, especially direct taxation, which accounts for 40 per cent of the tax revenue, and possibilities in this direction are, therefore, limited. Nevertheless, since 1924 some tax reductions had been made, notably in income tax, and the budget for 1933 increases the present tax by 30 per cent. The tax of the "Funds of the Communes" was also increased by rates varying from 30 to 150 per cent of the present tax. A new tax on luxury consumption was estimated

to yield 10 million florins in a full year. A proposal to increase the rates of import duty from 10 to 13 per cent (they had recently been raised from 8 to 10 per cent) met with bitter opposition in the Chamber as an undesirable encroachment on the principles of free trade, and is for the moment in abeyance.

But more is apparently expected from economies than from increases in taxation. The Welter Commission on Economy was appointed by the Government in 1931 to examine ways and means of reducing public expenditure. The Committee presented its report in the summer of 1932, and proposed a reduction in the current administrative expenditure of over 100 million florins, that is a reduction of the ordinary budget by one-sixth. The report, too drastic to be adopted by the Government in its entirety, nevertheless sheds an interesting light on the budgetary situation of Holland. The Commission pointed out that in a budget of 597 million florins, 192 millions represented legally incompressible expenditure. Thus there remained 375 million florins of expenditures on which economies were possible, and on this amount the Commission suggested that savings could be achieved in the following manner in the budget for 1933 :—

COMPRESSION OF EXPENDITURE PROPOSED BY WELTER COMMISSION

	Million fl.
Reduction of salaries and establishments	24·0
,, ,, subventions	2·8
,, ,, expenditure on materials	1·0
,, ,, ,, by Ministry of Public Works	25·3
,, ,, ,, ,, ,, ,, Education	15·4
,, ,, ,, ,, ,, ,, Commerce and Labour	13·2
,, ,, ,, ,, ,, ,, Defence	7·5
Total	101·8

These suggested reductions involved drastic economy measures. The chief changes proposed were : Reductions in unemployment benefit by 15 per cent ; all-round reduction in administrative staff of 12 per cent ; a reduction in the pay of employees by 13 per cent for unmarried employees, and 8 per cent for married ; a 10 per cent cut in the military budget ; and a postponement of the Zuyder Zee reclamation works.

Referring to the actual budget for 1932, results of which are not yet available, the Commission thought that the deficit on the ordinary budget would amount to 43·4 millions, as against an estimate of 9·5 millions in the voted budget. The

estimate of the Commission was based on the fact that certain items of expenditure would exceed the original estimates, chiefly the National Debt service, 10 millions more than estimates, the railway deficit, 11 millions in excess, and the deficit on Funds of Communes, 8 millions in excess.

The proposals of the Welter Commission are interesting, as a very concrete example, comparable with the May and Ray Reports in Great Britain, of the attack which is being made on the rigidities of public expenditure under modern conditions, and under pressure of financial difficulties. The actual achievements of the Government in reducing expenditure, though considerable, fall much below the clear-cut and devastating severity of the Welter Report. The reasons lie partly in the political impossibility of making such extensive reductions in various social services, and partly in the fact that increasing expenditure on unemployment relief, and in the railway and other deficits, offset savings in other directions.

The total expenditure in the ordinary budget in 1931, the latest year for which closed accounts are available, was only very slightly less than that for 1930, but was more than the expenditure in 1928 and 1929. The estimates for 1932 and 1933 visualize considerable reductions which, however, will still leave the total expenditure in the ordinary budget for 1933 at about the same level as that for 1928. It is worth while to compare these expenditures between 1928 and 1933, with regard to both the total expenditure, and those of the most important separate chapters.

EXPENDITURES IN THE ORDINARY BUDGET, 1928–33

(Million Florins)

	1928. *Actual.*	1929. *Actual.*	1930. *Actual.*	1931. *Actual.*	1932. *Estimates.*	1933. *Estimates.*
Defence . .	93·6	95·0	99·9	100	96	88
Public Debt .	88·4	82·0	80·9	84·5	73	84
Education . .	145·6	152·2	158·8	165·0	165·0	159·0
Public Works .	47·0	59·3	59·8	59·0	52·0	63·0
Labour and Commerce	71·7	79·6	77·3	66·0	60·0	44·0
Other . .	127·7	130·4	134·1	111·9	142·0	116·2
Total .	573·8	598·2	610·1	606·4	588·0	572·8

Thus no extensive economies were applied before the budgets of 1932 and 1933. The expenditure of the Ministry of Education and Arts, which steadily rose from 145·6 million florins in 1928 to 165 millions in 1931, stands at the latter figure in the estimates for 1932, but is reduced by 6 million florins, or 3·6 per cent, in the 1933 estimates. Some reductions in the amount required

for debt service were due to the repayments in 1928 and 1929, but the result of borrowing largely to meet the budget deficits in 1930 and 1931, as well as for special purposes, has increased the debt service in the estimates for 1933. The expenditure for national defence, which increased from 93 million florins in 1928 to 100 millions in 1931, is reduced to 96 millions and 88 millions in the estimates for 1932 and 1933 respectively.

The budget voted for 1933 visualizes economies over the budget of 1932 amounting to 57 million florins, or about half those proposed by the Welter Commission. They are, however, offset by increases in other departments. The chief economies are in the Ministry of Labour, Commerce, and Industry, which is reduced by 16·5 millions, of which 14·5 millions are due to savings by a reduction in various workmen's insurance benefits, including unemployment ; in the Ministry of Education which submits to a reduction of 5·8 millions ; in the Ministry of National Defence which submits to a reduction of 7·5 millions. The increases are chiefly for service of the debt, 10·6 millions, and the Ministry of Public Works and Communications, 10·1 millions, a large part of which is attributed to the deficit on the railways. The expenditure on Public Works is 8 millions less.

CHAPTER III

SWITZERLAND, BELGIUM, AND AUSTRIA

I

SWITZERLAND

The Public Finances of the Confederation of Swiss Republics were naturally less rudely disturbed by the Great War than those of her belligerent neighbours. There was no currency inflation of the type which occurred in Belgium and France, and a return to the gold standard at the pre-War parity was made without serious disturbances. Nevertheless, the War has had its effects on the public finances of the Confederation. During the War the expenditure of the State for emergency purposes caused total expenditure considerably to exceed current revenue. A series of deficits during and after the War was met by borrowing, and thus the State debt was greatly increased. As a result, the annual debt service rose from 5·6 million francs in 1913 to 123 million francs in 1930. Moreover, though Switzerland suffered none of the extreme inflationary troubles common in many other countries, there was a sharp rise in the price level during and after the War, followed by a fall to a relatively stable level in 1926. Compared with 100 in 1913, the retail cost of living index was 200 in 1921 and had fallen to 165 in 1925.

Since most of the debt was incurred during the period of high prices, and at high rates of interest, the real burden of the debt was increased further since the end of the War. It must not, however, be imagined that the increase in total budgetary expenditure is entirely, or even chiefly, due to the War. It is due to the rapid growth in recent years, here as elsewhere, of Government obligations in economic and social life.

In considering the budgets of the Swiss Confederation we must remember that in Switzerland the central administration is responsible for a smaller proportion of the total public expenditure than is the case in most other countries. Most of the social services, such as education, maintenance of roads, and public health, are administered by the Cantons with

separate budgets and a large measure of independence. The responsibility of the Confederation in many of these services consists in granting subventions to the Cantons. The municipalities are also responsible for an unusually wide range of local services.

A distinction is drawn between ordinary and extraordinary revenue and expenditure. The ordinary budget comprises the accounts of administration together with the net surplus or deficit of Government enterprises. The extraordinary budget shows on the revenue side the yield of the special " War " taxes, the realized surplus of the administration accounts, and sundry other items. On the expenditure side, it shows certain debt redemptions, deficits of the administrative accounts, and special subventions to industries and for unemployment relief. The Federal Railways have a separate budget, and the debt on the railways is kept distinct from the public debt. There are many special funds, of which the most important is the unemployment insurance fund. The published accounts are in two main parts, the administrative accounts of revenue and expenditure, and the capital account, first introduced in 1913, showing the net position of the State regarding total liabilities and total assets.

There was a small deficit on the administrative accounts in 1913. During and immediately after the War the deficits assumed large proportions, and thus between 1913 and 1925 the total deficits amounted to 1,682·8 million francs, of which 116·1 millions were covered by available credits and the balance, 1,566·7 millions, was covered by loans. In 1926 and 1927 deficits of 9·4 millions and 1·6 millions respectively were realized, but the years 1928 to 1931 each realized a substantial surplus. Administrative expenditure has risen from 308 million francs in 1925 to 426·4 millions in 1930. In 1931 expenditure was slightly less at 426·1 millions, and the estimates for 1932 were reduced to 417·9 millions. However, the estimates for 1933 are increased to the record figure of 442 millions, largely on account of an increase in direct subventions to the railways, to industries and for unemployment relief.

Increased revenues largely supported this increase in administrative expenditures, particularly since 1925. Revenues in the budget increased from 299 million francs in 1925 to 433·1 millions in 1930. Indeed, between 1915 and 1930 each year shows an increase in revenue over the previous year. It was not until 1931 that revenues declined. These increases are, of course, due to increased taxation. In 1913 the proceeds of the military

tax and the customs were the only tax receipts of the Federation. Since then various taxes have been imposed to meet the new costs of unemployment and subsidies for various economic and social purposes. In 1915 the special war tax was imposed, and was renewed in 1922 in the form of a tax on income and property, to be levied for twelve years in periods of four years, that is to say, in 1926, 1930, and 1934. A 10 per cent rebate is granted to persons paying in advance for a period of four years. Thus the receipts in 1926 and 1930 are to some extent swollen by the fact of this tax falling due for payment. This accounts for the high taxation yield in 1930, despite the depression. Some increases have been made in the customs duties and in the petrol tax, which has yielded increasing sums in recent years up to 1931.

The revenue and the final results of the administrative budget since 1925 are as follows :—

REVENUE AND FINAL BALANCE OF ADMINISTRATIVE ACCOUNTS, 1925–31
(Million Francs)

	1925.	1926.	1927.	1928.	1929.	1930.	1931.
Income from Capital	21	23·3	25·2	27·3	26·2	31·4	29·2
Finance and Customs	261·6	275·1	288·8	334·1	348·4	379·9	380·5
Other . . .	16·4	15·3	17·3	21·7	21·3	21·8	18·7
Total Revenue .	299·0	313·7	331·3	383·1	395·9	433·1	428·4
Total Expenditure .	308·0	323·1	332·9	359·4	371·9	426·4	426·1
Balance + or − . .	− 9·0	− 9·4	− 1·6	+ 23·7	+ 24·0	+ 6·7	+ 2·3

The very marked extension of State activity is reflected in the administrative expenditures. This is not due to the assumption of duties by the Federal administration, previously performed by the Cantons, but represents a real extension of State responsibility in economic and social life. No important changes have taken place which limit the independence of the Cantons and, moreover, the total expenditures in the administrative budgets of the latter have themselves increased from 525 million francs in 1925 to 591 millions in 1928. Increased expenditures have been met out of increased revenues, which have been maintained despite the depression. Indeed, Swiss finances reflect the depression less than those of many other countries, for, although the revenue in 1931 shows a slight fall over the previous year, it is nevertheless still considerably higher than in 1928 or 1929. However, the revenue in 1930 and to a lesser extent in 1931 is affected by the payments due on the War tax, and by increases in certain customs duties. Nevertheless the yield of customs duties, excluding petrol and tobacco, were greater in 1931 than in 1930 by over 2 million

francs, and it is only in 1932 and 1933 that the estimates anticipate a decrease.

We turn now to the analysis of expenditures in the administrative budget in recent years. The principal items are detailed in the table below :—

ADMINISTRATIVE EXPENDITURES, 1927–31
(Million Francs)

	1927		1928		1929		1930		1931	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Debt Service .	111·9	33·7	128·3	35·6	114·6	30·8	123·6	29·0	111·6	26·2
Amortization	2·2		3·6		6·5		6·5		9·8	
Interest (Consolidated) .	102·6		100·2		94·5		94·5		80·9	
Interest (Floating)	6·3		8·4		14·8		14·8		15·5	
Military .	85·1	25·6	87·1	29·8	89·4	24·1	99·1	23·2	92·6	21·7
Public Services	57·2	17·2	63·3	18·0	70·1	19·0	80·9	19·0	90·6	21·2
Interior .	31·0	9·3	31·8	8·7	37·3	10·0	42·8	10·0	48·7	10·1
Total .	332·9		359·4		371·9		426·4		426·1	

The figures and percentages in the above table are likely to be misleading unless read with caution. The debt service and military expenditure appear as a very high proportion of the total expenditure, and magnified beyond their true relative importance by the fact that most of the social services are administered independently by the Cantons, while the military administration is entirely a responsibility of the Federation. This is a striking illustration of the pitfalls which beset direct comparisons between the national budgets of different countries. As for the figures themselves, there are several facts to be noted. We have already pointed out that the growth of total expenditure is due to a real extension of State activity, since it is not due to a greater centralization of administration, and is, in fact, accompanied by an increase in the expenditure in the budgets of the Cantons. The expenditure for debt service has been the most fluctuating item. In 1928, when the total debt charge increased to 128 million francs from 111 millions in the previous year, the total consolidated debt fell by 55 million francs and the floating debt rose by 41 millions. On the whole, the interest charge has steadily fallen and is expected to continue to fall, in accordance with the scheme for amortization drawn up in 1925, whereby successive appropriations of the War tax are to provide a total of 275 million francs for debt repayment up to 1934. This appears as extraordinary expenditure in the

capital account, and is in fact the chief item in the extraordinary expenditure. The scheme of repayments is as follows :—

1926	45	million francs.	1931	25	million francs.
1927	25	,, ,,	1932	25	,, ,,
1928	25	,, ,,	1933	25	,, ,,
1929	25	,, ,,	1934	20	,, ,,
1930	60	,, ,,			

Military expenditure very slightly increased between 1927 and 1930, but was reduced in 1931. Relatively, however, the cost of military service has decreased from 25·6 per cent of the total administrative expenditure in 1927 to 21·7 per cent in 1931. The greatest increase in expenditure is, therefore, accounted for by the various public services, largely in the form of subventions to industry and to various social services. Thus the expenditure on Public Services (which includes grants for education, general economic purposes, and unemployment and other insurance funds) increased from 57·2 million francs in 1927, representing 17·2 per cent of total expenditure, to 90·6 millions in 1931, or 21·2 per cent.

The Swiss public finances have suffered much less in the depression than those of most other countries. In 1931 the accounts of administration closed with a surplus of 2 million francs and revenue, though less by about 4½ million francs than in 1930, was nevertheless greater than in 1929 by over 30 millions. However, the depression has left its mark on Swiss industry, seriously increasing unemployment and reducing activity, particularly in the export industries and the tourist traffic. In these circumstances the favourable budgetary results cannot possibly continue, for on the one hand expenditure on unemployment and special subventions to depressed industries are increasing, while on the other hand the revenues cannot be maintained. The relatively high prices in Switzerland have no doubt been an important factor in maintaining the volume of imports, which are the chief source of Federal revenue. According to statistics published by the League of Nations, the average monthly value of imports into Switzerland was 231 million francs in 1929, 222 millions in 1930, and 187 millions in 1931. In the same period exports had fallen from a monthly average of 175 millions in 1929 to 147 millions in 1930, and 112 millions in 1931. These figures refer, of course, only to merchandise trade, but they serve to indicate the general trend, and the fact which is important for our present purpose, that the relative inelasticity of the imports up to the end of 1931 has enabled favourable

budgetary results to be maintained. Without some attenuation of the depression this situation cannot long continue, for eventually imports must fall to a greater extent, failing an improvement in exports or the placing of increased foreign balances in Switzerland, which would temporarily relieve pressure on the exchanges. The factors, which have hitherto shielded Switzerland from the full blast of the depression, have not averted, but only postponed, its incidence. For the export industries continue to decline, the average monthly value of exports (merchandise only) in 1932 being only 67 million francs as against 112 million in 1931. The tourist traffic, the largest single item of " invisible " export, has naturally suffered from the general depression and from the depreciation of currencies which are more or less tied to sterling. Merchandise imports, too, have fallen from a monthly average of 187 million francs in 1931 to 145 millions in 1932. According to voluntary unemployment insurance returns at the end of December, 1930, 6·6 per cent of insured workers were wholly unemployed and 10·4 per cent partially unemployed. At the end of December, 1931, the figures were respectively 10·1 and 14·9 per cent.

Thus there is likely to be an increase in expenditure—on account of unemployment—and a decrease in revenue due to the decline in trade. This situation has given rise to misgivings in some quarters, and to attempts to check the rising trend of Government expenditure or even to reduce it. Since more than 60 per cent of the revenue of the Confederation is obtained from the customs duties, including the tobacco monopoly and the petrol tax, the possibilities of increasing revenue by increased taxes is limited. Moreover, taxes on barley, beer, malt, and automobiles were already increased in 1928, while the tobacco duties were increased in 1932. The main immediate relief to the budget is, therefore, looked for on the expenditure side. Some important charges have, in fact, been reduced in the budgets of 1931, 1932, and 1933.

Thus the debt charge has been reduced by favourable conversions, and still further reductions are possible by this means. In 1930, 1931, and 1932 six separate loans to a total of 950 million francs were either converted or paid off, bringing a total saving of 10 million francs in the annual debt charge. Of this 950 millions, 900 millions represents converted loans and 50 millions amortization. Assuming conversions to a rate of interest at $3\frac{3}{4}$ per cent, loans falling due between 1933 and 1937 could be converted with a further saving of nearly 12 millions

in the annual charge. These are the 4½ per cent loan of 1915 of 86 million francs, falling due in April, 1933, an American 5½ per cent loan of 1924 of 30 million dollars, falling due in April, 1934, and two 5 per cent internal loans totalling 220 million francs, falling due in 1935 and 1937. The Swiss Government, like the British, is in the fortunate position of being able to make favourable conversions. The budget for 1933 anticipates further economies on the debt service, chiefly from this source, to the amount of 7 million francs.

National defence expenditure is not high in Switzerland, as compared with most of her neighbours, but some reductions have been achieved in 1931 and more are anticipated. In 1931 the expenditure on defence was reduced to 92 million francs from 99 millions in the previous year. Apart from slight reductions to be obtained by reductions in pay, further cuts are contemplated in the budget for 1933 to bring the total down to 90 millions.

The most important of the remaining items of expenditure in the budget are the subventions to various social services and industries. Of these some are fixed by legal agreements and are therefore non-modifiable; others are modifiable within the budget. In 1931 some of those subventions were in excess of those paid in 1930. Thus new constructions and reconstructions increased by nearly 2 million francs in 1931 over 1930; unemployment insurance increased by 1 million francs; subvention to milk producers and to corn producers by 2·5 and 2·3 millions respectively. According to a recent calculation, the situation is briefly as follows:—

SUBVENTIONS PAYABLE TO VARIOUS PURPOSES
(Million Francs)

	1931 (*Closed Accounts*)	1932 (*Budget*)	1933 (*Budget*)
Modifiable . . .	42·9	43·1	40·1
Non-modifiable . .	109·5	101·5	127·4
Including unemployment . .	6·0	10·0	28·0

Some of these classed as "non-modifiable" are, of course, susceptible to reduction by changes in the law, but such changes would encounter strong resistance. The budget of 1933 anticipates a 15 per cent reduction of all subventions not fixed by international agreements, from which a saving of from 20 to 25 million francs is calculated.

Finally, the salaries of Government employees which, including the railways, comprise 40 per cent of the total expenditure, will

yield further savings by an all-round reduction of 7½ per cent, taking effect from July, 1933. By this, a saving of 12 million francs on general administration and 12 millions on the railways will be achieved.

II

BELGIUM

(*a*) *Public Finances*, 1919–1927

The national finances of Belgium were deeply disturbed by the Great War. For a number of years after the establishment of peace Belgian Governments, like many others in Europe, in order to meet their obligations made up for the deficiency in the yield of normal taxation by resort to the printing press. Since the stoppage of inflation was dependent upon balancing the budget by other means than the fatally easy one of working the Bank of Issue overtime, it is natural to take 1926, the year of currency stabilization, as a dividing line in the recent history of Belgian Public Finance.

Between 1921 and 1926 the annual expenditure in the budget rose from 8 to over 13 milliard francs. During the same period the wholesale price index, on a base of 1914, rose from 366 to 664, and the rise in expenditure, therefore, was less than the rise in the wholesale price level. The financial difficulties of the Government, from the point of view of meeting necessary budget expenditure, are more clearly realized by considering the fact that in 1920 the budgetary revenues, excluding loans, were only 44·5 per cent of the expenditures. This situation was gradually improved as the yield of taxation increased, and by 1926 the corresponding figure was 86·8 per cent. During the early years following the conclusion of peace in Belgium, no less than in other countries with War claims on Germany, the illusion was cherished that Germany would provide all the funds required for complete reconstruction. This illusion died hard and remained an obstacle to the reform of public finances, until the adoption of the Dawes Plan in 1924 did something to dispel it, and ideas of stabilization began to occupy the thoughts of politicians. A first attempt in 1925 failed; a second effort in 1926 succeeded in stabilizing the currency and balancing the budget.

The outstanding feature of these post-War Belgian budgets is the exceedingly high proportion of expenditure required for the Public Debt. In 1926 the debt charges amounted to

50 per cent of the ordinary budget. The accumulated deficits of the years 1921 to 1924 amounted to over 5 milliards and these were met ostensibly by borrowing, but actually by inflation. Nevertheless inflation was not sufficient to reduce the dead weight of the debt, since the increase in the nominal amount of the debt practically kept pace with the depreciation of the currency. The nominal amount on 30th September, 1920, was 32 milliards of francs, or about 11·9 milliards expressed in gold francs; on 30th September, 1925, the nominal debt was 48·5 milliards, which represented a gold value of 10·7 milliards. Thus, while the budgetary deficits had been covered by inflation, the real burden of the debt on the eve of stabilization was practically what it had been in 1921. Moreover, a high proportion of the whole was floating debt, a fact which was largely responsible for the failure of the first stabilization plan. Speaking in 1924 of the difficulties of the Treasury, M. Theunis, the Finance Minister, said, "of a debt total of 41 milliards more than 6 milliards are repayable within one year."

The plan of stabilization attempted in 1925 was based on the raising of a foreign loan. It failed partly on account of unfavourable international conditions. But a more important cause of failure, which brought a rapid fall in the external value of the franc, was the inability of the Government to check continued inflation, largely due to budgetary instability, and the extremely high level of the floating debt. It is not surprising, therefore, that the plan of 1926 which was successful, provided for a much more vigorous reform of public finances.

As a result of the measures adopted by the new Government in the latter part of 1926, several important changes took place in the budget itself. Of these the chief were the formation of the State Railways into a *Société Nationale* with an independent budget, and the incorporation of the budget of recoverable expenditures (*Budget des dépenses recouvrables*) into the extraordinary budget. For dealing with the budget itself the Government obtained wide powers under the law of *plein pouvoir*, operative for a year from June, 1926, to June, 1927. Three lines of action were followed, increased taxation, economy in expenditure, and funding of the floating debt. Nearly all the important taxes were increased with the object of raising the revenue from these sources by 1,500 million francs. New taxes were introduced on the consumption of luxury articles, the rates of duty were raised on imports, on automobiles, and on

personal income and property. Economy in expenditure was achieved by a drastic cutting down of services on the initiative of a commission resembling the Geddes "Axe Committee" in Great Britain. The economies included a suppression of some services and a regrouping of others, a reduction in staffs, and the cessation of all public works not considered absolutely necessary. The steps taken for dealing with the debt were more drastic. They included a forced conversion of 5·8 milliards of floating debt consisting of six months' Treasury bonds, and of other debt maturing in December, 1926. All these obligations were converted into preferred shares of the Belgian Railways.

These measures were successful in balancing the budget, and in 1927 for the first time for many years the accounts, including amortizment of the debt, closed with a surplus. The years 1927, 1928, and 1929 were relatively prosperous and the increasing yield of taxation furnished surpluses in each of these years, in addition to a further net reduction in the public debt. At the same time expenditure was increased, reaching a maximum in 1930. The brief results of Belgian national finances for the years 1927 to 1930 are indicated in the table below :—

BELGIAN BUDGETS, 1927 TO 1930
(Million francs)

	1927.	1928.	1929.	1930.
Revenue . .	10,702·4	12,130·0	13,595·4	11,137
Expenditure .	9,282·6	10,746·7	12,281·2	13,072
Balance . .	+ 1,419·8	+ 1,383·3	+ 1,314·2	− 1,835

It should be noted that there is included in these expenditures, for the amortization of the debt, 453 million francs in 1927, 586 millions in 1928, and 687 millions in 1929. As the proceeds of loans are excluded from the revenues the actual situation, from the point of view of the Treasury, was even more favourable than the above figures suggest.

The increased expenditure during these years is shown by several administrative departments. In the ordinary budget, representing chiefly current administrative expenses, the credit granted to the chief administrative departments in 1927 and in 1930 were as follows :—

	1927.	% *of total.*	1930.	% *of total.*
Ministry of National Defence . .	653	7	1,250	11·6
,, Science and Arts . .	651	7	1,087	10
,, Public Works . . .	133	1·4	573	5·3
,, Industry, Labour, and Social Service . .	591	6·1	776	7·2
Total Debt Expenditure in budget .	4,019	43	4,258	33

Thus between 1927 and 1930 the total expenditures in the ordinary and extraordinary budgets increased by 41 per cent. There were, however, relatively slight but interesting changes in the proportional importance of different items of expenditure. The greater part of the increase in expenditure was due to the Ministry of National Defence and to Ministries responsible for certain social services. The debt service, which is the most dominating item in the budget, required a slightly larger sum in 1930 than in 1927, but its relative importance was reduced from 43 to 33 per cent of total expenditures. This result followed quite naturally from the success of the stabilization, and the comparative prosperity of the years immediately following that event. It must be remembered that the budget of 1927 was balanced by cutting down to a minimum all administrative expenditure. Since the debt service dominated the whole budget and, apart from the consolidation of the floating debt, was a rigid item of expenditure which had to be provided for, the economies in the other administrative departments were carried to the utmost limit. They were thus likely to be expanded again at the first favourable opportunity. Further, before the War, Belgium had been one of the least taxed countries in Europe and the new and increased taxes of 1927 tapped new sources of revenue which were no longer available in some more highly-taxed countries. This fact, together with the good trade conditions, explains the very rapid expansion of State revenue between 1927 and 1929, which was more than sufficient to support the increase in expenditure.

