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THE FINANCE OF GOVERNMENT

By
JOHN WALLER HILLS
(Sometimes Financial Secretary to His Majesty's Treasury)

Assisted by
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CHAPTER I
~~THE~~
INTRODUCTION

THE ordinary man, whether he reads of mysterious proceedings such as the Appropriation Bill in Parliament, or whether he sees in *The Times* that borrowings on Ways and Means Advances amounted to so many millions, is inclined to think that our financial system is a fantastic jumble of absurdities. He may go further, and, frowning over his income tax return, may believe that those in authority are intentionally keeping it so, solemnly intoning an empty creed, designed to bemuse the vulgar, to keep them in ignorance of their rights and thereby to extract an undue sum from their pockets. He is mistaken. Though some of our procedure is antiquated and has ceased to have meaning, and some more, once of essential utility, is being clumsily adapted to purposes for which it is ill suited, it is neither absurd nor misleading. Intricate our system is, and must be, as are all attempts to apply broad general principles to the infinite complexities of life and of affairs; but illogical it is not. It is capable of improvement, like other human institutions: but the main outline of its structure will probably remain unchanged.

To make clear the intricacies of this system and to explain its machinery is the business of this

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book. It is designed to show the system in working, and incidentally it is hoped to prove that much which looks irrational or designed to puzzle or to deceive is nothing but the working out of accepted principles.

The difficulties, however, which beset the ordinary man in his attempt to understand the business of public finance are not due solely to the complexity of the machinery; they arise also from a misconception of its nature. This misconception has been fostered by the use of false analogies, that most dangerous method of reasoning. Volumes could be written on the errors into which the human mind has fallen through explaining the state by analogy either with a machine or with a man or with an organism. It is none of them: it is not a mechanism, nor is it man writ large: and in the same way its finance is not comparable with that of a well-managed business or with that of a prudent father of a family, with both of which it is so often compared, with tiresome iteration.

A business tries to make profits. The state makes no profits. A business keeps down expenses in order to increase its income: the state keeps down expenses in order to diminish its income. There is not analogy here, but contradiction, and the same is the case if you take the symbolism of the prudent citizen. He earns an income, keeps out of debt, makes wise investments and spends the balance. The state does the reverse. It earns little, is never out of debt and makes practically no investments. The individual spends what he gets. The state gets what it spends. He is conditioned by his income, the state by its expenditure.

These are no verbal dialectics, but the statement of a truth so obvious as to be a commonplace. And yet false analogies lead one to overlook it. They lead their followers into strange places; to the idea that the state's income is like that of a business, or that it can congratulate itself if it obtains a high yield from the beer duty, just as an individual can congratulate himself on developing a property. It is looked upon as an increase of wealth. It is forgotten that more money received by the state means so much less money in the pockets of the people. The state does not earn money but takes it. It should not take more than it needs, for its income is a burden upon its subjects. The justification and the measure of this burden must be the value of the services provided. A state is not prosperous when its income is great, but when its expenditure is wise and efficient, and when the benefits from that expenditure outweigh the load imposed by its income. Taxable capacity must only come in to fix the outside limit. If we proceed otherwise, we approach national finance from the wrong end. Incidentally we run the danger of thinking that the more the state can raise the more prosperous it is. And when we have reached that point, we are putting out upon a sea to which there is no shore.

This misconception of the relative positions of state income and expenditure is not confined to the man in the street. We find it in parliamentary procedure. Too little attention is paid to expenditure. Estimates, if discussed at all, are debated in a House which is empty and languid.

On the other hand taxation, the raising of the money, excites keen interest and controversy. And no doubt it is right that it should. But it is forgotten that the amount of taxation is fixed by expenditure. And about half of this expenditure is never even discussed in the House of Commons, but is fixed by the government without criticism.

And now for an account, and it will be short, of what our national expenditure and income consist of. We are not concerned with the amount of expenditure, only with the manner in which it is authorised and paid, nor with the system under which the country is taxed, only with the method by which taxes are collected. Free trade or protection, capital levy or tax on betting, reach our ears only as confused murmurs from distant battle-fields. All that need be said is that a state spends money on the Army, Navy and Air Force, on interest on, and redemption of debt, on education, on health, on housing, on the hundred and one activities of a government.

The money to meet this expenditure is found in four ways : either from the yield of certain assets, or from fees for services, or out of taxes, or by borrowing. The first two are its only true revenue. They come from many sources. The state receives dividends on investments, such as shares in the Suez Canal and Anglo-Persian Oil Company. The Commissioners of Woods, Forests and Land Revenues collect the rents of its mines, its farms and its houses. The Post Office carries our letters, and its net income is revenue of the state. We receive payments from foreign nations, such as the Boxer indemnity from China, or the Reparations

which Germany will pay. The Disposals Board sells surplus stores; and there are many more receipts, either for goods or services, permanent or temporary. These together constitute its revenue, and its only revenue. But they pay only a fraction of our expenditure. Most of it is met out of taxes, and they, both from their amount, and from social, political and psychological reasons too obvious to need statement, engage most of our activities and controversies. All imposts in every state, whether free trade or protectionist, communist or individualist, fall into two broad classes. They are either direct, or indirect. Our business is collection and payment only, and we shall see that a different method is adopted in each case.

After this glance at the nature of government expenditure and income, we may turn to consider the manner of administration. In constitutional countries, finance is the affair partly of the legislature, partly of the executive. The legislature authorises expenditure and imposes taxes: the executive collects the money and pays the bill. That is the theory: but the practice in the United Kingdom is very different. First of all, in financial questions, legislature no longer means Crown, Lords and Commons, but the House of Commons and the House of Commons alone. In the past taxation was the prerogative of kings, but after a long series of struggles, which began with Magna Charta and ended with the passage of the Bill of Rights, Lords and Commons secured the sole authority over taxation. But not only have the rights of the Crown completely disappeared: to-day those of the House of Lords are hardly more substantial. As far back

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as 1678 the House of Commons claimed the sole power to levy money and to decide for what purpose it should be spent. Gradually the claim was admitted, the only shadow remaining in the House of Lords being the right to reject, not to amend, a money bill. This right, challenged by Gladstone in 1860, was exercised by the House of Lords in rejecting the budget of 1909, and was for all practical purposes taken away by the Parliament Act of 1911. It is therefore an anachronism to talk of the control of Parliament over finance: the control is that of the House of Commons alone. But to talk of the power of the House of Commons is almost as misleading, for over expenditure it has little power against the government. Its power over it, in theory absolute, is slight in practice. A private member of the House can criticise expenditure or move to reduce it: he cannot move to increase it or to authorise a new commitment. He can criticise a tax or move to lower it: he cannot move to increase it or to levy a new one. This is the prerogative of the government alone. This rule is founded on sound financial sense, as will be shown later: what must be noted at the moment is the immense power it gives governments over the House of Commons. This power is further enhanced by the convention whereby governments treat all questions of expenditure as matters of confidence, and if they are beaten on such a question they resign. This, though it looks like accepting the decision of the House, in reality overrides it: for supporters of a government, who know that if they defeat it they will turn it out, are reluctant to do so. In practice therefore the House accepts

the financial proposals of the government. Thus, though it is theoretically permissible to point to the divided function of legislature and executive, the first allowing the expenditure and levying the impost, the second gathering the cash and paying it out, you have not told the whole truth, unless you at the same time explain what legislature means and show the power of governments. You must show their dual position. They are the executive: they dominate the legislature; and the long battle, which began by refusing to one executive—the Crown—all financial powers, has ended by surrendering these powers to another executive, the government. A different executive, truly: a government elected by a suffrage nearly universal. But still, an executive and a powerful one, more powerful than any Plantagenet or Tudor sovereign. Over expenditure the executive is supreme. Its powers over taxation are less absolute, as we shall see.

It is perhaps as well at this point to state exactly the powers, such as they are, of the Crown and House of Lords over finance, in order not to have to mention the matter again. No expenditure or tax is finally valid until enshrined in an Act of Parliament, and an act has to pass the Upper as well as the Lower House and to receive the royal assent. Such royal assent, however, is never in practice withheld, and in our constitutional monarchy and under our wise sovereigns it is inconceivable that it ever should be withheld. The powers of the House of Lords, again, are strictly limited by the Parliament Act, 1911. Under that act, all money bills which reach the House of Lords

one month at least before the end of the session and are not passed by it within one month of receipt, can receive royal assent and become acts over the head of the House of Lords. The term money bill includes all measures dealing only with finance, under a wide definition, and the question whether any particular measure is financial only is decided by the Speaker, after consultation with two of the senior members of the House of Commons. It will be noticed that, in order to fall within the Parliament Act and to become law against the will of the House of Lords, a bill must be entirely financial. Hence two interesting consequences. On the one hand, some of the war-time finance bills, including as they did some non-financial provisions, have not been so certified by the Speaker. On the other, bills which are not in form money bills at all have been so certified. The Parliament Act makes, as it was intended to make, the House of Lords powerless in finance. At the most it can hold up a bill for a month. Its position resembles that of the Crown. The assent of both is still necessary to an Act of Parliament, but that of the first has become a courteous figment, of the second a stately formality. From the student of financial realities, neither requires more than a passing glance.

There are certain other pieces of procedure for which the Crown's assent is required. For example, money granted to meet yearly expenditure, technically called Supply, is still in words granted to His Majesty, and in order that it may become available for Army, Navy or Civil Service, certain signatures are necessary. But these have long become matters of form only.

All expenditure made by the state is authorised by Parliament at some time or another. Some expenditure is authorised every year. This is the current expenditure of the departments, expenditure on what are called Supply Services. Other expenditure of a more permanent character, upon what are called Consolidated Fund Services, is paid out of the Consolidated Fund year by year, and is imposed by an Act of Parliament which authorises the payment until the act lapses or is repealed. After expenditure has been authorised, and taxes imposed, by legislation, finance passes out of the hands of the House of Commons into those of the civil service. The various spending departments carry out the work for which Parliament has granted them money. The Admiralty builds ships; and the Home Office inspects factories; the Ministry of Health subsidises house-building. On the other side of the account the great revenue offices, the Board of Inland Revenue and the Board of Customs and Excise, collect taxes and pay them into the Consolidated Fund at the Bank of England. This fund represents the income of the state, and in theory all receipts go into it and all payments are made out of it. In practice there are exceptions, as we shall see. The Comptroller and Auditor-General, who is a high official, raised above the civil service, sees that not a shilling is issued from the fund beyond the amount that has been authorised by Parliament. No payments are made directly out of the Consolidated Fund, but the Comptroller and Auditor-General issues the money required to the Paymaster-General. This official sees that the spending departments of

state receive the stream of cash and credit necessary to carry on the country's business. Of great importance in this scheme of administration is the part played by the Treasury. The Treasury fills the rôle of financial expert. All through the year it supervises the expenditure of the departments. Working in close touch with them, it discusses their programmes, criticises their costs and lays down rules for financial administration. Finally, at the end of the year—and our financial years end awkwardly enough on 31st March—the spending departments close their accounts. Expenditure and receipts are brought together and there is a final balance and audit. If the departments have outrun the constable they hurriedly come to Parliament before 31st March to legalise their excesses. If on the other hand they have underspent, they surrender their balances, with some exceptions, into the Consolidated Fund. On 31st March at 3 o'clock in the afternoon the guillotine falls. Immediately the next year starts, each year being a separate, self-contained, watertight unit, and the ordered processes of our finance begin all over again.

All expenditure and income are settled in advance for the coming year. The state has no capital account in the sense that a large business has one, though capital and income are separated for certain purposes. It may build a railway in Nyasaland out of income. If it sells war stores, bought out of borrowed money, it treats the proceeds as revenue. It has a national debt, and a big one, but this is not charged against its assets, which would not cover a fraction, but on taxes, actual or potential.

And it has only one yearly balance sheet, for it does not follow the evil practice of some countries and separate its extraordinary or so-called non-recurrent expenditure from the ordinary; and at normal times it balances its budget without borrowing.

It is now advisable to see how far we have got, and to sum up what has gone before. Certain broad principles emerge, some of them of wide social and political import, others matters only of good accountancy.

First.—No tax can be levied, or expenditure authorised, except on the motion of the government, with the assent of the House of Commons. Money must be applied to the object for which it is voted.

Second.—All receipts must be paid into, and all payments made out of, a single fund, the Consolidated Fund. This rule has been, is being, and will be broken.

Third.—The financial unit is the year, ending 31st March, and all expenditure and income is estimated in advance. In normal times the yearly accounts should balance without borrowing.

Fourth.—Money unspent at the end of one year must be surrendered. This rule is frequently broken.

These are the principles on which our finance is organised. They are sound, in that misapplication of money is nearly impossible, that financial stability is assured, that our exact position at any moment is known, and that we have no concealed assets or liabilities. Their weaknesses we shall see as we go along. Governments are too powerful :

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**if they like to economise, no one can do it better ;
if they like to waste money, it is difficult for any
one to prevent them. And now, after this short
and general introduction, let us go into more detail.
And first of all, as to the actual financial machine.**

CHAPTER II

THE EXECUTIVE

THE government, as has been shown, controls Parliament, or it ceases to be the government. It is also the head of our great civil service, which acts under the direction of its parliamentary chiefs. Both the rules which govern our civil service, and the character of the men who run it, must be carefully understood, if we are properly to appreciate the system in working. Good rules are necessary, but so are good men ; each react on the other, and before explaining organisation, a word must be said of those who operate it. The civil service works behind closed doors. It indulges neither in propaganda nor in defence. Its merits are often claimed by politicians and its mistakes often visited on its own head. The integrity of the civil service and its sense of duty are too well known to need emphasis. But what is not always recognised is its business capacity and common sense. Indeed it is often accused of the opposite defects of being apt to be bound by rule, and of regarding the form as more important than the substance. This is untrue, as all who know the service must recognise ; and much of such criticism is due to ignorance of the nature of government, and of the qualities it requires in its servants. Over the whole civil

service runs a spirit, difficult to put into words, but unmistakable to everyone who has met it, of sanity and of balance, whilst those at the head of it are men of quite exceptional ability.

The work to be done by the state is carried out by the various departments, War Office, Ministry of Education, Home Office and so on. Most of these have a direct parliamentary chief, and in the case of all the great spending departments, such as Army, Navy, Ministry of Health and others, he is a member of the Cabinet. Under him, the office is staffed by civil servants who do not change with governments. This dual constitution, a civil service permanent and technical, under a politician who is transitory and often an amateur, must always be remembered.

Outside the departments themselves there is an elaborate system, as we shall see, which controls the amount and the nature of their expenditure. But though these external checks offer a valuable safeguard against the misapplication of public money, the responsibility for efficient expenditure must lie, to a very considerable extent, with the departments themselves. They prepare estimates of the money they require, the House of Commons grants it, they spend it, their accounts are audited by the department whose special function this is, and the House of Commons checks the audit. Therefore the actual outlay of the public money is in their hands and it is their duty to spend it in such a way as to provide most adequately the service for which it was granted by Parliament. The parliamentary chief of an office usually starts with no technical knowledge of his department's work

and often with no business experience of running an office. But he does, or ought to bring the invaluable qualities of common sense and of power to decide between conflicting experts. That is perhaps the most admirable feature of our political life, and few want to change it. Under him is a Permanent Secretary, a civil servant, who is his expert adviser, his chief-of-the-staff, and the head and ruler of the office. Under him again will be many high officers: the one who is responsible for finance is known as the Accounting Officer. He must see that the money provided by Parliament is expended on the objects for which it was intended. He is appointed by the Treasury from the officers of the department and, though he never comes into the public eye, his position is one of great importance. He is personally responsible for all payments made by his department, for ensuring that they are regular, and properly chargeable to the grant. He signs the Appropriation Accounts which are presented to the House of Commons after the end of the year, and thereby makes himself responsible for their correctness. Further, he is answerable for balances in the custody of the department, though, for the most part, these balances are not held by him, but are in the hands of sub-accountants. He must therefore see that adequate regulations are enforced to ensure their proper management, and must check the accounts and cash balances of the sub-accountants. All officers executing business of account and book-keeping, and all persons in charge of balances held by the department, are under his direct control and supervision. He cannot delegate his responsibility

to them. He must himself allow all payments made by the department. Before making or allowing any payment he must assure himself of the correctness and propriety of the transaction. As he cannot go into the details of every payment made, he is considered free of responsibility if he acts on certified statements made by the officers in charge of the detailed duties of account. He must, however, use his common sense and administrative experience in considering these statements, and in cases of serious doubt or difficulty he may consult the Treasury.