In each of the financial years 1927, 1928, and 1929 the tax revenue considerably exceeded the estimates.

Receipts from taxes alone exceeded the estimates as a whole, but in some particular cases failed to come up to the estimates. In 1928 total taxation receipts of 8,341 million francs were in excess of the estimates by 914 million francs, though receipts from direct taxes fell slightly below. However, the receipts of customs and stamp duties yielded considerably more than anticipated. In 1929 nearly every important source of taxation yielded results considerably in excess of estimates.

Between 31st December, 1927, and 31st December, 1929, the national debt had been reduced from 55,367 to 52,516 million francs, and by 31st December, 1930, practically the whole of the floating debt had been wiped out. This is an indication of the improvement which had been achieved, from the point of view of the Treasury, in the Belgian public finances between 1926 and 1929.

(*b*) *Public Finances and the Depression*, 1929

These results were achieved, however, in favourable circumstances which did not last. Favourable tax returns reflect rather the prosperity of the period immediately preceding their collection rather than that of the period to which they relate in Government accounts. Already in 1929, a very good year for the public finances, there were signs of declining activity which were likely to upset the calculations for 1930. Belgium did not feel the effects of the world depression quite so early as certain other countries. Nevertheless 1930 was a full year of depression, which became even more intense in 1931. According to the League of Nations' statistical Monthly Bulletins, the indices of production in Belgium, on a base of 1928, were 100 in 1928 and 100·1 in 1929, but fell to 89·8 in 1930 and 78·5 in 1931. Similarly the values of merchandise exports were in 1930 only 82 per cent, and in 1931 only 72 per cent, of their value in 1929, while import values fell in 1930 to 88 per cent and in 1931 to 65 per cent of their 1929 value. These figures serve to indicate the extent of the decline in economic activity in the depression, and explain the inevitable decline in tax revenue which followed. In 1929 the total revenue had reached the high level of 13,595 million francs. In 1930 it fell to 11,137 millions. While the figures for 1931 are not yet available, the budget being open for collection of taxation ten months after the close of the financial year, the final results will undoubtedly show revenue much below the estimates. The estimated total revenue for 1931 was 11,635 million francs, or very slightly more than the actual yield in 1930, but the returns up to March, 1932, were below the estimates in the case of practically every important item of taxation. A brief examination of the estimates and actual receipts from taxation for the years 1929, 1930, and 1931, is sufficient to show the difficulties of the Treasury.

	1929		1930		1931 [1]	
	Actual.	*Estimates.*	*Actual.*	*Estimates.*	*Actual.*	*Estimates.*
Direct . .	3,673	2,812	2,868	3,000	1,944	3,046
Surtax . .	3,076	2,425	2,285	2,490	—	—
Customs . .	1,319	1,000	1,336	1,330	1,303	1,388
Excise . .	836	745	805	725	790	788
Stamp duties, etc.	4,091	3,333	2,856	3,100	2,520	2,498

The heavy decline in the yield of taxation in 1930 and 1931, and the fact that the decline was greater than had been estimated,

[1] First fourteen months. The accounts are open for twenty-two months.

made budgetary deficits inevitable in both these years. But the decline was not due entirely to reduced economic activity. It was due, in part, to an ill-timed reduction in taxation in 1930. The relatively high taxation in 1927 was regarded as a temporary imposition to amortize a large portion of the debt. The favourable results of the years 1928 and 1929 led the Government in 1930 to reduce a great many taxes, including the stamp duties, the luxury tax, the *taxe de transmission*, and the tax on earned incomes. Further, the method of calculating the income liable to super-tax was changed from that of a sworn statement to a method based on an external index of wealth, as for example, the possession of a motor car. Already, when these reductions were made, there were signs of less prosperous times ahead, and in the following year, 1931, the policy was reversed, most of the taxes being restored. Undoubtedly, the policy of tax reduction in 1930 was very unfortunate, since it is generally easier to maintain taxes already existing than to increase them, or to introduce new ones. Moreover, between 1926 and 1930 there had been a considerable increase in expenditure for the expansion of certain social services which, if their principle were to be accepted, required the support of revenue, and inevitably involve increased taxation. The receipts for 1931, too, were increased by 500 million francs due to the sale of sequestered German property, a revenue which will not be available in following years.

Let us now turn to Government expenditure and the policy adopted to deal with the budget during the depression. The fall in revenue is a natural result of depression. Expenditure is in any case much more rigid and, in respect of the cost of unemployment, is actually increased. Already we have seen that expenditure on certain services was increased between 1926 and 1930, while with the virtual extinction of the floating debt, the debt charge occupied a relatively less important place in expenditure in the latter year. Nevertheless the debt charge is the most important single item of the Belgian budget, being from 25 to 35 per cent of the total. This is an expenditure which is entirely rigid (apart from default as in the case of the American payment due in December, 1932), the more so as the floating debt had been reduced to a very low figure by the end of 1930. Even though the total debt had been reduced between 1927 to 1930 from 55,367 to 52,516 million francs, the weight of the debt service had not been substantially lightened.

A second relatively rigid item of expenditure is that for

Defence. In 1930 this accounted for 11 per cent of the total expenditure. The estimates for 1931, as voted by Parliament, decreased the expenditure for Defence in the ordinary budget from 1,250 to 1,206 million francs but increased the expenditure in the extraordinary budget from 23 to 219 millions. The estimates for 1932 achieved a considerable reduction of all administrative expenditures and Defence estimates were cut by about 20 per cent over the estimates for 1931.

Economies in expenditure were aimed at in all administrative departments, and an effort was made to compress all administrative expenditure by 15 per cent, representing a total saving over 1931 of 1,500 million francs. The realization of these economies was facilitated by a Government decree limiting supplementary appropriations. In Belgium, as in France, the original voted estimates are often greatly increased by supplementary votes to various departments. Under the new decree increases in expenditure from this source could only take place on the recommendation of the Finance Minister and with the assent of the Budget Committee of the Chamber. Some departments, however, were faced with an inevitable increase in expenditure—notably the Ministry of Industry, Labour, and Social Welfare, which is responsible for the relief of the unemployed. The estimates of this Department in 1931 and 1932 were 883 and 939 million francs respectively, as against an actual expenditure in 1930 of 776 millions. These estimates have, in fact, been exceeded. Though no final figures are available, it appears that of the deficit of about 3 milliards likely to be realized in 1932, 750 millions are due to unforeseen unemployment relief. Public Works expenditure, on the other hand, has been cut to a minimum, and partly by reduction of current expenses, partly by holding up further development, economies have been achieved in most administrative departments. How effective these measures have been it is impossible to say, closed accounts not yet being available, but it is quite certain that they have not been, nor could be, sufficient to prevent a large deficit.

The attack on highly inflexible expenditures, in Belgium as elsewhere, has included a reduction in the salaries of Government officials. In 1931 the salaries of railway workers and Government officials were reduced all round by 6 per cent.

The deficits for 1930 and 1931 will probably be about 3,000 million francs and that for 1932 not much below. These will be met by borrowing, which will swell both the long-term and the floating debt. In September, 1932, the Chamber approved

a long-term loan of 1,500 millions, and an issue of Treasury bonds to the value of 1,000 millions, of which 500 millions will be at medium term and 500 millions at short term. The issue of Treasury bonds is made against arrears of taxation estimated at 1,500 million francs.

III

AUSTRIA

The story of the financial reconstruction of Austria between 1922 and 1926, with the assistance of the League of Nations, has been often told. There is no purpose in repeating it here in detail, as it may be followed in the official documents of the League. It is sufficient to recall that the piecemeal loans granted by various Allied Governments between the end of the War and 1922 ended in a confession of failure on the part of the Allied Council to rescue Austria from her distress. The matter was referred to the League of Nations and a scheme was drawn up covered by three Protocols signed on 4th October, 1922. This scheme was based on a League of Nations loan guaranteed as to 80 per cent by Great Britain, Italy, France, and Czechoslovakia, and as to 20 per cent by other governments. A complete financial reform was to be undertaken, including economy in Government expenditure and increased revenue from taxation, and the inevitable deficits in the early stages, expected to total about 650 million gold crowns, were to be met out of this loan. Inflation was to be brought to an end and the note issue strictly controlled. The scheme was to be supervised by a Commissioner-General, who was the final authority supervising the disposal of the loans.

One of the most important tasks of the reconstruction scheme was, of course, to secure budgetary equilibrium, but since this was not immediately realizable, it was first necessary to secure advances on the long-term reconstruction loan. To tide over the period of negotiation, a short-term loan of £3,500,000 sterling was raised from a group of countries in February, 1923. The long-term loan to a nominal amount of 769·3 million Austrian gold crowns, and giving a net yield of 611 million crowns, was completed in the summer of 1923. The reform of the budget was meanwhile being undertaken and very severe administrative economies were adopted. An important feature was the adoption

of the practice of making monthly estimates, and later of establishing closed accounts monthly, a device which was also adopted under the League scheme of reorganization for Hungary, and was voluntarily adopted by the Polish Government somewhat later. The economies in administration involved the dismissal of 50,000 employees up to 1st July, 1923, the reduction of Ministries from nine to seven, and the suppression of sixty-three sections out of a total of 211. The State Railways were reorganized and established as an independent concern, distinct from the central administration. The burden of the railway deficit on the budget was thus progressively reduced. A general improvement in economic conditions, following the restoration of confidence, was reflected in improved direct taxation receipts, which were more than double the estimates in 1923, though the taxes on railway traffic and the returns from monopolies were disappointing.

The economy and deflationary measures required in the budget under the League scheme naturally met with a good deal of opposition. According to the reports of the Commissioner-General, administrative reforms were not sufficiently achieved. The agreement to dismiss 100,000 officials by 1st July, 1924, was not fulfilled since, while the dismissal of half this number did not entail serious reorganization, a reduction of staff by the full number certainly did. Moreover, the question of salaries proved a very thorny one. The determination of official salaries in accordance with a cost of living index employed during the inflation was to be discontinued. But salaries were low, and the Commissioner-General insisted that any increases in salaries were to be met out of additional economies. The Government failed to reach an agreement with its employees, despite strikes and prolonged negotiations. Actual economies were, in fact, below the demands of the Commissioner-General, who, in his report of February, 1924, said that Government expenditure must be much further reduced. The year 1924 was a year of trade depression, intensified by the heavy burden of taxation, and therefore the question of reducing budget expenditure received more consideration.

In the first agreement, 350 million gold crowns had been the suggested figure at which budget equilibrium should be established. There was, in fact, never any prospect of reducing expenditure to this figure, since, despite economies, new expenditure was being incurred for salaries, pensions, and other objects. Thus in 1924 the total expenditure amounted to

621 million crowns. Finally the Austrian Government agreed with the Financial Committee of the League to an expenditure for 1925 of 545 million crowns, of which 50 millions was for investments. It was agreed that, if the budget figure for 1925 was kept within these limits and if that for 1926 were based on the same figures, the Committee would recommend the League Council to declare that financial stability had been achieved. In June, 1926, this period of control came to an end with the termination of the Commissioner-General's office.

When the supervision of the League over Austrian finances came to an end, it was considered that the budget was stabilized and was no longer a danger to the stability of the reformed currency. Considerable progress had been made and a large part of the League loan was available for investment purposes. The progress of Austrian budgets during the reconstruction is shown in the following table :—

AUSTRIAN BUDGETS, 1923–26

(Million schillings)

Revenue.	1923.	1924.	1925.	1926.
Administration . .	763·15	1,021·75	894·33	939·98
Monopolies . . .	92·91	136·45	172·53	199·74
Enterprises . . .	0·37	0·79	9·42	5·52
Railways . . .	0·14	4·94	0·68	0·21
	856·57	1,163·93	1,076·96	1,145·45
Expenditure.				
Administration . .	787·60	1,010·46	902·67	1,115·70
Monopolies . . .	1·49	3·56	4·94	6·39
Enterprises . . .	46·22	47·99	21·56	47·42
Railways . . .	179·54	114·96	71·36	108·35
Total . .	1,014·85	1,176·97	1,000·51	1,177·86
Balance . .	− 158·28	− 13·04	+ 76·45	− 32·41
Investment included in Expenditure . .	76·0	103·6	90·6	54·5

If account is taken of the investment expenditure it will be seen that in 1924, 1925, and in 1926 current expenditure in the administrative budget was more than covered by current receipts. Of the reconstruction loan only 13 per cent was used to cover the deficits on current account in 1922 and 1923. The fall in expenditure in 1925 is due to the execution of a number of the

economies demanded by the Commissioner-General and is conditioned also by the fall in revenue due to the depression in 1924 and 1925 which followed the boom conditions of 1923. Taking the figures as a whole, however, though administrative economies played an important part, the equilibrium of the budget was very largely obtained by means of increased revenues.

After 1926, and until the world depression, expenditures and revenues show an upward trend. But the apparent stability and prosperity of the years 1926 to 1929 are shown by subsequent events to be an illusion. The progress of the Austrian national budgets from 1928 to 1933 are analysed in the following table :—

AUSTRIAN BUDGETS, 1928–33
(Million Schillings)

A. *Expenditures.*	1928.	1929.	1930.	1931.	1932.	1933.
Salaries . .	468·6	449·9	480·8	476·0	424·1	422·0
Pensions . .	281·0	278·7	289·8	287·2	274·8	278·4
Total Personnel	749·6	728·6	770·6	763·2	698·9	700·4
Social Administration	272·3	306·6	376·0	411·9	481·3	500·3
Debt Service .	207·4	164·3	164·4	208·3	192·7	211·5
Capital Expenditure	212·5	147·2	248·4	98·4	13·4	6·1
Railways . .	22·1	22·1	39·9	22·3	99·3	96·2
Other . .	507·6	621·5	689·2	826·6	478·4	459·4
Total .	1,971·5	1,990·3	2,288·5	2,330·7	1,964·0	1,973·9

B. *Revenues.*	1928.	1929.	1930.	1931.	1932.	1933.
Direct taxes .	352·6	385·1	372·7	342·4	330·0	301·0
Customs . .	260·0	283·9	287·8	267·1	244·0	220·0
Excise . .	90·7	101·6	126·0	185·4	155·1	158·3
Sugar Tax . .	(13·6)	(20·5)	(40·4)	(70·8)	(43·2)	(57)
Turnover Tax .	251·0	255·9	249·7	291·1	173·0	145·0
Turnover " Emergency Tax "	Introduced in 1932 :				44·0	130·0
Net Total Taxes[1]	824·0	882·2	899·4	892·4	847·7	882·9
Total Revenue	1,892·4	2,010·0	2,027·0	2,008·5	1,964·1	1,974·1

Expenditures increased slightly in each year up to and including 1931. In the estimates for 1932 and 1933 reductions equivalent to about 16 per cent of the total budget for 1931 are anticipated from various economies. In view of the fact that expenditures were already at a very low level, these reductions are considerable. It will be seen from the tables above that savings were contemplated on salaries and pensions ; these

[1] After deducting shares of local authorities.

are due to dismissals and cuts in pay. Such as they are, however, they are offset by increases in the cost of social administration, due almost entirely to the effects of the depression and increased unemployment relief. The chief savings have been obtained at the expense of capital investment, particularly railway investment, which has been practically discontinued. The increase in expenditure for the railways from 22 millions in 1931 to 99 millions in 1932 was to meet the current railway deficit not previously charged against the budget, but met by increases in the floating debt. The transfer of this deficit to the budget was an implied, if not an express, condition of the League of Nations loan to Austria in 1932.

Revenue already showed signs of falling off in 1931. Despite increases in taxation, further falls were anticipated in 1932 and 1933. The provisional returns for 1932 showed a yield of 10 million schillings less than the estimates. But, as several important increases only came into force in August, 1932, a considerably greater yield was reasonably expected in 1933. The supplementary budget of August, 1932, doubled the turnover tax and increased certain customs duties, while the sugar tax had already been increased.

In considering these facts it should be remembered that the moderate resources of Austria were already severely taxed by the efforts of reconstruction, and that before the coming of depression expenditure was kept very low and taxation correspondingly high. The depression has only served to increase difficulties in a way not adequately revealed by these figures. In the third quarter of 1932 imports and exports fell by over 5 per cent, as compared with the corresponding quarter of 1931, itself a year of depression. The crash of the Credit Anstalt in 1931 not only set in train a series of indirect consequences which affected almost the whole of Europe, but definitely saddled the national budget with a charge of over 100 million schillings. Like most other Central European Governments, the Austrian Government has restricted foreign exchange transactions, and, like Hungary, has temporarily suspended payment on the League of Nations loan. On certain occasions in 1932 and 1933 the Treasury has been so short of cash that it has resorted to the payment of salaries in fortnightly instalments. In these circumstances the maintenance of budgetary and financial stability is something of an achievement, but it is difficult to see how this precarious equilibrium can long be maintained without an improvement in European trade, even assuming

the absence of serious political disturbances. The League of Nations guaranteed loan to Austria, confirmed by the Protocol of 15th July, 1932, was recognized as an exception to the principle accepted at the Stresa Conference that loans to Central European Governments provided in themselves no solution to the problem. It may tide over the situation for a time, but it is unlikely to disprove the truth of the Stresa principle.

Chapter IV

CZECHOSLOVAKIA, POLAND, AND FINLAND

I

Czechoslovakia

By far the most favourably situated, economically, of the Succession States created by the Peace Treaties, Czechoslovakia was among the first to set its finances in order. The first plan of the Finance Minister, put forward in 1919, involved a deflation to the extent of 80 per cent, and was much too drastic to obtain the assent of the National Assembly. Nor was it necessary to deflate so violently in order to achieve the other objects in the plan, namely the creation of a Central Bank of Issue and a monetary reform based on a foreign loan of 100 million dollars. A second plan was, therefore, adopted which aimed at a gradual withdrawal from circulation of the Notes of the Bank of Austria-Hungary and the separation of the Czechoslovakian Monetary system from that of the ancient Empire. The Notes of the Bank of Austria-Hungary circulating in Czechoslovakia were subject to a stamp tax of 1 per cent of their value, and the Minister of Finance had the right to withdraw from circulation the quantity of notes considered no longer necessary, the retained notes being regarded as titles to a State loan bearing interest at 1 per cent and repayable at any time by the State. This debt was to be amortized by a special levy on capital, which came into effect in April, 1920, for a period of three years.

The effect of this policy was decidedly deflationary, and Czechoslovakia suffered the effects of deflation in much the same way as Great Britain during the same period. By 1924 monetary stability had apparently been achieved and between 1924 and 1927 both the internal and the external value of the currency were remarkably steady. The budget was not actually balanced until 1927, but much of the expenditure was in the nature of capital investment for general development purposes, either directly or indirectly productive. Moreover the budget itself was undergoing a gradual reform during these years. The State enterprises, besides providing out of their own revenue

an increasing share of capital for their further expansion, made increasing contributions to the revenue of the State. A budgetary deficit was evidently compatible with monetary stability. But the policy of deflation increased the burden of the debt contracted during and before stabilization, and thus imposed an increased charge on future budgets.

The budget itself assumed its present form in 1927. The budget statements, therefore, before and after 1927 are not directly comparable.

Four stages in the evolution of the national finances may conveniently be distinguished and their chief features summarized as follows :—

(1) *From the Armistice to the end of* 1920.—The first budgets of the new State were presented in the same form as those of the ancient Austrian Empire, and were divided into ordinary and extraordinary budgets. This was a period of violent inflation and the total nominal expenditure of the State rose from $8\frac{1}{2}$ milliards in 1919 to over 15 milliards in 1920, when the revenue at $7\frac{3}{4}$ milliards was thus only about 50 per cent of the expenditure.

(2) 1921–5.—This saw the stabilization of the currency on the basis of the new Czechoslovakian crown. Though the budget was never actually balanced during this period, important steps were taken towards this end. The necessity for capital development in the new State influenced the form of the budget, which was divided into an Administrative Budget and a Development Budget. In 1923 a distinction was made between expenditure on personnel and on materials. As the budgets in these years were gross budgets, including the gross returns of the State enterprises, the expenditure includes a good deal of investment in productive enterprises.

(3) 1925–7.—In execution of two laws previously enacted in December, 1922, and September, 1924, State enterprises were excluded from the general budget, which shows henceforth only the net surplus or deficit of these undertakings. Capital development was re-defined to include only investments capable of creating new revenues, through the improvements of services or the extension of enterprises to create new public wealth. In 1926 it was decided that the period of special development should be closed, the special capital development budget was discontinued, capital investments being thereafter included either as investments in the budget of State enterprises, or as administrative funds to be accounted for in the general budget.

After 1926, moreover, the share of local authorities in public revenues was placed in a separate account.

(4) 1927 *and After*.—Great changes had been effected in the form of the budget from the beginning of the stabilization scheme down to 1927, when the reforms may be said to be completed. Since 1927 the budget has been presented each year in four separate parts : (*a*) The General Budget of Administration, (*b*) the Budget of State Enterprises, (*c*) the Budget of Autonomous Funds, comprising the share of local authorities in taxation, and also, since 1928, the road fund, and (*d*) the Account of the Public Debt. In the yearly statement of accounts it is important to distinguish between the Administrative Accounts and the Cash Accounts. The Administrative Accounts give a statement of acknowledged claims and liabilities of any particular financial year, while the Cash Accounts refer to the collections and payments made by the Treasury during the year, irrespective of the year to which they properly belong. For the most part, the following analysis is based on the Cash Accounts. When any accounts other than Cash Accounts are in question the distinction will be indicated.

The budgetary situation of Czechoslovakia may be said to have been satisfactorily stabilized by 1926, when the General Budget, according to the Administrative Accounts, closed with a substantial surplus of 2,352 million crowns, though the Cash Accounts of the Treasury for 1926 showed a deficit of 260 million crowns in the General Budget. However, in 1927, while the Administrative Accounts show a deficit of 81 millions, the Cash Accounts for that year closed with a surplus of 404 millions, and in 1928 the Cash Accounts show a deficit of only 112 millions, as against a deficit of 1,358 millions in the Administrative Accounts. The Cash Accounts for 1929 closed the General Budget with a surplus of 169 million crowns. Thus over the period 1926 to 1929 the cash position of the Treasury in respect of receipts and payments in the General Budget was on the whole favourable. Between 1923 and 1928 the total cash deficits amounted to 6,619 million crowns, which is 1,516 millions more than the deficit in the Administrative Accounts for the same period, the difference being due to an increase of the receipts in arrear and a slight decrease of the payments in arrear. During the same period the public debt increased by just over 6,000 million crowns. It should be remembered, however, that a good deal of expenditure within the budgets during these years was investment of a productive character, either directly

through the development of State enterprises or indirectly by general development of the resources of the new State.

The financial policy of Czechoslovakia during the time of reconstruction and up to the present owes much to the ideas and efforts of Carel Englis, the Finance Minister during the greater part of this time and well known as a theoretical economist. His main object has been to achieve monetary stability by consolidating the financial position and removing all possibility of currency inflation, while at the same time providing for the economic development of the country. Applied to budgetary policy this aim has involved an attempt to stabilize expenditures. That this end has been largely achieved we may see from a brief recapitulation of the expenditures and revenues of the administrative budget after 1926.

ADMINISTRATIVE BUDGETS, 1927 TO 1931
(Million Kc.)

	1927.	1928.	1929.	1930.	1931.
Revenue	10,987	10,907	10,444	9,653	9,029
Expenditure	10,583	11,019	10,275	9,928	9,763
Balance	+ 404	− 112	+ 169	− 274	− 743
Amortization of Debt	—	1,277	864	444	484

The expenditures in the above table include investments as well as current expenditure. Thus between 1927 and 1930 expenditure, including investment, was more than met out of current revenue and the cash reserves of the Treasury were on balance increased. Indeed, as a result of the cash reserves accumulated during the relatively prosperous years from 1927 to 1928, the budget deficits of 1931 and 1932 could be met without increasing the debt. It should be noticed, too, that a considerable sum for the repayment of debt is included in the expenditures. The most remarkable feature, however, is the relative stability of expenditures up to 1930, when most other countries show considerable increases.

The effect of the depression on revenue has been less disastrous than in other Central European countries. Nevertheless, there has been a considerable decline from 10,444 million crowns in 1929 to 9,132 millions in 1931, while the estimates for 1933 are reduced to 8,634 millions. A considerable amount of revenue is provided by the profits of Government enterprises. In 1929, when the results were favourable, more than 10 per cent of the total revenue came from this source. The onset of bad trade conditions, however, immediately affected the results of these enterprises and in 1930 the net gain to the budget from this

source was only half of what it had been in the previous year. The returns of taxation have been much steadier, but have all declined in some degree, a tendency which became more marked in 1932. Various forms of indirect and trade taxes play a more important part in the taxation structure than do direct taxes, and the former have naturally been more immediately sensitive to general economic conditions. The yield of the most important taxes since 1927 is shown in the following table :—

YIELD OF VARIOUS TAXES SINCE 1927
(Million Kc.)

	1927.	1928.	1929.	1930.	1931.
Direct . . .	2,545	1,970	2,031	1,693	1,552
Turnover . .	1,781	1,970	2,031	1,807	1,746
Customs . .	1,440	1,465	1,387	1,195	1,289
Consumption and luxury .	2,101	2,340	2,345	2,221	?

In 1927 the direct taxes were reformed and reduced, which accounts for the fall in the returns in 1928. The fall in 1930 and 1931 marks the appearance of the depression. The turn in the tide of trade in 1930 is shown by the reduced yields in that year. In 1931, in order to counteract the effects of the depression on the revenues, some of the trade taxes were increased. The 8 per cent profits tax was slightly increased, passenger railway rates were raised to offset the railway losses, and the beer tax was increased. But for these measures, the decline in the trade-taxes would have been even greater.

Expenditures of recent budgets of Czechoslovakia are summarized in the following table, for the purpose of examining briefly the structure of the budget and the relative importance of different types of commitments. The figures quoted are those of the voted estimates and should not be confused with the closed cash accounts quoted in the previous tables. Reference to the total expenditures of the closed accounts already quoted will show that the final results have not greatly differed from the estimates.

BUDGET EXPENDITURES ON DIFFERENT ITEMS, 1930 TO 1933
(Million Kc.)