But the Accounting Officer is not an independent critic. He is subordinate to the political head of his department, and he may be directed by him to make a payment which he considers to be wrong. In such cases the Accounting Officer must send a written objection to his superior, giving reasons for his disagreement with the payment. If the order is then repeated in writing, he must obey it, but is freed from responsibility, which then rests with his superior.

There has been an increasing tendency recently to regard the Accounting Officer as closely concerned with questions of economy and not restricted to questions of regularity. This means that he criticises expenditure not only from the point of view of its technical correctness, but from that of financial policy. In order to do this he must be in a position to 'influence the working of his department in all those respects which affect the methods of its receipts or expenditure.' Consequently he must be a person of high standing in his department. To this end it has been the policy of the

Treasury to appoint, wherever possible, the permanent head of the department as Accounting Officer. In some large departments, however, the duties of the permanent head are too heavy to permit him to discharge adequately the additional work. But many of the large departments have a special finance branch, with an expert head, known as the Accountant-General, and in such cases it is he who is selected by the Treasury as Accounting Officer. The Accountant-General is likely to be more expert in matters of finance than the permanent head of the department. He gives his whole time to such business, and, as he actually handles the accounts, he is in a position to make valuable criticisms on expenditure. On the other hand, it has been objected that where the Accountant-General is Accounting Officer the responsibility for demurring to expenditure lies chiefly with him, whereas it is the permanent head who must be ultimately responsible (under ministers) for economy in the policy and management of his department. A discussion has consequently arisen as to whether closer financial control would be obtained by appointing the permanent head as Accounting Officer in all cases, and making the Accountant-General responsible for the more technical financial business. It has been agreed, however, to keep to the present position.

In either case the Accounting Officer is in a position to do much towards securing economy and efficiency in expenditure. His power to criticise the merits, as distinct from the regularity of payments, is of great importance. He works in close touch with the Treasury and they regard him as a

valuable instrument for securing uniformity and economy. It is through the Accounting Officer also that the House of Commons is able to exercise control over the departments, for he has to appear before the Public Accounts Committee, and, as we shall see when we discuss that body, he may have to defend the action of his department before them. Their criticism, coupled with his personal responsibility, is a powerful check on the expenditure of departments.

The duties of the Accounting Officer have been described at what may appear to be undue length. The reason is that the importance of his office is hardly known, and that his responsibilities and power to effect economies are growing and will grow further.

But each department is not a watertight unit: it forms part of a larger whole. The expenditure of each is conditioned by the general scheme of expenditure put forward by the executive and authorised by the House of Commons. The Cabinet is head of the executive and the Prime Minister sitting in Downing Street has to reconcile the views of those of his colleagues who want to spend with those of the Chancellor of the Exchequer who wants to save. The Chancellor of the Exchequer is head of the Treasury and corresponds to what on the continent is called Minister of Finance. The business of the Treasury is to co-ordinate the expenditure of the various departments; it has charge of the general finance of the country, and supervises the financial administration of all government departments. It prepares the Budget, supervises all expenditure, considers taxation, and

arranges for the raising and repayment of loans. With our fondness for preserving the pomp and circumstance of the past, this office is still nominally ruled by My Lords of the Treasury, and its letters still express the opinions of Their Lordships. But this is no more than a picturesque survival. The political head is the Chancellor of the Exchequer, and his political assistant is the Financial Secretary to the Treasury. The Lords of the Treasury play no direct financial part, but the fact that the Prime Minister still holds the nominal post of First Lord is not quite meaningless, for unless he and the Chancellor of the Exchequer work in the closest sympathy and communication, a government is dead at the heart. The Chancellor of the Exchequer is not only head of the most important department of state, but that department has wide duties of supervision over the whole. Moreover, he has under him those great organisations which collect the revenue and see to its proper expenditure. And lastly his connection with his office is perhaps closer and more intimate than that of any other political head. He is of it as well as in it: symbolised perhaps by the fact that he is one of the few ministers who live in the building. When other chiefs, their work finished, have gone home, he is still 'over the shop.' There are other political posts nominally belonging to the Treasury, such as the Parliamentary Secretary and the Junior Lords, but these have no financial duties beyond formal signature of transfers of money, and they are in fact the party whips. The Chancellor's assistant is the Financial Secretary to the Treasury, and just as the Chancellor is different from other

ministers so is he different from other parliamentary secretaries. He has wide original powers. All financial business has to traverse his room, and much is settled there without question. In the House of Commons all the routine business of finance rests on his shoulders. It is not too much to say that, next after the Leader of the House, the smooth working of the parliamentary machine depends on him. He is not in the Cabinet, but his office is recognised as more important than those of some members of that august assembly.

Under the Chancellor and the Financial Secretary, the chief of the Treasury is the Permanent Secretary to the Treasury, a civil servant and head of the whole civil service. He is chief-of-the-staff to the Chancellor of the Exchequer. Under him the Treasury is organised into three branches, Finance, Supply Services and Establishment, each under a Controller. Establishment deals with personnel, and not of the Treasury alone, but of the whole civil service. The Controller must give his consent before any department can increase their staff even by one writing assistant, and all rates of salary are settled by him. The Controller of Supply Services and the Controller of Finance between them have charge of the estimates of all the spending departments, War Office, Admiralty, Colonial Office and the rest. This means that the Treasury supervises national expenditure before it reaches the House of Commons, for each department estimates the amount of money which it will need during the course of the year and it is on these estimates that the scheme of national expenditure is based. The powers of these two Controllers are wide and

important. They subject the estimates to a detailed examination. Any proposals put forward by the departments which involve increased expenditure must be sanctioned by them before they are submitted to the House of Commons. The merits of each case are considered in detail, and the cost involved is scrutinised. This process of examination and discussion goes on throughout the year, the departments make applications and the Controller of Supply Services criticises and judges. Finally the proposals approved by the Treasury are embodied in the estimates for the following year which are then laid before the House of Commons. The Controller of Finance looks after all questions concerned with the Budget, and all matters which come under the heading of finance. These include revenue, expenditure, the national debt, the raising and repayment of loans, banking, currency and financial relations with the Dominions and foreign countries. It is a rule which should be invariable, but which some governments break, that no expenditure should be brought before the Cabinet until it has been discussed with the Chancellor of the Exchequer, and he has had time to examine it with the Permanent Secretary to the Treasury and the Controller of Finance. It may be feared that this gives the Treasury too much power, in that they will look at all reforms from the money standpoint only and disregard larger issues. But this is not so. The thread of finance runs through all questions, but none are purely financial. This is well recognised, and Treasury criticism is on the broadest lines.

In all these instances the three Treasury

Controllers have actual power, and appeals to the Chancellor of the Exchequer only take place on larger issues. And all, and of course the Permanent Secretary to the Treasury as well, have immense influence also. The supervision exercised by them is real and powerful, as everyone who has had to do with a spending department knows. Under each Controller is a large and highly skilled staff. The Treasury obtains the pick of candidates for the civil service, and its organisation, which has recently been remodelled, is exceedingly wise and efficient. And let us again remind ourselves of the position of the Financial Secretary to the Treasury, the Chancellor's deputy. It is in consultation with him, and subject to his approval, that the Controllers carry on their continuous and laborious work.

Treasury control over finance varies in intensity according to the character of the department concerned. It is most direct in the smaller civil offices, while at the other end of the scale, in the case of War Office and Admiralty, it has by now become indirect. These two great departments have their own Financial Secretaries, minor ministers, members of the government, sitting in Parliament. They also have their own financial officers who are civil servants and have more responsibility than the Accounting Officers of other ministries, and under each is a large and highly trained staff. On these financial officers falls the work of daily supervision and economical administration of the service. Much of the criticism of estimates, also, which in other cases the Treasury do, is carried out by them : though the Treasury must approve their estimates

before they go to the House of Commons. The reason of the change is that the War Office and Admiralty had become so big that direct supervision was deemed impossible. On the whole, the change has worked in favour of economy. The case against it is that these special financial officers might tend to become identified with the offices of which they form part. Economy can never be attractive, especially to an eager and progressive minister, believing, as all ministers should, in the importance of his department and intensely anxious to extend its usefulness. All extensions cost money, and to oppose such extra cost must always be unpopular. It is surely difficult for one identified with an office to perform so thankless a task. It is more easily done from outside. But the argument on the other side is stronger. No Treasury representative, coming in from outside, could possibly have the knowledge possessed by special financial officers of the department. It is they alone who can really supervise the daily cost of the service. They work, it is true, in close contact with the Treasury: but the chief burden of prudent and economical spending must rest on their shoulders. The distinction between the War Office and Admiralty on the one hand and the rest of the departments of state on the other is one of degree rather than of kind. As the latter grow bigger, so do their Accounting Officers tend to take on the position occupied by the financial officers of the War Office and Admiralty.

Treasury control over establishment follows much the same course. It is both close and exact; for the Controller and his assistants survey all departments

and do so over a long period. Consequently they are in a position to equate the staff of an office to the work to be done and to equate salaries to the amount that a good employer would pay. As may be imagined, however, the Treasury have to work with and through the permanent heads of the departments concerned, and, in the case of the bigger offices, largely to rely on them.

Attached to the Treasury are various important offices. There is the Board of Inland Revenue, under a chairman who rules over Somerset House and collects all direct taxes, and the Board of Customs and Excise housed in Lower Thames Street, also under its chairman. Then there is the Mint, under a Deputy Master (the Chancellor of the Exchequer is titular master): the Disposals and Liquidation Commission, engaged in selling war stores: the Public Trustee: the Public Works Loan Board: the National Savings Committee: and, strangely enough in such lofty company, the Stationery Office. Of more importance is the National Debt Office, in Old Jewry, next to the Bank of England. It is under a Comptroller, a civil servant. The National Debt Office does not manage the national debt: that is done by the Bank of England: it buys and sells government stocks, and invests money for such government departments as possess it. Of all these offices the Chancellor of the Exchequer is political chief, and either he, or more usually the Financial Secretary to the Treasury, answers all questions concerning them in the House of Commons. The Commissioners of Woods and Forests are also responsible to the Treasury. But one of the Commissioners is the

Minister of Agriculture, and questions in the House relating to agriculture are answered by him. Other questions concerning the department are answered by the Chancellor of the Exchequer or the Financial Secretary. Another office which in fact is under Treasury control is the Pay Office. The titular head of the department is the Paymaster-General, who is a minor minister ; but he is unpaid and has no connection with the work of the office. The Assistant Paymaster-General is the real head of the department, and he is under the direct supervision of the Treasury.

CHAPTER III

THE HOUSE OF COMMONS

THE machine and the men who run it have been shortly described : we shall know both much better before we have finished, and now the time has come to witness the working. The year's finance has to be shown in detail.

The first step is to get parliamentary authority both for spending and for collecting income, as no money can be spent, and no tax levied by the government without direct authority from the House of Commons. The whole income of the state (with a very few exceptions) goes into the Consolidated Fund, and a government can only draw on that fund with the consent of the House and for the purposes which the House has decreed. The whole of the year's finance, however, is not voted afresh every year. The bulk of the expenditure is so voted on what are called estimates, prepared by the different spending departments. This annual expenditure is for services called Supply Services, and the business of getting it through Parliament is called Supply. It includes the cost of Army, Navy, Air Force and Civil Service. The expenditure which is authorised by permanent acts which do not need renewing, or by acts operating for stated periods, is for services called Consolidated Fund

Services. They include interest on the national debt, the king's civil list, and salaries of judges. It is chiefly non-controversial, while on the contrary, much controversy centres round Supply Services and the estimates on which they are based. Revenue also is partly yearly, partly permanent, but in proportions opposite to those of expenditure, for it is mainly permanent. Some comes in of itself, as do dividends on Anglo-Persian Oil Shares. But infinitely more comes from taxes, and about 60 per cent. even of tax revenue is permanent, resting on statutes which are not re-enacted yearly. Two important taxes, however, income tax and tea duty, are annual.¹

The financial year begins on 1st April. All through the preceding autumn, as the stress of parliamentary business slackened, there will have been informal conversations between the spending departments and the Treasury as to how much money will be needed by each department in the coming year, for, as we have seen, all expenditure is calculated and voted in advance. The cost of each service is considered in detail, and requirements are made out in a form called estimates. It is the duty of all spending departments to prepare their own estimates, subject to Treasury supervision. The questions arising on them may be matters of high policy, on which only the Cabinet can pass judgment, such as a Naval Base at Singapore. Or they may be quite small concerns, such as an increase of staff at the Board of Education, on which the Treasury's decision is final. Or they may be affairs of intermediate moment, some of

¹ Though both are important, income tax is much more so. It yielded 38·6 per cent. of this year's revenue, tea duty 0·8 per cent only.

them agreed directly between the head of the spending department concerned and the Controller of Supply Services at the Treasury, and approved by the Financial Secretary to the Treasury as the Chancellor's deputy, others going perhaps to the Chancellor himself or even to the Prime Minister. It must be remembered that this kind of battle is going on at the Treasury all the year round, and much ground has therefore been cleared before the first formal step is taken, the issue by the Treasury of the Estimates Circular on 1st October. This calls for the forwarding of all Estimates to the Treasury, at the latest by the middle of January, and directs attention to the necessity for economy. On that the departments send in their estimates to the Treasury, where they are scrutinised by that important gentleman, the Estimate Clerk. Then comes a process of bargain and of give and take, the departments trying to get all they can, the Controller of Supply Services trying to prevent the finance of next year from being upset.¹ Here again the differences may be too severe for departmental adjustment, and the Chancellor of the Exchequer or the Prime Minister or even the Cabinet may have to give a ruling. Especially is this the case on Army, Navy and Air Force Estimates. How many cruisers are laid down, what shall be the size of our Expeditionary Force, how many squadrons of aeroplanes we should maintain, are questions for the Cabinet to decide, after consulting the technical chiefs of these great departments. On the decision,

¹The detailed examination of estimates falls to the Controller of Supply Services. The Controller of Finance, who is in charge of next year's Budget, is deeply concerned also, but only with totals not details.

millions of money may depend. On the other hand, should big new expenditure be incurred on the Civil Services, as it has recently been incurred for housing, it does not make its first appearance in an estimate, but in a bill, and it is on the bill that the question of policy arises. Finally, the estimates are agreed, printed, signed by that member of the government who will present them to the House of Commons, and, when the House meets in the following February, they are presented, and circulated to members. The Army, Navy and Air Estimates are signed and presented by the Board of Admiralty, the Army Council, and the Air Council respectively, but all estimates for the civil services are signed and presented by the Financial Secretary to the Treasury.

Estimates are grouped under four heads, Army, Navy, Air Force, Civil Service and Revenue Departments. They are divided into items called Votes, and each Vote may be further divided into two or more sub-heads. The unit of the Vote runs throughout financial procedure. Each Vote can be discussed separately, it is passed separately by the House of Commons, separately paid, and separately audited. Money cannot be transferred from one Vote to another, except in the case of a Vote for a fighting service, where such transfers are allowed, subject to Treasury sanction. These transfers are formally approved by the House of Commons after the close of the year. In all cases the Treasury has power to sanction the transfer of money from one sub-head to another.

An estimate is drawn up in one column of contents and four of figures, the latter giving the sums required for the year, those for the previous

year,¹ and the increases or the decreases ; the sums are then added up, and the result, whether more or less than the previous year, is shown in figures. Any chance revenue which may have fallen to the department, called an appropriation in aid, is deducted, and the net amount is the sum demanded. Then there follow various explanations and amplifications. An actual estimate for the current year is here reproduced.

The two items grant in aid (sub-heads C and M) and appropriation in aid (sub-head T) need explanation. A grant in aid is 'moneys provided by Parliament,' but it differs greatly from an ordinary Vote. It is given once and for all, not for the year only. Unspent balances are not repaid, as we shall find that unspent balances of Votes are, but can be used in the next or subsequent years. Unless specially subjected to audit (the above grants in aid are so subjected), it escapes the audit which other expenditure goes through. The receiver gives a bare receipt for it and has not to render an account. It is really a payment of a different character altogether, for grants in aid are given for objects Parliament wants to help and yet not to be responsible for. The grant in aid, for example, to the British Museum is for buying books, or other objects of historical or artistic interest: the Museum is given the money, and trusted to make the best use of it. Or a grant may be made to some poor Protectorate to enable it to balance its accounts.

¹ That is, the original estimates for the previous year, not including supplementary estimates, unless, which is not normally the case, the latter have been sanctioned at the time these estimates are presented.

BRITISH MUSEUM.

I. ESTIMATE of the Amount required in the Year ending 31 March 1925 to pay the Salaries and other Expenses of the BRITISH MUSEUM, and of the NATURAL HISTORY MUSEUM, including certain Grants in Aid (26 Geo. 2, c 22, 41 & 42 Vict. c. 55; 57 & 58 Vict. c. 34; 2 Edw 7 c. 12; &c., &c.)

Three Hundred and One Thousand Seven Hundred and Ninety-three Pounds.

II. SUBHEADS under which this Vote will be accounted for by the TRUSTEES of the BRITISH MUSEUM.

	1924-25.	1923-24.	Increase.	Decrease.
	£	£	£	£
A.—SALARIES, WAGES, AND ALLOWANCES	131,442	129,476	1,966	—
B.—POLICE	12,217	12,197	20	—
C.—PURCHASES AND ACQUISITIONS (GRANT IN AID)	25,000	21,000	4,000	—
D.—BOOKBINDING, PREPARING, &c.	21,290	19,620	1,670	—
E.—PRINTING CATALOGUES, &c.	10,047	12,145	—	2,098
F.—FIRE-EXTINGUISHING APPARATUS	250	250	—	—
G.—FURNITURE AND FITTINGS	6,000	7,000	—	1,000
H.—INCIDENTAL EXPENSES	6,433	6,455	—	22
I.—TELEPHONES	485	450	35	—
J.—ANNUITY IN RESPECT OF LOAN FOR PURCHASE OF LAND (57 & 58 Vict. c. 34) AND EXPENSES OF THE PROPERTY	7,863	7,933	—	70
TOTAL, BRITISH MUSEUM	221,027	216,526	7,691	3,190
NATURAL HISTORY MUSEUM, SOUTH KENSINGTON				
K.—SALARIES, WAGES, AND ALLOWANCES	65,924	64,802	1,422	—
L.—POLICE	6,351	6,335	16	—
M.—PURCHASES AND ACQUISITIONS (GRANT IN AID)	6,700	5,500	1,200	—
N.—PREPARING, BOOKBINDING, &c.	6,200	5,500	700	—
O.—PRINTING CATALOGUES, &c.	6,300	5,150	1,150	—
P.—FIRE-EXTINGUISHING APPARATUS	50	50	—	—
Q.—FURNITURE AND FITTINGS	3,000	3,000	—	—
R.—INCIDENTAL EXPENSES	3,590	3,128	462	—
S.—TELEPHONES	692	550	142	—
TOTAL, NATURAL HISTORY MUSEUM	98,807	93,715	5,092	—
GROSS TOTAL	319,834	310,241	12,783	3,190
<i>Deduct—</i>				
T.—APPROPRIATIONS IN AID	18,041	18,425	384	—
NET TOTAL	301,793	291,816	13,167	3,190
			NET INCREASE ..	£9,977

NOTE—The expenditure out of the Grants in Aid included in this Estimate will be subject to audit by the Comptroller and Auditor General; but the unexpended balances (if any) of sums issued will not be surrendered at the close of the financial year

Appropriations in aid (sub-head T) are revenue, received by the department, not paid into the Consolidated Fund, but retained and deducted off the gross sum of the Vote. For example, the £18,041 received by the British Museum was made up by sales of publications, of picture postcards, interest on invested benefactions, and special gifts from patrons of learning. Appropriations in aid were regularised by the Public Accounts and Charges Act, 1891. The Treasury is the authority which allows the appropriation. It decides according to circumstance. Its procedure is not uniform. For instance, two similar offices like those of the Land Registry and Public Trustee are treated differently. Both ought to pay their way by the fees they charge. The Land Registry pay over their fees to the Consolidated Fund and come to the House of Commons for their expenses. The Public Trustee is allowed to retain all his fees as appropriations in aid. If there be a credit balance on the year, he pays it into the Consolidated Fund: for a debit he presents an estimate.¹ Departments are usually allowed to retain revenue as appropriations in aid if it is revenue which is germane to their business, and accrues at convenient times of the year.

The system of appropriations has had curious results. First of all, it is a breach of the sound

¹ It may be necessary to present an estimate even for an office which makes a profit, and therefore does not ask the House of Commons for any money: for an estimate is not only a sanction of expenditure, but also an opportunity, perhaps the only opportunity, of parliamentary criticism. In such case the government put down what is called a 'token vote': that is, an estimate for a nominal sum of £10. The House of Commons can then discuss the policy or administration of the office.

rule that all receipts should be paid into the Consolidated Fund, and that all payments should be made out of it. It is argued that this objection is met by the fact that appropriations in aid are not true revenue at all, that their inclusion would inflate the apparent revenue, that they are cross entries, and complicate book-keeping. But this is not so. Most of them, though small in amount, are true revenue; and as for complication, it is a strange argument that if accounts are simple it does not matter if they are incomplete. No doubt the Treasury exercise a wise discretion in deciding what revenue a department should pay into the Consolidated Fund and what it should be allowed to keep: but why should it keep any? It is said that if departments could not do so, if they could not thereby reduce the amounts for which they had to ask the House of Commons (a matter on which a departmental chief ponders night and day) they would be less active in collecting such revenue. But this is untrue, and no one who has the slightest knowledge of the civil service would ever advance it. Another result of the system is that, by a ruling of the Speaker, a member may not move to reduce an appropriation in aid, presumably on the ground that thereby the net charge on the taxpayer would be increased, and also by reason of the wording of the Public Accounts and Charges Act, 1891, which gave the Treasury the duty of allowing appropriations in aid and by inference withdrew them from the committee. The House, therefore, grants only the net sum of the Vote. But it can and does criticise the items for which the gross provision is necessary, and a department can never spend more

than this gross sum, even though appropriations in aid produce more than was expected, and give it a bigger income.

The estimate printed above is a typical Civil Service Estimate. The figures are set out plainly, but they are not in the form in which an accountant would cast them. A scientific analysis of expenditure is lacking. For in the larger estimates the Votes and sub-heads do not record the total cost of any specific object of expenditure, but show the cost of a single item, such as pay, which is relevant to many services. The result is that it is almost impossible to calculate the true and complete cost of any particular service. The Army Estimates, however, have been modernised and are in the form adopted by big businesses in cost accounting, to the advantage of the student of finance, and to the ultimate benefit of the parliamentary critic, though for the moment he suffers from the fact that they are not comparable with previous estimates. But, the form of one set of estimates having been changed, that of the rest should be altered also. A great difficulty in criticising expense is the absence of comparable figures. It should be possible, for example, to see at a glance the comparative cost of a man in the Army and a man in the Air Force. That is a simple problem, but it becomes much more difficult when you have to correlate the cost of an Inspector of Schools under the Board of Education with that of a Factory Inspector under the Home Office, and almost insoluble when you try to relate the value of work done against staff employed in two diverse departments such as the Ministry of Pensions

and that of Labour. You cannot begin to do it until you have a system of accounting which is both unified and modern. This system need not necessarily be the one adopted for the Army. Very likely it will be found that no private business method is wholly applicable to public accounts, and that a new model must be devised. But a common system you must have.

The somewhat tangled skein of financial procedure in the House of Commons will become easier to unravel if the reader will get three points firmly into his head. First, there are two great financial committees of the House of Commons, Committee of Supply and Committee of Ways and Means. Each, under Standing Orders, must consist of the whole House, for no expenditure can be imposed and no tax levied, except in committee of the whole House.¹ Committee of Supply authorises the yearly expenditure. Committee of Ways and Means finds the money. It imposes the taxes. It must be noted, that though Committee of Supply authorises expenditure in detail, no expenditure can be made at all until Committee of Ways and Means has granted money to the government. Thus the House of Commons has a dual control over the expenditure of the executive, for Committee of Ways and Means can prevent the government making any expenditure at all, and Committee of Supply criticises all expenditure in detail.

¹ In 1919, owing to pressure of business, estimates were sent to a Standing Committee instead of Committee of Supply. A Standing Committee consists not of the whole House, but of some eighty to one hundred members, chosen proportionately from all parties. The experiment was not a success, and is unlikely to be repeated. See *Erskine May's Parliamentary Practice*, 13th ed., 1924, pp. 458 and 459.

Second, from Committee of Ways and Means spring two bills, which finally become acts of Parliament, the Finance Act and the Appropriation Act. The Finance Act finds the money, reimposing annual taxes and making the necessary changes in the permanent ones: the Appropriation Act links expenditure and revenue together, and assigns to each service authorised in Committee of Supply the money it requires. The Appropriation Act closes the work of the House of Commons: it starts the work of the executive.

Third, in addition to the expenditure passed every year by Committee of Supply, for services called Supply Services, there is expenditure authorised permanently or for stated periods out of the Consolidated Fund, for services called Consolidated Fund Services. The first is met, in the parliamentary phrase, 'out of moneys provided by Parliament': and the second 'out of the Consolidated Fund and the growing produce thereof.' The annual estimates are an example of the first; in the second class come payments such as salaries of judges, interest on debt and the king's civil list. They are imposed once and for all and are paid until the Act of Parliament sanctioning them lapses or is repealed. And the method of authorising them is different.

Such is a skeleton of financial procedure. It is simple, though complications occur in working it out. It is sound, in that it gives the House of Commons complete mastery over taxation and expenditure if they want to use it, subject to what was said in the Introduction of the overwhelming power of governments. Let that never be

forgotten. There are certain other processes, but to describe them now would cause confusion. They will be examined when we meet them.

Now with these three points clearly in mind we will return to the House of Commons. It reassembles probably about 15th February: and it has still to complete some work for the current year before that year closes on 31st March. This work consists in passing supplementary estimates, that is to say in authorising any expenditure which may have been incurred for the year now ending, in excess of the amount granted by Parliament. Supplementary estimates out of the way, members are ready to discuss next year's finance. We know what the House has to do. It has to sanction Supply and reimpose income tax and tea duty. This is its main duty, though it may impose, repeal or vary other taxes, or authorise other expenditure. But it would be impossible for the House to complete this business before the 31st March, when the financial year ends, and with it all parliamentary authority to spend money. In practice the discussion of estimates continues through the spring and summer, and the Appropriation Act, which winds up the year's finance, is not passed until August. It is this act which finally grants money for the various services. But expenditure cannot be postponed until August. The king's government must be carried on. Consequently some provision must be made, before the passing of the Appropriation Act, for meeting expenditure in the coming year; otherwise on 1st April there would be no money to pay anyone. The difficulty is met by a Vote on Account. The Army and Civil

departments, when sending their estimates to the Treasury, state how much they require to carry on for a period which is now usually between four and five months. A vote called the Vote on Account is then taken in Committee of Supply for the total sum, with the amounts allotted to the different departments set out in a schedule. The necessary resolution passes committee and report, and then goes to Committee of Ways and Means, which, it will be remembered, is the committee which finds the money. Here it is again passed in committee and on report, and an act called the Consolidated Fund Act is enacted. This grants to the government a lump sum, the total of the items in the schedule to the Votes on Account (and also of the Votes taken for the Navy and Air Force, mentioned below), and authorises the Treasury to issue out of the Consolidated Fund money up to this lump sum. How the money is got out will be seen later. The Consolidated Fund Act, is passed through both Houses of Parliament, and receives royal assent before 31st March. It may be, however, that as the year runs on and the Appropriation Act is not passed, the departments either find they have underestimated and require more money to carry on, or else the Appropriation Act is not passed within the four or five months. In that case a second Vote on Account is introduced and a second Consolidated Fund Act passed.¹

With the Navy and Air Force the system by which money on account is obtained is slightly

¹ A Consolidated Fund Act is not an Appropriation Act (see p. 54) for it authorises a lump sum only, not an individual sum against each Vote.

different. The House of Commons passes their Vote I (Pay) and one or two other Votes. The amount of these Votes is then included in the Ways and Means Resolution which covers the Votes on Account for Army and Civil departments, and therefore forms part of the total granted by the Consolidated Fund Act. The Admiralty and Air Ministry are allowed, during the early part of the financial year, to spend the money thus voted on any Naval or Air service, finally adjusting the account at the end of the year, when of course they should show that they have not spent more on any Vote than what the House of Commons decreed.

In these ways government is provided with money to carry on during the early months of the year, and the House of Commons can discuss the year's finance at its leisure, a discussion which may last till August. It should be added, for the sake of completeness, that a general debate takes place upon the estimate for each fighting service, a debate held on 'getting the Speaker out of the Chair,' a process to be described in a minute. Also, in addition to voting money on account for each service, the House also discusses their Vote A. This Vote gives men, not money, but is of course of great financial importance, since the numbers of men voted are a large element in cost.

As has been said, estimates are discussed in Committee of Supply. This, like all committees of the whole House, is really the House of Commons under another name; it is the House presided over not by a robed and bewigged Speaker, raised above the clamour of parties in his chair of state, with the mace on the table in front of him, but by

the Chairman of Committees or his deputy, elected by the House of Commons from among its members for the duration of Parliament, sitting at the afore-said table alongside the Clerks of the House. A member too, on addressing the committee, must recollect to begin not with the words 'Mr. Speaker' but 'Mr. Chairman,' and he must recollect also to refer to the body he is addressing as 'the Committee,' not as 'the House.' That is formal and picturesque rather than important. But there are essential differences between a committee of the whole House and the House itself, for in committee you get a freer and, to the new member, less terrifying atmosphere, and a member can talk on any subject as often as he likes, or rather as often as the chairman will call him and the committee tolerate him, while in the House itself he can only speak once on each subject. But the really important point is, that the existence of Committee of Supply, before which all estimates must go, puts finance in a place by itself apart from ordinary business and prevents expenditure being sprung upon members. All Supply expenditure must go before it and, under Standing Orders, notice must be given that a certain estimate will be taken. Therefore, soon after the House meets the Prime Minister proposes that on a certain day 'this House will resolve itself into committee to consider the Supply to be granted to His Majesty, and that the estimates presented be referred to that committee.' Thus is the Committee of Supply set up, and all the money included in the estimates must be voted by it. But before it starts work on an actual estimate, a ceremony has to be gone through, the

motion 'that Mr. Speaker do now leave the Chair,' colloquially called 'getting the Speaker out of the Chair.' This process has to be repeated four times, on Army, Navy, Air Force and Civil Service Estimates—for the first three before, and for the Civil Services after 31st March. This is the atrophied survival of that once active organ in our constitutional body, the principle of 'grievances before supply'—the rule that before Parliament granted the Crown the money it wanted, the Crown must hear and remedy grievances. This occasion, so momentous in our history, round which has centred so much of the struggle of the Commons against the Crown, has fallen to other uses, and is preserved as one of the few liberties of the private member of Parliament against governments which progressively take more and more of the time of the House. Private members ballot for the right to move some motion on this occasion, the subject of which must be germane to the estimates to be discussed. A wide latitude is given both in the choice and in the discussion. Only one such motion can be put to the vote, though if time allows other motions may be debated, but not voted on: and, after the House has got into committee, the estimate of the day is discussed.