Item	1930		1931		1932		1933	
	Amount	%	Amount	%	Amount	%	Amount	%
Defence . .	1,309	13·9	1,400	14·2	1,309	14	1,252	14·3
Social . .	1,779	18·9	1,875	19·0	1,896	20·1	1,842	21·3
Debt . .	1,804	19·2	1,829	18·5	1,691	18·1	1,996	23·1
Other . .	4,475	48·0	4,734	48·3	4,422	47·8	3,542	41·3
Total .	9,367	100·0	9,838	100·0	9,318	100·0	8,632	100·0

Total expenditures, as we have already remarked, have been kept fairly stable, in accordance with the policy deliberately adopted from 1926 onwards. Introducing the budget for 1931, the Finance Minister stated that a departure from this policy was in some degree dictated by the necessities of the crisis, which increased the expenditure for the relief of unemployment, whether by direct relief to the unemployed or by aid to industry and agriculture. Also the payment of teachers' salaries, previously undertaken by the Treasury outside the budget, had now to be introduced into the budget. This is seen in the increase in expenditure in 1931 over 1930, an increase which is more notable if we take into account expenditures not provided in the budget, which raise the total from nearly 10 to over 12 million crowns. In 1932 and 1933, however, this tendency is reversed by economy measures and the somewhat deflationary policy which has been adopted, which has reduced the estimates of expenditure for 1933 to 8,632 million crowns.

The relative importance of the various items of expenditure distinguished in the table has not changed to any great extent during the period under review. It should be pointed out that the classification is based on the distinction maintained in the budget between the different Ministries. " Social " expenditure is composed of the expenditures of the Ministries of Education and Social Affairs. Some expenditure, which would be properly described as " social ", is included in that of other Ministries under the head of " other expenditure ". In comparison with the budgets of other countries, defence expenditure absorbs only a modest proportion of the total, being only about 14 per cent. Some economies are to be realized under this head in 1933. Social expenditure has slightly increased in importance to 20 per cent of the total. This is due to an increase in education facilities, to the assumption by the budget of the charges for teachers' salaries, and to increased outlays for unemployment relief. The debt charge, which includes repayment as well as interest, is not unduly heavy. These three items taken together only account for just over half the total expenditure. That nearly half the outlay of the budget should be outside these three classes is due to the fact that an unusually high proportion of budget expenditure is devoted to economic purposes, and also that the budget includes contributions made to local authorities and autonomous bodies. In 1928 expenditure on economic administration, including the Ministry of Public Works, but excluding investments made by the Ministry of Finance,

amounted to nearly 12 per cent of the total, while the contribution to local authorities amounted to 10 per cent.

In order to meet the situation created by the prolonged depression, taxes have been increased and expenditures reduced by special economy measures. The policy of preventing progressive increases of expenditure during the prosperous years of 1927 to 1929 resulted in the accumulation of cash balances at the Treasury, out of which it was possible to meet the budget deficits in the first years of depression, even though in 1931 expenditures were heavier. Apart from the temporary increase in expenditure in 1931, and the raising of a loan of 1,300 million crowns for public works to relieve unemployment, the policy of the Government has been deflationary. This policy is most evident in the budget for 1933 which by various means has considerably reduced expenditure. It was dictated by the desire to maintain a stable currency and to avoid the danger of inflation which might arise from an unbalanced budget. In 1932 a Parliamentary Commission, consisting of members of all the majority parties, was appointed to consider means of reducing budget expenditure and to secure collaboration between the Government and Parliament. This Commission proposed a reduction of expenditures amounting to 1,526 million crowns, while the budget subsequently introduced provided for a reduction in expenditure, as against that of 1932, of 686 millions.

The budget of Czechoslovakia is rather less rigid on the expenditure side than those, for example, of the Scandinavian countries, since the charges which are generally the most fixed, namely the debt service and expenditure for defence and social service, are a smaller proportion of the total in the case of Czechoslovakia. While administrative economies have been realized in most departments, the greater part of the savings have been realized by departments concerned with economic development, notably, the Ministry of Public Works and the Ministry of Agriculture. Outside these economies, which may be considered as a reduction in investment, the chief measures have been a reduction in military expenditure and a reduction for two years in the salaries of State employees, which is estimated to save the budget 633 million crowns.

On the revenue side, estimates assuming the continuance of the depression have been cautious. Revenue will undoubtedly suffer from the greatly reduced yield of State enterprises, and by the increased deficit on the railways which will have to be

met. Taxation has been increased all round and some new taxes have been introduced. Among the latter the most important is a special tax on public companies. Many exemptions are suppressed and the regulations for collection, especially of direct taxes, are tightened up. Finally, customs duties have been readjusted and in some cases increased.

The measures which have been taken for the relief of unemployment have, of course, been affected by the general public finance policy. Unemployment relief in Czechoslovakia is connected with the execution of public works by the Government and local authorities. The necessities of the financial crisis, which for the maintenance of the external value of the currency has necessitated restrictions on dealings in foreign exchange, has required as a natural corollary a policy of deflation in public expenditures. Thus no extensive scheme of public works for the relief of unemployment has been seriously entertained. The loan of 1,300 million crowns already mentioned was raised in 1931 for this specific purpose, but was no more than an isolated relief measure. It was used outside the current budget and was largely applied to investments in State enterprises. Six hundred millions were invested in the State Railways and 65 millions in other State undertakings. One hundred and fifty millions were applied directly to unemployment relief, and the remainder was at the disposition of the Government for investment in various public works or for aid to local relief funds.

II

Poland

When, at the end of the Great War, Poland resumed its independent existence, the monetary system was in chaos. No less than four different currencies were in circulation in different parts of the country, for in addition to the rouble, the mark, and the Austrian crown circulating in the territories previously under Russian, German, or Austrian rule, the German Government had created during the War-time occupation the Polish mark. By 1920 the new Republic had succeeded in making the Polish mark the sole national currency unit. It was a paper currency, subject to uncontrolled Government issue and, despite various attempts to achieve stability, it suffered

a rapid inflation which became so violent in the latter part of 1923 that its value was practically extinguished. A stabilization scheme adopted in 1924 was only temporarily successful, and between 1925 and 1927 a second inflation took place. Finally in 1927 a second plan was undertaken with the aid of an American loan and executed under the supervision of an American financial adviser.

The inflation in Poland was directly related to the budgetary deficits which were covered by new issues of notes. Naturally the organization of the new State was difficult in the early years, and it is not surprising that the yield of taxation was far below what was necessary to meet the demands for expenditure. Nor was it any easier to raise a loan either internally or externally. Thus, with deficits in the budget in 1919–1920 equal to four-fifths of the total expenditure, in 1921 equal to 60 per cent of expenditure, and in 1922 to 50 per cent, the rapid inflation was a natural consequence. In 1923 Sir Hilton Young was invited to make a report for the Polish Government on the financial situation and to suggest reforms. The report presented in 1924 emphasized the necessity of achieving a stable budget, but in view of the fact that normal taxation could not be expected to yield greatly increased revenues for some time, emphasis was placed rather on reducing expenditure. From the point of view of Polish budgetary history it is important to realize the fiscal difficulties facing the Government. At least three different tax systems were in existence in different parts of the country, based on widely different and to some extent opposing principles. A reform and unification of the tax system was a necessary task of the Government, if the public finances were to be satisfactorily reorganized. But taxation systems are not changed in a day, or if changed do not at any rate yield immediate fruits.

The budget continued to show annual deficits until the financial year 1926–7, after further special efforts had been made to reduce expenditure and increase revenue. Though the budgetary situation was far from being the only cause of the debacle of the zloty (the new currency unit) after the stabilization of 1924, it was certainly one. However, we must distinguish between the inflation before 1924 and the fall of the zloty in 1925. The former was immediately due to budgetary deficits, the Government merely taxing by inflation, the latter was due to a number of causes of which the budget deficit was only one and not the most important.

It is necessary to emphasize this relationship between the general monetary problem and the budget in Poland in order to understand the history of Polish budgets. We may now briefly consider the budget figures themselves. First, taking the period up to 1924 :—

POLISH BUDGETS, 1919–22
(Milliards Marks)

	1919–20.	1921.	1922.
Receipts . .	17·53	104·89	498·29
Expenditure .	78·73	269·56	968·41
Balance + or —	— 61·20	— 164·67	— 470·12

The violent inflation of 1923 makes the figures for that year astronomical in appearance and meaningless in fact. According to one estimate the deficit in that year was 81 billions. These figures need no comment ; the deficits were met by direct inflation which between 1918 and 1923, according to one estimate, was equivalent to taxation amounting to 549 million dollars.

The foundation of the zloty on a gold exchange basis in 1924 was carried out without recourse to a foreign loan, and without any definite policy for ensuring the eventual equilibrium of the budget. The external value of the zloty remained steady from the beginning of 1924 to the middle of 1925, when a severe financial crisis occurred and the exchange slumped almost continuously until July, 1926, when it ceased to fall further, and was eventually stabilized legally, at a new gold parity. These difficulties led to a more determined effort to balance the budget at the end of 1925, which were renewed after the establishment of a virtual dictatorship by Marshal Pilsudski by the *coup d'état* of May, 1926. The budgets of 1924 and 1925 closed with heavy deficits of 208 and 138 million zlotys respectively. In the following budget the period of the financial year was altered from the calendar year to cover the period 1st April to 31st March. The budget of 1926–7 showed a surplus of 161 million zlotys, and that of 1927–8 a surplus of 214 millions, and thereafter until the world depression of 1930 the Treasury built up a substantial reserve from yearly budgetary surpluses. Since 1924 the general summary of budgetary accounts is as follows :—

SUMMARY OF POLISH BUDGETARY ACCOUNTS SINCE 1924
(Million zlotys)

	1924.	1925.	1926–27.	1927–28.	1928–29.	1929–30.	1930–31.
Expenditure .	1,662·7	1,883·9	1,971·8	2,554·0	2,841·0	2,970·0	2,801
Revenue . .	1,453·8	1,745·1	2,133·0	2,768·3	3,008·3	3,030·9	2,748
Balance . .	— 208·9	— 138·8	+ 161·2	+ 214·3	+ 167·3	+ 60·9	— 53

From the above table it appears that both expenditure and revenue increased in every year from 1924 to 1929–1930. We must allow, however, for the depreciation of the currency which took place in 1925 and which to a certain extent offsets the increase up to 1926. The budget of 1926–7 included cuts in administrative expenditure, nearly all of which were at the expense of the Government employees, whose salaries were reduced by an Act of 22nd December, 1925. These reductions were practically restored by a 10 per cent increase in December, 1926, while two further increases in 1927 and 1928 added about 73 million zlotys to the expenditure of the budget. After 1926 the price level was stable and the second stabilization of the zloty was completed by the American stabilization loan raised in November, 1927. The increases in expenditure after 1926, therefore, represent a real expansion of the budget. Introducing the budget for 1931–2 to the Sejm in December, 1930, the Finance Minister stated that, apart from reductions in the salaries of Government employees, which he did not then contemplate, 2,700 million zlotys represented an absolute minimum of budgetary expenditure, and this amount included only 350 millions, apart from salaries, for the public health, encouragement and reform of agriculture, and the maintenance of roads. The total expenditure in 1926–7 was just under 2,000 millions.

This increase in expenditure after 1926 is quite natural in a new country in the process of development. It was supported entirely by an increase of revenue, which rose from 2,133 million zlotys in 1926–7 to 3,030 millions in 1929–1930. This was partly due to reforms in the taxation system, including the establishment of a permanent income tax on the French and Belgian models, increases in the land tax, and reforms of the administrative machinery of tax collection ; partly it was due to the general economic improvement in the country, particularly marked in the latter part of 1926, when Poland benefited from the coal stoppage in Great Britain, and in 1928. This greater economic activity increased the yield from taxation and from the State monopolies and public enterprises. Thus receipts from taxes in 1927 were 38 per cent greater than in 1926 ; State monopolies brought increased returns by 27 per cent in the same period ; State enterprise showed an increase on net income of 80 per cent in 1927 as against 1926. In 1930 this period of relative prosperity came to an end and the revenues of the Government suffered severely in the general depression. From a total of 3,030 million

zlotys in 1929–1930 they fell to 2,748 millions in 1930–1 and to 2,262 millions in 1931–2, while the estimates for 1933–4 anticipate a revenue of only 2,059 millions. Expenditure has been less easy to reduce, but has nevertheless proved more flexible than in many countries. The estimates for 1933–4 provide for an expenditure of 2,452 millions, against an actual expenditure in 1931–2 of 2,446 millions, and in 1930–1 of 2,801 millions.

With this general picture in mind we may now analyse in greater detail the expenditures and revenues in the Polish budgets with a view to considering the problems and policy of the Government in the depression. The Polish budget is a gross budget, the revenues including the proceeds of State monopolies and undertakings, though by the conditions of the American stabilization loan of 1927 separate budgets were instituted for the latter. A special feature of the Polish budget is the practice of maintaining monthly budgets. This plan was suggested by Sir Hilton Young in his report to the Polish Government in 1924 in order to bring expenditure into close relationship with current revenue. Under the conditions of the American loan of 1927 the Government undertook to balance the budget and monthly accounts were kept, the provision being made that any surplus in a given month could only be used within the limits of the estimates already approved. The monthly accounts have been continued ever since, and explain to some extent the relative flexibility of certain expenditures.

Since the exigencies of the currency situation, and the conditions of the American stabilization loan, have largely determined Polish budgetary policy, it is necessary to be acquainted with the most important of these conditions. They are as follows :—

(1) Budgetary equilibrium must be maintained.

(2) Any additional administrative expenditure must be provided for by the creation of new revenues.

(3) No supplementary expenditure outside the budget may be made without a corresponding increase in revenues.

(4) The budgets of State-owned enterprises must be separately kept.

(5) The Government must raise no loans for ordinary budgetary purposes.

(6) The Treasury may make short-term loans, not exceeding twelve months, to municipal bodies up to the limit of 20 per cent of the total receipts of the latter.

(7) A Treasury reserve must be created at the Bank of Poland.

Most of these requirements were met by a Government decree of 13th October, 1927. The loan, amounting to 62 million dollars, is repayable in twenty years.

The years 1926–7 to 1929–1930 were favourable to Poland from a budgetary point of view. The total surplus in these years amounted to 580 million zlotys, despite the fact that administrative expenditures increased in each of these years and no loans were raised for budgetary purposes. Expenditures during these years are analysed in greater detail in the following table :—

MAIN ITEMS OF EXPENDITURE IN POLISH BUDGETS, 1927–28 TO 1929–30
(Million zlotys)

	1927–28		1928–29		1929–30	
	Amount	%	Amount	%	Amount	%
Debt Service	186·2	7·4	228·1	8	251·2	8·4
Ministry of Defence	806·3	32·0	812·4	28·5	851·7	28·7
Ministry of Education	360·5	14·3	419·5	14·7	466·3	15·7
Ministry of Public Works	113·1	4·5	137·4	4·8	116·6	3·9
Agriculture	126·6	5·0	133·5	4·8	160·1	5·7
Labour and Social Relief	68·2	2·7	62·2	2·2	101·1	3·4
Ministry of Interior	—	—	248·7	8·7	253·2	8·5
Other	—	—	—	28·3	—	25·6

The most striking features of the above table are the relatively low cost of the debt service and the high expenditure on national defence, which accounts for more than a quarter of the total budgetary expenditure. As for the increase in total expenditures between 1927–8 and 1929–1930, these are spread over practically all the chief Ministries, the only exception being the expenditure on the Ministry of Public Works, where, however, the fluctuations are small and not of great importance. Those Ministries covering the social services, namely Education, Labour, and social relief, and the Ministry of the Interior, have all steadily increased, both absolutely and relatively to the total expenditure. Among the social services the steady increase in expenditure on education is the most striking and is due to a development of educational services generally throughout the country, to improvements in equipment, and in the conditions of teachers. The sudden increase in the expenditure of the Ministry of Labour and Social Welfare in 1929–1930 is mainly due to unforeseen demands for unemployment relief, particularly in the latter part of the financial year. The expenditure on National Defence had increased by about 45 million zlotys between 1927–8 and 1929–1930, but had declined slightly in relative importance from 32 per cent of total budget expenditure to 28·7 per cent.

A very large part of the increase in total expenditure, and in that of every department in the period under review is due to increases in the salaries of Government employees. Since about 50 per cent of the expenditure in the Polish budget is accounted for by salaries and wages, changes in rates of pay have a considerable effect on the total. In 1925 the salaries of all Government employees were reduced, and in fact the budget cuts at that time fell almost entirely on the civil service. In December, 1926, salaries of Government employees were increased all round by 10 per cent and again in 1928 by a further 15 per cent, while certain concessions regarding rent allowances were made to civil servants living in the capital and in other large cities. The public debt does not impose a heavy charge on the budget, as the internal debt was practically extinguished by inflation and in the uncertainty which existed until 1927 the Polish Government found it practically impossible to raise either an external or an internal loan. Thus this most rigid item in budgetary expenditures occupies a relatively small place in Polish national finances.

Before considering the measures which have been taken to reduce expenditure in face of the depression, we must turn to a brief examination of the revenues before and during the depression in order to know the extent of the difficulties which confront the Treasury. In 1926–7 the total revenues were 2,128 million zlotys and had risen by nearly 50 per cent to 3,030 millions in 1929–1930. In the following year revenues fell to 2,748 millions, and in 1931–2 they were only 2,262 millions as compared with an estimate of 2,866 millions. Thus in two years since 1929–1930 revenues have fallen by over 25 per cent. Any attempt to compare the proceeds of different sources of revenue over this series of years is limited by the fact that changes have taken place in the fiscal system. Nevertheless, while important changes have been introduced in this field, the main principles have not been greatly altered and the reform has been piecemeal and gradual rather than extensive and fundamental. Direct taxation in the form of income taxes and property taxes are a less important source of revenue than in more highly developed States ; taxes on trade and transactions, stamp duties, customs, and turnover tax provide a large part of the tax revenue ; the exploitation of Government monopolies, such as tobacco, salt, and munitions manufacture, provide nearly a third of the Government revenues. In 1927 various of the property and land taxes were

revised, a permanent flat rate property tax replacing an extraordinary property tax with a sliding scale. A rural building property tax was adopted at the same time, the annual yield being estimated at 60 million zlotys. The turnover tax, which is common to most countries in Europe which experienced inflation, dates in Poland from 1923, when it was fixed at 2 per cent. It was reduced in 1925 by alterations in the scale, and again in the budget of 1928–9 to an equivalent of 1 per cent for all trading concerns. Finally, the relations between the central Government and local authorities have gradually been modified to increase the administrative responsibility of the latter. Most of the income of local authorities is derived from grants in aid from the Treasury. A project was considered in 1928 for ceding to the local authorities certain definite revenues, chiefly from property and land taxes, but no complete reforms have yet been defined.

With these facts in mind, we may examine the yield of the main sources of revenue in recent years.

MAIN ITEMS OF REVENUE IN RECENT POLISH BUDGETS

	1927–28.	1928–29.	1929–30.	1930–31.	1931–32.
Taxation .	1,494·6	1,736·8	1,736·1	1,825·5	1,436·4
Monopolies .	796·7	890·3	886·1	804·7	677·9
Enterprises .	200·6	104·8	111·2	117·7	147·8
Miscellaneous	275·9	276·4	297·3	—	—
Total .	2,767·8	3,008·3	3,030·7	2,747·9	2,262·1

The fall in the revenue yield in 1930–1, and again in 1931–2, reflects the extent of the economic depression. All items of revenue show a high degree of sensitiveness to the state of economic activity. This is to be expected in a country where indirect taxation occupies so important a place in the fiscal system as in Poland. Similarly the yield of Government monopolies and enterprises are immediately affected when general economic activity slows down. Thus the Polish fiscal system is much more immediately sensitive to the pulse of economic life than are those, for example, of the Scandinavian countries, where various forms of direct taxation are of greater importance.

The Polish Treasury, faced with such a formidable fall in the revenues, is thus confronted by a difficult problem. Budgetary equilibrium has been closely associated in Poland with the maintenance of a stable currency and, with an adverse trade balance and the need of foreign capital for development, heavy

budget deficits are more immediately a source of danger to currency stability than in the case, for example, of Belgium. The policy of the Bank of Poland during the depression has been deflationary, in order to maintain the external value of the zloty, endangered by the reduction in gold stocks and foreign holdings of the bank. Thus in 1931 the returns of the Bank of Poland show a reduction in notes of 109 million zlotys and in credits of 625 millions. Further reductions took place in 1932, so that the note issue fell from 1,218 million zlotys in December, 1931, to 1,105 million in December, 1932, and a further fall in outstanding credits by over 70 million zlotys in the first half of 1932. These figures concern only the Bank of Poland, but it is certain that the credits of other banks are reduced in conformity with the policy of the central institution. This deflationary policy is not less marked in regard to the budget, particularly in the 1931–2 and subsequent budgets.

To what extent has the Government been successful in reducing expenditure ? As we have seen, the years 1926–7 to 1929–1930 each yielded a surplus, the total of which was 580 million zlotys. This was invested partly in short-term credits to public and semi-public bodies, partly in rural and urban mortgage bonds, while a part remained in the coffers of the Treasury. Thus the deficit of 53 millions in 1930–1 caused no immediate anxiety, as it was easily met out of accumulated reserves, and the budget of 1931–2 as first presented to the Sejm foresaw no important reductions, such as have been made since. A certain flexibility is given to the budget by the system of monthly accounts, for if a deficit appears in any month steps may be taken to reduce expenditure in following months, the credits being voted monthly. Thus the expenditure of the budget of 1930–1 was originally estimated at 2,940 million zlotys, but as a result of arrangements between various Ministries and the Ministry of Finance the estimates were reduced by 234 millions, or 8 per cent. The Ministry of Labour, however, exceeded voted credits by 54 millions for unemployment relief, while 48 millions in excess of estimates was spent on various supplies. The actual saving over estimates in 1930–1 was thus 132 million zlotys, while over actual expenditure in 1929–1930 the saving was 183 millions. This comparatively slight saving was due to administrative economies, spread over most Ministries with the exception of the Ministry of Labour.

The budget of 1931–2, according to the first estimates, made a further reduction in total expenditure of 75 million zlotys.

As the first months showed deficits amounting in the first half of the year to 124 million zlotys, the Government took further steps of a more drastic nature to reduce expenditure. The importance of these steps we may best appreciate by considering to what extent different items in the budget are rigid. It suffices to take these under the three heads, debt service, defence, and social services.

(1) The Debt Service is a relatively light charge, being no more than 10 per cent of the total expenditure. Thus, the most rigid item of expenditure covering only a relatively small proportion of total expenditure, the possibility of economies extends over a larger field in the Polish budget than in many others. This charge is not, however, without possibility of reduction, first as regards provision for amortization, and second as regards the possibilities of conversion of the floating debt to long-term debt at a lower rate of interest. The total debt of Poland in December, 1931, was 4,427 million zlotys of which only a half-million was floating debt. Of this, 3,987·9 millions represented external debt. The interest charge in 1931–2 was 210 million zlotys, and the repayments 104·7 millions. This amortization does not, however, represent a net reduction of debt, for the total debt had increased from 4,079 million zlotys in 1930 to 4,427 millions in 1931. Poland defaulted, along with Belgium and France, on the American War Debt instalment due in December, 1932, and the budget estimates for 1933–4 are based on the assumption of a final settlement of the War Debts question. Cancellation would relieve the budget to the extent of about 55 millions at gold parity. It is clear that no great reduction of expenditure is possible under the head of debt charges.

(2) National defence is the greatest single item of expenditure in the Polish budget, about 27 per cent of the total. For political reasons it is very rigid. Introducing the budget for 1931–2 the Finance Minister expressed the opinion that no reduction of military expenditure was possible in present circumstances. Some reductions have, however, been made since that time, but these are chiefly due to administrative economies and reductions in the pay of officers.

(3) The administration of the social services, Education, Public Health, Social Insurances, and Pensions, have suffered economies since 1931. Education has suffered some retrenchment. In August, 1931, 2,000 teachers were dismissed, leading to the closing of a number of schools. Other services have suffered from reduction in staff, which occurred at the same date. Finally,

by a considerable restriction of investment credits, further development of social services has for the time being been checked.

The position was put clearly by the Finance Minister in his *exposé* of the budget for 1931–2. He considered 2,700 zlotys as the absolute minimum for the budget and set out his arguments thus :—

	Million zlotys
Expenditure on Personnel	1,287
Sick Pensions	160
Service of Debt	300
Army (excluding personnel)	527
Education (excluding personnel)	60
Unemployment (minimum)	50
Other expenditure	500
Total	2,884

Debt service and military expenditure the Minister regarded as fixed and incapable of reduction. Unemployment relief and education were minimum estimates—and in any case could not greatly contribute to a reduction in total expenditure. There remain two items, namely, expenditure on personnel—a reduction in which, of course, results in more or less degree in the reduction of the total expenditure of each department—and " other " expenditure. The latter includes an estimate of 150 millions for investment credits, which leaves only 350 millions for all other administrative purposes including public health. Clearly no great relief can come to the budget from that item. The Government were at that time—December, 1930—indisposed to consider a reduction in the salaries of employees, though they considered the possibility of withdrawing the 15 per cent cost of living bonus.

This exposition points clearly to the chief means by which the Government have, in fact, reduced expenditure, below the above-mentioned minimum figure even in the actual budget of which this is the first estimate presented to the Sejm, as well as in that for 1931–2 and in the estimates for the two following years. The estimates of expenditure for 1933–4 are less than 2,500 million zlotys.

Most of these reductions have been reached by reductions in the salaries of Government employees. Including the employees of the railways and all other Government enterprises, about 60 per cent of the budget is represented by salaries. If we add pensions, which have suffered similar percentage reductions,

there is a large field over which savings could be achieved at the expense of employees and dependents of the Government.

In April, 1931, the Government withdrew the 15 per cent cost of living bonus. From 31st May, 1931, the pay of civil servants was reduced by a further 15 per cent and that of army officers by 5 per cent, bringing a total monthly economy of about 14 million zlotys, or about 170 millions in a full financial year. In July, 1931, a further reduction of 12 per cent was made in salaries of employees, estimated to save in the current budget (1931–2) a further 55 million zlotys. The total reductions are, therefore, equivalent to reductions from 30 to 35 per cent, though the Government declared that in no case were reductions to exceed 35 per cent.

In addition to direct reductions in salaries the "rationalization" of administrative departments brought further economies. A large number of employees were dismissed or retired, three months' pay being granted to those dismissed, including 2,000 teachers, from 1st August, 1931. The total expenditure in 1931–2 was 2,446 million zlotys, a reduction of 343 millions, or 12·2 per cent, in comparison with the actual expenditures of 1930–1. Of this saving roughly 220 millions is due to reductions in the salaries of employees. To this sum must be added the savings due to dismissals and all-round reduction in staffs. We are thus left with approximately 100 millions which is explained by reductions in investment credits, and general administrative expenditures including military and all other administrative items.

III

Finland

The immediate post-War economic experiences of Finland had much in common with those of other States given a new independence by the Peace Treaties. Up to 1922 the currency depreciated rapidly. Inflation was then brought to an end and from 1922 onwards the mark was fairly stable, and finally in 1925 the gold standard was restored. These were years of transition and development, and heavy capital outlays in industry and agriculture. These tendencies were reflected in the public finances, where expenditure and revenue on both ordinary and extraordinary account gradually increased. Between 1922 and 1927 the results of the ordinary budget are as follows :—

STATE FINANCES OF FINLAND, 1922–27
(Million Marks)

Year.	*Ordinary Revenue.*	*Ordinary Expenditure.*	*Balance on Budget Account.*	*Cash Balance of Treasury.*
1922	2,669	2,076	+ 593	683
1923	3,063	2,257	+ 806	1,099
1924	3,158	2,530	+ 628	1,167
1925	3,316	2,829	+ 487	897
1926	3,424	2,999	+ 425	791
1927	3,908	3,329	+ 579	788

Thus in the ordinary budget a surplus was achieved each year while at the same time both expenditures and receipts rose steadily. The fall in the cash balance of the Treasury is due to investments in the extraordinary budget averaging about 400 million marks annually. During this period the total indebtedness of the State was increased by 201 million marks. These years were relatively prosperous for Finland and the public finances benefited from the general prosperity.

In 1928, however, Finland experienced a severe financial crisis, which was preceded by the collapse of the timber market in the beginning of the year. In August, 1928, the situation became worse and a severe strain was imposed on the money market by the action of the Government in withdrawing 220 million marks currently invested in certain commercial banks. The discount rate was raised to 6½ per cent and then to 7 per cent, and it was not until 1930 that the monetary situation became easier and the discount rate was again reduced to 6 per cent. However, though the export industries, and particularly the timber industry, experienced depression in 1928, it was not until 1930, when the world depression appeared, that their condition became really distressed.

These general conditions naturally affected the public finances. The fact that Finland experienced a monetary crisis before the world depression began, caused a certain stringency to be exercised there earlier than in some other countries. The results of the ordinary budgets for 1927 to 1930 were as follows :—

SUMMARY OF ORDINARY BUDGET ACCOUNTS, 1927–30
(Million Marks)

Year.	*Ordinary Revenue.*	*Ordinary Expenditure.*	*Balance.*	*Cash Balance of Treasury.*
1927	3,908	3,329	+ 579	788
1928	4,476	3,568	+ 908	819
1929	4,302	3,643	+ 659	653
1930	4,275	3,834	+ 441	313

Revenues thus yielded a high return in 1928, but fell slightly in 1929 and 1930, while ordinary expenditures slightly increased in each year. The fairly favourable yield of taxation is partly explained by revised and increased customs duties introduced at the end of 1929, by which means the fall in the yield of direct taxes was counterbalanced. The increases in ordinary expenditure, too, are relatively slight. If, however, we take into account extraordinary expenditure, which includes all capital expenditure productive and unproductive and all non-recurrent expenditure, there was a reduction in total State expenditure. In 1928 extraordinary expenditure amounted to 1,473 million marks, while in 1930 it was only 903 millions. Total expenditure (ordinary and extraordinary) thus fell from 6,041 million marks in 1929 to 4,738 millions in 1930. Still taking into account both extraordinary and ordinary expenditures, the final results of the State accounts for 1928, 1929, and 1930 left deficits of 504 millions, 161 millions, and 350 millions respectively. These deficits were covered by appropriations from the Treasury balance which fell from 788 million marks in 1928 to 313 millions in 1930, and by new loans. The expenditure, however, includes repayment of debt, and as the total State debt was reduced from 3,624 millions in 1927 to 3,566 millions in 1930, the general position of the public finances was satisfactory despite the monetary crisis of 1928, and the adverse economic conditions of 1929 and 1930.

During the period 1922–7 considerable economic development had been achieved in Finland both in industry and agriculture. The Government directly and indirectly had played an important part in this process. The total capital actually invested by the State between 1922 and 1927 was greater than the total outstanding amount of the public debt in the latter year. With the crisis of 1928 the investment of capital both through public and private channels was largely held up, and the world depression, coming after the earlier difficulties in Finland, has further adversely affected investment. This is evident in the budgetary policy of the Government which, in the effort to reduce budget expenditure, has greatly reduced capital investments. Thus in 1931 expenditure in the extraordinary budget was only 591 million marks as against 1,473 millions in 1927. With this general background in mind we may turn to a more detailed analysis of recent Finnish budgets.

The budget of Finland is divided into two parts, ordinary and extraordinary. In 1926 a slight change was made, by which

certain items of recurrent expenditure were removed from the extraordinary to the ordinary budget. The latter, therefore, consists now, on its expenditure side, of all administrative and current expenditure. The extraordinary budget consists of (*a*) all capital expenditure, whether productive or unproductive, (*b*) all non-recurrent expenditure. Public undertakings are included in the general budget, and there are no special budgets. Accounting for the public undertakings is based on gross receipts and expenditures. Maintenance and renewal charges are included in ordinary expenditure. In Finland a large part of expenditure on education and social services, generally undertaken in other countries by local authorities, is met by the Government and included in the budget. The revenue of the Government consists of income from State property and enterprises, taxation, and various miscellaneous items of revenue. Deficits are met by loans authorized by Parliament, but it must be remembered that expenditure includes repayment of public debt.

From the Treasury point of view the problem posed by the depression is that of falling revenues in face of more or less fixed expenditures. To what extent revenues of the Government have suffered we may see from the ensuing table :—

YIELD OF REVENUES IN FINLAND, 1928–31

	1928.	1929.	1930.	1931.
Revenue from State Enterprises and Property . .	1,655·6	1,583·4	1,258·2	1,275·7
Direct Taxes . . .	566·5	544·2	604·6	492·2
Indirect Taxes . . .	1,604·7	1,557·8	1,615·5	1,348·2
Miscellaneous Taxes . .	516·3	462·4	442·8	429·6
Other Miscellaneous Revenue	159·5	183·8	265·8	429·0
Total . . .	4,357·4	4,342·0	4,398·1	3,975·1

No serious fall in total revenue took place before 1931, when the fall was considerable. Some items of revenue, however, gave reduced yields in earlier years. This is more specially true of the income from State enterprises and property, which account for more than one-third of the total revenues. Income from those sources is, of course, immediately affected by adverse economic conditions, and the progressively smaller yields each year since 1928 is only a natural consequence of trade depression. A large measure of dependence on income from State enterprises for budgetary purposes introduces, therefore, a greater element of instability into the budget. Income from taxation, and especially from direct taxation, is less immediately affected and only seriously suffers after the depression has well advanced.

Thus no serious fall is seen from these sources until 1931. This is also due, in large measure, to increased taxes at the end of 1929 introduced to balance the budget. Higher customs duties, in particular, gave a very favourable yield in 1930. Despite the fall in exports, imports were maintained in 1929 and 1930, partly as a result of the increase of short-term foreign loans during this period. Thus revenue from this source did not fall before 1931. In the latter year, however, there is a serious fall in tax revenue, both direct and indirect, and taxation having already been increased to meet the effects of the earlier depression, possibilities of further increase are limited.

Up to 1929 both ordinary expenditures and revenues were steadily increasing. In 1929, however, the revenues showed a slight decline over the previous year. Ordinary expenditure, on the other hand, continued to increase up to 1931. Thus ordinary expenditure in 1927 was greater than that of 1926 by 11 per cent, that of 1928 greater than that of 1927 by 7·2 per cent, that of 1929 greater than that of 1928 by 2·1 per cent, and that of 1930 greater than that of 1929 by 5·2 per cent. The reduction in ordinary expenditure achieved in 1931 was relatively slight, the actual expenditure in that year, though less than that of 1930, being nevertheless greater than in 1929. On the other hand, extraordinary expenditure has been so heavily reduced since 1928 that the total of ordinary and extraordinary expenditures has fallen since that time. The expenditures on the main items in recent years are shown in the following table :—

CHIEF ITEMS OF EXPENDITURE IN FINNISH BUDGETS, 1929–31
(Million Marks)

	1929			1930			1931		
	Ordinary	Extra-ordinary	% of total	Ordinary	Extra-ordinary	% of total	Ordinary	Extra-ordinary	% of total
Defence . .	448·9	155·3	13·4	472·6	152·4	13·2	490·4	158·6	15·3
Education .	491·5	70·5	12·5	526·5	85·3	12·9	516·4	24·4	12·7
Social Affairs .	107·2	10·7	2·6	108·1	19·2	2·7	77·1	5·5	1·9
Agriculture .	407·2	150·0	12·4	370·9	107·5	10·1	329·5	93·6	10·0
Communications	1,046·2	308·5	30·0	1,057·2	330·0	29·3	974·0	208·6	27·9
Debt . .	260·1	18·0	6·2	273·1	10·0	6·0	302·1	10·0	7·3
Total, including all other .	3,642·8	865·2	100·0	3,334·0	903·2	100·0	3,654·2	519·4	100·0

Thus while the rate of increase in the ordinary expenditures after 1928 was somewhat checked in comparison with that of the years immediately preceding, it was not until 1931 that a definite reduction was secured. The total expenditure in 1931 was less than in 1930 by 493·1 million marks, of which

311·8 millions is in the extraordinary and 179·8 millions in the ordinary expenditure. It is evident, therefore, that no serious attack has been made on administrative expenditures, and the chief savings have been achieved by reductions in capital investment. Of the total extraordinary expenditure of 519 million marks in 1931, about 108 millions representing investments in railways, and other State undertakings, is likely to yield a future revenue. The corresponding figure in 1930 is 275 millions of productive investments. In 1931 a further 164 millions of extraordinary expenditure was allocated to special purposes, for special loans, for old age and sickness insurance funds, and for the repayment of the funded insurance debt. The remainder was invested in ordinary non-revenue producing State departments, for schools, hospitals, etc.

Considering now the individual items of expenditure in the above table several facts command our attention. In the first place, though the proportional importance of the different items has not greatly changed, the reduction of expenditure has been achieved in both an absolute and a relative sense in regard to State enterprises. Thus the Ministries of Communications (including State railways) and of Agriculture are each responsible for a slightly less percentage of the total expenditure in 1931 than in 1929. On the other hand Defence expenditure has steadily increased, both absolutely and relatively. Expenditure on education has hardly changed relatively to total expenditure, but, while administrative expenditure has slightly increased, capital expenditure on education has been reduced from 85 million marks in 1930 to 24 millions in 1931. The debt expenditure has slightly increased with an increase, chiefly in the short-term foreign debt, in 1929 and 1930.

From the point of view of the relative rigidities of the most important items of expenditure we may make several inferences. First, with regard to Defence expenditure the tendency has been upwards and in present political circumstances no great reduction is likely to be achieved under this head. The social services, including education, have suffered some economies in 1931, but, since these cover less than one-sixth of the budget, the economies to be obtained are relatively small. The debt service, which in 1931 represented only 7·3 per cent of total expenditure, cannot in any case be a source of great economies. On the contrary expenditure under this head is more likely to increase, as budget deficits will eventually have to be met by borrowing. In 1930 the internal funded debt was 353 million marks, while the

external funded debt was 2,565 million, and the short-term foreign debt 196 millions. This dependence on foreign capital suggests that interest rates are not likely to fall to the extent of those for Governments more favourably situated for borrowing. Moreover, the increase in the floating foreign debt will increase the immediate debt charges until either repayments or conversions are effected. As we have seen, the greatest reductions of expenditure have been achieved in regard to State enterprises. As these are merely gross returns it is impossible to deduce from the budget the real nature of these economies. In part no doubt they are the inevitable result of trade depression, in part the result of reduced investment.

On the other hand, the depression results in an increasing expenditure on unemployment, which eventually becomes a charge on the budget. The situation was considered by the Economic Council in Finland when a special committee was appointed in May, 1932, to consider the question of increasing employment. The committee proposed an extension of Public Works during 1933, and advised the investment of 500 million marks for the construction of roads and bridges. The funds were to be partly raised by means of a loan and partly from the profits of the alcohol monopoly. In September, 1932, the proposals of the Council were considered and eventually a credit of 350 million marks was granted for Public Works to be executed in the autumn of 1932 and in 1933. This sum is more than half the total expenditure of the extraordinary budget in 1931, and the policy is thus a reversal of that adopted in 1930 and 1931, when capital expenditure was cut down.

PART VI

AUSTRALIA, NEW ZEALAND, AND A NOTE ON THE UNITED STATES OF AMERICA

By W. J. Leaning

CHAPTER I

AUSTRALIA

In July, 1930, a conference of the Premiers of the six States and the Commonwealth met at Melbourne to consider Australia's financial position which had been causing disquiet among her creditors. In the words of Sir Otto Niemeyer, the expert from the Bank of England, "Australia was off Budget equilibrium, off exchange equilibrium, and faced by considerable unfunded and maturing debts both internal and external; in addition to which she had on her hands a very large programme of loan works for which no financial provision had been made." [1]

As a result of the Conference it was resolved :—

" (1) That the several Governments represented at this Conference declare their fixed determination to balance their respective Budgets for the financial year 1930–1, and to maintain a similar balanced Budget in future years. Further, if during any financial year there are indications of a failure of revenue to meet expenditure, immediate further steps will be taken during the year to ensure that the Budgets shall balance.

" (2) That the Loan Council raise no further loans overseas, until after existing overseas short-term indebtedness has been completely dealt with. This decision will apply to overseas borrowing by large public authorities, in controlling the operations of which the State Treasurer concerned will act in agreement with his colleagues on the Loan Council.

" (3) That it is resolved by the several Governments, as regards such public works as it may be possible to finance by loans raised in the internal market, that approval will not be given to the undertaking of any new works which are not reproductive in the sense of yielding to the Treasury concerned, within a reasonable period, a revenue at least equal to the service of the debt, both interest and sinking fund.

" (4) That in order to secure the regular service of the public debt from revenue, steps shall be taken to provide that all interest payments shall be made to a special account in the Commonwealth Bank, to be used solely for the payment of interest.

[1] See Shann and Copland, *The Crisis in Australian Finance*, 1929–1931.

" (5) That the Commonwealth and State Treasurers will publish monthly, in Australia and overseas, a brief summary on uniform lines, showing their Budget revenue and expenditure, the position of their short-term debt, and the state of the loan account ; such statements to be drawn up after a uniform model to be agreed upon. . . ."

These proposals were repudiated by the Central Executive of the Australian Labour Party in New South Wales and by the Australian Council of Trade Unions, in successive conferences. The former resolved that :—

" This executive views with amazement the spectacle of the Commonwealth Government, composed of members of the Labour movement, permitting its policy to be laid down for it by a conference of State Premiers, in which Nationalist Ministers held a majority of the votes.

" While feeling confident that the Federal Labour Party will never repudiate its election pledge to maintain and improve the standard of living and the arbitration system, we feel that it is necessary to call upon the Federal Labour Party to affirm that it does not accept as binding any decision of the recent conference with the Nationalist Premiers, which calls for a reduction of wages or a lowering of the standard of living.

" We are of the opinion that the recent proceedings of the Loan Council have demonstrated that this body is merely an instrument in the hands of the loan mongers and capitalists generally, which can always be manipulated to prevent a Labour Government, Federal or State, from carrying out the platform of the Australian Labour Party.

" It is desirable in the interests of the Labour movement and the people generally, that steps be taken immediately to amend the financial agreement and dissolve the Loan Council.

" Further, this executive calls upon the Federal Government to instruct the Prime Minister to take this, the first opportunity afforded a Labour Prime Minister, to negotiate with the British Government with a view to re-adjusting the burden of War indebtedness now borne by the Australian people as a result of her participation in the Great War.

" That in his negotiations the Prime Minister should be instructed to discuss the following points :—

" (1) That the British Government made a profit of over £250,000,000 on the wool which it bought from the Australian producers at a fixed price, and sold overseas at a tremendous profit.

" (2) That all the other Dominions were relieved of all expenditure relating to their troops upon embarkation for overseas, whereas Australia was charged with the whole cost of her troops from the day of enlistment until they were discharged.

" (3) That the British Government paid the Australian farmers less than half the amount paid to the farmers of other Dominions for their wheat, and only one-third of the price paid to foreign countries for the same commodity.

" (4) That Australia made available to the British Government many millions of pounds worth of gold, to enable it to buy Argentine wheat, notwithstanding that Australian wheat was offering for sale at the time the foreign purchase was made.

" (5) That the British Government has agreed to write off four-fifths of the War debts owed to it by foreign countries, which were its allies during the War, and allowed those countries to spread the repayment of the balance over a period of sixty-five years.

" (6) That while Australia's annual payments in regard to her War indebtedness (interest and sinking fund) amount to 7 per cent, the annual payments made by Great Britain in regard to her War indebtedness to America amount to only 3½ per cent. . . ."

A similar resolution was passed by the Australian Council of Trade Unions.

In opposition to the resolutions of the Premiers' Conference, the Federal Labour Caucus proposed the following monetary policy :—

(1) That the Commonwealth Bank be required to create sufficient credit, as and when required, for the following purposes : (*a*) To finance the requirements of the Commonwealth Government in connection with all services covered by Parliamentary appropriations ; (*b*) to meet that portion of the internal loans maturing during the financial year which has not been otherwise provided for ; (*c*) to provide for financing State and Commonwealth loan works programme up to a limit of £20,000,000 ; (*d*) to provide financial accommodation through the Commonwealth Bank, trading banks, State financial institutions, and, if necessary, through insurance companies, to be used for productive purposes in primary and secondary industries. The ultimate amount of credit to be issued under this head to be determined by the effect upon the commodity price levels.

(2) The credit under the various heads to be made available at an interest rate not exceeding 5 per cent.

(3) An effective exchange pool to be continued to provide Australian Governments with first claim on Australian funds in London. The external exchange rates to be fixed at such rates as will give primary producers the full benefit of the exchange premiums on their exports to compensate for the diminished market prices.

Nevertheless, despite Labour opposition, various States did make some reductions in " adjustable " expenditure, that is, in Public Service salaries and wages, but not in interest, exchange on overseas interest, or unemployment relief.

In November, 1930, the Commonwealth Government attempted to deal with its growing deficit, which was shown by returns for the first quarter to have reached £6,747,000. A Supplementary Budget was introduced.

Savings in expenditure were made aggregating £1,230,000. They were comparatively unimportant and were at the expense of the Post Office, Bounties, Defence, Ordinary Services of Departments, Railways, Territories, and miscellaneous works. A readjustment of contributions to the Sinking Fund was also made.

Additional taxation was imposed, which was expected to yield £1,720,000. It consisted of new customs duties, new income taxes on property and on personal exertion income, and a special income tax on salaries.

A super tax of 7½ per cent was imposed on all incomes from property, including the incomes of companies, and income tax allowances were cut down. The increase in the yield of the income tax from property expected as the result of these proposals was £1,500,000.

With regard to income tax on personal exertion income, in the previous Budget (1930–31) provision had been made for an increase of 10 per cent in the rate of tax on such income, where the total income of the taxpayer exceeded £500. This tax was now increased in such cases by 15 per cent instead of by 10 per cent. The additional 5 per cent was expected to produce £160,000 additional revenue.

The special income tax on salaries consisted of a special tax on allowances of Ministers and Members of Parliament, and also on those salaries of Government employees which exceeded £725 a year. This was effected by means of a super tax calculated on the gross remuneration and payable at the time

of payment of salaries; in the case of Ministers the tax was to be at the rate of 15 per cent, in the case of M.P.s 10 per cent. As regards Government employees, where salary exceeded £725 and did not exceed £1,000, the rate of tax was 10 per cent, subject to the proviso that salary was not reduced below £725 a year; where salary exceeded £1,000 but not £1,500, the rate of tax was 12½ per cent, but salary would not be reduced below £900; where salary exceeded £1,500, the rate of tax was 15 per cent, but lower salaries of the grade would not be reduced below the amount to which a salary of £1,500 would be reduced by a 12½ per cent tax, namely £1,312 10*s*. This tax was expected to produce £60,000 in a full year.

During this month also, the Australian Labour Caucus again found itself at variance with the Federal Government on the question of the redemption of a loan of £27,000,000 maturing in December. The Caucus wished redemption to be suspended for a further twelve months, interest to be paid as usual with a proviso that persons in necessitous circumstances should receive immediate payments of small amounts by cashing their bonds at the Commonwealth Bank. The Government, however, refused to consider this proposal.

In December employers and the State Railway Commissioners were attempting to persuade the Arbitration Court to reduce the basic wage. Application for a reduction had already been made by the Railway Commissioners of Victoria, South Australia, and Tasmania in August and September, and expert evidence before the Court had recommended it as essential. The Federal Government opposed any reduction. But in January, 1931, the Court ordered a reduction of 10 per cent in real wages. Together with a reduction in the Commonwealth basic wage in accordance with the fall in the cost of living, the total reduction amounted to 23 per cent. It applied to all workers under communal awards, that is to about 20 per cent of the total number of wage earners. All State wage-fixing tribunals were to reduce their basic wage to the same extent. The enforcement of this reduction was postponed till after the acceptance of the Premiers' Plan, and even then was ignored in New South Wales.

In February there was another Premiers' Conference at which three plans were put forward. A committee of Under-Treasurers from the Commonwealth and all the States except New South Wales stated that: "Reduction in Government expenditure at the rate of £15 million a year is the key to the whole position.

The possibility of recovering financial equilibrium and general prosperity within a period of three years depends entirely upon the adoption of this policy by the respective Governments. Any lesser reduction would not only postpone the return of financial stability, but would postpone the restoration of prosperity to the people of the Commonwealth as a whole."

The Commonwealth Treasurer, Mr. Theodore, proposed the inflation of currency and credit to an extent sufficient to restore prices to the level of two years before.

The New South Wales Premier, Mr. Lang, made a proposal which he said would be the policy of New South Wales whatever the Conference decided. It was that the Australian Government should pay no further interest to British bondholders till the Australian War debt was scaled down; that interest on all Government borrowing in Australia should be reduced to 3 per cent, and that Australia should abandon the gold standard and set up instead a currency based on the actual production of wealth in the country.

Three Bills designed to carry out the Government's financial policy were introduced during March. First, a Fiduciary Notes Bill, which was to increase the note issue by £18 million. Secondly, a Commonwealth Bank Act Amendment Bill, proposing among other things to abolish the statutory gold reserve requirements and to force the Commonwealth Bank to surrender to the Government such amount of gold as was necessary to meet the Commonwealth indebtedness in London. Thirdly, a Bank Interest Bill, providing for the constitution of a board of five members, who would hold office for a period not exceeding five years, to advise the Ministry on the maximum discount rates to be charged by banks.

Meanwhile New South Wales had defaulted, according to plan, on payments due to London. By the terms of the Financial Agreements Validation Act, 1929, the Commonwealth had, in fact, assumed responsibility for State loans issued before 1st February, 1929, and the New South Wales default legally involved the Commonwealth Government. The Commonwealth, therefore, made available the funds necessary to meet the interest due on 1st April. Defaults continued throughout March, April, May, and June. The gross amount of interest in default, plus exchange, was nearly £6,000,000. After allowing for a certain sum set off against this interest, the net amount owing to the Commonwealth was £4,559,000. However, by agreeing to the Premiers' Plan in June, Mr. Lang assumed

liability for these sums, and obtained from the Loan Council a further loan of £500,000 to meet his obligations.

By April the financial situation was desperate. The decline in the national income and the fall in imports had decreased revenue beyond all expectations. There was a Budget crisis. The Commonwealth Treasury was informed by the Commonwealth Bank that £25 million was the limit to its accommodation on Treasury Bills. At the existing rate of borrowing this limit would have been reached by the end of June. The controlled inflation proposed by the Government was rejected by the Senate. The Loan Council decided to " balance the Budget by the end of June, 1934 ", and appointed the Copland Committee of experts to examine the situation. The proposed Socialist legislation was abandoned, and reaction and the financial interests won the day.

The Committee found that the disorganization of public and private finance was due to the sudden loss of income from overseas borrowing and to the heavy fall in export prices. The cessation of loans alone would have involved a comparatively slight reduction in expenditure and in the standard of life ; but the additional loss of income due to the depression caused this reduction to be far greater. It was the fall in export prices which was Australia's most serious problem. Income from exports for 1930–1 was £62 million less than for the previous year, despite an increase in the volume. Income from overseas borrowing was £28 million less. This gave a total loss of income from abroad of £90 million. Moreover, the reduced purchasing power of those directly dependent on loan expenditure, and of the export producers, caused decreased production and increased unemployment among the sheltered and protected industries with their rigid costs and high prices. The result was a still further fall in the national income and an unbalanced Budget. The national income had fallen from £650,000,000 to £450,000,000. The combined deficits of the Commonwealth and the six State Governments for 1930–1 amounted to £27,202,000, and it seemed likely that deficits for 1931–2 would amount to £40,000,000. With abysmal export prices beyond her control Australia's main problem, apart from increasing exports, was to establish a proper balance between the prices of the goods of the export industries and those of the protected and sheltered industries ; and drastically to cut down public expenditure.

The main recommendations of the Copland Committee, based on the principle of " equal sacrifice ", were adopted by the

Premiers' Conference immediately following and embodied in the Premiers' Plan. This proposed :—

(*a*) A reduction of 20 per cent in all adjustable Government expenditure, as compared with the year ending 30th June, 1930, including all emoluments, wages, salaries, and pensions paid by the Governments, whether fixed by Statute or otherwise, such reductions to be equitably effected.

(*b*) Conversion of the internal debts of the Government on the basis of a 22½ per cent reduction of interest.

(*c*) The securing of additional revenue by taxation, both Commonwealth and State.

(*d*) A reduction of bank and savings bank rates of interest on deposits and advances.

(*e*) Relief in respect of private mortgages, by means of legislation to be passed in the six States providing for a reduction of 22½ per cent on existing contracts.

Professors Shann and Copland in *The Battle of the Plans* (1931) give the figures in tables on p. 403.

The attitude of the Labour Party to this plan was summed up in the following resolution passed by the Federal Executive of the Australian Labour Party : " The executive of the A.L.P. is definitely opposed to that part of the Premiers' Conference Plan which involves reductions in wages, pensions, and social services. The executive recognizes that the Commonwealth Labour Government's monetary policy has been thwarted by the banks and the reactionary Senate, thereby creating widespread industrial stagnation and unemployment, and leading to a collapse of the national finances. The executive is convinced that a Nationalist Government, as an alternative to the present Labour Government, would be abhorrent to the workers and disastrous to the country. It is of the greatest importance that the Labour Government should remain in office during this time of crisis, in order to prevent the enemies of Labour enforcing a ruthless policy of aggression against the hard-won rights of the workers ; and the restoration of their conditions will depend on the return of Labour at the poll with a majority in both Houses of the Commonwealth Parliament."