An estimate, like all expenditure, must be moved by a member of the government in committee of the whole House. That rule is unbreakable and invariable. Consequently the estimate printed above will be moved by the Financial Secretary to the Treasury in Committee of Supply. He makes

¹ But only four times; the Speaker has not to be 'got out of the Chair' every time every estimate is considered.

an explanatory statement, and then the debate is open and any member can speak, and speak as often as the chairman may call him. It is informal, questions are asked and answered at once, and speakers are short and unrheterical. But on important estimates, such as Army, Navy, Air Force or the bigger Civil Service Estimates, like those of the Ministry of Health or Board of Education, the minister in charge makes a longer speech, reviewing the whole government policy, and this is followed by a general debate of a more formal character. After that the discussion comes down to detail. Each Vote is put separately from the chair and can be debated and voted on separately. The chairman on the estimate presented above will put the question 'That a sum not exceeding £301,793 be granted to His Majesty to defray the cost of salaries and other expenses of the British Museum and of the Natural History Museum for the year ending 31st March, 1925, including certain Grants in Aid.'

Once an estimate has been presented to the House of Commons, not even a member of the government can move to increase it. If he wants to do so, he must either present a supplementary estimate, or withdraw the original estimate and present a new one. Nor can he attach a condition to it or alter its destination, for that is in effect a fresh grant and requires a fresh estimate. And, of course, a private member can do so still less. But either a member of the government or a private member can move to reduce it.

What can a private member do? Four things. He can speak or vote for the Vote, or against it,

or move to reduce it, or he can, in effect, take a vote that the Vote be increased. True, no private member can ever *move* to impose or increase an expenditure or tax. But he can suggest to the government the desirability of increase, and can take a vote, in which such members of the committee as support him in the lobby do in fact vote for an increase. He does this by a parliamentary fiction. For instance, if he thinks that the Principal Librarian of the British Museum is paid too little, as very possibly he is, he can move the following motion: 'Civil Service Estimates, Class IV, 2: To reduce Sub-head A by £100.' Sub-head A, as he will see from the explanations which follow the estimate, includes the Principal Librarian's salary. If he wants it increased, he must move that the appropriate sub-head be reduced. His whole speech will urge an increase, and his vote and those of his supporters are cast in favour of increase.

An estimate, after it passes Committee of Supply, goes before the House on report; before the House with the Speaker in the chair and the mace on the table. Here much the same process is gone through, and all questions can be debated again, but remember the rule stated before, that no expenditure can be authorised except in committee of the whole House. It can never be done on report. Any increase involves a new estimate in Committee of Supply. But an estimate can be reduced on report even on the motion of a private member, and of course it can be rejected. After passing Committee of Supply and report, the estimate goes to Committee of Ways and Means, which it will be remembered is the committee which finds the

money. This is a formal proceeding: Committee of Ways and Means grants a lump sum to cover all the Supply Votes. The estimate could be debated here, or on certain later stages of financial procedure; but this rarely happens. The debate on it takes place in Committee of Supply, or on report.

Comment was made in the Introduction on the power given to governments by the Standing Orders of the House which forbid any one except the government to impose expenditure or taxation. That is true: but the other side of the case must now be pointed out. The results of breach of such a rule would be appalling. It is not so much because of the financial chaos which would follow, for though a motion doubling the supertax might, if carried, provoke a financial panic, a proposal to abolish all income tax would be received by the Chancellor of the Exchequer with a deeper dismay; but because it would open the door to corrupt influences on the constituencies. Mr. Hilton Young wittily points out what might follow.¹ Members are already accused of promising electors benefits out of the public purse; how much greater would be the evil if the member for Lootville, seconded by the member for Plunderborough, could move that £500,000 of public money be spent in providing each of those enlightened towns with a free cinema. No doubt those public-spirited members would not get their money: the government would oppose, and the committee reject, such a piracy: but a most unscrupulous use could be made of the fact

¹ *The System of National Finance*, by E. Hilton Young and N. E. Young, 2nd ed., 1924.

that the proposal had been made, or would be made, if a particular member were returned.

Supply drags out its weary length through the hot days of July and August, and it will be shown elsewhere that economy is not served by these continued discussions. But here again a piece of parliamentary procedure must be noted. Lord Randolph Churchill said that the duty of an opposition was to oppose, and an opposition has a mighty ally in time. The longer Parliament can be kept occupied on finance, the shorter will be the time that governments can spend on their nefarious legislation. Therefore if there were no time limit, active and ingenious gentlemen could occupy most of the session in discussing Supply; declaiming against the inadequate wages paid to charwomen, or the scandalous waste of red tape by the Ecclesiastical Commissioners. To protect itself, the House by its Standing Orders limits the number of Supply Days to twenty in the year,¹ with power to the government to give an extra three days if it likes. These days are called the Allotted Days. On the last day but one all unvoted estimates have to be passed in committee and on the last day on report. On these two days perhaps half the finance of the year is passed without discussion. The eighteen, or twenty-one, previous days will have been used as the opposition or oppositions require, for it is their traditional right to call for a discussion of any Vote they please on an Allotted Day. This they do for many reasons, for

¹ Including days spent on the vote on account, and procedure on Ways and Means, but not including those spent on supplementary estimates or votes of credit or 'getting the Speaker out of the chair.'

airing a grievance, for running a crusade, for embarrassing the government, rarely, very rarely for economy. On these two last days, therefore, half of the year's finance may be voted undiscussed. On the other hand, some other estimates may have been debated more than once. That may be right: it may be advisable to look at both sides of a half-crown before spending it. But it shows a want of proportion to follow that up by spending a thousand pound note without even seeing it.

Finally, as the year runs on, the departments may have to spend more than their Votes. They must then lodge a supplementary estimate. They should never have to do so, unless they have had new services thrust on them. But remember that estimates are prepared in October for a year which only begins in the following April, so that miscalculations are excusable. If, as usual, there is an autumn session, some supplementary estimates are taken then and the rest, or the whole if there be no autumn session, between when the House of Commons meets in February and 31st March. By that date they must all be passed. They are in the same form as ordinary estimates and follow the same procedure.¹ They pass Committee of Supply and report, and then go to Ways and Means, where they are usually included in the same resolutions as contain the Vote on Account and Navy and Air Force, Vote I (Pay), etc., for the ensuing year, and are then covered by the lump sum granted by the Consolidated Fund Act. The gross amount

¹The debates, however, are restricted to the necessity for the Supplementary Estimates themselves, and to points of policy thereby raised: and must not, as a rule, refer to the policy of the original estimate. But see Erskine May, pp. 536, and 536 n. and 537 n.

required for all supplementary estimates is not finally appropriated, that is, divided up among the different Votes, until the Appropriation Act is passed, which will be towards the end of the session.

Excess Estimates are supplementary estimates one year older, that is, they authorise excess expenditure incurred in a year which has closed. If any of the departments failed to get their overspendings legalised in a current year, and have to come to the House of Commons after 31st March, they must lodge an excess estimate. As may be imagined, these are rare, and usually for small amounts which have been overlooked. They go through the same procedure as supplementary estimates, but before being presented they must be scrutinised and approved by the Public Accounts Committee (see p. 122).

If a sudden emergency, such as a threat of war, should require special and immediate expenditure, a Vote of Credit is introduced in Committee of Supply. It grants a lump sum to the government, not allocated to any particular service. It passes Committee of Supply and of Ways and Means, and is then either included in the next Consolidated Fund Bill or in a special Consolidated Fund Bill of its own. Like other Votes, it is available only for the year, and a balance unspent must be surrendered.

That finishes Committee of Supply. It authorises expenditure. But not how it is to be met. For this there must be set up the Committee of Ways and Means 'for raising the Supply to be granted to His Majesty.' This also consists of the whole

House. It has certain formal work. Its real work is to pass the Budget, the chief event of the financial year. We know what money we want : we have now to see how we can get it. Committee of Supply did the first work ; Committee of Ways and Means will do the second. By the time the Budget is introduced, expenditure is a fixed thing, known to all the world. Estimates are public property, and the other items of expenditure, Consolidated Fund Services, are known accurately to the Chancellor, and since they consist mostly of national debt charges, more or less accurately to the world at large. Revenue is not. This, like expenditure, is based on estimates, obtained from the Board of Inland Revenue, the Board of Customs and Excise, the Post Office, and the other income producing departments. But these estimates, unlike those of expenditure, are given to the Chancellor alone. Their secret is jealously guarded and offers an interesting field for the ingenuity of amateur financiers. More especially, not a hint is allowed to escape about increase or remission of burdens, especially of customs or excise : for, if it were known that the sugar duty was to be reduced, importers would hold back supplies in order to get in at the lower rate : while the knowledge that sparkling wines would pay more would open veritable floodgates of champagne. The finance of the year might be seriously compromised, speculation would be rife, and the consumer would gain no ultimate benefit. Although the forecasts of Inland Revenue and of Customs and Excise are estimates, they are wonderfully accurate. All factors which will increase income over that of last year, good

trade, good harvest, good weather and such-like have been allowed for, and so have the adverse features. The experts at Inland Revenue and Customs may err here or there, but their totals are remarkably true. Often one error corrects another.

It is in Committee of Ways and Means that the Budget is introduced, some time after, usually shortly after, 1st April,¹ when the new year has begun. The Chancellor's speech in introducing it, called the Financial Statement, contains a review of the finance of the year which has just closed, and gives the final balancing of that account. If there is a surplus, it goes by statute in reduction of the national debt. Surpluses paid over in this way are called the Old Sinking Fund. Any deficit will have been covered by borrowings. That matter cleared out of the way, he turns to his forecast of revenue for the current year, and compares it with expenditure already known, including any new expenditure, such as repayment of debt or fresh services, which the government may contemplate. He gives details of new taxation, and remission and alteration of old. If he anticipates a surplus, he can use it to pay off debt, or to reduce taxation or on new services. If he anticipates a deficit he must impose new taxes, or increase old ones, or borrow. He gives the final balance sheet. He examines also the state of the national

¹ This date cannot now be later than 4th May. The income tax year expires on 5th April. By the Provisional Collection of Taxes Act, 1913 the Ways and Means Resolutions reimposing it must be passed within one month of 5th April, if they are to be operative immediately on passing. But see later (p. 52 n.) as to the whole effect of this important act.

debt, and gives a general disquisition upon the condition of the country's finance, trade and prosperity.

Most of the taxes, fixed permanently by statute, require no fresh legislation, unless the Chancellor seeks to increase or diminish the rate. It is, however, a well settled practice that at least one important direct and one important indirect tax should be non-permanent and reviewed by the House of Commons every year. Consequently income tax and tea duty are re-enacted annually. These, and alterations of existing taxes, are carried by resolutions which are often hotly debated. Private members can move reductions, though not increases, of a tax. If the government wish to drop an annual tax, all they have to do is to refrain from moving the resolution imposing it. Ways and Means Resolutions also specify the date when changes in taxation come into force. In addition to the specific tax resolutions, a general resolution is also passed, which enables amendments of previous Finance Acts, re-arrangements of debt, and other financial adjustments to be carried out, in the Finance Act which is to follow. This is necessary, because it is a rule of the House that the Finance Act can include nothing not included in a Ways and Means Resolution.

The Ways and Means Resolutions dealing with specific taxes are passed on the day on which the Financial Statement is made, so that they can come into force at once where necessary: then comes the discussion on the general resolution, which by the practice of the House can range over the whole field. The Ways and Means Resolutions have not

the force of law,¹ they must be embodied in an act, the Finance Act. This act must pass through all stages, second reading, committee, report and third reading: then it goes to the House of Lords and finally receives the royal assent, but, as has been said, these latter processes are usually formal only, though debates of a general character do sometimes take place in the House of Lords upon second readings. In all its various passages through the Commons it can be, and is, discussed at length. The chief financial debates on principle take place either on the general resolution mentioned above or on the second reading (the first reading is automatic) and third reading of the Finance Bill: those on detail in the committee stage of that bill. The Finance Act is the Budget in its legal dress. It re-enacts income tax and tea duty, imposes new taxes and varies existing ones. It also contains

¹ With the important exceptions contained in the Provisional Collection of Taxes Act, 1913, which makes large alterations in parliamentary and executive procedure. Previously it had been the custom to collect taxes on the strength of the Ways and Means Resolutions without waiting for the Finance Bill to become an act. Mr. Gibson Bowles challenged this, and the courts held that he was right. So this act was passed which establishes the right, with qualifications. It refers only to income tax and customs and excise. It covers only the renewal or variation of an existing tax and not a new tax, the collection of which it cannot authorise. The Ways and Means Resolutions renewing or varying existing taxes should claim the benefit of the act by including the words 'That it is expedient in the public interest that this resolution shall have statutory effect' under the act. Moreover the act gives a series of time limits. The resolutions only have statutory force for four months, running either from their passage through committee, or from the date at which they take effect. If, therefore, the Finance Act is not passed within these four months, the resolutions can no longer be acted on. Further the resolutions must be agreed to on report within ten sitting days of their passing committee, and the Finance Bill read a second time within twenty sitting days of report. Also the act ceases to operate if the provisions contained in the resolutions are rejected, or if Parliament is dissolved or prorogued.

amendments of existing laws desired by the Treasury, Inland Revenue, Customs and Excise and other departments. Such amendments are necessary, because high taxation, like high pressure, finds out the weak places in the vessel, and once a taxpayer has made a gap in the hedge many are the sheep who are anxious to follow. It must impose no charges higher than those contained in the Ways and Means Resolutions.¹

And now let us see how far we have got. The House of Commons has passed or is passing the estimates in Committee of Supply and on report. These when passed must also go to Committee of Ways and Means, which finds the money: but this is really a technical stage, and is rarely debated. Therefore Parliament is sanctioning the expenditure. It has also, in the Finance Act, decreed how the money is to be raised. Its collection will be described later; at present we are concerned with expenditure. So far the only money available to the departments is the amount granted by the Consolidated Fund Act, passed in March to cover four or five months Supply. There is one more parliamentary stage to be gone through, and then the executive receives the final authority to spend.

From the resolutions in Committee of Ways and Means, which we may remind ourselves authorise

¹ Should the government wish to include in the Finance Bill taxing provisions not included in the Ways and Means Resolutions, they must introduce new resolutions in Committee of Ways and Means. Or again, if any provision of the bill imposes a charge either on voted money or on the Consolidated Fund, as, for example, for debt redemption, a Financial (or Money) Resolution must be taken in committee of the whole House. The procedure is that described on p. 55 hereof. The clauses in the Finance Bill imposing these new charges are printed in italics.

the issue out of the Consolidated Fund of a lump sum, the total of the Supply Votes, springs another act, the Appropriation Act, which divides up this lump sum and allocates the proper amount to each Vote. It is the duty of the Speaker to see that the sums do not exceed those voted on the estimates. And the act authorises the Treasury to borrow in anticipation of revenue. The departments will get the sums voted. They cannot get more. And they are ordered to spend them only on the services set out in the estimates. Until the Appropriation Bill becomes an act the executive can spend nothing, except what is authorised by any Consolidated Fund Acts which may have been passed.

This concludes the working out of two of the three great principles of parliamentary finance which the reader was asked to keep always in mind. Committee of Supply has authorised expenditure, Committee of Ways and Means has found the money, the Finance Act has legalised the collection of the necessary taxes, and the Appropriation Act has enabled the executive to pay expenses by drawing money from the Consolidated Fund. But there is, as we know, another class of expenditure, imposed not year by year, but permanently or for stated periods, created by some Act of Parliament, and paid regularly without further parliamentary authority until the act in question is repealed or comes to an end. This expenditure is for services called Consolidated Fund Services, which are charged not on 'moneys provided by Parliament,' but on 'the Consolidated Fund and the growing produce thereof.' Examples of such payments are the salaries of judges of the High Court, the king's civil

list, and interest on the national debt. Consolidated Fund Services differ from services paid for out of annual Votes not only in their more permanent character—some of the latter are in reality permanent—but in the fact that they are, whilst services charged on the Votes are not, withdrawn from parliamentary criticism, once the act providing for them has been passed. This is often done advisedly: for were the salaries of all judges voted annually, every word spoken by every judge, from the Privy Council to the police court, could be criticised in Parliament—with results dreadful to contemplate.

Before such permanent payments out of the Consolidated Fund can be established, they must, like all expenditure, be authorised by resolution in committee of the whole House, passed in committee and on report, and then embodied in an act which goes through all stages. The resolution is called a Financial (or Money) Resolution. The act is the authority to pay, and enables the money to be issued out of the Consolidated Fund.