The Plan was carried out as follows :—

(*a*) The reductions in " adjustable Government expenditure " were proposed in the Budget as part of the Rehabilitation Plan, and effected by the Commonwealth Financial Emergency Act of July, 1931, and by similar Financial Emergency Acts in all the States. They were as follows :—

(i) Salaries and wages of Commonwealth employees were reduced on a graduated scale, so designed that the total reductions represented 20 per cent on the whole salary bill. All adult

BUDGET DEFICITS AND ESTIMATED EFFECT ON THESE OF EXECUTION OF PREMIERS' PLAN

(Million £)

	1929–30 Actual	1930–31 Estimate	1931–32	
			Original Estimate	After making agreed Adjustments
Commonwealth .	1·50	13·4	20·4	4·38
New South Wales	5·57	10·48	11·51	5·41
Victoria . .	1·17	2·60	3·06	1·31
Queensland .	·72	·74	1·63	·76
South Australia .	1·63	2·20	2·40	1·50
Western Australia	·52	1·52	1·86	1·20
Tasmania .	·02	·21	·22	·09
Total States .	9·63	17·75	20·68	10·27
Total .	11·13	31·15	41·08	14·65

ESTIMATED EFFECT OF PLAN ON BUDGETS

(Million £)

	Expenditure	Revenue	Deficits before Adjustments	Additional Reductions in Expenditure and Increase in Taxes	Deficits after Adjustments
Commonwealth .	80·60	60·20	20·40	16·02	4·38
New South Wales	59·56	48·05	11·51	6·10	5·41
Victoria . .	26·50	23·44	3·06	1·75	1·31
Queensland .	16·24	14·61	1·63	·87	·76
South Australia	13·09	10·69	2·40	·90	1·50
Western Australia	9·93	8·07	1·86	·66	1·20
Tasmania . .	2·90	2·68	·22	·13	·09
Total .	208·82	167·74	41·08	26·43	14·65

male officers were subject to a reduction of £34 to cover the fall in the cost of living, inclusive of any reductions effected since 1st July, 1930. The residue of the salary or wages was subject to a percentage reduction on a sliding scale varying from 3 to

24 per cent. It was also provided that reductions would not bring the salary of any adult male officer below £182 a year. The relief afforded to the Budget by these salary reductions was estimated at £1,800,000.

(ii) Maternity allowances were reduced from £5 to £4 and were not paid in those cases where the income of the claimant and her husband for the preceding twelve months exceeded £260. The resultant saving in expenditure was estimated at £230,000.

(iii) All invalid and old age pensions were reduced by 2*s*. 6*d*. per week. The limit of income, including pension, was to be £78 a year, instead of £84 10*s*. Pensions payable to inmates of benevolent asylums were reduced from 5*s*. 6*d*. to 5*s*. per week, and the rate of payment to State institutions for maintenance of pensioner inmates was reduced from 14*s*. 6*d*. to 12*s*. 6*d*. War pensions were to be treated as income for the purpose of calculating pensions, and the standard of adequate maintenance in respect of invalid pensions was to be reduced. The estimated saving on the Pensions Bill was £1,825,000.

(iv) War Pensions suffered a cut of 22½ per cent in respect of payments made to the following : parents of members of the Forces ; children of members of the Forces in receipt of pensions under the principal Act ; wives of members of the Forces in receipt of such pensions ; brothers and sisters of deceased members of the Forces or members who are in receipt of such pensions ; other persons dependent within the meaning of the principal Act and not here referred to. But the above reductions were not to apply to the widowed mother of any deceased unmarried member of the Forces, or the widow or children of any deceased member of the Forces.

(*b*) Ninety-seven per cent of the Government stock was voluntarily converted under the threat of compulsion, which was continually used on those who did not convert voluntarily.

(*c*) Increased Commonwealth taxation under the Rehabilitation Plan consisted of further increases in income tax and in the sales tax. General exemption in respect of income from personal exertion was reduced from £300 to £250, vanishing at £750 (estimated yield £290,000) ; the special super tax on property income was raised from 7½ to 10 per cent (estimated yield, £830,000) ; normal rates of income tax payable by companies and individuals were increased all round by 5 per cent (estimated yield, £380,000). The sales tax was raised from 2½ to 6 per cent.

(*d*) Bank rates were not dealt with, since the banks had

already agreed to a reduction of 1 per cent all round in their deposit and advance rates.

(*e*) Reductions in all kinds of mortgage interest, rents, and other fixed interest charges, were effected by the various States, either through a separate part of the Financial Emergency Act, or by separate Acts. The actual methods varied somewhat in the different States, but the general results were the same as those achieved by the following Acts passed in New South Wales.

As early as 1st December, 1930, New South Wales had passed a Moratorium Act, which was renewed in October, 1931. Under this the mortgagee could not dispossess the mortgagor without leave of the Court.

At the same time, in October, 1931, an Interest Reduction Act and a Reduction of Rents Act were passed. The former reduced the amount payable by 4*s.* 6*d.* in the £; the minimum mortgage rate was to be 5 per cent; the minimum debenture interest 4 per cent. Creditors were given the right of appeal to the Courts within three months, if the interest had already been reduced, or had been fixed after 1st March, 1931, in anticipation of general reductions of interest rates. Creditor trustees were protected. In the case of hire purchase agreements, the Court had power to reopen agreements and revise payments—and even to demand the return to the lessee of excessive payments. Interest on preference shares was subject to a reduction of 22½ per cent with a minimum rate of 5 per cent. But, when ordinary shareholders had received a dividend equal to that of the preference shareholders, the latter could share in the surplus.

The Reduction of Rents Act, 1931, reduced all rents by 22½ per cent. Reductions made since 30th June, 1930, were to be allowed for. Lessors were given the right of appeal to the Court and lessor trustees were protected. The reduction did not apply to Crown rents.

The effects of these Emergency Acts were reviewed by the Conference in September. Deficits were still found to be greater than those allowed for in the Premiers' Plan, chiefly because revenue had fallen still further below the estimates, and the agreed economies in expenditure had not been fully realized in New South Wales and in Queensland. There was no improvement in unemployment, since, in the words of the Conference, "the wage reduction in most industries fails to lower costs sufficiently to increase employment because of the high wages still paid in other industries—such as coal and iron—on which they depend."

A further reduction of costs was, therefore, recommended as an essential long-range policy for unemployment. By way of reducing the immediate deficit, the Conference proposed the reduction of the loan programme to £15 million as compared with £45 million before the crisis. Together with the existing deficiency of £18 million, this brought the total sum to be borrowed to £33 million, which the banks agreed to provide.

In November the Scullin Ministry was defeated on a comparatively unimportant issue. In the resulting election the Nationalists under Mr. Lyons won a big majority over the divided Labour Party.

The Lyons' Government's first few months of office were occupied with the struggle with Mr. Lang. On 29th January 1932, the latter informed the Prime Minister, as Chairman of the Loan Council, in Melbourne, that he could not meet in full the overseas obligations of New South Wales falling due in London and New York between 1st February and 4th February, amounting to £958,763, including exchange. He said that his Government was in a position to find £458,763 and desired the Commonwealth to obtain an advance to New South Wales for the balance of £500,000. The Loan Council decided by a majority vote to refuse this request. It was further revealed, by the figures submitted by Mr. Lang to the Loan Council, that he had exceeded the amount of financial assistance which the Premiers' Plan allowed him by £3,460,000.

Thereupon the Commonwealth Government decided to take action against New South Wales for the amounts due, and to retain all moneys falling due from time to time to New South Wales from the Commonwealth, and to use them for the discharge of the interest liabilities of New South Wales.

As has been said before, under the Financial Agreements Act, 1929, the Commonwealth Government had made itself virtually responsible for the debts of the States incurred before that date. The Financial Agreements Enforcement Act now passed, in March, 1932, provided means for the Commonwealth Parliament to require revenues of the State to be paid to the Commonwealth instead of to the State, in order to meet the unfulfilled obligations of the State to the Commonwealth for payments due under the Financial Agreement.

The appeal of New South Wales to the Courts failed, and various revenues were appropriated. When by the middle of April the total net default had reached £2,000,000, still more taxes were diverted. The total net default of the State amounted

to £3,572,473 before Mr. Lang was driven from office. Under the Enforcement legislation amounts totalling £612,414 were recovered by the Commonwealth from New South Wales.

In the second week in May Mr. Lang introduced in the New South Wales Parliament a Bill to collect 10 per cent of the value of mortgages, with a penalty of 10 per cent per annum for any delay, and a final provision to seize the mortgage altogether. Immediately the Commonwealth Government, horrified at anything in the nature of a capital levy, and by now benevolently assuming complete responsibility for the erring State, rushed through Parliament the Financial Emergency (State Legislation) Bill which had the effect of declaring the legislation of the New South Wales Government on this subject void.

At the same time Mr. Lang was dismissed on the ground of his refusal to withdraw a circular issued by the New South Wales Government to certain State officers, instructing them not to pay money to the Commonwealth. On Friday, 13th May, the most serious menace to vested interests in Australia was, for the time being, removed.

Meanwhile, the tariff was revised; a controversy raged on the question of exchange rates; and conferences were held with a view to dealing with unemployment. The exchange controversy was notable chiefly for Mr. Lyons' naïve assertion that monetary policy was the sole concern of the financial interests and that governments " should not be entitled to dictate to those who are controlling the exchange what the rate should be ". The conferences to check unemployment, which had risen from 28·3 per cent in February to 30·0 per cent in May, reaffirmed the time-honoured principle that the best cure for unemployment is economy and ordered more stringent enforcement of the Premiers' Plan with regard to the lowering of wages.

The financial year 1931–2 ended on 30th June, 1932, with a net deficit of £18,509,526 for the seven Australian Governments, the Commonwealth showing a surplus of £1·32 millions, but every State a deficit. The actual deficits realized by the several States, as compared with the deficits expected after the adjustments of the Premiers' Plan, are shown in the table on p. 408.

The Commonwealth surplus was due to the suspension of interest and sinking fund payments on the debt to the British Government in accordance with the Hoover Moratorium and the consequent arrangement made by the British Government; these payments had absorbed £5,548,810 in 1930–1. But income

tax receipts at £13,482,000 were £3,662,000 more than the estimate, and receipts from the land tax and from the profit on the note issue were larger than was expected. £6·5 millions had been saved by the conversion of internal debt. Customs and excise revenue realized £28,405,758, as against £18,224,227 in 1930–1 and £30,157,040 in 1929–1930.

In the Commonwealth Budget in September the deficit for 1932–3 was estimated at £2,781,000, presuming a continuation of the Moratorium. To relieve this the previous year's surplus was used, and the remainder of the deficit was to be met by further economies. The greatly increased tax receipts proved that taxation had not reached the point of decreasing returns; but no new taxation was imposed. Instead relief was promised at the first opportunity, and was given two months later; and

(Million £)

	Estimated deficits after adjustments for 1931–32	Actual deficits for 1931–32
Commonwealth .	4·38	Surplus of 1·32
New South Wales	5·41	13·25
Victoria . .	1·31	1·61
Queensland .	·76	2·07
South Australia .	1·50	1·07
Western Australia	1·20	1·55
Tasmania . .	·09	·26
Total States .	10·27	19·82
Total . .	14·65	18·50

the Budget gap was bridged by further cuts in maternity allowances, Ministerial and Parliamentary allowances, public service salaries and wages, and invalid and old age pensions.

Payment of maternity allowances was limited to cases where the total income did not exceed £208 per annum instead of £260. Ministerial and Parliamentary allowances were still further reduced to make a total reduction of 25 per cent on members' allowances, and 30 per cent on those of Ministers. A flat rate reduction of £8 per annum was made on all public service salaries and wages on account of the fall in the cost of living. Maximum invalid and old age pensions were reduced from 17*s.* 6*d.* to 15*s.* per week, with a consequential reduction of 2*s.* 6*d.* per week in all pensions. With additional economies

in the gold and wine export bounties, the total savings amounted to £1,479,000.

In November the promised taxation relief was provided by the Financial Relief Act, 1932. The land tax was reduced by one-third, involving a remission of £600,000 or £700,000. With regard to the special tax of 10 per cent on property incomes, an exemption from this tax of £250 on a flat rate basis, applicable only to individuals resident in Australia, was granted. This represented a remission of £500,000 per annum. Further exemptions were made in the sales tax and primage. The total tax remissions amounted to about £2,000,000. Thus ended the eventful year 1932.

PUBLIC DEBT

	Commonwealth	States	Total
	£	£	£
1919	307,917,342	397,487,829	705,405,171
1920	352,433,489	425,908,346	778,341,835
1921	357,135,088	470,880,758	828,015,846
1922	364,839,590	519,537,643	884,377,233
1923	358,509,219	546,975,727	905,404,946
1924	361,964,470	588,322,885	950,287,355
1925	362,072,767	601,064,157	963,136,924
1926	374,938,714	639,061,929	1,014,000,643
1927	366,611,505	676,869,719	1,043,481,224
1928	372,784,089	722.189,969	1,094,974,058
1929	377,621,572	726,406,490	1,104,028,062
1930	372,957,362	727,639,836	1,100,597,198
1931	388,718,545	767,317,573	1,156,036,118
1932	398,884,730	788,943,138	1,187,827,868
1933[2]	396,806,503	807,851,620	1,204,658,123

COMMONWEALTH FINANCE[1]

	Commonwealth *Revenue* (Consolidated Revenue Fund)	Commonwealth *Expenditure* (Consolidated Revenue Fund)	Surplus or Deficit	Commonwealth *Net Loan Expenditure* for Works
	£	£	£	£
1927	75,544,382	73,008,785	+ 2,535,597	9,404,632
1928	73,808,227	79,258,464	− 5,450,237	8,662,089
1929	74,894,799	77,253,774	− 2,358,975	8,244.119
1930	77,143,390	78,614,393	− 1,471,003	5,294,202
1931	69,566,919	80,324,538	− 10,757,619	1,991,026
1932	71,532,298	71,532,298	—	nil
1933[2]	73,512,809	69,996,201	+ 3,516,608	nil

STATES FINANCE[1]

	States *Revenue* (Consolidated Revenue Fund)	States *Expenditure* (Consolidated Revenue Fund)	Surplus or Deficit	States *Net Loan Expenditure* for Works
	£	£	£	£
1927	113,913,190	114,129,885	− 216,695	33,319,719
1928	116,190,898	117,410,451	− 1,219,553	35,562,638
1929	118,884,115	120,329,420	− 1,445,305	31,873,948
1930	113,484,404	122,812,235	− 9,327,831	24,074,752
1931	103,590,885	118,362,409	− 14,771,524	12,664,513
1932	97,087,304	116,759,233	− 19,671,929	5,763,963

[1] From official *Year Books of Commonwealth of Australia*, 1926-32.
1932 and 1933 figures from *Quarterly Summary of Australian Statistics*, June, 1933.
[2] Preliminary figures subject to revision.

SELECTED ITEMS OF COMMONWEALTH REVENUE, CONSOLIDATED REVENUE FUND[1]

	1927	1928	1929	1930	1931	1932
	£	£	£	£	£	£
Total	75,544,382	73,808,227	74,804,799	77,143,390	69,566,919	71,532,298
Customs	31,332,600	29,848,379	29,502,755	30,157,040	18,224,227	18,565,630
Excise	11,719,878	11,598,351	11,555,816	11,617,351	10,070,846	9,840,166
Sales Tax	..	..	..	..	3,472,854	8,425,067
Land Tax	2,615,900	3,027,206	2,988,885	2,840,078	2,758,598	2,156,765
Income Tax	11,126,278	10,165,175	9,841,496	11,120,029	13,638,949[2]	13,486,286[2]
Estate Duties	1,362,351	1,752,118	2,080,149	2,122,478	2,068,865	1,385,811

SELECTED ITEMS OF COMMONWEALTH EXPENDITURE, CONSOLIDATED REVENUE FUND[1]

	1927	1928	1929	1930	1931	1932
	£	£	£	£	£	£
Total	73,008,785	79,258,464	77,253,774	78,614,393	80,324,538	71,532,298
Interest on Public Debt	18,731,163	19,287,776	19,571,677	19,327,613	20,434,330	
Sinking Fund	..	5,434,332	5,761,467	5,673,144	3,647,274	
Total Debt Charges	..	24,722,108	25,333,144	25,000,757	24,081,604	(a)
Defence	4,240,831	4,185,819	4,104,507	4,552,550	4,117,768	
Invalid and Old Age Pensions	9,034,938	9,681,837	9,991,299	10,633,979	11,549,828	

(a) Figures not yet available.

SELECTED ITEMS OF STATE REVENUE, CONSOLIDATED REVENUE FUND[3]

	1927	1928	1929	1930	1931
	£	£	£	£	£
Total	113,913,190	116,190,898	118,884,115	113,484,404	103,590,885
Probate and Succession Duties	3,197,781	3,779,456	3,908,107	4,022,146	3,561,005
Land Taxes	1,631,091	1,813,319	1,881,865	1,849,330	1,765,214
Income and Dividend Taxes	15,189,274	15,191,526	15,629,653	15,051,914	14,033,162
Revenue from Business Undertakings	63,604,992	64,669,650	65,724,448	60,780,287	52,083,782

SELECTED ITEMS OF STATE EXPENDITURE, CONSOLIDATED REVENUE FUND[3]

	1927	1928	1929	1930	1931
	£	£	£	£	£
Total	114,129,885	117,410,451	120,329,420	122,812,235	118,362,409
Total Debt Charges	29,568,404	31,070,847	35,149,477	36,970,674	41,608,129
Education	10,101,203	10,728,092	11,637,150	11,729,480	10,973,922

[1] From official *Year Book of Commonwealth of Australia*, 1932.
1932 figures from *Quarterly Summary of Australian Statistics*, June, 1933.
[2] Includes special income tax on Federal Officers' salaries.
[3] From official *Year Books of Commonwealth of Australia*, 1927–32.

RETAIL PRICE, NOMINAL AND REAL WAGE INDEX NUMBERS [1]

	Nominal Wage Index Numbers	Percentage Unemployed	Rate of Wage Index Numbers allowing for lost time	Retail Price Index Numbers (Food, Groceries, Rent, etc.)	Real Wage Index Numbers	
					Full Work	Allowing for Unemployment
1911	1,000	4·7	1,000	1,000	1,000	1,000
1927	1,946	7·0	1,899	1,766	1,102	1,075
1928	1,963	10·8	1,837	1,760	1,115	1,044
1929	1,972	11·1	1,839	1,822	1,082	1,009
1930	1,939	19·3	1,642	1,683	1,152	976
1931	1,752	27·4	1,335	1,479	1,185	903
1932		29·0		1,403		

WHOLESALE PRICE INDEX NUMBERS [1]

	Jute, Leather, Wool, etc.	Agricultural Produce, etc.	Dairy Produce	Meat	All Commodities
1911	1,000	1,000	1,000	1,000	1,000
1926	1,582	2,001	1,784	1,931	1,832
1927	1,650	1,826	1,823	2,111	1,817
1928	1,781	1,726	1,751	2,015	1,792
1929	1,556	1,792	1,853	2,246	1,803
1930	1,127	1,484	1,627	2,025	1,596
1931	1,039	1,121	1,399	1,508	1,428
1932	998	1,231	1,304	1,350	1,411

UNEMPLOYMENT [1]

	Unions	Membership	Unemployed	
			Number	Percentage
1927	375	445,985	31,032	7·0
1928	375	423,422	45,669	10·8
1929	382	424,093	47,359	11·1
1930	395	438,874	84,767	19·3
1931	397	430,004	117,866	27·4
1931—				
1st Quarter	397	440,234	113,614	25·8
2nd Quarter	397	429,687	118,424	27·6
3rd Quarter	396	426,603	120,694	28·3
4th Quarter	396	423,493	118,732	28·0
1932	395	415,434	120,454	29·0
1932—				
1st Quarter	395	425,094	120,366	28·3
2nd Quarter	396	413,742	124,068	30·0
3rd Quarter	395	412,997	122,340	29·6
4th Quarter	392	409,902	115,042	28·1
1933—				
1st Quarter	394	412,674	109,182	26·5
2nd Quarter	394	415,559	106,652	25·7

[1] From official *Year Book of Commonwealth of Australia*, 1932, and *Quarterly Summaries of Australian Statistics*, 1932–3.

Note on Revision of Contracts

Was there a Breach of Contract of Service?

Did the Commonwealth or State Governments break contracts by reducing salaries and allowances of Public Servants?

The Commonwealth Public Service Act merely states the rates of wages, etc., payable. There is no clause dealing with the question of subsequent reduction, either allowing for it, or limiting it. Thus presumably reductions or increases are merely a question of passing an Amendment to the original Act.

Yet in the Financial Emergency Act, 1931, the following clause appears:—

"Where in pursuance of this part any salary allowance, or amount payable under any contract or agreement is reduced, the payment of the reduced salary, allowance, or amount shall be a full and complete discharge of all liability under the contract or agreement, in respect of the payment of the salary, allowance, or amount provided for therein."

This would suggest that contracts were in some cases being broken. Or it might merely have been inserted as a precautionary protection against possible accusations of breach of contract. There is no definite mention of any contract in the original Act.

In the Public Service Acts of the various States there is no mention of contracts and, where mention of adjustments is made, it is to give the Government power to adjust at will, as in the Western Australian Act. Nor do their Financial Emergency Acts contain any such clause as that quoted above from the Commonwealth Act.

Modification of Public Loan Contracts

Except for the small minority of dissenters, the debt Conversions were nominally, and legally, voluntary. But the penalty for dissent made them, in practical effect, compulsory, and not essentially different from a breach of contract. On the other hand, there was no important opposition to this salutary proceeding.

Modification of Private Contracts, etc., effected by the various States in their Financial Emergency Acts, 1931

These Financial Emergency Acts, besides reducing the salaries and wages of Public Service in the different States,

in the same way as the Commonwealth Financial Emergency Act, reduced also, whether by different parts of the one Act, or by separate Acts, all kinds of mortgage interest, rents, and other fixed interest.

The methods varied somewhat in the different States. Thus in some cases the onus of appealing for a Moratorium was on the mortgagor (e.g. Victoria), in other cases the onus of appealing against it was on the mortgagee (e.g. New South Wales).

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Chapter II

NEW ZEALAND

Agricultural countries began to be affected by the slump, when the prices of their particular exports began to fall. New Zealand—like Denmark and the Irish Free State—being an animal exporting country, was in a relatively favoured position up to the beginning of 1931, owing to the comparatively small percentage decline in the prices of meat and other animal foods. Her troubles began later than those of Australia. On the other hand, the fall in her export prices, once it started, hit her severely, as she has the highest export trade per head in the world.

In March, 1931, an Emergency Session of Parliament was called to deal with the problem. The Finance Act, 1931, reduced salaries and wages in the public service by 10 per cent, and also reduced wages generally by 10 per cent, in accordance with the judgment of the Arbitration Court. The Mortgagors' Relief Act, 1931, relieved those farmers and others who, hard hit by the fall in export prices, had to pay interest under a mortgage. Its chief features were :—

(1) The mortgagor was given a right of appeal to the Supreme Court against foreclosure by the mortgagee.

(2) The Court could judge the case according to the hardship involved, and postpone action on the part of the mortgagee.

(3) Power was given to the Governor-General to apply the Act to leases containing a purchasing clause.

The financial year 1930–1 closed in July, 1931, with a deficit of £1·6 millions. Imports had contracted as well as exports, thus preserving the balance of trade but further decreasing the revenue. According to the Budget estimates reductions in revenue and unavoidable increases in expenditure in 1931–2 would bring this deficit up to £6·8 millions. It was proposed that :—

(*a*) £1·8 millions of this deficit should be made up by additional taxation, in the form of higher income tax, customs duties, and Post Office charges.

(*b*) £5 millions should be saved in expenditure. The 10 per cent

reduction in public service salaries, which had been made by the Finance Act of 1931 in February, was included in the economies of this Budget. And an agreement was reached between the Government and the various financial institutions whereby rates of interest were lowered by at least ½ per cent.

Throughout the summer of 1931 the financial situation continued to cause anxiety, and in October the Budget was revised to cope with a further anticipated deficit of £1·5 millions ; small economies and further increases in customs duties and income tax were made.

In the meantime, since mortgagors were found to be receiving insufficient protection from the first Mortgagors' Relief Act, an Amending Act was passed in November by which increased powers were given to the Court ; to postpone payment, to reduce rates of interest, and to remit the whole or part of any arrears of interest. The right was also given to the mortgagor to apply for a renewal of relief.

In February, 1932, a growing deficit and the increasing gravity of the situation led to the appointment of an Economic Committee to study the question. It found that the fundamental cause of the depression was the fall in export prices, combined with the failure of other prices, including interest, rents, wages, fees, taxes, and other payments for services, to fall in sympathy. On the Committee's recommendation the Mortgagors' and Tenants' Relief Act, 1932, and the National Expenditure Adjustment Act were passed.

The former extended the protection and relief afforded by the Mortgage Relief Act, 1931, to include all forms of mortgages, and provision was also made for the relief of lessees in certain cases. But the most significant amendment was that mortgagors could now apply for relief, even though the mortgagee had not given notice of his intention to exercise powers of sale.

The second Act made an all-round reduction in fixed charges, on the following lines. Further reductions were made in the salaries of Ministers, Members of Parliament, and all public servants, including State railway employees. The reductions ranged from 15 per cent in the case of Ministers, and public servants with salaries exceeding £720 a year, to 5 per cent in the case of public servants with salaries not exceeding £225 a year. Grants to Education Boards and local authorities were reduced by amounts equal to the reduction in the salaries of their employees. But superannuation rights were safeguarded, rates of pensions still being reckoned on the basis of the original

salary. Reductions were made in various pensions and allowances paid by the State, including old age, widows', miners', and South African War pensions, including those of disabled men. A reduction was also made in the amount of income allowed without disqualification to applicants for family allowances and old age pensions. A 20 per cent reduction was made for three years in interest on mortgages, rents, dividends, cumulative preference shares of companies and certain other fixed charges, such as annuities, alimony, maintenance charges, and solicitors' fees, in order to effect a reduction in such charges commensurate with the reductions in salaries and wages. But mortgage interest was not to be reduced below 5 per cent, nor ground rent below 5 per cent on the unimproved value of the land. The right of application to the Court for relief, on grounds of undue hardship, was provided for. The Supreme Court was empowered to authorize the reduction of annuities, alimony, or maintenance payments derived from the proceeds of rent or interest. A stamp duty of 10 per cent was levied on receipts of interest, payable in New Zealand, from Government and municipal securities.[1] The Governor-General was authorized to fix the maximum rates of interest payable on deposits with savings banks, building societies, and trading companies.

The Budget for 1932–3 started in October, 1932, from a realized deficit of £2,140,000 for the past year. This was almost wholly due to decline in revenue, which amounted to £1,946,000. Expenditure had increased only by £232,991, and Treasury reserves amounting to £1,494,825 had been thrown in to help to fill the gap.

Revenue prospects for 1932–3 were £21,630,000, or £1,090,000 less than the receipts for the previous year. Unavoidable increased expenditure amounted to £1,020,000. Including the previous year's deficit of £2,140,000, there was thus a prospective deficit of £4,250,000 for 1932–3.

The Economic Committee considered that a further reduction of £2,250,000 was as much as could be expected without unduly impairing the existing social services, or breaking down the organization of the public service. It was, therefore, decided that it was not possible to balance the Budget for the current year, but that efforts should be confined to reducing the deficit to not more than £2,000,000 which was considered a manageable amount. Savings amounting to £2,250,000 were made, chiefly

[1] The Economic Committee had recommended voluntary conversion as preferable.

by the postponement of the funded War Debt payments to Great Britain.

During the Christmas adjournment the Economists' Committee was called together again, chiefly to deal with the further distress of the farming industries caused by still lower prices.

As a result, the exchange rate on London was raised from £110 to £125. The Associated Banks agreed to this only after strong pressure had been brought to bear on them by the Government, and after the Government had promised to indemnify them against losses on overseas credits accruing at the higher rate. By the Bank Indemnity Act of 26th January, 1933, the Government undertook to buy at par of exchange any excess of purchases over sales of London credits accumulated by the banks after 20th January.

An account of the financial position and prospects showed a prospective deficit for the current year of nearly £3½ millions, or about £900,000 after bringing into revenue reserves of about £2½ millions. For 1933–4 the deficit was expected to reach £9,850,000.

Various steps were taken to counteract the deficit. First, increased taxation was imposed. A sales tax of 5 per cent, with certain exemptions, was passed. Income tax exemption was reduced from £260 to £210, though new allowances were made for wives. Increased taxes were imposed on tobacco and petrol. The total new revenue produced by these taxes was expected to reduce the deficit for 1933–4 to £4½ millions, which amount could be met by borrowing and by the use of reserves.

A Bill was introduced to convert the whole of the internal national debt. Of the total of £115,320,000, £69½ million was held mainly by the public and the rest by Government Departments. In the latter case, therefore, changes in the rate of interest meant corresponding changes in both receipts and expenditure of the Government. Under the Conversion scheme internal interest was to be reduced by 20 per cent, with a minimum of 4 per cent on taxable securities, while tax-free securities were to be reduced, at the option of the holders, either to 3½ per cent still free of tax, or 4 per cent subject to income tax. The special Stamp Duty on interest from Government securities imposed in 1932 was abolished and all securities whose interest was subject to income tax were reduced to a flat rate of 4 per cent, adjustments being made in the issue price in order that the reduction of interest should not in any case exceed

20 per cent. The Conversion, which was expected to save the Government £570,000 per annum, was announced as "voluntary"; but it was added that a special tax of 33⅓ per cent would be imposed on the interest from securities which were not converted. This Conversion is proceeding satisfactorily (30th June, 1933).

Thirdly, a Local Authorities' Interest Reduction and Loans Conversion Act was passed. Under this Act, the interest on securities of local authorities payable in New Zealand was reduced by 20 per cent, with a minimum of 4½ per cent. Local bodies were also enabled to convert existing issues with the consent of the Local Government Loans Board. If a holder dissented from Conversion, the rate of interest payable to him was to be reduced by 33⅓ per cent below the rate originally offered.

An agreement was also reached by the Government with the banks that the minimum rate on overdrafts should be reduced to 5 per cent, and some reduction in deposit rates also followed.

These Conversion operations were approved by the annual Municipal Conference of delegates from local bodies throughout the country, and a resolution was passed suggesting the conversion of overseas debt likewise to lower rates of interest.

Finally, a Finance Bill imposed various other increases in taxation, including higher registration fees and certain special taxes.

All these revolutionary measures are reported as having been well received.

REVENUE, EXPENDITURE, AND PUBLIC DEBT, 1927–33

	Total Revenue	Total Expenditure	Gross Public Debt
	£	£	£
1927 . .	24,943,107	24,355,965	245,850,889
1928 . .	25,123,980	24,944,904	251,396,252
1929 . .	23,599,070	24,176,928	264,191,983
1930 . .	25,349,861	25,200,882	267,383,343
1931 . .	23,068,931	24,708,042	276,033,358
1932 . .	22,719,733	24,860,552	281,942,800
1933 . .	22,568,521	22,528,379	(a)

(a) Figures not yet available.

On only two occasions in the history of New Zealand has a reduction in the gross public debt been made during the financial year. The first occasion was in 1891–2 when the debt was reduced by £117,282, and the second in 1922–3 when it was reduced by £101,061.

SELECTED ITEMS OF REVENUE AND EXPENDITURE, 1927-33

	1927	1928	1929	1930	1931	1932	1933
	£	£	£	£	£	£	£
Revenue							
Total	24,943,107	25,123,980	23,599,670	25,349,861	23,068,931	22,719,733	22,568,521
Customs revenue	8,252,575	7,942,589	7,954,252	8,897,047	7,605,976	5,904,348	6,131,414
Land tax	1,229,067	1,154,479	1,140,324	1,506,911	1,145,617	542,128	498,916
Income tax	3,422,216	3,273,720	3,310,877	3,533,764	4,003,606	4,447,814	3,556,775
Death duties	1,690,374	1,899,370	1,944,514	1,727,439	1,809,735	1,444,298	(a)
	£	£	£	£	£	£	£
Expenditure							
Total	24,355,965	24,944,904	24,176,928	25,200,882	24,708,042	24,860,552	22,528,379
Interest on Public Debt	8,450,794	8,397,074	8,675,220	9,136,301	9,266,676	9,035,025	(a)
Amortization of Debt	1,295,138	1,360,528	1,435,521	1,563,644	1,638,672	1,421,751	(a)
Total debt charges	9,745,932	9,757,602	10,110,741	10,699,945	10,905,348	10,456,776	9,807,127
Education	3,095,096	3,126,904	3,229,529	3,350,389	3,354,484	3,010,794	(a)
Defence	1,020,297	968,589	928,091	892,401	696,636	527,648	569,921
Agriculture	322,070	365,610	451,926	435,283	388,277	440,630	555,614
Public Works[1] (financed not out of Revenue, but out of Public Works Fund)	6,658,672	6,925,372	7,648,513	7,505,496	8,221,646	4,634,475	(a)

(a) Figures not yet available.

PRICES AND WAGES INDICES

Year	Retail Prices	Nominal Wages	Effective Wages
1914	1,000	1,000	1,000
1927	1,594	1,604	1,007
1928	1,602	1,656	1,034
1929	1,599	1,658	1,037
1930	1,562	1,665	1,066
1931	1,443	1,542	1,069
1932	1,334	1,413	1,062

UNEMPLOYMENT FIGURES

Date	Building Tradesmen	Engineering Tradesmen	Other skilled Tradesmen	Labourers and Quarrymen	Farm Hands	Hotel and Restaurant Workers and Cooks	Others	Total
1930—								
10th Mar.	272	141	82	1,489	169	84	387	2,652
9th June	384	228	86	3,332	279	120	609	5,067
8th Sept.	492	273	102	3,535	212	146	715	5,536
8th Dec.	1,014	450	251	5,002	298	204	1,213	9,630
1931—								
9th Mar.	3,367	1,192	2,086	13,613	1,262	680	1,550	29,941
8th June	4,768	1,894	4,755	20,441	2,294	794	5,549	43,453
7th Sept.	5,780	2,107	5,875	25,149	2,670	769	8,668	51,018
7th Dec.	5,536	1,863	5,608	22,526	2,116	701	8,736	47,096
1932—								
7th Mar.	5,773	2,008	5,249	19,974	2,030	710	8,179	44,368
13th June	6,589	2,164	6,336	25,365	3,149	832	9,687	54,122
12th Sept.	7,375	2,223	6,201	25,086	3,299	851	11,463	56,498
10th Dec.	6,421	1,975	5,731	22,146	2,584	817	11,243	52,510
1933—								
11th Mar.	6,365	1,873	6,146	21,052	2,441	781	10,949	50,409
10th June	6,605	1,967	6,577	23,937	3,388	955	10,884	55,993
9th Sept.	6,490	1,854	6,612	24,961	3,301	927	12,736	56,881

[1] i.e. capital expenditure including railways, roads, telegraph extensions, development of water power, public buildings, lands and river improvement, irrigation, etc., immigration, departmental and other.

Note on Revision of Contracts

Does reduction of salaries and wages of Public Servants involve breach of contract?

Section 24 of The Public Service Act, of New Zealand, 1912, reads as follows :—

" Notwithstanding anything in this part of this Act, before transmission of the message accompanying the estimates in any financial year the Governor may, by message to the House of Representatives, recommend a rateable reduction or increase, according to a specified rate, in the salary or wage of each person in each class of any division ; and if such rate of reduction or increase is adopted by the said House, then the minimum and maximum limits of each of the respective classes shall be reduced or increased, as the case may be, according to that rate, and a proportionate reduction or increase of increment shall be attached thereto ; and such minimum and maximum limits of increment shall remain at such reduced or increased sum until another recommendation is adopted by the said House in accordance with the provisions herein contained."

Moreover, Section 62 states :—

" Except as in this Act provided, no officer of the Public Service shall be deemed to be entitled to any compensation by reason of any reduction of his salary, or in consequence of his services being dispensed with."

The former Section might be interpreted as applying only to new entrants to the Public Service ; but the latter seems to be more definite.

It is significant also that neither in the debates in the House, nor in the various Reports of Committees, is there any mention of breach of contract in this case. The idea which had grown up in some quarters that Public Servants' salaries were more or less sacrosanct, was found to have no foundation in law in New Zealand.

Is a general reduction of wages by the Arbitration Court a breach of Contract?

This was alleged by the Parliamentary Opposition in the debate on the Finance Bill, 1931. The Prime Minister replied as follows :—

" It is said that this (general reduction of wages by the Court) is a breaking of agreements. But this is a misuse of terms. What

is an Arbitration Court Award? How is it brought about? Often the process is that employers and employees get together and agree upon certain rates of pay, which they ask the Court to put into an award and those are the wages that have to be paid in the industry. The award does not say that the worker has to accept these wages. He can say, 'This is no good to me, I am not going to work for this wage.' There is nothing binding in that respect. There is, however, as far as the employer is concerned. If he pays less wages, he is liable to appear before the Court. On the other hand, the worker can walk out. The award cannot, therefore, be called a contract, as a contract is something to which two persons subscribe and is equally binding on both. But neither the Courts nor anyone else can compel a worker to work for the wages laid down."

The Opposition did not press the point further.

Public and Private Loan Contracts

The same remarks apply here, as in the case of Australia. (See note to the preceding Chapter.)

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Chapter III

A NOTE ON THE UNITED STATES OF AMERICA

General Course of Governmental Revenue and Expenditure in Recent Years

Federal expenditure in the United States does not cover the whole field to which national, as opposed to local, expenditure is directed in England. It is mainly limited to those objects, such as national defence and the conduct of foreign relations, which are exclusively the function of the Federal Government. The provision of roads, for example, and the maintenance of law and order, fall chiefly on the budgets of the States, whose Governments have extensive police powers denied to the Federal Government.

The separation of Federal and State finance extends also to the means of raising revenue. Although certain taxes, such as income tax, are levied by both Federal and State Governments, customs duties are constitutionally reserved to the Federal Government, while property and poll taxes, for administrative reasons, and petrol taxes[1] and motor licences, by tacit agreement, are reserved to the State and local Governments.

An important item of State expenditure is the provision of grants to local governments in respect of education, expenditure on which, together with that for the construction and maintenance of roads, social welfare, and police and fire protection, absorbs the greater part of local revenues. The table on p. 423 shows the large increase which has taken place in all Governmental expenditure since pre-War times and the percentage of total expenditure attributable to Federal, State, and local expenditure respectively.[2]

From the figures given " per capita " in 1913 dollars it will be seen that, even allowing for the increase in the population and the rise in the price level between 1913 and 1928, the volume of Governmental expenditure in the United States increased during that period by approximately 140 per cent. In the case

[1] See, however, the Revenue Act, 1932.

[2] From the National Industrial Conference Board's *Cost of Government in the United States*, 1928–29.

of the Federal Government, this increase is largely to be attributed to the burden of interest and sinking fund necessitated by the addition to the public debt brought about by the War ; while another important charge has been pensions and compensation for War veterans.

But the pronounced rise in State and local expenditure, though perhaps partly due to the inflationary influence of War finance, and partly reflecting social and economic developments, is mainly a result of the expansion which has taken place in Governmental activities, particularly with regard to capital

AMERICAN GOVERNMENT EXPENDITURE, SELECTED YEARS 1903–28

Disbursing Authority	1903	1913	1923	1928
	Amount (in million $)			
Federal	475	692	3,885	3,970
State	182	383	1,242	1,826
Local	913	1,844	5,136	6,813
Total	1,570	2,919	10,263	12,609
	Per capita in " 1913 " dollars (millions)			
Federal	6·85	7·17	24·17	23·66
State	2·63	3·97	7·73	10·88
Local	13·19	19·10	31·95	40·60
Total	22·67	30·24	63·85	75·14
	Percentage distribution by disbursing authorities			
Federal	30·3	23·7	37·9	31·5
State	11·6	13·1	12·1	14·5
Local	58·1	63·2	50·0	54·0
Total	100·0	100·0	100·0	100·0

construction. It is estimated that more than half the State and local bond issues made between 1925 and 1929 were for the purpose of financing the building of roads and schools.

This expenditure has led to a considerable increase in State and local indebtedness.

Thus the combined net debt—gross debt less sinking fund assets—of the forty-eight States was in 1922 $936 millions, and in 1929, $1,856 millions.

Similarly local debt, for which only figures of net bonded debt are available, was in 1925, $8,602 millions, and in 1928, $11,106 millions.

The total amount of State and local indebtedness outstanding represents a considerable proportion of the total national indebtedness. But a more important consideration than the total volume of the debt, is the recent deterioration of State and local credit, owing to lack of confidence on the part of the investors in the ability of these Governments to raise sufficient sums in taxation to meet the service of the debt thus incurred.

Up till 1929 the very considerable increase in the national income allowed an increase in the tax receipts of the State and local Governments, though Federal tax receipts, owing to reduction in taxation, remained fairly constant. Since 1929, however, the still continuing increase in Governmental expenditure has no longer been accompanied by an increase in the national income, but on the contrary by a heavy decline. And it is evident that the recent emergence of a deficit in the Federal finances is a development which started earlier and has, therefore, been carried further, in the budgets of State and local Governments. If these were not balanced in the days of prosperity, it is natural that, now that America is feeling the full force of the depression, they should in many cases be in a serious position.

The condition of State and local finances must be borne in mind in considering the recent change which has taken place with regard to the Federal budget.

But for these, even so large a Federal deficit as exists at present could not be regarded as a grave danger, in view of the large reductions effected in the Federal debt in the decade ending in 1930, and the reserves of taxable capacity which exist even now, in view of the reductions in taxation made over the same period.

In the ten years ending 30th June, 1930, $8,100 millions of interest-bearing public debt was retired, the total outstanding at that date being $15,922 millions. Forty per cent of the total reduction was effected by Treasury surpluses totalling $3,250 millions. Sinking fund provided $3,000 millions, and payments by foreign governments over $1,416 millions.

This extremely favourable record was radically altered in 1930–1 when there was a deficit in the Federal budget of $903 millions, as compared with a surplus in 1929–1930 of $184 millions.

The outstanding public debt was increased by $616 million, but, deducting sinking fund payments during the year, the net excess of expenditure over receipts is reduced to $516 millions, as compared with a net surplus of $572 millions for 1929–1930.

In 1930–1 the total ordinary receipts were $3,317 millions, a decline of $861 millions, and the ordinary expenditure (excluding public debt retirements, chargeable against ordinary receipts, but including interest) $3,780 millions, an increase over 1929–1930 of $340 millions.

The decline in ordinary receipts is chiefly due to the depression. Thus customs receipts fell by $109 millions to $378 millions, and income tax fell by $351 millions to $1,860 millions.

The increase in expenditure was largely a result of the rising demand for agricultural relief, for additional benefits to War veterans, and for accelerated Governmental constructional activities, which more than offset other reductions.

The expenditure on War veterans, under the scheme for making advances on their War service certificates, was, with one month of the fiscal year to go, $1,100 millions. And the increased expenditure for the construction of public works to relieve unemployment was, at the same time, $540 millions.

Growth of the Deficit

During the execution of the 1931 budget, beginning on 1st July, 1930, and ending on 30th June, 1931, neither the Administration nor Congress anticipated the huge deficit which was to appear at the end of the financial year.

Revenue receipts fell off more rapidly than any of the Government's financial experts had thought possible, while expenditures were pushed to the limits of appropriations. Efforts to balance income and outgo during the months of 1931 were practically thrown to the wind. The mentality of War-time, or of widespread pestilence, held sway in official circles.

The successive estimates of the deficits are amazing. In his budget message of December, 1930, President Hoover presented the figures of the Treasury, which indicated a deficit on 30th June, 1931, of about $180 millions. At that time Mr. Mellon, the Secretary to the Treasury, went so far as to predict an increase in revenues, particularly from income and corporation taxes. Congress then started making appropriations by hundreds of millions for emergency relief and other purposes, many of which were in line with the President's recommendations. In February Mr. Mellon became uneasy and stated before a Congressional committee that the deficit for 1931 would reach $375 millions. Before the end of March, Treasury experts saw indications that the deficit might reach $700 millions by the close of the

fiscal year; the income tax returns at this time showing a large decrease—well over $130 millions. Shortly after 1st April an $800 million deficit was forecast. This created a stir among some Congressmen, who began to discuss the necessity of tax increases when the new Congress assembled in December, 1931. Early in May, 1931, it appeared that the deficit might reach $1,000 millions, or even more. The *New York Times*, commenting editorially, found a " Billion Dollar Deficit something of a shock ", and remarked that the estimates which had been given out from time to time did not " do credit to the Government actuaries " The actual deficit proved to be $902,716,000.

The Budget for 1932 (July, 1931–June, 1932)

The 1931 deficit being so seriously underestimated, the President's budget for 1932 was quite inadequate. At the time his budget was formulated, a deficit of a mere $180 millions was anticipated for the year 1930–1. Thus, in his budget message to Congress on 3rd December, 1930, explaining the 1932 budget, President Hoover said that a " moderate deficit for the current financial year, which in fact amounts to less than 5 per cent of the total Government expenditure " was a matter of no great concern : that it was primarily due to the world-wide depression, accentuated by the expenditures which were necessary because of relief measures at home. He did not look with favour on any attempts to meet the deficit by a reduction of the statutory debt redemption requirements of some $440 millions a year. It could be met by reducing the Treasury balance in hand at the beginning of the year, and by temporary borrowing, since during the previous eleven years large surpluses had yielded nearly $3,500 millions for debt retirements. He anticipated that Congress would appropriate additional amounts beyond the budget recommendations to take care of unemployment and the drought. While these would increase the deficit, he thought they could also be met by temporary borrowing. He proposed that the reduction in income taxes, which had been adopted for the calendar year 1929, should be discontinued for the calendar year 1930. This, he estimated, would provide approximately $160 millions toward wiping out the anticipated deficit. He insisted that this was not the time for Congress to embark on any new or enlarged ventures, but that due consideration should be given to the financial situation.

Despite the President's plea for economy in his budget message in December, by the end of the Congressional session, 4th March, 1931, his estimates were increased over the original figures by more than 11 per cent. No serious attempt seems to have been made to balance the budget after the original estimates were submitted in December, although a marked decline in the revenues was apparent even before Congress adjourned.

The grand total of estimated expenditure was $5,180 millions in the 1932 Budget, as against $4,220 millions in the 1931 Budget, an increase of $960 millions, despite a deficit of $903 millions, which, even when the budget was finally ratified at the beginning of March, was estimated at about $700 millions.

What steps were taken to make good the deficit and cover the increased expenditure? Practically none. Congress remained unalterably opposed to any changes in the tax system, although it was apparent that the Government would be faced by a large deficit at the end of the current fiscal year.

It approved the President's recommendation for the discontinuance of the income tax reduction, and permitted the rates to go back to the previous scale, applicable to incomes of the calendar year 1930. The Treasury was left to borrow in order to make ends meet.

Attempts at Economy

In April the President started economy drives in the various Governmental departments. A few millions were saved on the Army, the postal services, and the Department of Agriculture. But these were much more than counter-balanced by increased expenditure of $227 millions, due to the stabilization operations in wheat and cotton by the Farm Board.

In the middle of the summer he tried again, by a circular letter to department heads. The result was small—economies amounting to $25 millions.

The outcome of all this was a deficit for the financial year 1932 of $2,473 millions, as compared with a deficit in 1931 of $903 millions.

Fall in Receipts, 1932

The total ordinary receipts in 1932 were $2,121 millions, as against $3,317 millions in 1931, a fall of $1,196 millions, or $238 millions less than had been estimated in the autumn of 1931.

ANALYSIS OF FALL OF RECEIPTS
(Million dollars)

	1931.	1932.	*Fall in* 1932.
Total Receipts from Taxation .	2,801	1,889	912
Receipts from Income Tax .	1,860	1,057	803
Income Tax from Corporations	892	517	375
Income Tax from Individuals .	730	351	379

The effect of the depression on the revenue was shown by the figures given by Mr. Ogden Mills, Secretary of the Treasury, at the beginning of December, 1932. Two-thirds of the decline of $896 millions in individual income tax which occurred between 1928 and 1931, took place in the net income class of $100,000 and over, and was due to the shift in taxable incomes from the higher to the lower income groups. In 1930 this shift resulted mainly from the decline in profits on the sale of stocks and bonds, which under American law are subject to income tax. These fell from $4,322 millions in 1928 to $92 millions in 1930.

In 1931 the returns from this source showed a *net loss* of $634 millions, and at the same time income from all other sources, particularly dividends, declined.

Of the yield of the miscellaneous internal taxes, which declined by $66 millions, 90 per cent is due to tobacco, stamps and estate duties, which, with the exception of the last, reflect changes in the current business situation.

Finally, the Hoover Moratorium on European War Debts created a blank in receipts, where there were $236 millions in 1931.

Rise in Expenditure, 1932

A new high level was reached for the post-War period. Total expenditures were $5,007 millions in 1932, as against $4,220 millions in 1931, an increase of $787 millions, or 19 per cent. The increase of expenditure was mainly due to measures adopted to combat the depression, including $500 millions for the capital stock of the Reconstruction Finance Corporation, $136 millions for net loans under the Agricultural Marketing Act, an increase of $306 millions for public works, and $117 millions for the postal deficit.

BUDGET FOR 1933 (1ST JULY, 1932–30TH JUNE, 1933)

It was announced that the budget for the financial year 1934 would be balanced. The deficit for the year 1933 was estimated at $1,146 millions. This was $1,327 millions less than the realized

deficit for 1932. This estimated reduction was based on an increase of $503 millions in estimated receipts, and a decrease of $738 millions in estimated expenditure.

The Revenue Act, 1932

This provided " one of the largest increases in taxes ever imposed by the Federal Government in peace time " for the Budget of 1933. It was passed with great difficulty, and raised corporate and individual income taxes, lowered the personal exemption limit, and imposed graduated surtaxes on net incomes, up to 55 per cent on net incomes in excess of one million dollars a year.

Additional estate duties were imposed and a number of manufacturers' excise taxes were introduced, on lubricating oil, automobiles, trucks, parts and accessories, tyres and inner tubes, domestic and commercial consumption of electricity, radio sets, jewellery, toilet preparations, furs, etc. Other miscellaneous taxes included new and increased stamp taxes, and new taxes on telephone, telegraph, cable, and radio messages, and increases in postal rates.

When the Revenue Act was passed it was estimated to yield $1,118 millions of additional revenue for 1933. The income taxes, in spite of the increased rates, were estimated to yield only $860 millions as compared with $1,857 millions for 1932 ; and the increase of revenue was expected to come from the manufacturers' excise taxes, stamp duties, etc., the item of miscellaneous internal revenue being estimated at $900 millions for 1933, as compared with $504 millions for 1932.

Decreased Expenditure, 1932

The most noticeable estimated reductions were :—

(1) The disappearance of any charge for the Reconstruction Finance Corporation, which in the 1932 budget cost $500 millions.

(2) The Agricultural Marketing Fund reduced from $136 millions in 1932 to $10 millions in 1933.

(3) The disappearance of an item of $194 millions for the Adjusted Service Certificate Fund, which appeared in 1932.

The Deficit, 1933

There were signs that the deficit would be in excess of the estimates, owing to further decrease of revenue, and to expenditure above the estimates.

The Budget for 1934

According to President Hoover's message there would be a deficit of $307 millions, excluding debt retirements. But this depended on the acceptance of President Hoover's proposals, or the substitution of others with the same effect, and also on the assumption that no further emergency expenditure would be required. The receipts also included a highly speculative item of $329 millions for War Debt payments by various European Governments.

Reductions in Expenditure were proposed as follows :—

Expenditure on	Veterans to be cut by . . .	$127	millions.
,,	Government employees' salaries to be cut by	$55	,,
,,	Public Roads to be cut by . . .	$148	,,

Minor savings were contemplated on rivers, harbours, etc.

Revenue for 1934

It was proposed to continue the gasoline tax for another year, providing additional revenue of $137 millions, and to impose a general manufacturers' excise tax at the rate of 2½ per cent, to yield $355 millions.

But the arrival in power of the new Roosevelt Administration threw all these plans into the melting-pot.

President Roosevelt and the Budget for 1934

On 11th March, 1933, in his budget message President Roosevelt asked for legislation empowering him to balance the budget by reducing ex-Servicemen's pensions and by cuts in the salaries of Government employees. He proposed savings as follows :—

Ex-Servicemen's pensions	$300 millions.
Government employees' salaries . . .	$135 millions.
Reorganization of Government Departments .	$200 millions.

Despite the activities of the ex-soldier's lobby, the most powerful in Washington, Congress passed legislation giving the President this authority. The passage of the Bill was expedited in the House by the statement of a Democratic leader that the record of the vote would be put before the President and be kept in mind in the allocation of patronage !