The committee of the whole House referred to above is not Committee of Supply, which grants the annual Votes, nor Committee of Ways and Means, which finds money to meet them. It is merely the House sitting in committee, and therefore, as we saw above, in a freer debating atmosphere, with opportunities of closer criticism and enquiry.

If the bill in question has for its main object the creation of the charge, the Financial Resolution must pass committee and be agreed to on report before the bill can be introduced. But if the charge is subsidiary only to the bill's main purpose, the bill can be introduced, be printed, pass second

reading and be sent to a committee before the Financial Resolution is taken: but the clauses of the bill which create the charge are printed in italics, and cannot be considered by the committee in charge of the bill until the necessary Financial Resolution has been passed. This takes place in committee of the whole House, on the motion of the government, always in such cases represented by the Financial Secretary to the Treasury. The Speaker decides whether the charge is the main object of the bill or not.¹

This is the way in which both government bills and private members' bills which authorise expenditure from the Consolidated Fund get through: the clause authorising it must be moved by a member of the government. Similarly, should the government introduce in the House of Lords before it has passed the Commons a bill involving expenditure (a proceeding they sometimes adopt in order to get it debated and thus shorten discussion in the Lower House, always more busy than the Upper), its financial clauses are printed in italics and are not valid until the necessary Financial Resolution has been passed by the House of Commons on the motion of a member of the government in committee of the whole House. Thus does the House jealously maintain its right to be the

¹ This distinction has an important practical result. Generally speaking, any member can bring in a bill on any subject, whereupon it is printed at public expense and circulated. But a bill whose main object is to create a charge cannot even be printed, unless the government move the Financial Resolution, which means adopting the bill, and this they hardly ever do. Consequently a private member can never get such a bill printed and its contents ventilated, e.g. a bill to lower the age at which old age-pensions are granted. His only chance is to move a motion on a private member's day. But his right to move such motion depends upon his luck in the ballot.

sole authority allowed to levy charges on the people.

If a bill of the government or of a private member¹ entails expenditure 'out of moneys provided by Parliament' (not 'out of the Consolidated Fund and the growing produce thereof'), the same procedure is followed. A Financial Resolution is required. The money must, of course, be provided in the estimates for any year in which it is proposed to spend it. A supplementary estimate is presented, if necessary.

Such is the process of getting the legislature to approve expenditure and authorise taxation. For the next act the executive steps in. Public departments want their money. Taxes must be collected and paid over. The executive machine has been started and we must see its working.

¹ To avoid misunderstanding, it should be pointed out that a 'private member's bill' is a very different thing from a 'private bill.' It is a public bill introduced by a private member, and follows the same form and procedure as similar public bills introduced by the government. Private bills (e.g. bills of railway or water companies, municipalities etc.) have a totally different procedure. No private bill can impose a tax or charge.

CHAPTER IV

COLLECTION OF REVENUE

NATIONAL income is derived from four sources: taxes, the yield of certain national assets, fees for services rendered, and borrowing. The last, a dubious form of income, must be used when the receipts from the first three are insufficient to cover expenditure, or when liabilities fall due before cash wherewith to meet them is collected. It will be dealt with later; at present we are concerned with the three other sources of income.

This chapter will show how the revenue from them is collected, and how it is made available for spending. We may remind ourselves that, with certain exceptions, receipts of public money go into, and expenditure of public money is made out of, a single fund known as the Exchequer or Consolidated Fund. These two terms mean the same thing. For the most part, revenue is paid into this fund, but some of it is used where it comes to hand, and never reaches the Consolidated Fund at all.

Of the three forms of income, taxation is by far the most important. In 1914 it represented 82 per cent. and in 1924 86 per cent. of the total national revenue. Before going on, however, to describe the manner in which taxes are collected, a word

must be said of the two other sources of revenue. The income-yielding assets of the state are the Crown Lands and certain investments, such as shares in the Anglo-Persian Oil Company and in the Suez Canal. Dividends from these shares are paid directly into the Consolidated Fund. The Commissioners of Woods, Forests and Land Revenues administer the Crown Lands. They collect the rents arising from the properties and pay over the proceeds. But it is net revenue which they so pay over. Like any other landlord, the state has certain expenses in connection with the upkeep of its estates. These are not voted by Parliament, in the way of other public expenditure, but are paid out of the revenue arising from the estates; and it is the revenue remaining after these expenses have been paid which goes into the Consolidated Fund. Here then is the first exception to the principle that this fund should represent total receipts. It is not in itself important, as the sums which thereby escape parliamentary control are not considerable. But the principle is of vital importance, and all exceptions are, for that reason, to be deprecated.

Of the fees received by departments, the receipts of the Post Office are the largest. These are paid into the Consolidated Fund, while the expenses of the department are voted by Parliament, as are those of other services. The money needed for expenses is temporarily borrowed from revenue. This procedure is similar to that adopted by the Board of Customs and Excise and will be described when we come to deal with that body. Many other departments collect minor sums during the course

of their work. Some of them pay these receipts directly into the Consolidated Fund. But others (and these now form the majority) treat their receipts as appropriations in aid. In this way a double transfer of money is avoided, the receipts are paid into the Paymaster-General's cash account, where they are placed to the credit of the service concerned, and the departments draw a proportionately smaller sum from the Exchequer for their voted expenditure. This is an administrative convenience, but an important contravention of the idea of the Consolidated Fund. In Chapter III possible dangers of appropriations in aid were pointed out, and it was shown that they might weaken parliamentary control over expenditure. There is a further risk, that if their total becomes considerable they might also weaken control over the Consolidated Fund on which Parliament's ultimate hold over the executive depends. However, more will be said about this in the next chapter.

All these sources of revenue, however, are trifles compared with taxation. The House of Commons imposes the taxes: the two great revenue departments extract the money from the pocket of the taxpayer, and transfer it to the Consolidated Fund. The Board of Inland Revenue collects direct taxes, the principal items of which are Income Tax, Super-tax and Estate Duty; while the collection of indirect taxes is the province of the Board of Customs and Excise. Put briefly, the duties of these two departments consist of assessment, prevention, collection and transfer. The revenue departments can also give the Chancellor of the Exchequer

valuable information, when he is considering the imposition of new, or the alteration of old taxes. The cost and difficulty of collection, as well as the probable yield of any tax, are obviously vital considerations, and on these points the revenue departments alone are in a position to offer expert advice.

We may begin by considering the manner in which indirect taxes are collected. The first problem which faces the Commissioners of Customs and Excise is to ascertain the amount of goods liable to duty. In the case of excise this means the amount of dutiable goods or services produced, and in the case of customs, the amount of such goods entering the country. Closely allied with this problem is that further one of preventing the evasion of duty. To keep account of the dutiable goods produced, and to see that no such goods escape taxation, a large staff of excise officers is employed. The country is divided into areas, and these again into districts, each of which is in charge of a surveyor, and under the surveyor are stations controlled by officers. Each officer is responsible in his district or station for supervising, not only the production (and in coastal stations the importation) of dutiable goods, but also entertainments, licences and other activities liable to excise.

In the case of customs this supervision entails the examination of every ship reaching this country, and the control of her cargo. When a ship arrives at the quay she is boarded by customs officers who rummage to see that no dutiable goods are concealed about her. None of her cargo may be

delivered from the quay until the importer has obtained papers known as 'entries' from the custom house. Before claiming delivery, therefore, the importer must attend the custom house with a list of the goods which he is importing. These goods may be free, or subject to duty. If they are free the importer obtains an 'entry' signed by custom house officials, which he presents at the quayside. The goods are examined by an officer to see that the importer's declaration is correct, and if all is in order, the goods are delivered to him. If, on the other hand, he is importing dutiable goods, three courses are open to him. He may wish for immediate delivery, or he may trans-ship the goods for re-export, or he may wish to store them for a time. In the first case he pays duty forthwith, and having done so, obtains an 'entry' which enables him to remove the goods from the quay. Goods for re-export are not subject to duty, and, in the case of such transactions, the importer gets an 'entry' from the custom house which enables him to trans-ship the goods, and the process is supervised by customs officers. If, and this is the third alternative, the importer does not wish for immediate delivery of the goods, there is an arrangement whereby he can store them in a bonded warehouse. He makes no immediate payment, but enters into a bond with the government for the amount of the duty. The goods are then removed from the quay, under the supervision of customs officers, and stored in the bonded warehouse. These warehouses must be approved by the Commissioners of Customs and Excise. They are furnished with a Crown lock and key, and are

under the supervision of a customs officer. No goods may be released from them without his authority. The importer houses his goods in the warehouse until such time as he wishes to re-export them or to dispose of them for consumption in this country. In the former case no duty is payable, and the goods are removed to the port under bond, and this bond is finally discharged by the custom officer's certificate of shipment. In the latter case duty must be paid, and the importer discharges his bond, and obtains delivery of his goods by payment to the custom house.

Thus the custom house maintains a strict check on all goods entering the country, by a system of examination and control. In the case of excise, supervision entails a great variety of procedure. The officer has to keep watch over excise licences and entertainment duties, as well as over dutiable goods produced under very various conditions. It is easy to measure quantities and check evasion where goods are manufactured on a large scale. This, for example, is the case with spirits. Beer, on the other hand, may be produced on a large or on a small scale. A description of the control exercised over beer gives a good illustration of the system. It must be noted, however, that procedure varies in each instance, according to the conditions of production.

Before a brewer can make beer for sale he must take out an excise licence, and must fill in a form describing in detail his premises, and the vessels to be used in production. In this way all brewers are known to the department, for though beer can

be brewed on a small scale, illicit production is easily detected. Breweries are visited by officers a number of times during the week, and at the larger breweries an officer is permanently stationed. The brewer must give notice to the officer whenever a brewing is to take place, and he must record in a book (known as his brewing-book) the quantity and nature of the materials used at each brewing. The officer knows the amount of beer which should be produced from a given quantity of raw materials, so that from the entries in the brewing-book he can calculate what is called 'the theoretic quantity' of beer produced. This theoretic quantity is a check on the actual quantity declared by the brewer. When the brewing reaches a certain stage the liquor is run into fermenting vessels. These are gauged, so that for every inch the quantity contained in the vessels is known. The brewer measures the quantity contained in the fermenting vessels, and ascertains the gravity of the liquor, both of which figures he enters in the brewing-book. The officer, who has had notice of the brewing, may then come and take his own measures and check the entry made by the brewer. Officers do not always inspect each brewing, but the brewer must leave the liquor in the fermenting vessels for twelve hours, in order to give the officer an opportunity for inspection. The bulk quantity produced at each brewing, in conjunction with the gravity, shows the standard quantity on which duty must be paid. The officer compares his estimate of the standard quantity with that of the brewer and with the theoretic quantity calculated from the raw materials, and duty is charged on whichever

amount is the largest.¹ In this way the officer is able to exercise a very complete check over the quantity of beer produced. If he has reason to suppose that the brewer is evading his control, he has very considerable powers of inspection and search.

By this system of supervision, the surveyors are able to prevent the entry into consumption of goods which have not paid duty, and to ascertain the amount liable to duty. They have then to make an assessment, after which there remains the question of collection. This is the function of the Collector who is the head officer in each area. The surveyors who work under him furnish him with reports of their assessments, which they also communicate to the head office. The total of the assessments in his area is a charge against the collector who is responsible for the collection of this amount. It is his duty to receive the money which is paid over to him by the assessed persons. He pays the money which he receives into his official account at the local bank, and every day he makes remittances from thence to the cash account of the Commissioners of Customs and Excise at the Bank of England. He then notifies the Accountant and Comptroller-General, who is the head of the financial department of the Board of Customs and Excise, of the amount remitted, and forwards to him the branch bank receipt for the transfer. It should be added, though more will be said about it later, that for current expenses the collector keeps back a certain amount of cash in hand and

¹ With a 6 per cent. allowance for waste.

of credit at the local bank. Every day he furnishes the Accountant and Comptroller-General with a statement of receipts and payments. The statement of his remittances is compared with the passbook of the Board's general account which is made up daily by the Bank of England. That is the check on the bank. What about the check on the collectors? As we have seen, it is the duty of the surveyors to furnish the head office with a report of the amount of goods liable for duty which are produced and imported into their area. From these reports the Accountant and Comptroller-General can ascertain the amount of duty which should have been collected and paid in. This amount is compared with the receipts shown in the accounts of the collectors, and an independent check is thus established on the amounts received and paid in by them.

So much for prevention, assessment and collection. The money is safely lodged in the Bank of England. We must now witness its transfer to the Consolidated Fund and the manner in which the expenses of collection are met. Every day the Accountant and Comptroller-General transfers money in even thousands from the general account of the Commissioners to the Consolidated Fund at the Bank of England. He does not remit the whole balance, however, but keeps back a certain sum for replenishing his drawing account, which is a balance for the payment of current expenses. Now the expenses of revenue departments have been voted by the House of Commons in the same manner as other Supply Services, and to ensure the control of the House they must be paid out of the

Consolidated Fund. The principle is maintained, but by a roundabout procedure. In order to avoid unnecessary transfers of money, the revenue departments draw upon their receipts for the payment of these expenses, and moneys so used are treated as advances on account of the Vote. The expenditure incurred by the department is met provisionally out of the balances retained by the collectors at their local banks, and by the Head Office in its drawing account. Once a month a statement is sent to the Treasury of the sums thus borrowed from revenue on the Vote Account, and the Treasury then authorises the transfer of this amount from the Consolidated Fund to the general account of the Commissioners at the Bank of England. Thence, on the same day, the Commissioners return it to the Consolidated Fund, thus paying back to revenue the amount that has been borrowed for expenditure.

The Board of Inland Revenue treat departmental expenditure in the same way. They, too, draw money from their general account to pay for Vote expenditure, and the money is periodically repaid by the Treasury. Let us now see how they collect our taxes. Super-tax and estate duties are administered centrally, income tax locally. As the latter forms so large a part of the revenue received by the Board, it is as well to study its collection in detail. Here, as in the case of excise, the Board is met with the problems of assessment of tax, prevention of evasion and, finally, of collection. In outline the system adopted is as follows. A form is issued to the taxpayer on which he must make a return of income. These returns form the

basis of assessment. A careful enquiry is made into their accuracy, and they are examined and checked as far as possible. But such an enquiry is inevitably difficult, because in many cases the taxpayer alone is in possession of complete information. There is an effective check in the case of incomes of salaried persons, through the returns of salaries made by the employer, and a partial check in the case of limited liability profits through the accounts which companies furnish, but at present the production of full accounts for purposes of assessment can only be enforced in cases of appeal. With the small trader who does not keep accounts, and the professional man in the receipt of fees, an adequate check on the return is almost impossible. One course, however, is open to the assessing authority, when it is thought that a return underestimates income. The taxpayer can be assessed on a higher income than he has returned, and the onus of proof is then shifted on to his shoulders. If he is able to bring evidence in support of his lower figure he can appeal against the assessment, otherwise he accepts the estimate made. There is a further safeguard against the inaccuracies of the individual's return to which much importance is attached. This is the system of deduction at the source. Limited liability companies are assessed on the full amount of their profits before the payment of any dividends, and on distributing dividends to their shareholders they are entitled to deduct the appropriate tax from the amount paid. As the profits of limited liability companies are more easily checked than the incomes of individuals (the publication of accounts is compulsory in the

case of public companies) this system greatly facilitates assessment, and over 70 per cent. of income tax is collected in this way.

The assessment having been made, notice is sent to the collector and to the taxpayer. At this point the taxpayer may make an appeal against the assessment, and if the matter cannot be settled by negotiation, the case is heard by the Commissioners, of whom more hereafter. The collectors then proceed to collect the amounts due and to pay them into their local banks. As in the case of excise revenue, the total of the assessments made in his area is a charge against the collector, and he is responsible for the collection of this sum. His receipts are checked by the assessments. The collector may not draw on the account at the local bank. At stated periods the bank manager transmits the moneys collected to the Board's account at the Bank of England. Thence daily transfers are made to the Consolidated Fund, but as in the case of customs, the whole amount is not transferred; a balance is retained for the payment of expenses, and to meet claims for repayments and rebates.