REVENUE, EXPENDITURE, AND PUBLIC DEBT [1]
(Thousands of Dollars)

	Ordinary Receipts	EXPENDITURES			Surplus or Deficit	Public Debt
		Net	Public Debt Retirements	Gross		
1927	4,128,423	3,001,837	519,564	3,521,401	+ 607,022	18,510,174
1928	4,038,236	3,071,409	540,246	3,611,655	+ 426,581	17,604,291
1929	4,036,219	3,322,619	549,604	3,872,223	+ 163,996	16,931,198
1930	4,174,052	3,392,077	553,884	3,945,961	+ 228,091	16,185,308
1931	3,318,637	3,854,193	440,082	4,294,275	− 975,638	16,801,485
1932	2,121,200	4,594,000	412,600	5,006,600	− 2,885,400	19,587,002
1933	2,238,300	3,568,000	461,600	4,029,600	− 1,791,200	22,538,673 [2]

The figures for 1932 and 1933 are on the basis of daily Treasury statements. All others for Revenue and Expenditure are on the basis of warrants issued.

MAIN ITEMS OF UNITED STATES REVENUE, 1927-32 [3]
(In thousands of dollars)
(Figures on basis of warrants issued by Secretary of Treasury)

	1927	1928	1929	1930	1931	1932
Total (net)	4,128,423	4,038,236	4,036,219	4,174,052	3,318,637	2,121,228
Customs (including Tonnage Tax)	605,672	568,157	602,820	584,771	378,793	329,361
Income and Profits Tax	2,219,952	2,174,573	2,331,274	2,410,259	1,860,040	1,056,757
Estate (Death) Tax [4]	100,340	60,087	61,897	64,770	48,078	47,422

MAIN ITEMS OF UNITED STATES FEDERAL EXPENDITURE, 1927-32 [3]
(In thousands of dollars)
(Figures on basis of warrants issued by Secretary of Treasury, except 1932 figures which are based on daily Treasury statements)

	1927	1928	1929	1930	1931	1932
Total (net) (excluding Public Debt Retirements)	3,001,837	3,071,409	3,322,619	3,392,077	3,854,193	4,593,961
Defence	684,608	737,953	792,037	840,338	844,964	836,710
Pensions [5]	230,556	229,401	229,781	220,609	1,057,916	1,053,114
U.S. Veterans	564,677	556,916	580,784	600,906		
Interest on Public Debt	787,794	731,850	678,980	658,602	610,758	599,277

Figures for public debt retirements and agriculture are not included in the above table, but in a table based on the unrevised daily Treasury statements which is less accurate, and which differs considerably in some items from the above.

(Figures on basis of unrevised Treasury statements)

Total (gross) (including Public Debt Retirements)	3,493,585	3,643,520	3,848,463	3,994,152	4,219,950	5,006,590
Interest on public debt	787,020	731,764	678,330	659,348	611,560	599,277
Public debt retirement	519,555	540,255	549,604	553,884	440,082	412,630
Total debt charges	1,306,575	1,272,019	1,227,934	1,213,232	1,051,642	1,011,907
Agriculture	156,237	159,915	171,147	177,581	296,866	318,976

[1] From Statistical Abstract of the U.S., 1932.
[2] Preliminary figure.
[3] From Statistical Abstracts of the U.S., 1932 and 1933.
[4] Note that all State death tax payments up to 80 per cent of the Federal Tax are credited against the Federal Tax (i.e. the greater part of the revenue from death taxes goes to the States). State death taxes for the years 1928-30 were :—

(Thousands of Dollars).

1928	1929	1930
127,538	148,592	180,794

[5] Includes only Army and Navy Pensions for service prior to World War.

Prices, Wages, and Unemployment

Prices

1923–25 = 100	Wholesale Prices [1]	Retail Food Prices [1]	Farm Prices [1]
1927	94·7	103·7	94·0
1928	96·0	103·0	100·0
1929	94·6	104·6	99·0
1930	85·8	98·2	84·0
1931	72·5	81·0	58·0
1932 (April)	65·0	69·2	42·0

Wages

There are no statistics for real wages after 1929. But they can be deduced from the following index numbers of wage rates and cost of living.

1913 = 100	Rates of Wages per Hour [2]	Cost of Living [3]
1927	259·5	172·0
1928	260·6	171·3
1929	262·1	171·4
1930	272·1	160·7
1931	273·0	145·8
1932	241·8	132·1
1933	231·2	

Unemployment

Few details are available. In April, 1930, 2,429,062 persons were " out of a job, able to work and looking for a job ", and 758,585 " having jobs but on lay-off without pay ". In January, 1932, according to an unofficial estimate of the American Federation of Labour, there were 8,300,000 totally unemployed. In March, 1933, estimates ranging from 12 to 14 millions were being cited.

[1] From *Commerce Year Book*, 1932, U.S. Department of Commerce.
[2] From *Statistical Abstract of the U.S.*, 1932, and *Monthly Labour Review*, November, 1933.
[3] From *Monthly Labour Review, U.S. Dept. of Labour*, February, 1933.

PART VII

CONCLUSIONS

By Hugh Dalton

CHAPTER I

SOME COMPARATIVE PERFORMANCES

I

The studies contained in Parts II to VI of this book show a certain uniformity of experience in the fifteen countries examined, though with national variations in detail. British experience, which is not included in our field of study, but which is sufficiently familiar to British readers, is also broadly similar.

The falling price level has caused much the same budgetary troubles everywhere. National finances have been waterlogged by the rising tide of unemployment. Less economic resources —in men, material, and industrial plant—have been employed, and the result has been less revenue and more expenditure, to furnish unemployment relief in place of wages.

Not much ingenuity has been displayed in finding new sources of revenue. Very few new expedients have been invented, Germany being in this respect the most fertile. But, generally speaking, the sources of originality in tax-gathering seem to have run dry. Sales taxes and turnover taxes have been adopted in some countries which were previously without them. Customs duties have been extended over a wider range of commodities, and raised to greater heights. Existing taxes on income have been increased.

Taxes on inherited wealth, the most attractive of all fiscal instruments for redressing social inequalities, have been surprisingly little developed. In Italy, indeed, which runs counter to the current of modern tendencies in this respect, death duties, except on inheritance by distant relatives, were abolished in 1923. This was one of the first important fiscal changes of the Fascist era. In 1930 there was a partial reversal of this policy, extending the range of death duty taxation to cover some of the ground which had been abandoned seven years earlier.[1] In Sweden, on the other hand, a recent increase

[1] Those who are interested will find the detail of these changes in the Royal Decrees of 20th August, 1923, and of 30th April, 1930, to which Mr. Hughes has drawn my attention. The former abolished all taxes on

of death duties has been made, and the proceeds earmarked for repayment of loans raised for public works. This is a novel and interesting idea.

But the redress of inequalities and the better distribution of wealth have hardly anywhere been among the objects of financial policy in these last years. In the rush of the crisis, the object has been to balance budgets at all costs, or to come as near to balancing them as considerations of practical politics permitted. And this has sometimes implied, as in the United Kingdom and elsewhere, a deliberate increase in inequality, through heavy cuts in many of the smaller incomes, including incomes from civil rights, of which unemployment benefit is an outstanding example.

As Governments have feverishly pursued the retreating figure of the Balanced Budget, they have, for the most part, pursued it with a limp. The foot which treads down expenditure has come more heavily to the ground than the foot which presses upon taxpayers. There has been, not only lack of originality in finding new taxes, but hesitation in increasing old ones. This has been due, partly to current doctrines of " taxable capacity ", which harbour errors both of statistical interpretation and economic reasoning; partly to the political resistance of influential groups. Because, with falling prices and declining economic activity, a given rate of tax yields less revenue than before, it has often been argued that the point of maximum yield has been passed and that a higher rate would yield less revenue still. But, except in a few special cases, this argument is false.[1] Again, it is often argued that high taxation is an

wealth inherited within the family circle, *nel nucleo familiare*, which is defined to include all transfers on death, in either direction, between parents and children or grandchildren, husbands and wives, brothers and sisters, uncles or aunts and nephews or nieces. All direct descendants of brothers or sisters of the testator were likewise to inherit free of tax. The second Decree narrowed this circle of exemption by making subject to taxation, inheritances by ascendants in the direct line, by an only child or his or her descendants, by a spouse without children or with only one child, by a brother or sister, and by an uncle, aunt, nephew, or niece. But where there are two or more children, these inherit from their parents free of tax, and the parents inherit free of tax from one another. The scale of taxation on inheritances is fairly steep, rising from 12 per cent of 10,000 lire to 30 per cent of half a million lire, and 50 per cent of ten million lire.

[1] The curve representing the yield of a tax with varying rates normally slopes upwards, a higher rate giving a higher yield. In some cases, e.g. taxes on separate commodities, the curve will reach a peak and then, for still higher rates, slope downwards. But the effect of a depression on such curves is not so much to alter their *shape*, though it may to some extent do this, as to lower their *general level*.

important cause of trade depression, and that higher taxation will deepen the depression and postpone recovery. But, in general, this argument too is false. In the catastrophic fall of prices, the level of taxation has not been a significant factor. Forces far more powerful than variations in this level have raised the economic blizzard. And, if at last it slackens its fury, taxation, whether high or low, will have played an insignificant part in its abatement. But if, even while the blizzard rages, budgets must balance, taxes must be much higher than in the old days of still weather. It is idle to will the end, but not the means.

II

Some Governments have deliberately preferred a moderately unbalanced budget to the strain which would be required, whether through increased taxation or increased economies, to balance it. Italy is a case in point, continuing, for example, to expand her expenditure on public works and education in 1933, even at the cost of increasing her budget deficit. I was informed by responsible officials in Rome in the winter of 1932 that the practical guide to action was that the deficit must not become so large as to necessitate inflation. Italy was still on gold, though the lira was at a slight discount in terms of the gold dollar, and there was no convertibility into gold or gold exchange currencies. They claimed that tax collection was being speeded up, the names and contributions of direct taxpayers being published. The adverse trade balance was being reduced by reducing trade, an absurd system, but one which Italy was compelled to follow in an absurd world. But she was doing less badly, so they maintained, than most other countries, having in the past shown much financial prudence and being unembarrassed either by large foreign debts or by unrealizable foreign credits.

France likewise, through a succession of Ministerial crises, has aimed half-heartedly at a balanced budget, but been content in the end to keep her deficit within bounds.[1] The blizzard struck her later, and less hard, than most other countries and, but for the reluctance of her taxpayers to pay their dues, and of her Governments to enforce the law, her budgetary problem,

[1] And generally, in the last few years, within the bounds of her sinking fund, as Mr. Reedman shows in Part IV above, so that, in these years, there has been no true deficit.

at least since the stabilization of 1926, would never have been really difficult.

This policy of the moderately unbalanced budget is facilitated where two separate budgets are presented, one for current and one for capital expenditure.[1] If the former is balanced, while the latter shows only a moderate deficit, it may plausibly be held that honour is satisfied. Some high authorities, indeed, go further, as we have seen already,[2] and urge the wisdom, in time of depression, of deliberately unbalancing the budget by additional capital expenditure. To this argument I shall return below.

It is interesting to notice that, after the post-war stabilizations, in none of the countries examined has inflation of currency and credit been attempted as a means of escape either from budgetary difficulties, or from the underlying difficulties of the crisis itself. To raise the national price level, and let the world price level and the foreign exchanges go hang, is a possible policy, for which there is a good deal to be said. But there is no record in the preceding studies of its adoption. The bold currency experiment of President Roosevelt is only just beginning, as this book goes to press, and it is, as yet, too early to pass a judgment on its consequences. Inflationary proposals were, indeed, made in Australia, but they were rejected. On the Continent of Europe, all countries which were belligerents in the War experienced inflation, and are unwilling to risk a repetition. The burnt dog dreads the fire; he prefers to drown, if this be the only alternative, in the waters of deflation.

Sweden, indeed, a neutral in the War, and with no disabling memories of severe inflation, has lately successfully pursued a policy of keeping her price level stable. This Swedish experiment dates only from December, 1931, when, following Britain's example, she left the gold standard. Since that event the aim of the State Bank—whose Governor, it is interesting to observe, is appointed by the Crown and whose Directors are chosen by Parliament—has been to stabilize the currency in terms of a comprehensive index number of retail prices. This aim seems, up to the present, to have been attained with surprising precision. It is obvious that, if either the retail or the wholesale price level in any country is approximately stabilized, the other price level will only show comparatively small fluctuations. This is borne

[1] As Mr. Reedman has pointed out in Part V above, this practice is adopted by a number of European Governments.

[2] See Part I, Chapter II, above.

out by Swedish experience, wholesale prices in that country having moved much more steadily since the beginning of 1932 than in either Britain or the United States.[1] Nor did the Kreuger crash in the early part of 1932 disturb the even course of Swedish prices. There are strong reasons for believing that, with a comparatively stable price level, production and employment are also likely to be comparatively steady, though it is argued by some economists, partly on theoretical grounds and partly in the light of American experience in the period ending in 1929, that a stable price level is apt to generate various maladjustments and to provoke a serious collapse at a later date. These questions are too complicated to be pursued here, though they are of primary importance in relation to monetary policy.[2]

The rigidity of public expenditure, in face of changing price levels, works both ways. A moderately inflationary policy, which raises the price level, may, whatever its other effects, yield a budget surplus without much difficulty. "Prices," it has been said, "go up by the lift, while wages go up by the stairs." It might be added that long-term interest stays below in the hall. A policy which stabilizes the price level, as in Sweden, renders a rigid public expenditure comparatively unimportant. But a policy which either encourages, or passively permits, a rapid fall in the price level, encounters in these rigidities, as we have seen in the preceding studies, a serious obstacle to a balanced budget.

It is of interest, therefore, to compare the attacks made by various Governments upon these rigidities. Cuts in the pay of Government employees are a common feature of economy campaigns and in many countries such cuts have been repeated and severe. But in some, and notably in France, there has been effective political resistance to this form of economy, which has not up to date been carried very far.

A similar resistance in the United States prevented for some time any large cut in the ever swelling expenditure on War pensions and allowances. But President Roosevelt made this the occasion for one of his first successful trials of strength with a reluctant Congress.

[1] See an interesting chart, and commentary upon it, published by Mr. Francis Williams in the *Daily Herald* of 31st July, 1933.

[2] Mr. Brinley Thomas is engaged in the autumn of 1933 and the spring of 1934 in making an examination in Sweden, on behalf of the Acland Trustees, into this and other features of Swedish economic and financial policy.

Broadly speaking, as Mr. Reedman shows in Part V of this book, on the Continent of Europe west of the Soviet border attacks on social service expenditure have failed or succeeded in proportion to the political influence of the Parties of the Left. Where these have been weak, divided or non-existent, this branch of expenditure has been ruthlessly lopped and others, by comparison, only slightly tipped, while tax increases have been relatively moderate. Where the Left Parties have been strong, the pressure on the social services has been partly shifted, and Governments compelled to think again.

Both Germany and Italy have attracted much attention by their attacks upon rigidities. Both, as Mr. Brinley Thomas and Mr. Hughes have described, have made a multitude of price reductions by decree. In Italy the decrees were frankly dictatorial, whereas the stream of Emergency Decrees issued by the Brüning Government marked the flickering out of formal democracy in Germany. In Italy wages, salaries, rents and retail prices were authoritatively reduced. The reductions were not confined to the sphere of public finance, but touched private employment and private trade as well. Interest payments, however, were untouched.[1] In Germany the range of reductions was somewhat wider. Long-term interest rates, if above 6 per cent, were reduced, but the main weight fell on wages, salaries and pensions. There were also price reductions by decree, and immense powers of price control, with formidable penalties. But both in Germany and Italy this effort was spasmodic and short-lived. It was not developed into a continuous policy consistently pursued. It had little significance, except as a display of State power and, outside the sphere of public finance, as an acceleration of certain price falls—most of which, even without the decrees, would have soon taken place—and an occasional peck at the profits of monopolists.

III

Much the most vigorous attack upon rigidities, along the most extended front, was made by the Australians and New Zealanders. In Peace, as in War, the Anzacs have astonished the world.

[1] Great care was taken, in a series of official pronouncements, to repudiate all idea of a compulsory conversion of the public debt. And for a voluntary conversion the conditions of the market had been continuously unfavourable. In 1926 a mild form of compulsory conversion had taken place, holders of short-term Government securities being compelled to exchange these for long-term Lictorial Loan, but without any serious loss of income. Signor Mussolini has, so far, been very tender with the rentier.

Thus in Australia, once economy became the order of the day —an order not very congenial to the Australian temperament— nothing could withstand the assault of the woodman, axe in hand. Nothing was sacred against his cuts ; neither wages, nor salaries, nor superannuation ; neither interest on internal debt, on mortgages, on debentures or on preference shares ; neither public nor private contracts ; neither War pensions, nor old age pensions, nor maternity allowances. Rents, too, were cut down, foreclosures stopped, and hire-purchase agreements reopened. As a dramatic spectacle it was magnificent, though one may doubt whether it was truly scientific forestry. Together with heavy increases in taxation, this very violent assault came nearer than the relatively half-hearted attacks made elsewhere, to reaching the goal of equality of sacrifice—among Australians. But not among all who lived upon Australian labour. Nothing was sacred, except one vested interest. Nothing was cut off the income of the external bond-holder. Sir Otto Niemeyer, the envoy of the Bank of England, explained, one supposes, that this would be going too far. It was suggested, one imagines, that some loan contracts were in a special category. It was hinted, one is inclined to suspect, that in certain circumstances future loans would be unobtainable in London, and that the United Kingdom might, in other matters also, become somewhat disinterested in Australia. " Money talks," says the old proverb.

Yet, from the standpoint of an impoverished Australian, this special exemption was a piece of gross inequity, and it is impossible for a fair-minded man to feel no sympathy with the point of view of those who supported Mr. Lang. They resented the goad wielded, as it seemed to them, by a remote and relentless money power. But they were wrong in thinking that it was practical politics to kick against the pricks. Mr. Lang was dismissed, and his political opponents won the next election.

Since the end of Mr. Leaning's narrative, two events of great financial importance to Australia have occurred. The first is the series of voluntary conversions of her external debt ; the second is the sharp rise from their lowest point of the prices of some of her principal exports.

The series of conversions began in October, 1932, and continued through 1933. Up to November, 1933, there have been five of these operations, covering £71,600,000 of stock. A further £35,000,000 of optional maturities are outstanding, and will probably be converted in the near future.[1]

[1] As this book is passing through the press in December, 1933, an

The results of the conversions already made are shown in the table on p. 443.

The saving in loss on exchange is calculated on the basis of £125 Australian equal to £100 sterling. The first and third of these conversions are into short-term issues, and a rise in the rate of interest in the next few years would increase the cost of renewing these loans. But the saving on the fourth and fifth is more stable. It may, however, be noted that the total annual saving on the series only amounts to one-twentieth of the total external interest burden of Australia, as compared with the saving of 22·5 per cent in the internal interest burden brought about in 1931–2. Broadly speaking, the British bond-holder has enjoyed two years of grace, with undiminished interest rates, as compared with the Australian bond-holder, and has made, up to date, less than one-quarter of the sacrifice of future income. And many British bond-holders have not yet sacrificed a penny. Even if the outstanding maturities are converted on terms favourable to the Australian Government, there will be no close approach to equality of sacrifice between these two groups. This contrast is ironical. But it may be added that the Australian Government suffers no such consequential loss of revenue through its external, as through its internal, conversions, since the British bond-holder contracts out of all Australian taxation.

The recovery in the Australian Government's credit in London has been spectacular. Five per cent Commonwealth Stock, 1945–75, touched its lowest point in September, 1931, when it was priced at 58, giving a running yield of more than 8½ per cent. It had risen to 78½ on 3rd February, 1932, to 93½ on 29th June, 1932, to 104 on 21st June, 1933, and to 111 on 11th October, 1933. And no long-term Australian loan had been floated in London at such a low rate as the September 3¾ per cent conversion loan for more than twenty years. Such, it may be said, is the reward of virtue, as understood in the City of London. But it would be only fair to allow something for the repercussions on long-term interest rates of the British conversion operation of May, 1932, and for the recent rise in Australian export prices.

additional £16,600,000 of stock (£6,000,000 New South Wales and Victoria 5½ per cent 1934; £3,900,000 Victoria 5½ per cent 1930–40; £6,800,000 South Australia and Tasmania 5 per cent 1932–42) has been converted into 3¾ per cent Commonwealth Stock 1946–9 at 99 per cent. The annual saving in interest is £257,400 and in interest plus exchange loss £321,800.

See also p. 448, Postscript.

Date of Conversion Prospectus	Description of Stock Converted			Description of Conversion Loan				Economy Effected	
	Amount and Title	Rate of Interest	Redemption Date	Amount and Title	Rate of Interest	Redemption Date	Issue Price	Annual Saving in Interest in £ Sterling	Annual Saving in Interest plus Exchange Loss
3rd Oct., 1932	£12,400,000 New South Wales	5¾	1st Nov., 1932	£12,400,000 Commonwealth	3½	1936–37	97½	£278,100	£347,700
3rd Feb., 1933	£9,600,000 New South Wales	4	1st July, 1933	£9,600,000 Commonwealth	4	1955–70	Par	*Nil.*	*Nil.*
30th May, 1933	£6,400,000 New South Wales	6½	1930–40	£11,400,000 Commonwealth	3½	1937–38	99	£342,300	£427,900
	£3,000,000 South Australia	6½							
	£2,000,000 Tasmania	6½							
15th July, 1933	£9,500,000 New South Wales	6	1930–40	£17,200,000 Commonwealth	4	1943–48	99	£344,400	£430,500
	£2,000,000 Queensland	6							
	£3,000,000 South Australia	6							
	£2,700,000 West Australia	6							
14th Sept., 1933	£15,000,000 Commonwealth	6	1931–41	£21,000,000 Commonwealth	3¾	1948–53	98	£457,000	£571,000
	£4,900,000 New South Wales	5¾	1925–35						
	£1,000,000 West Australia	5¾	1930–40						
Total	£71,600,000			£71,600,000				£1,421,000	£1,777,000

This is, indeed, the dominant cause of the recovery, not merely of Australia's credit, and of her budgetary position, but of her whole economic life. " The fact of outstanding importance," says the City Editor of *The Times*, commenting on 14th July, 1933, upon the fourth conversion offer, " is that the average price of Australian export products is now about 25 per cent higher than a year ago. In the case of wool tops the advance in the past twelve months is over 40 per cent." And on 4th October, 1933, the Commonwealth Treasurer in his Budget speech reported an average rise of 40 per cent between March and September of the current year in the chief export prices. He recorded buoyant revenue, in excess of the estimates, a realized surplus of £3½ millions in place of an anticipated deficit of £1¼ millions, and an unexpected increase in imports. He proceeded to propose tax reductions on a considerable scale, and the partial restoration of a number of the previous cuts in pay and pensions.

It is the rise in prices, rather than the cuts, which is pulling Australia out of the mire. Herein is a moral for others and a clear hint for policy.

The case of New Zealand is broadly similar, both in the nature of the problem and in the measures taken to deal with it, and I have little to add to Mr. Leaning's account.[1] There are similar tax increases and similar cuts in rent, interest, salaries, wages, and social service income, including old age and War pensions. There is a similar conversion of internal Government debt, " voluntary," but with a penalty for dissent, in the form of a special tax of one-third of the annual income from unconverted stock.[2] There is a conversion, on much the same lines, of the internally held debts of local authorities, reducing the interest by one-fifth, subject to a minimum of 4½ per cent. And there is the same disinclination to risk a fall with the forces which protect the external creditor.[3]

[1] See Part VI, Ch. II, above.

[2] " This," said a Labour Member of the New Zealand Parliament, " is not a voluntary conversion. It is like putting fire under the heretic, or making the bond-holders walk the plank." (*The Times*, 6th March, 1933.) The dissenters only owned £500,000 out of £115 millions of Government stock offered for conversion, but of the latter total nearly £46 millions were held by Government Departments.

[3] The uncompromising vigilance of these watchdogs is illustrated by the short controversy over the Auckland Tramway case in the summer of 1933. The Auckland City Council were instructed by the Courts of Law in New Zealand to pay interest at the reduced rate, i.e. diminished by one-fifth, and in New Zealand currency, not in sterling, to holders domiciled in the United Kingdom of Auckland securities originally issued in New Zealand. This raised a storm in the City of London, the Stock

The New Zealand Government has made one voluntary conversion in London during 1933, replacing in October £5 millions of 5 per cent stock, 1932–4, repayable in January, 1934, by £5 millions of 3½ per cent stock, 1929–54, issued at 97. This new issue was largely over-subscribed. The annual saving in interest is just on £75,000 sterling, or, allowing for loss on exchange, £93,750 in New Zealand currency. The Budget statement, issued on 13th June, 1933, shows a deficit on current revenue of £2,460,000, but this is transformed, by the transfer of £2,500,000 from Treasury reserves, into a nominal surplus of £40,000. This is a better result than was anticipated, revenue having exceeded the estimates by £938,000. Rising export prices, though much less marked than in Australia, are largely responsible for this improvement.

IV

I now turn from economies to their opposite, increased expenditure for capital development.

Policies of public works[1] have been pursued, with greater or less energy and persistence, in nearly every country. They have been conceived partly as a stimulus to employment, partly as a means to national development, partly as means of mitigating

Exchange refusing to deal in these tainted securities, and City editors protesting against breach of faith and " the penalizing of the overseas investor ". The New Zealand Government quickly gave way. It promised to bring in amending legislation, exempting from the reduction of interest all " optional domiciled securities " sold in London before 1st July. It promised further to amend the law, so as to authorize payments of interest in sterling, even on securities issued in New Zealand, in exchange for funds received in London, or " wherever past practice has clearly indicated the right of holders to receive their dividends in London ". " On this question," commented *The Times* City Editor, " the Government has adopted the proper attitude, which will be duly noted by the general body of investors, that moral obligations shall be regarded as superior to legal obligations." (*The Times*, 7th July, 1933.) But even this sanctimonious approval was coupled with a further threat. " On the currency question, the statement will not satisfy the market quite so completely as in the domicile case, unless the Auckland Council promptly pay the interest in sterling in full, in anticipation of the promised legislation." The Auckland Council promptly paid !

[1] Definitions of " public works " vary. But, for my present purpose, they imply at least some degree of initiative, and some degree of financial responsibility, in the central Government, in addition to a high degree of durability in the material outcome. Undertakings otherwise similar, but carried out exclusively on the initiative, and at the cost, of subordinate public authorities, important though their effects may be, fall outside my present definition.

the crisis. The emphasis upon these different objects has varied from one country to another, and from year to year.