This is the scheme of income tax collection in outline. In practice the system is complicated by the fact that there are two authorities concerned. In each division of the country, unpaid local authorities are appointed, known as Commissioners of Income Tax, who are independent of the Board of Inland Revenue. It was originally intended that these commissioners should be responsible for the administration of the tax. But, side by side with this voluntary body, there is in each

district an inspector of taxes, appointed by the Board of Inland Revenue. He is assisted by a staff of clerks. In theory, his duty is not to administer the tax, but to observe its administration by the commissioners in order to safeguard the interests of the state. The commissioners appoint an assessor (who is not a whole time government servant but is in receipt of fees), and according to the strict law, it is he who issues forms, examines the returns of taxpayers, and makes the assessment which is then allowed by the commissioners. It is to this body also, that appeals against assessment may be made. This system was established at a time when the administration of the tax was much less complicated than it is at present. The difficulties of assessment have now become so considerable, the examination of returns and the settlement of liabilities so technical, that a voluntary body is no longer able to deal with them adequately. Consequently a great deal of the work has now devolved upon the inspector. He, who was originally an observer, has become chief actor. In practice it is he who checks the returns, examines accounts, and ascertains the liability of the taxpayer. Notices of appeal are sent to him, he makes the necessary investigations, and in a large number of cases is able to settle the matter with the taxpayer, without anything more than the formal consent of the commissioners. They, however, still hear appeals, which is their most important duty. The Royal Commission on the Income Tax urge very strongly that this anomalous arrangement should be abolished. They recommend that the work of commissioners should be confined to the hearing

of appeals, and that the business of assessment should be by law, as it is in fact, the duty of the inspector. There is little doubt that they are right, and it is to be hoped that the existing makeshift will be replaced by a more orderly and modern system.

Enough has now been said to show the manner in which the revenue departments perform their duties. Taxes are imposed by the House of Commons, and it is the province of the revenue departments to see that the money arising from these taxes reaches the Exchequer with the least cost to the state and the least inconvenience to the taxpayer. They must not let money slip through their fingers in the process, and as we have seen, assessments once made, adequate checks are provided against loss in transfer. The receipts of the collectors are checked by the returns of the assessors, and the banks are checked by the returns of the collectors, while the expenses of the departments are confined to the amounts voted by Parliament. These expenses are paid out of revenue in the first instance, but this process involves a debt which must be repaid to the Consolidated Fund. The revenue departments cannot escape the control of Parliament by spending more from revenue than has been allotted them. What they have spent must be repaid, and should they exceed their allowance they must go to Parliament in the guise of debtors to ask for a supplementary estimate. In the end therefore the total revenue collected finds its way into the Consolidated Fund. It is the process of assessment which is the danger point in the whole system. This is the gap by which revenue

may evade the tax-collector, and, as will be evident from the foregoing description, it is round the question of assessment that the problems and difficulties of the revenue departments centre. The rest may be considered a matter of routine, but this is a problem involving judgment and responsibility. The departments have to steer a middle course between two evils. On the one hand, they must not work their system in such a way as to cause undue inconvenience or irritation to the taxpayer, and, on the other hand, they must not be so lax in their investigations as to let incomes or commodities escape taxation. It does not lie wholly with the departments, however, to make the system of assessment as watertight as possible. It depends partly on the legal powers given them, and partly on the nature of the tax imposed. When the taxes imposed are such as to tempt or to facilitate evasion, the difficulties of the departments are increased. High rates of income tax make evasion tempting, and excise duties levied on a number of goods produced in small quantities make it easy. The Royal Commission on Income Tax make certain recommendations which would undoubtedly facilitate the investigations of the inspector of taxes. They suggest that the assessing authority should have power to require the production of full accounts certified by the taxpayer, and they recommend that the penalties for incorrect returns should be made more severe. It is difficult to understand how these reforms would damage any but the fraudulent.

Such are the difficulties involved in collection. We may now leave the revenue departments, and

having watched the flow of revenue into the Consolidated Fund, may turn to examine the workings of that fund, or, as it is otherwise called, the Exchequer.

CHAPTER V

THE CONSOLIDATED FUND

THE Exchequer or the Consolidated Fund (it can be called either) is an account at the Bank of England. Into this account is paid the money collected by the revenue departments and the income which the state receives from its various properties. The fund therefore represents national income, and we have to consider, in this and the succeeding chapters, the machinery which governs the spending of this income. The present chapter deals more particularly with the restraints which protect it from misuse, or at least from uses not sanctioned by the House of Commons.

Three principles underlie the idea of a Consolidated Fund.

First, all the receipts of the state should be paid into a single fund, and all expenses of the state should be paid out of it. This is a principle of good accountancy, and it is also of paramount importance in facilitating central control.

Secondly, the fund which represents the total income of the state should be in the control of Parliament and not of the government. Parliament's ultimate hold over the executive lies in its power to refuse money. In order to exercise this

power, Parliament must be in a position to stop all issues from the Consolidated Fund.

Thirdly, issues from the Consolidated Fund should be made not only with the sanction of Parliament but also only for purposes approved by Parliament. This is allied to the second principle, but with a difference: the former means that the government may be forced to resign by the refusal of Ways and Means, whereas this third principle means that even when Ways and Means have been granted, they can only be spent on purposes approved by Parliament. It is well, in passing, to remind ourselves that Parliament means the House of Commons: for the rights of the Crown have lapsed and those of the House of Lords practically so.

How far does the actual system conform to these excellent principles? To the first there are some exceptions. The receipts which accrue to certain spending departments in the course of their work are treated, with the sanction of the Treasury, as appropriations in aid, and are paid by the departments which receive them, not into the Consolidated Fund at all, but into the Paymaster-General's cash account. The expenses of the revenue departments are paid in the first instance from revenue, some of which is withheld from the Consolidated Fund for the purpose; but, as we have seen, accounts are made up every month, and total revenue is then paid into the Consolidated Fund. Thus this is no real breach of the principle. It does not weaken the House of Commons control over expenditure. The same cannot be said, however, with regard to appropriations in aid. It is clear that these are an important, and might become

a serious exception to the principle that total income should be paid into the Consolidated Fund, and all expenditure disbursed from it.

There is another exception which is of a different character from those just mentioned. Under the Road Act, 1920, the proceeds of the tax on horse power of motor cars, though paid into the Consolidated Fund, do not form part of the general pool from which all expenditure is made. They are specially earmarked for the Road Board Fund, and can only be used for the purposes which this fund serves. Two consequences which are conducive neither to economy nor to equity of taxation spring from the special assignment of this tax. First, the total proceeds of the tax must be spent on the maintenance of roads, although a more profitable use might have been found for the money. This is an uneconomic procedure, for it is obvious that, if money is spent on a less urgent service while the needs of the more urgent remain unsatisfied, the maximum benefit has not been obtained from expenditure. Indeed the result may be excessive and wasteful expense on roads. Secondly, the persons who pay the taxes are in a position to demand that the rate imposed should be fixed by the amount that is needed for the maintenance of roads. Thus an artificial limit is placed upon the money that can be raised by a tax, which is in effect a luxury tax, and which might otherwise prove a profitable source of revenue. The principle of earmarking a tax has little to recommend it either from the point of view of equity or of convenience, and it is to be hoped that this exception to the general rule will shortly be reconsidered.

The other two principles deal with Parliament's power over the executive through its control of the Consolidated Fund. It is worth while looking at the actual machinery to see how this control is exercised and how complete it really is.

The department which administers the Consolidated Fund is the Exchequer and Audit Department. The head of this department is the Comptroller and Auditor-General. The peculiar importance of his office is reflected in his status. He is not technically a civil servant, though he is generally chosen from their ranks. His function is to keep watch over the expenditure of governments through his control of the Consolidated Fund, and he is responsible to no minister, but is the servant of the House of Commons alone. He is specially appointed by letters patent and is removable only on a joint address of both Houses of Parliament, an event which can hardly ever happen. His salary, like that of a judge, is not included in the annual estimates, but is a charge on the Consolidated Fund. In this way his independence of governments is secured. He holds the key to the national income, and when governments want to spend money, they must come to him to unlock it.

No money is paid directly out of the Consolidated Fund to the creditors of the state. The Comptroller and Auditor-General places money from the fund at the disposal of the Treasury, and the Treasury transfer it as required to the two authorities who actually make payments, the Bank of England and the Paymaster-General. Let us see how the Comptroller and Auditor-General issues

this money. Note that the system adopted in issuing money for Supply Services differs from that for Consolidated Fund Services. And first as to issues for Consolidated Fund Services.

The money for these services is not voted annually, as we have seen, but there is a standing authority from Parliament for its payment. At the beginning of each quarter a requisition is sent by the Treasury to the Comptroller and Auditor-General, demanding money for Consolidated Fund Services. The requisition gives a list of the charges for which the money is required. The Comptroller and Auditor-General goes through the statement in detail to see that there is authority for each payment. He carefully checks the requisition of the Treasury and makes no issue unless he is assured that the payment is a duly authorised charge on the Consolidated Fund. When he is satisfied that all is in order, he grants the credit to the Treasury and informs the Bank of England. The Treasury can then draw upon the Consolidated Fund up to the amount and for the purposes stated. It does not make the payments itself, but transfers money for meeting debt charges to the Bank of England, which is responsible for making such payments, and money for meeting other charges it transfers to the account of the Paymaster-General. This account, like the Consolidated Fund, is kept at the Bank of England, and therefore the money never leaves the Bank. During the course of the quarter further requisitions will be presented, examined in the same way by the Comptroller and Auditor-General, and at the close a schedule of the total charges during the quarter is sent in. The

Comptroller scrutinises the schedule, assures himself that all the charges are in order, and when he is satisfied, issues the balance.

Over Consolidated Fund Services, therefore, the control of the Exchequer and Audit Department is complete. The Comptroller and Auditor-General checks each issue that is made and sees that the sums demanded are authorised charges on the fund. The government can only obtain credits up to the amount due, for the Comptroller and Auditor-General is in a position to limit them to this amount.

The issue of money for Supply Services is somewhat different. This, it will be recollected, is expenditure passed every year by the House of Commons. After Supply has been voted by the House, and Ways and Means have been granted by Act of Parliament, the government knows how much money is at its disposal, but it still has to get it out of the Consolidated Fund. Supply is technically granted to the Crown, so that the first step in procedure is a Royal order to the Treasury which transfers to that body the Crown's right to the Supply voted by Parliament. The Treasury have then to get the money out of the Consolidated Fund, and accordingly they write to the Comptroller and Auditor-General requiring him to grant them credits on that fund.

Let us take the position on any 1st April, when the financial year begins. In March the House of Commons will have passed the Vote on Account, and this will have been perfected by the Consolidated Fund Act. The Vote on Account contains a schedule which sets out the sum which departments

(except Admiralty and Air Ministry, which have a different system) require to enable them to carry on for the next four or five months: that is, until the Appropriation Act is passed, which finally grants their money. The Consolidated Fund Act authorises the Comptroller and Auditor-General to issue money from the Consolidated Fund up to the total of the sums in the schedule to the Vote on Account, and of the money on account voted for Admiralty and Air Ministry. Note that the Consolidated Fund Act authorises issue of a lump sum, not, as does an Appropriation Act, a specified sum for each service. These specified sums are not incorporated in the act itself. Now, when the Treasury write to the Comptroller and Auditor-General asking him to release money from the Consolidated Fund so that the departments can pay their bills, they do not ask and he does not grant the total amount included in the Consolidated Fund Act: that would mean that he lost control altogether of four or five months' expenditure, and that so far as he was concerned the Treasury might spend that money as they liked. No. He places at their disposal about a month's supply. His authority for granting the credit is of course the Consolidated Fund Act, and he must verify this act, and compare the amount of his grant with the total grant of the act. He then authorises the Bank of England to give credits to the Treasury on the Consolidated Fund, up to the amount which he has granted. This sum is now at the disposal of the Treasury, and though in actual fact it remains in the Consolidated Fund, the power to draw it out has passed from the hands of the Comptroller

and Auditor-General to those of the Treasury. They draw upon the sum as money is required, authorising the Bank to make transfers from it to the account of the Paymaster-General. As we shall see in the next chapter, transfers to the Paymaster are made in respect of specified services, and the Comptroller receives daily from the Treasury an account of the total sum, and of the amount for each service so transferred. In this way he can see how much has been issued to the Paymaster on behalf of each Vote. Total issues are also checked by the passbook of the Exchequer Account (the Consolidated Fund) which is made up by the Bank and forwarded daily to the Comptroller.

It will be seen that the credit granted to the Treasury is a lump sum, for it is not issued by the Comptroller in respect of specified services, but for Supply in general. He has a check against misapplication. The Treasury render him an account of transfers to the Paymaster-General, and as these are for specified services he can see that no Vote is overspent, by comparing it with the schedule to the Vote on Account, and with the amount voted for Admiralty and Air Ministry. But this is a check after the event. How then do these facts accord with the principles stated above? And how far is the Consolidated Fund protected?

The Comptroller, by his hold over issues from the Consolidated Fund, can prevent the government getting money until it has been granted by a Consolidated Fund Act or by an Appropriation Act. He can prevent the government from securing a greater sum than has been granted, by ensuring

that total issues do not exceed the total granted. But as the issues which he makes are unappropriated, he cannot directly prevent a government from spending money in ways other than those agreed upon by Parliament.

And this is the case with issues under Appropriation Acts as well as with those under Consolidated Fund Acts. It will be recollected that the Appropriation Act, passed late in the session, is the final authority for the issue of the year's Supply. It allots to each Supply Service the exact sum it requires, and authorises its issue from the Consolidated Fund. But here again the issues which the Comptroller authorises are not specific, he grants to the Treasury a lump sum, not money for an individual service. Therefore we must look elsewhere if we wish to find a check against misapplication of money issued for Supply Services. Three other authorities are concerned in the matter. First, the Treasury, on which lies the responsibility of not transferring to the Paymaster-General more than the individual Vote authorises. Secondly, the Accounting Officer of each department, whose duty it is to ensure that the expenditure of his department is confined to the amount voted; and thirdly, the Paymaster-General who is also responsible for seeing that the expenditure on each service does not exceed the amount granted for that service.

Here then we have three independent checks against misapplication of money issued from the Consolidated Fund. These three authorities are all concerned to prevent unauthorised expenditure. And then, finally, there is audit. Audit is another and most important function of the Comptroller

and Auditor-General and it will be dealt with in a separate chapter; for the present it is enough to say that the knowledge that audit is to come and that misappropriation will be brought to light, is a powerful preventive against unauthorised expenditure.

That is the extent to which the Consolidated Fund is protected from misuse. Remember always that, unlike other financial functions, it is not in the hands of governments, but of the Comptroller and Auditor-General who is independent of governments. He is in a position to check completely issues made for Consolidated Fund Services, and no more can be spent on such services than is due and authorised. For Supply Services he is not in such a strong position. As Auditor, he can censure misapplication of money, but as Comptroller he cannot prevent it. For the correct appropriation of public money, therefore, Parliament must rely on the activities of the Treasury, the Paymaster and the Accounting Officers. If these checks prove insufficient, the irregularity will be shown up in the Comptroller and Auditor-General's report, and the fear of this report is likely to make the other checks more effective. Moreover, should the unexpected happen, should governments act wrongfully and persuade the Treasury, the Paymaster General and the Accounting Officers to abet them, it is impossible that the Comptroller and Auditor-General should not know. He could at once report to the Speaker and, if the case arose, doubtless would do so. The existing safeguards therefore completely prevent the government from getting hold of any more money from the

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Consolidated Fund than it has been granted, and practically prevent it from spending that money otherwise than was intended. These restraints on the executive have been of enormous importance in the past. At present the danger is less that the executive shall act, and consequently spend, without the approval of Parliament, than that it shall obtain Parliament's consent to unwise expenditure. But this does not mean that the safeguards are superfluous. The knowledge that they are there, and that they can be made effective, is in itself a sufficient check. And should a government ever be put in office which desired to spend without the authority of Parliament, the importance of these regulations would again become apparent.

CHAPTER VI

THE PAYMASTER-GENERAL

WHEN money is issued from the Consolidated Fund by the Treasury it is paid over either to the Bank of England for the service of the national debt, or else into the account of the Paymaster-General. The Paymaster-General pays the creditors of the state. This is his main responsibility. The spending departments pay no bills themselves, except petty expenditure. Indeed they have no banking accounts, except for these small sums. Before starting, it is well to recall that the titular Paymaster-General is a minor minister and a member of the government, but unpaid and doing no work in connection with his office. He delegates all work to the Assistant Paymaster-General, a civil servant and head of the Pay Office. This officer is always known as the Paymaster-General, not as the Assistant, and he is so called in this book. He and his office are not under their nominal political chief, but under the Treasury.

The Paymaster-General cannot himself affect the amount or the nature of expenditure. His concern is with two functions only :

First, to make the payments for which the state has become liable, and to see that these payments are made to the correct person with the minimum of risk, delay and machinery.

And, secondly, to ensure that the expenditure on any service does not exceed the amount granted by Parliament for that service.

In examining how the Paymaster adapts procedure to these ends, we may first consider the second function. When the Treasury has been granted credits on the Consolidated Fund by the Comptroller and Auditor-General, as has just been explained, it communicates to the Pay Office a list of the total sums authorised by Parliament, and of the amounts appropriated to each service. Every day the Paymaster-General, taking his liabilities and his bank balance into consideration, sends to the Treasury an estimate of the sum which he is likely to need from the Consolidated Fund for the payments of that day. The money is then transferred by order of the Treasury to the account of the Pay Office at the Bank of England, and the Paymaster is informed of the amount issued in respect of each service. He himself keeps accounts for the various Votes, and enters the amounts issued from the Consolidated Fund and the amounts paid by him in respect of each Vote. The Vote, it will be recalled, is the unit of financial procedure. In this way he is able to ensure that no payments are made on behalf of any department in excess of the amount granted by Parliament.

The above, however, is a simplified account of what is in reality a rather complicated process, for it must be noted that while the Paymaster keeps separate accounts, he does not hold separate balances at the Bank of England in respect of each Vote. The amount issued from the Consolidated Fund is allotted to specified services, but the whole

sum is paid into a single account at the Bank of England, known as the Exchequer Credit Account.¹ Similarly, sums received in the way of revenue by the spending departments, as appropriations in aid (described in Chapter III), are paid into a single account at the Bank, which is called the Paymaster-General's Cash Account. These two balances at the Bank, the cash account and the Exchequer credit account, form the Paymaster's total supply of credit. He treats them as a general cash balance, on which he draws for all payments² irrespective of the service to which they belong. This means that at a given moment he may have paid out in respect of one Vote more than has been issued from the Consolidated Fund on behalf of that Vote. Obviously this position could not be allowed to continue for long, or by the end of the year the Paymaster might find that, though total expenditure had not exceeded the total granted, the money spent on some particular service had been in excess of the sum authorised by Parliament. Such a transfer of credit from one Vote to another is not permitted except in the case of Navy and Air Force Votes. It will be remembered that the temporary needs of these services are not met from the Vote on Account, but they are given their big vote Pay, and allowed to use this money for any authorised purpose, adjusting their accounts at the end of the

¹ An alternative name for this account is the Paymaster-General's Supply Account.

² Payments are not made directly from these two accounts, but money is transferred from these, as required, to two working accounts kept by the Paymaster-General at the Bank of England. These two working accounts are known as the Drawing Account and the Bill Account.

year. Permanent transfers from one Vote to another must, in these as in all other departments, be authorised first by the Treasury and finally by the House of Commons.

Consequently every month the Paymaster balances the Vote accounts. If more has been spent on any Army or Civil Service Vote than has been issued under that heading from the Consolidated Fund the Paymaster asks for a further issue on its account, so that at the end of the month sums expended correspond closely with the sum issued for each service. In the case of Navy and Air Force Votes the accounts need not exactly balance month by month, but a quarterly reckoning is made, and at these times the sums issued for all services closely correspond to the sums expended on each. At the end of the financial year a final reckoning is taken, and the expenditure on each Vote must be completely covered by issues from the Consolidated Fund on its behalf.

By balancing the Vote accounts the Paymaster-General limits expenditure on each service to the amount voted by Parliament. At the same time by keeping a single undifferentiated fund (represented by his cash account and his Exchequer credit account), he is able to work with smaller balances than would be practicable if he kept different bank accounts for each Vote. For whereas with a number of balances he would need to keep on each a margin for unexpected liabilities, with a single fund uncertainties are likely to cancel each other in such a way that the total of a single balance may safely be lower than the aggregate of many smaller balances. This is important because the

security of public money is increased by keeping outstanding balances at a low figure. A further advantage which ensues from this practice will be clear when it is remembered that payments into the Consolidated Fund are not a steady flow but are made at irregular intervals. If the money in the fund at any moment is insufficient to meet the necessary outgoings, the government must borrow to fill the gap between expenditure and receipts. Unduly high balances in the hands of the Paymaster may necessitate borrowing which might have been avoided had he worked on a narrower margin.

So much for the second duty of the Paymaster-General, the duty of seeing that the expenditure on any service does not exceed what the House of Commons has granted. Now for the first and main function, of ensuring that the state's creditors get their money with the least risk and the least machinery.

There are two steps in the process, first the identification of the claimant and the establishment of his claim, and secondly the transfer of money. The Pay Office has erected a system of checks to ensure that these two steps are fraught with as little risk as possible. With regard to the first point the Paymaster must know that the liability has actually been incurred by the spending department, and that the individual making the claim is really the person to whom payment is due. The spending departments give their creditors drafts on the Pay Office, and send daily to the Paymaster a schedule of authority, which tells him what drafts are issued, their amounts and the persons to whom they are payable. It is signed by two officers of the department,

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and the Paymaster must verify the signatures. The Paymaster does not send cheques or money by post. The draft is presented for payment either by the creditor or by his bank, is compared with the authority received from the spending department, and if all is in order, payment is made. The manner in which money is actually transferred is as follows. Small amounts may be paid in cash, and the Paymaster draws from his account a small balance for this purpose. In such cases the creditor calls for his money at the Pay Office, and verification of the draft, its signature by the creditor and payment over the counter, complete the process of transfer. The majority of payments, however, are not made in cash, and in these other cases the creditor pays the draft into his bank and the banks attend daily at the Pay Office with the drafts which have been paid in by their various customers. Each bank adds up the amounts due on the drafts which it holds for presentation, and claims the total sum from the Paymaster. The drafts are then verified and, if they are found correct, the Paymaster writes off the total amount due to each bank from his account at the Bank of England, where, by a book entry, it is transferred to the account which the bank keeps there. For purposes of accounting and audit the receipted drafts are either kept by the Paymaster (as in the case of pensions) or returned to the spending departments. Here the Paymaster's function ends; it remains to the various banks to credit those customers who have paid in drafts with the amounts obtained from the Paymaster.

This system appears to provide adequate checks on the payment of public money, and when the

payee has a banking account is not unduly cumbersome. When, however, he wishes to be paid in cash, he has to attend at the Pay Office in person or else to send an agent. In the case of some departments, cash for weekly salaries and establishment charges are collected by the department's cashier from the Paymaster, and are paid over by him to the officers concerned. There are also a number of local paymasters who are responsible for expenditure which has to be made out of London in cash, such as payments to soldiers and sailors and the like. The Paymaster-General, acting on a draft from the department concerned, issues money to these local paymasters, which they then hold on imprest and for which they are responsible.

That is the machinery whereby Supply Services are paid. The Paymaster-General has to make two other classes of payments, those for Consolidated Fund Services and those for non-effective payments. He does not make payments on the national debt, for this is done by the Bank of England. Other Consolidated Fund Services he pays according to a quarterly schedule issued by the Treasury.

Non-effective payments include both war gratuities and war pensions, now very large, and also civil and pre-war pensions and gratuities. A different system is adopted in the two cases. Take war pensions first. The Paymaster-General receives from the Ministry of Pensions a list containing the names of pensioners, amounts of pensions and period for which they are granted. That is his authority, and it is a continuing authority for the period of the pension. On receipt he writes to the pensioner, sending him a form of application to

fill up and asking whether he wants to be paid in cash or by bank draft. On getting this back the Paymaster-General sends him the appropriate forms for receiving the pension. Pensioners are paid monthly or quarterly, as the pensioner chooses. If the pension is for less than a year, he sends forms covering the whole period: if for a year or more, forms for the year. On or after the date of payment, but not before, the pensioner fills in and signs the form which includes a declaration of his identity and also of course proves that he is still alive, and then either pays the draft into his bank or calls at the Pay Office, presents it there and gets the cash. Further forms are sent him as required. It will be seen that the responsibility for issuing the warrants, for paying the right person and for satisfying himself that the pensioner is still living, rests on the Paymaster. All that the Ministry of Pensions does is to tell the Paymaster that a certain person is entitled to a certain pension for a certain period or for his life. He does the rest.

In the case of other gratuities, and pensions, such as civil-service pensions, he is actually the Accounting Officer, and all the responsibility rests on him.

This is the manner in which payments are made. In addition to issues from the Exchequer and appropriations in aid, certain other balances are held by the Paymaster-General. For these other moneys he keeps separate accounts in his books, but he does not keep a separate cash balance under each head. They are all paid into his cash account, where they form part of the total supply of money from which he meets all expenditure as it falls due. In fact, he uses up all the balances in his cash

account before applying to the Treasury for money from the Consolidated Fund. The inclusion of these other funds in his general cash supply promotes that economy of balances which we have already had occasion to notice. These other balances held by the Paymaster are Deposit Funds, the Civil Contingencies Fund, and the Treasury Chest Fund.

Deposit Funds are moneys which come into the possession of various departments in the course of large transactions. They are sums held on deposit or suspense account, and are not due immediately or at all to the Consolidated Fund. Interest is not payable on them, and in most cases there is no legal direction to invest them. A part of them, however, is usually invested at the discretion of the Treasury. Part remains as cash in the Paymaster-General's cash account and is used by him to meet current expenditure.

The Treasury Chest is a small fund used for dealings in foreign exchange. No permanent payments are made from it, and it is kept at a fixed amount year by year. Various departments have to make payments abroad. The War Office, for instance, must pay its soldiers wherever they are stationed, the Foreign Office must pay embassy staffs, and the Office of Works must pay contractors. But the money granted to these departments is in England. Somehow it has to be transferred, and if the payment is to be made in some other currency, the pounds must be converted. In either case the question of exchange arises, and there is a possibility of loss or gain on the transaction. Now the sums voted by Parliament do not allow for fluctuating exchanges, and in fact the departments are not called upon to

bear the risk. They do not go into the market and buy exchange as they require it, but for payments in a foreign country they draw upon the Treasury Chest Officer stationed there. These officers hold balances on imprest in a foreign country, where they serve as local paymasters. Drafts are drawn upon them by the various departments and are met by the Treasury Chest Officers in the local currency, as drafts are met in pounds by the Paymaster-General at Whitehall. When their balances need replenishing, they draw upon the Paymaster-General by means of a bill, or a telegraphic transfer. By discounting this bill at their bank, or by drawing on the credit created there by the telegraphic transfer, they obtain money in the foreign country and the Paymaster-General pays the bill in pounds when it is presented to him in London. Any exchange loss on the transaction is temporarily met out of the Treasury Chest Fund; any gain goes to swell the balance of that fund in the hands of the Paymaster-General. At the end of the year the account is balanced, gains and losses are added up, and the Treasury Chest Fund is made up to the fixed amount. Any loss on the year is made good by Parliament voting the deficiency; any gain is paid into the Consolidated Fund. In this way the departments are able to make payments abroad without the risk of buying exchange.

The Civil Contingencies Fund is used for making small loans to the civil departments in anticipation of parliamentary grants. It is kept, like the Treasury Chest, at a fixed amount and no payments are permanently made out of it. It is administered by the Treasury. Advances are made from the

fund when there is urgent need for expenditure of a small amount, which has not been voted by Parliament. This may occur if the occasion arises for some small service which has not been included in an estimate, or if payments must immediately be made on behalf of a service which has not yet been voted by Parliament. Advances may also be made from the fund, if the Treasury agree that the overspending of a Vote by a small sum is inevitable. The sums advanced from the fund must all be repaid eventually out of moneys provided by Parliament. In this way the fund is kept up to a fixed sum year by year, and the Treasury is provided with a small loan fund which it can use in emergencies. Its use may sometimes be a breach of the sound principle that no money can be paid unless the House of Commons has voted it: but there must be some means of meeting unexpected and extraordinary requirements, and so long as only small sums are paid out, as is the case with advances from the Civil Contingencies Fund, no danger is incurred.

CHAPTER VII

AUDIT AND BALANCE

WE have seen how money is paid into the Consolidated Fund by the revenue departments, issued from it by the Comptroller and Auditor-General and made over to the creditors of the state by the Paymaster-General. That completes the process of collecting and spending. We must now look at the account of the annual expenditure which is finally submitted to the House of Commons.

An ordinary business customarily appoints an auditor to examine its accounts. The purpose of the audit is to establish the correctness of individual entries and to see that the accounts as a whole present a true and complete statement of the financial position of the business. The audit of the nation's accounts is the duty of the Exchequer and Audit Department.¹ We have already seen the independent position occupied by the Comptroller and Auditor-General, head of that department, and watched him at work as Comptroller. Equally important is his work as Auditor. He is the servant of the House of Commons alone, and on behalf of the House of Commons he is required to examine the accounts of the issues made during the year for Consolidated Fund Services and Supply

¹ See Exchequer and Audit Acts, 1866 and 1921.

Services. After his examination he has to certify the accounts as correct and to report to Parliament on his audit. In his examination the Auditor must ascertain first whether the payments shown in the accounts are supported by proofs of payment, and secondly, whether the money expended on each service has been applied to the purpose for which the grant was intended to provide. In addition, therefore, to the check on book-keeping which is required of the ordinary commercial auditor, the Comptroller and Auditor-General must see that the expenditure on each service conforms to the schedule appended to the Appropriation Act, and that the payments made on account of each service are due and relevant thereto. He must also see that, in cases where Treasury sanction for any expenditure is necessary, such sanction has been obtained. (This is the case, for instance, with alterations in establishment charges, or the transfer of expenditure from one sub-head to another). He is further required to examine the receipts of the spending departments and to see that they are put to the uses intended by the House of Commons.

In addition to accounts of expenditure, the Comptroller and Auditor-General audits the accounts of receipts of revenue. These accounts are not certified by him, for he cannot himself inspect the actual assessments; but he must ascertain that adequate regulations are enforced by the department to ensure the due assessment and collection of revenue. He examines, as he thinks fit, the correctness of the sums brought into the Consolidated Fund. Finally he reports to the House of Commons on the result of his examination.

In order to fulfil these various duties the Auditor must have full and complete access to all accounts and to the documentary evidence available. To this end, the accounts of the various departments are sent periodically to him together with the actual vouchers supporting the charges. It will be remembered that the Paymaster-General returns the receipted drafts—known as vouchers—to the departments, and these, therefore, are submitted as proof of the payments having been made.

The Comptroller and Auditor-General verifies the statements made in the accounts, comparing them with the vouchers and receipts. In all doubtful cases, he questions the departments concerned and obtains additional information from the Accounting Officers. He goes very carefully into the question of appropriation, seeing that the expenditure on each service is in accordance with the intention of Parliament. Unlike a commercial auditor, he does not check cash balances in the keeping of departments. It has been ruled by the Treasury that this is not his province. This is a serious qualification of the auditor's power to detect fraud, and indeed it is hardly considered to be his function to do so. It has been said of the commercial auditor that "he is a watchdog but not a bloodhound," and this is even more the case with the government auditor: the responsibility for such detection must lie to a large extent in the hands of the departments themselves. In dealing with revenue accounts, the Auditor sends officers at intervals to visit customs and excise stations, in order to check the accounts on the spot, and to see that the amount shown in the documents is duly collected.