The pundits of orthodox finance will be surprised, and perhaps shocked, to find how largely, as Mr. Reedman shows in Part V of this book, European governments have paid for their public works by taxes, rather than by loans, leaving behind no trail of burdens for interest and sinking fund.

France, almost alone, has attempted little in the way of public works,[1] though ambitious schemes, drawn up by her National Economic Council, exist on paper.

The British Government, between 1929 and 1931, made half-hearted beginnings, in face of an unfriendly Treasury and adverse external conditions, but since 1931 there has been no perseverance in these efforts, which have been condemned in principle in Ministerial speeches and allowed to lapse.

Both the United States and Sweden, as this book goes to press, are embarking on large programmes. But it is too early to discuss them.

The performance of Italy in this field has attracted much attention, and has been described by Mr. Hughes in Part III of this book. The emphasis has been upon national development, rather than on employment or the crisis. The present programmes were authorized and planned in broad outline, before unemployment became severe or the crisis arose. But it is claimed that they have kept unemployment lower than it would otherwise have been. They have not fallen victims to the economy campaign, but are regarded as a "section of the front", on which, in the military metaphor dear to her present ruler in his public orations, Italy is fighting the battles of peace.

The methods of finance are interesting. The method of deferred payments, which Mr. Hughes explains, amounts to borrowing from Savings Banks and gradual repayment by the State over a fixed term of years. How high a proportion of the funds of the Savings Banks is now tied up in these annuities, especially for *bonifica*, is not disclosed. But, as an Italian Treasury official put it to me in conversation, the State would have to come to the help of the Savings Banks in any case, if they were in difficulty, so the relative amount of their long-term credits is not of great importance. He also suggested, what I could not deny, that it was better to use Savings Bank deposits to finance productive work than to finance the payment of unemployment

[1] Unless we treat the elaborate fortifications along the eastern frontier as such.

benefit, as successive British Governments have done. Some financial authorities, including Professor De Stefani, argue that this method of deferred payments disturbs the market less than the public issue of State bonds. But I gathered that the Italian Treasury attached little weight to this argument.

The alternative method of finance, that of direct payments from the Treasury out of public revenue, is gaining ground, except in regard to the *bonifica*, which continues to depend on deferred payments.[1] The electrification of the railways, for example, is being paid for out of general, not railway, revenue, though new roads are paid for, through a separate consortium, by the tax on motor vehicles. And local authorities are often required to make a contribution to the cost of public works within their area. I was informed, at the Ministry of Public Works, that a new law for the expropriation of land for public purposes was being drafted, but that it had been delayed by conflicting views in the drafting Commission.

I have formed the opinion that the Italian public works policy is sound in principle and vigorous in execution. It is, on the whole, well adapted to the present needs of the country, though in other countries a similar programme might be less appropriate. And it is making a contribution to national development which could not otherwise be made. Even if development by private enterprise were preferable, which is a matter of opinion, there is no reason to suppose that private enterprise would, in fact, perform most of these particular tasks. The practical choice is between public enterprise, and the continuance of malaria, lack of water supplies, lack of roads, out-of-date railways and ports, and deforestation. In afforestation, in particular, Italy has much to teach this country, where the Forestry Commission were compelled by the Treasury to burn 50 million seedlings on the altar of economy in 1932.[2] It is humiliating for an Englishman to read, in an official Italian report on afforestation, that " the State takes account of interests wider in space and time than the individual ".

By comparison with Italy, the public works policy of Germany has been less successful and less well conceived. Mr. Brinley Thomas has given a picture of its amazing complication, a

[1] It may, of course, be argued that, with a budget deficit covered by short-term State borrowing, these direct payments are unreal, and that public works are, in fact, financed by loans, except in so far as the direct payments exceed the deficit, which in several recent years they do.

[2] See the debate on the Vote for the Forestry Commission in the British House of Commons on 3rd July, 1933.

feature characteristic of German public finance in general. For the conduct and finance of public works, as for other purposes, an elaborate pyramid of unnecessary institutions has been built up, with intricate credit and debit relationships, reminiscent of the creations, real and imaginary, of the late Ivar Kreuger. And additions to the fixed plant of public utilities have been paid for by short-term loans from abroad! There is evidence, as Mr. Brinley Thomas shows, of serious misdirection of capital in Germany. This is partly due to the concentration of the public works programme on too narrow a front. The moral is that planning, to be efficient, must go wide.

German attempts at planning, carried on in a queer half-way house between capitalism and a hierarchical socialism, even allowing for very adverse conditions, have been clumsy and half-hearted. The central planning of the location of industry, for example, is one thing, and there is much to be said for it; but a scramble by local authorities, bidding against each other by means of all manner of subsidies and other inducements, which in most other countries would be illegal, in order to persuade employers to set up in particular areas, is quite another; and there is nothing to be said for this.

Yet of these criticisms I would make one strong qualification. The finest monument to post-War and pre-Nazi Germany, called by the Hitlerites " the sow Republic ", is its magnificent achievement in housing and town planning. Some of the world's best architects and town planners, some of them Jews or Gentile Socialists, thus made their peaceful contribution to the welfare of their Fatherland, and to the health and joy of the rising generation, and to their vision of the beautiful. But not all these are public works, in the sense in which I use this term, since the Government of the Second Reich often took no part either in planning or in paying for them. The Third Reich only entered later on the scene, to reward, in its peculiar fashion, many of the most creative sons of Germany.

POSTSCRIPT

On 20th February, 1934, the seventh Australian Conversion was announced. It took the form of the offer of £21,637,000 of 3½ per cent Commonwealth Stock 1954–59 at 97 per cent to repay £3,979,000 New South Wales 5 per cents, £13,876,000 Victoria 5 per cents, and £3,782,000 Queensland 5½ per cents. The annual saving in interest will be £343,456 and in interest plus exchange loss £429,320.

CHAPTER II

SOME GENERAL REFLECTIONS

I

The capitalist system in its modern form is very ill adapted for large and rapid changes in the value of money. Many of its most characteristic arrangements, in regard to contracts, investments, and even social service benefits, when paid in money, presuppose a stable price level. At the worst, it is assumed that prices will only slightly vary over a considerable period of time. When prices fall sharply, the " delicate fabric " of the system—to use a phrase common among its admirers—is sharply torn. When prices rise sharply, it is torn in another direction, though the damage is not so quickly visible. Yet such a metaphor is not completely satisfactory, for one of the most astonishing features of this system during the last twenty years is its toughness, and its ability to survive, after a fashion, the successive and very powerful assaults of War, of post-War inflation, and latterly of accelerating deflation. Those who have believed, whether through blind faith or through processes of reason, in its imminent breakdown, have suffered many disappointments. Outside the wide borders of the Soviet Union, it is still, predominantly, the only way of economic life which the world knows, though many inroads, great and small, have been made upon it, and social controls, of varying efficacy, have been imposed upon its natural operations.

Public finance, moreover, under capitalism, is even less well adapted, than the system of which it forms a part, to stand the shock of a downward crash of the price level. Public expenditure is, by its nature, much more rigid than public revenue. Hence the emergence of the problems studied in this book. In this concluding chapter I shall set down some general reflections suggested by the facts and tendencies which these studies have revealed.

II

Thus the recent practice of many Governments, and especially those of Australia and New Zealand, suggests reflections on the legal revision of contracts. This raises interesting questions,

both of equity and expediency. Sanctity of contracts is Shylock's slogan, obstinate and absolute. But, as has been well said, it is " the absolutists of contract who are the real parents of Revolution ".[1] They become the unconscious allies of those who sing, " I like the sound of breaking glass." In ordinary circumstances the fulfilment of contracts is the normal and proper procedure of an organized society. But when circumstances are extraordinary, some of our standards must be modified. Under the heavy pressure of falling prices and economic crisis many a Shylock must break, if he will not bend. And if both prices fall and wealth shrinks, while the letter of his bond entitles him to fixed sums of money, there is a twofold case in equity for making him bend. Nor need the legal mind revolt from such a proposition. All property rights, including contractual rights, are the gifts of the lawgiver. And what the law has given, the law can take away, in whole or in part.

The term contract may here conveniently be used in a broad sense. Leaving it to the lawyers to argue how far, for their special purposes, our broad category should be narrowed, we may distinguish three types within it : first, contracts between Governments ; second, contracts between a Government and a private person ; third, contracts between private persons. The specimens of each type, which are now to be considered, are chosen because of their bearing on the subject of these studies ; they do not form a logically complete array.

Of the first type, the obvious example is the post-War Governmental debts. In theory, some of these are payments for services, and others for disservices, rendered during the War. In fact, they are all alike burdens on the budgets of the debtor, and aids to those of the creditor, Governments. They have had other important repercussions, nearly all harmful, both on politics and economics. These will not be discussed here.[2] All that we need here observe regarding these debts, is that the crisis is washing them all away. The " solemn engagements " of the Germans at Versailles in 1919, of Mr. Baldwin at Washington in 1923, of the French and Italians to Mr. Churchill in 1925 and 1926, all these and many others like them, are swirling down the stream, following, after an interval of some fifteen years, the promissory notes of the last of the Romanoffs, which the Bolsheviks, from the first hour of their arrival in power, bluntly refused to honour.

[1] J. M. Keynes, *Tract on Monetary Reform*, p. 68.
[2] See, however, my *Principles of Public Finance*, chapter xxv.

As regards War debts to foreign Governments, we are all Bolsheviks now. Little face-saving devices, more appropriate to Oriental bargainings—little token payments at Washington, to ease the final bump and dodge a declaration of default, or little slipshod undertakings at Lausanne to pay something more some time in the vague future—make no important difference. Neat schedules of payments, running on till 1984, or even longer, are now only scraps of paper.

But for the crisis, and the increasing burden on unbalanced budgets of these tributes fixed in terms of money,[1] this strange system of one-way traffic between State Treasuries might have endured a little longer. It is better that the end should have come now. From the hour when the Hoover Moratorium, nominally for one year only, was offered to a panic-stricken world at the time of the German credit crisis in 1931, it was obvious that the system was doomed.

III

Turning to the second type of contract, between a Government and a private person, we may distinguish the Government's contracts with its own nationals on the one hand, and with outsiders on the other; also contracts for the loan of money, as against contracts for the performance of work.

It is the usual practice of Governments, when they discriminate at all, to treat their own nationals better than outsiders. This practice is illustrated by protective tariffs and by much else in modern law and administration.

As regards loans, there have been a number of recent instances of default, partial or complete, upon external obligations, while internal obligations have continued to be fully met. Such default has often been politely renamed " transfer moratorium ", and blame for it has been put upon the recalcitrant foreign exchanges. But, as we have seen above, Australia and New Zealand have discriminated in the opposite sense, imposing cuts upon the internal, from which the external creditor of Government was

[1] Looking back to 1929, it is extraordinary to find the German Government of that day, by whom the continued payment of reparations was still regarded as inevitable, demanding, when the Young Plan superseded the Dawes Plan, that their future obligations should be fixed in gold marks, without reference, as heretofore, to any " index number of prosperity ". On this occasion false pride and economic foolishness met and kissed each other and, immediately after, prosperity and prices fell like stones.

left free. The external private creditor, however, such as a mortgagee resident in London, shares the same fate, under recent Australian and New Zealand legislation, as a mortgagee resident in either of these Dominions. But this is an example of the revision of the third type of contract, between private persons, which will be considered below.

As regards contracts for the performance of work, nearly all Governments have discriminated, often severely, against their own employees, as compared with those in private employment. Lawyers, indeed, argue that there is no true contract of service, on which a State employee can sue his employer, and legislators, in the United Kingdom and Australia at any rate, have made this doctrine doubly sure by inserting in their Economy Acts a provision that, even if there be any breach of contract in this deliberate and sudden worsening by Government of the conditions of its employees, the latter shall be deprived of any right to sue for it.[1] A sort of guilty conscience clause, for the better protection of the Treasury !

But the inequity is obvious. It has been forcibly expressed by Mr. Keynes, writing in the autumn of 1931. " The incomes of well-to-do people have been cut by 2½ to 3½ per cent. The school teachers are cut 10 per cent, in addition to the extra taxes which they have to pay. It is a monstrous thing to single out this class and discriminate against them, merely because they happen to be employees of the Government. . . . The same considerations apply in varying degrees to all the attacks on the standards of Government employees. The principle of discriminating against persons in the service of the State, because they can be reached most easily, is not right. At least it would have been more decent in the circumstances if the phrase ' equality of sacrifice ' had not been used." [2]

But this inequity is not a British patent. Wherever it has

[1] The question of legality, mixed up with the questions of " constitutionality " and propriety, has been raised in regard to the cut in British judges' salaries, nor have some of the judges themselves refrained from public expressions of disapproval at the action of Parliament in 1931 in requiring them, like other persons paid from public funds, to take less pay. A debate on this subject in the House of Lords on 23rd November, 1933, including a long speech by the Lord Chancellor, is interesting. The judges seem to me to have a case in equity, but not so much against Parliament or the Government, as against those responsible for the fancy fees paid to fashionable counsel who, it is said, are increasingly unwilling to make the " financial sacrifice " of promotion to the Bench.

[2] *Essays in Persuasion*, pp. 163–4. He goes on to argue that " the Government's programme is as foolish as it is wrong ", since it will increase unemployment and diminish revenue.

seemed one of the lines of least resistance, harassed Governments have followed it. Only when, as in France, the resistance has been formidable, have they tried alternative courses.

There is another form of discrimination which has been practised scarcely less widely, discrimination against those who work for the State, as compared with those who have lent it money, or at least have bought its bonds. Compulsory cuts in pay have been almost universal, compulsory cuts in interest very rare. This, too, is hard to defend on grounds of equity.[1] The British Government in 1931 rejected a proposal for a special tax on income from fixed-interest-bearing securities which, taken in conjunction with cuts in pay, would have helped to remove this particular inequity, while equally avoiding discrimination against holders of Government securities as compared with other rentiers. It would, indeed, have left untouched the holders of ordinary shares, but the trade depression had touched them heavily already, while leaving the rentiers to benefit by the fall in prices. Such discrimination between these two classes of capitalists could, therefore, have been defended as retrospective equity.

IV

Turning to the third type of contract, that between private persons, we pass outside the range of public finance, but into the sphere of true contracts in the eye of the lawyer. Here we find, in the previous studies, many examples of legal revision, partly because Governments sought to break rigidities, and so revive prosperity, partly because they desired to correct inequities between the contracting parties due to the fall in prices, partly to avoid, or at least mitigate, discrimination due to revision confined to contracts made by Government itself. In particular cases, the first two motives often coincided. Thus a farm mortgage, fixed in terms of money, had become so crushing a burden, now that prices of farm produce had collapsed, that the farmer was in danger of being driven out of production into bankruptcy and destitution. Further, the

[1] It may, of course, be said that in Britain voluntary conversions have much reduced the interest on the Public Debt. This is true, but the reduction has been arbitrarily distributed among bond-holders, according to the stock they chanced to hold. There has been nothing remotely resembling equal sacrifice among them.

farmer had suffered undeserved bad luck, and had a case in equity against the mortgagee.[1]

No further comment will be made here on the treatment of this third type of contract, except that, generally speaking, contracts for the performance of work have been revised more drastically than contracts for the hire of land and houses, and these again more drastically than contracts for the loan, or investment, of money. Contracts for the sale of goods have also been controlled, but since these are generally of short duration, it has seldom been a question of revising existing contracts, but of controlling new ones. The same is true, to some extent, of wage contracts.

V

A closer approach to equity, and to equality of sacrifice, than any of the programmes actually adopted by Governments, might have been found in a uniform percentage reduction of all money incomes, of whatever kind, in proportion to the fall in the general price level since a given date. This was the underlying idea of the so-called National Treaty, which attracted some members of the Macmillan Committee on Finance and Industry.[2] This is, in principle, a most conservative device for regaining a lost equilibrium of prices and costs, without either changing the monetary system or seeming to violate social justice. But it would be fiercely resisted by conservative minds in all parts of the community. It seems not to be practical politics.

If a sufficient body of opinion would support it, it would have merits, as a rough and ready solution of the immediate problem presented by the fall of prices. But it would be, at the best, a makeshift. It would not, of course, restore exactly the situation which existed before the slump. For it would reduce all incomes by an equal proportion, whereas prices have fallen unequally, some more and others less than the average, and would probably fall again unequally, as a consequence of the cut in incomes. And equal proportionate cuts in all incomes, large and small alike, do not yield equal sacrifice. This requires a scheme of progressive cuts, taking a higher

[1] For a good account of the handling of this problem in Roumania, a country not covered by the studies in this book, see W. A. Sollohub, "The Conversion of Agricultural Debts in Roumania." (*Economic Journal*, December, 1932.)

[2] See *Report* (Addendum I), pp. 193–200.

proportion from large incomes than from small.[1] Moreover, equal sacrifice, even if perfectly achieved, is not perfect equity. There are other principles, including, in particular, minimum aggregate sacrifice, which may, not unreasonably, be held to be more equitable.[2]

VI

Equity, justice, fair play—these are only different names for the same thing, a quality in which the capitalist system is not rich. Will a system, so poor in this moral quality, and liable to such heavy strains and partial breakdowns, continue to be tolerated ? And if not, what will replace it ?

The breaking strain of any economic system can only be tested by experience, not by doctrine. Nor, in my opinion, can doctrinaires foretell—though they may influence a little, if they can influence opinion—the course of change to a new system. But not all our doctrinaires are of the stature of a Rousseau, or a Lenin, or even of a Mussolini. In the contemporary flux, we may observe facts and guess at tendencies and cherish hopes. But cocksure prophecy is brittle and cheap.

We may, for instance, speculate, without dogmatism, whether modern Italy is not moving along a path which will lead, not only to Economic Planning, but to Socialism. This suggestion is repugnant both to most Italian Fascists and to many Socialists, including Italian *émigrés*, outside Italy. Yet it is not to be ruled out as unthinkable, nor even as exceedingly improbable.

There are incidents which are like straws, showing the momentary direction of the wind. Even though the wind veers, they have their meaning. Thus we find Professor Spirito, at a conference held at Ferrara in May, 1932, propounding the thesis of corporate property, *corporazione proprietaria*, of which more has since been written in the Italian press. He argued that the Corporative State must move towards a classless society, ridding itself of the " classical dualism " of employers and

[1] It may be argued that this doctrine is not applicable here, since prices would fall in proportion to money incomes, and everyone would have the same real income as before, and better future prospects. But this is too facile, for, as I have pointed out above, different prices would probably fall unequally.

[2] For a discussion of this question of principle see my *Principles of Public Finance*, chapter ix, and Pigou, *A Study in Public Finance*, part ii, chapter i.

employed. The logical solution, he held, was corporate property, the ownership of capital within the corporations passing from private shareholders to the corporation itself. The class struggle should be ended by eliminating the conception of class, and eliminating, in particular, the private capitalist. As a stage towards this end, he advocated the representation both of the State and of the workers' organizations upon the Boards of Directors of all large companies, and the distribution of an increasing proportion of the profits to the workers. He was bold enough to add that Italian Fascism could learn many useful lessons from Russian Bolshevism.

Having thus put the Bolshevik cat among the Fascist pigeons, he easily succeeded in creating an uproar in the conference, many of those present shouting that such subversive sayings should not be allowed.[1] Apparently unnerved by this tumult, Professor Spirito offered to resign his Professorship, but Signor Mussolini refused to accept his resignation, and has since permitted him further to develop these ideas in the Government-controlled press.[2]

In a recent speech, delivered on 14th November, 1933, Signor Mussolini " began by saying that some time ago he had put to himself the question whether there was a crisis *in* the capitalist system or *of* the capitalist system. To-day he could reply that the crisis had penetrated so deeply into the system, that it had become a crisis *of* the system. During the last hundred years, capitalism had passed through three phases, dynamic, static, and decadent. From 1830 to 1870 was the dynamic phase, with the appearance of factories and the domination of individualism. The static phase lasted from 1870 to 1880. Then came the trusts and cartels, which modified our whole economy and even succeeded in modifying the law of supply and demand. Decadence had become more rapid after the war with inflation and other modern phenomena. He spoke of two dominating figures, Kreuger and Insull, as personifying the decadence of post-War capitalism ".[3] He went on to

[1] See *Atti del Secondo Convegno di Studi Sindacali e Corporativi* (1932), vol. i, pp. 183 ff., and vol. iii, pp. 107–151.

[2] See, for example, an article on " L'Iniziativa Individuale ", published in *Critica Fascista*, 15th December, 1932. " Atomistic individualism," Professor Spirito here argues, began with nineteenth-century Liberalism. It is to-day a bankrupt philosophy. We confide to the State the Army, Justice, Education—all the most delicate tasks. Why should industry alone be abandoned to individual egoism and caprice ? If it be objected that the State is a bad administrator, why not farm out the Army to private enterprise ?

[3] From a report in *The Times*, 15th November, 1933.

expound the virtues of the new " category corporations " as " instruments through which the masses themselves can improve their existence ".

And if it be replied that all this is only verbiage, attention may be redirected to some of the events described by Mr. Hughes in Part III of this book. In particular, to the creation in Italy of a number of new financial institutions, State and " parastatal ". The banking reform of 1926 has led to the control of all deposit banking, including foreign branches, by the State. Very wide joint powers are exercised by the Ministry of Finance and the Bank of Italy and, in addition, the State now controls all new capital issues.

Likewise in Germany, as Mr. Brinley Thomas has explained in Part II of this book, the collapse of some private banks, and the threatened collapse of others, has forced the hurried building of a new structure. And to-day a Reich Commissioner of Banking and a Banking Board of Control preside over a socialized German banking system.

In the United States, again, private financiers are under a cloud of popular disfavour and, though new institutions are slow to take shape, a return to old banking forms seems scarcely conceivable and the increased authority of the State over financial operations scarcely in doubt. Nor are President Roosevelt's innovations confined to the sphere of finance.

The Soviet Union, moreover, is a living example of a Planned Socialist Economy, which, in proportion as it succeeds in raising the standards of life of its inhabitants, in realizing social equality and in abolishing the " trade cycle ", with its attendant unemployment, will produce an increasing repercussion, and a spirit of imitation, in the minds of those who dwell in capitalist communities.[1]

VII

Returning to the narrower question of unbalanced budgets, it is important to notice the expansionist doctrine, to which reference has been made above. According to this doctrine, escape from budgetary disequilibrium, and from its causes, should be sought, not by economies, which are a policy of contraction, but by a planned expansion of production, designed to bring back idle resources of all kinds into employment and

[1] For a brilliant study of the comparative possibilities of Planned and Unplanned Economies see Mrs. Barbara Wootton's *Plan or No Plan*.

thus increase revenue, while diminishing expenditure for the relief of unemployment. A stimulus to capital development, to be imparted by the State, by way of public works or guarantees to private enterprise, is an essential part of such a policy. Those who hold this view regard the exclusive pursuit of a balanced budget along the path of economies and increased taxation as the pursuit of a will-o'-the-wisp, round and round a vicious circle of diminishing purchasing power, prices, and production. If, they argue, a balanced budget is finally reached along this path, it is reached only by chance, because in the end a trade revival comes, in spite of a mistaken public policy which delays its coming, and at a needless cost of suffering and impoverishment. And most, if not all, of those who hold this view, expect and hope that the policy which they advocate will raise prices. Some, coining a new word, intended to have a reassuring sound, advocate "reflation", a partial retracing of our steps from the deflationary depths of the depression.[1]

Whether or not this doctrine is well founded is one of the major issues in current controversy. For there are those who hold it to be a dangerous delusion which, if applied, would make bad worse and postpone, if not destroy, hopes of a real recovery.

Here I will only express the personal opinion, without embarking on the lengthy argument which would be necessary to justify it, that those who advocate the expansionist doctrine have the better case, but that their policy, in order to be fully effective, needs to be pushed a good deal further than most of them seem willing to push it. I believe that freedom from the plague of recurrent booms and slumps can be found only in a Planned Economy.

VIII

One final reflection forces itself upon my mind at the moment when these words are being written, when the Disarmament Conference at Geneva, after nearly two years of evasion, obstruction, and cross-purposes, shows signs of petering out altogether.

[1] The doctrine which I have here summarized is expounded by Mr. Keynes, among others, in his *Essays in Persuasion*, pp. 148 ff., and in his *Means to Prosperity*, chapters i–iii, by certain members of the Macmillan Committee (*Report*, pp. 203–8), by Sir Arthur Salter in his *Recovery*, part iv, and in a more moderate form, with special reference to German conditions, by Professor W. Röpke in his "Trends in German Business Cycle Policy" (*Economic Journal*, September, 1933).

Expenditure on "national defence" is in most countries larger than the recent budget deficits, large though these have seemed in relation to previous experience or financial prudence. In all countries, including not only the heavily armed, but also the lightly armed and the nominally "disarmed", such expenditure is still a formidable item in the taxpayers' bill. In no country would sweeping economies in war preparations have failed to make a valuable contribution to financial health, and in most countries such economies would have wiped out the deficits altogether and put surpluses in their place.

Thus the collective failure of Governments since the War to honour the Covenant of the League of Nations and agree to substantial all-round cuts in "defence" expenditure and to effective international supervision of national armaments, is, in itself, a sufficient explanation of the budgetary difficulties of the great majority. No reductions in such expenditure, however drastic, could indeed have prevented the slump, or much affected the general collapse of prices and production. But they might have completely transformed the budgetary problem. If the beginning of the slump had chanced to coincide with the beginning of an effective programme of disarmament, the task of keeping budgets balanced would have become comparatively easy. Under a system of drastic and controlled disarmament, all States would have been more secure, not only in their international relations, but in their national finance. But we are compelled to record a world-wide preference, difficult of explanation on rational grounds, for incurring the risks both of war and of national bankruptcy.

Mr. A. G. Gardiner, in his *Life of Harcourt*,[1] reports a conversation between the latter and Campbell-Bannerman. "What a good thing for the world it would be," said Harcourt, "if all nations were altogether insolvent. How much less mischief they would do!" "But," replied Campbell-Bannerman, "even beggars will fight." Since those Victorian days beggars have learned to fight with modern weapons, and to pay for a good stock of the most up-to-date killing-machines, even if they can pay for little else.

Behind to-day's Financial Crisis looms the dark shadow of another graver still, a War Crisis, which may to-morrow completely destroy the civilization which we know, and finally burst asunder that framework of economic relationships which the Financial Crisis has so harshly strained.

[1] Vol. i, p. 573.

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