The task of examining and checking the whole of the national accounts in detail would be a tremendous and costly undertaking. In practice the Auditor does not cover the whole field. In the case of certain departments he makes what is known as a test audit ; that is to say, he selects some point or section of the account and submits it to the closest possible detailed examination. For the rest of the account he satisfies himself that money in the mass is applied as Parliament has directed, and that the department concerned has duly examined the account and checked the vouchers. The departments themselves do not know what section of their accounts will be tested, and the Auditor makes his selection in such a way as to cover the whole field in a number of years. Before 1921 the system of a test audit was only applied to the accounts of the Army and Navy, but the Exchequer and Audit Act, 1921, enabled the Comptroller and Auditor-General to extend the system to the civil departments, at his discretion. In addition to his examination at headquarters, he carries out occasional test audits on the local expenditure of departments, for which purpose he sends down officers to conduct examinations on the spot.

The smaller departments submit their accounts together with the vouchers and other evidence once a month. In the larger departments the Comptroller and Auditor-General keeps a resident staff, who work on the department's own books. Thus, in both cases, audit is a continuous process carried on throughout the course of the year.

The Comptroller and Auditor-General notes down

any irregularities which the departments are unable to justify, and they go into his report at the end of the year. That may be a long way off and an occasion might arise when it would seem advisable that the House of Commons should be acquainted immediately with some matter that had come to his notice. In that case he could go directly to the Speaker and get the matter laid before the House of Commons. Such an occasion has not actually arisen, but the fact that this course of action is open to him might prove of great importance.

Finally at the end of the year the Accounting Officers of the various departments render their final accounts, which are called Appropriation Accounts. These accounts are made up according to the schedule attached to the Appropriation Act, which, we may remind ourselves, contains the sums voted for Supply Services and the money appropriated to pay them. The Appropriation Accounts of the departments are divided into Votes, for we shall also remember that the unit of the Vote runs throughout financial procedure, and they show the grants made and actual expenditure in parallel columns. They also show actual and estimated receipts. The appropriation accounts are accompanied by a statement explaining the disposal of balances, and in cases where the grant for any vote has been exceeded, by an explanation from the Accounting Officer of the cause of the excess.

In the case of the civil departments these accounts have to be rendered to the Comptroller and Auditor-General by the end of the November following the financial year to which they apply, which ends, of

course, on 31st March. Army and Navy accounts have to be rendered by the end of December. The Comptroller and Auditor-General examines them and sees that they agree with the periodic accounts submitted to him, and finally certifies them as correct. He then forwards them to the Treasury together with his report, and the Treasury must lay accounts and report before the House of Commons early in the following year. This is done in February or March.

The report of the Auditor deals with the result of his examination. He draws attention in it to all cases where it appears to him that grants have been exceeded, or that money received by a department from other sources than the grants has not been applied or accounted for according to the directions of Parliament. He reports on any case which has come to his notice where expenditure has not been supported by Treasury sanction, and must consequently be regarded as not properly chargeable to the grant. He draws attention to any sum charged against a grant which he has found to be unsupported by proof of payment. But this is not all. So far we have discussed two aspects of audit only: verification of the accounts, and verification of appropriation: appropriation of course being the application of money to the objects ordered by the House of Commons. But there is a third aspect which has tended recently to become of increasing importance. The commercial auditor is not concerned to see whether the business is being conducted prudently or imprudently: his duty is to ascertain and state the financial result of what has been done. But the scope of the national

audit is not confined to these limits. The examination of the Comptroller and Auditor-General extends to the nature, as well as to the regularity, of expenditure. Since the present system of audit was established in 1866 the accountancy of the spending departments themselves has become more efficient, and the Accounting Officers of the departments more zealous in guarding against misappropriation. Consequently the Auditor's examination into the nature, as distinct from the appropriation of expenditure, has come into greater prominence. This is an interesting and an important development. The safeguards in our financial system offer, as we have seen, a fairly complete assurance that public expenditure is confined to the limits laid down by the House of Commons: what we more particularly lack is an assurance that the money granted by the House is well spent. In this matter, the criticisms of the Auditor are undoubtedly of value. He is an outside and an independent examiner and is in a position to bring to the notice of the House expenditure which appears to him unnecessary or ill-advised. But the power of the Auditor must not be overstated. It is sometimes possible for him to detect a glaring case of waste, but it is almost always impossible for him to determine whether money spent has been laid out to the best advantage. Even the first point is difficult, since his data are confined to the accounts, the documentary evidence and what the departments choose to tell him. In many cases the departments themselves are alone in a position to know whether and how far money had to be spent. It is impossible for an outsider, coming in after the

event, to have a full or competent knowledge of the conditions prevailing in each case, and the scope of his judgment is consequently limited. But the question whether money has been wisely spent is far more difficult, and one in which supervision over departments would be most valuable if it were practicable. The Auditor, however, has no means of knowing, and it is not considered to be his business to know, how much any object ought to cost. The most he can do is to observe if the cost of similar things is markedly different on different occasions. He can criticise, therefore, from the point of view of inconsistency rather than from that of excessive payment. Consistent extravagance might consequently go undetected, and deplorable as this may appear, it is difficult to see how any standard could be found of what payments should, and what payments should not, be considered excessive. In competitive enterprise there is a rough and ready test of efficient spending which is not available in government undertakings. The business man must sell his goods with a margin for profit if he is to continue in business. Consequently the amount which he spends on their production is conditioned by the amount which people are willing to pay for them. He may indeed spend unwisely, his costs of production may be unduly high, and he may not get the best value for his outlay. But his uneconomic spending will be reflected in his profits, and in the long run he will be ousted by more efficient competitors. The measuring-rod of profit is not available in the case of government expenditure. There is no competitor to oust the uneconomic department and none to serve as a measure of his

efficiency. Even comparison between the expenditure of various departments is difficult, because it is hard to find comparable units of cost. This is partly due to intrinsic differences in the nature of the services, and partly to the way in which the accounts are rendered. Accounts at present are not made up in such a way as to show the total cost of any object of expenditure. That cost is scattered under various headings, and it is impossible to isolate an item and to determine how much of the total expenditure was relevant to it.

With a view to obtaining more information on costs, and to facilitate comparisons, the Select Committee on National Expenditure advocated the adoption of cost accounting. The Army accounts are now made up on this principle, so that the whole expenditure is analysed and it is possible to see the total cost of any section. This scheme has not been in operation long enough for us to know if useful results have been obtained. It is undoubtedly true, however, that unless you have accounts which are comparable, it is nearly impossible to measure the efficiency of diverse departments. The new system introduced for the Army may not be the best and may not be suitable to all ministries. But a unified system you must have. And you must have more. Take as an illustration the clerical work carried on in many rooms, in many buildings in Whitehall. This work is largely the same, whether done in the Admiralty or in the Office of Works. It should not be impossible to assess the units of brain work and time required for a given service, and the number of

such services necessary for a given department. Private businesses find it profitable to do this, with far smaller staffs than those employed by the state. You can never have the measuring rod of profit in the nation's business: but there is no reason why you should not have the measuring rod of output of hand and head.

Under the existing system, however, an accurate and informed judgment as to the merits of expenditure is almost impossible. No nice test can be applied, and we must face the fact that though the Auditor may be able to detect the more glaring extravagances, he cannot be expected to discover whether the government has or has not obtained value for its money.

Finally it should be mentioned that, in addition to his examination of the appropriation and revenue accounts the Comptroller and Auditor-General is required to audit on behalf of the Treasury such other public accounts as the Treasury may direct.

The Auditor's work is continuous, as we have seen; his examination of the accounts goes on throughout the year. There is a further piece of accountancy which must now be mentioned. At the end of the year the nation's accounts, like those of an ordinary business, must be balanced in order that the exact position of the national finances may be ascertained. There are two accounts which show national expenditure for the year. These are the Appropriation Accounts and the Exchequer Account. The appropriation accounts, as we have seen, are made up by the departments and detail the expenditure made under each Vote. The

Exchequer Account shows the receipts which have been paid into the Consolidated Fund and the issues which have been made from it. This account is balanced at the close of the year and the difference between receipts and expenditure is ascertained. The appropriation accounts, however, are not prepared by the departments until some three months after the close of the financial year to which they relate, and owing to the amount of work involved, they are not presented to Parliament until the following February or March. They record the total expenditure chargeable to the grant of the year, and this includes all payments, the orders for which were signed before the 1st April. All liabilities must be met in the year in which they fall due, and departments must not postpone the payment of sums due in order to charge expenditure to the grant of the following year. If the order for payment is signed by 31st March the payment is included in the accounts of the financial year then ending, although it may not be actually met by the Paymaster until the succeeding year. That will depend on the date at which the payee presents his draft at the Pay Office. If he fails to do this within three months after the close of the financial year, a new draft has to be issued and the payment is charged on the Vote, and entered in the appropriation accounts, of the following year. Thus it is not until three months after the financial year ends that the departments know the total expenditure which has actually been paid out on their behalf, and not till then can the appropriation accounts be made up. These accounts show the whole expenditure which has been made during the year ;

but because drafts dated in one financial year may not be paid until the next, their total does not exactly correspond with the total issues made from the Consolidated Fund during the year. The latter figure is shown in the Exchequer Account. This account is closed at 3 o'clock on 31st March. The total receipts into the fund and the total issues made from it during the year can then be ascertained. If there is any surplus of revenue receipts over the expenditure on Supply and Consolidated Fund Services that surplus is allocated to an account known as the Old Sinking Fund. A surplus of capital receipts over capital expenditure is not so transferred, however, and the amount remains as an Exchequer balance which is carried forward to the next year. Thus the account of the Consolidated Fund is balanced and the position of the national finances is ascertained directly the year closes. But it must be noted that the account does not show with absolute precision the expenditure that has been made nor the revenue which has been received during the year. Some of the revenue collected is still in the hands of the revenue departments. Some of the issues made have not actually been spent, but are still in the balances of the Paymaster-General or of the sub-accountants. These balances, however, are kept as low as possible, and at the end of the year issues from the Consolidated Fund correspond very closely with total expenditure. For at the end of the year the Paymaster-General balances his Vote accounts. He applies for such issues from the Consolidated Fund as will ensure that the expenditure on each Vote is completely covered by money issued on its behalf.

But not more than covered. Some departments may not need to spend the amount granted to them for each Vote. In that case the Paymaster will not apply for the issue of the total sums. Towards the close of the year the Treasury make careful enquiries from the departments as to how much money they will require, and if the total sum is not needed the Treasury make what is known as a 'short issue.' That is to say they only issue enough for the net expenditure of the departments, and the amount saved on the grant remains in the Consolidated Fund. In this way issues from the fund are kept very close to actual expenditure and consequently the Exchequer Account at the end of the year gives a fairly complete picture of the financial position. The actual expenditure that has been made during the year on any Vote may prove to be more or less than the amount originally estimated. If it is more the matter is dealt with, as we have seen, by supplementary or excess estimates. If it is less the department concerned has a surplus standing to its credit. This surplus may be in the hands of the Paymaster, or if the saving has been foreseen, and the Treasury has made a short issue, it will still be in the Consolidated Fund. In neither case does the department retain the amount saved. The parliamentary grant represents the maximum expenditure to be made on each Vote, and any saving on the grant accrues to the Consolidated Fund and not to the department concerned. Consequently if there has been a short issue the surplus remains in the Consolidated Fund, and if it has been issued to the Paymaster the amount is written off the sum to be issued on behalf of the

department concerned, in the following year.¹ In this way the Paymaster retains the sum in his balances and a double transfer into and out of the Consolidated Fund is avoided.

¹The unexpended balance of a grant-in-aid is not surrenderable. Also there may be another form of grant the balance of which is not surrendered annually, where money is charged on the Consolidated Fund over a series of years for some special service. (E.g. for building a public office.) This is done not by Vote but by special Act. The surplus must be surrendered on completion of the service.

CHAPTER VIII

PUBLIC ECONOMY

THAT finishes the finance of the year. We have seen how the state makes its expenditure, and how it provides money to meet it. We have seen also what checks and controls have been erected. Complicated the system is and always must be. That we must accept, for it is in the nature of things. But is it effective? Let us, before ending, turn and look back over the road we have travelled and consider the system as a whole. How far do the various controls which we have examined ensure that money taken from the taxpayer is spent by the government in the most productive and efficient manner? The government draws up a plan of expenditure, and of the means by which it suggests raising the money. If the scheme were unchallenged and its fulfilment uncontrolled, our finances would be entirely in the hands of governments, and we should have to rely solely on their wisdom in expenditure and on their forbearance in taxation. In fact this is not the case. The government has to submit its scheme to the House of Commons, and the manner of its execution is subsequently criticised by the Comptroller and Auditor-General, and by the Public Accounts Committee. What we have to examine,

therefore, is how far this control over the government is real and useful, and to what extent the whole machine, government, Treasury and House of Commons together, tends to a wise and economic outlay of public money.

First of all, however, it is well to step aside for a moment to consider what constitutes wise expenditure on the part of a state. Governments spend money in order to provide services. There are two points to be considered. First, a question of policy—what services should be provided, and this implies a balancing of the cost of the service against the benefit derived from it. And secondly, a question of management—how can the money laid out upon a service be spent to the best advantage. Wise expenditure depends upon a competent decision, both as to the services provided and as to the way the money is spent. The first problem presents itself to the statesman in a much more complicated form than that which confronts the individual; for the income of the latter is limited, and so is his life; he does not have to look far ahead, and there can be an immediate balancing of utility against cost. There is no such hard and fast limit to the state's income, and none to the state's life. It has to think of the advantage to the future, as well as to the present generation, and the balancing of benefit against cost is far more difficult. The cost is the burden of taxation, and it is hard to assess this, and harder still to balance it against a service, the result of which is spread over many years and divided amongst many classes. Those who bear the burden may not derive the benefit; they certainly will not do so in the same proportion.

Consequently the value of any service is not easy to determine, and to fix upon that scheme of services which can most profitably be provided by the state is an extraordinarily difficult problem. The cause of economy is served when the choice is made well. It is not necessarily furthered by refraining from expenditure; that may prove a wasteful and short-sighted course. That is one sort of economy: a wise judgment as to what services should be given. Another sort is served by the successful answer to the second question, How can the money provided for a service be spent to the best advantage? The measure of efficient expenditure which competition offers in business is not available to the state. Consequently both aspects of state expenditure, the manner as well as the object, present problems which have to be solved without the help of comparison or analogy. And now, keeping these two questions in mind, let us look at the various authorities who control or criticise government expenditure and see what they do and how they do it. And first let us go to the House of Commons.

In considering the control of the House of Commons over finance, a distinction must be drawn between control over expenditure and control over taxation. The old quarrel between Parliament and the Crown was over the right to tax. This quarrel was settled by the Civil War, and the sole right of Parliament to levy taxation was confirmed after the Revolution of 1688 and has never been questioned since. But, in the early days of the struggle, Parliament claimed no supervision of expenditure. The king must remedy grievances before he obtained Supply: but the object of Parliament was to buy

that remedy as cheaply as possible, and, once the money was paid over, it did not concern itself with the use to which it was put. If the king spent it on a foreign war, such is the habit of kings: if he wasted it on less reputable activities, are we not all human? As constitutional government was slowly evolved, as more and more of the executive powers of the Crown passed to its ministers, as those ministers gradually became entirely responsible to Parliament, speaking in the king's name truly, but by one of our delightful fictions representing in reality the views of the House of Commons or of the constituencies which might be quite different, the distinction still remained. Governments maintained a tighter hold over expenditure than over taxation. On taxation the House of Commons, apart from the government, always had a weighty voice. And it has to the present day. It is a well-known constitutional practice, for example, that a government can afford to be beaten on a tax and not resign. It can always find the money in some other way. But rarely can a government suffer defeat on expenditure, and then on minor matters only. If beaten, it resigns. And, if we look beyond Parliament to the electorate, we cannot fail to see that much more interest is taken in taxation than in expenditure. Everyone tries to reduce the burden which he finds onerous, be it super-tax or tea duty. The electorate has a greater say over taxation than over expenditure. And so has the House of Commons. It is as though ministers said to it, as kings said to earlier Parliaments: If you give me the money, please yourselves how you find it.

Even over taxation, the supervision of the House of Commons is lessening, for less and less is the House a body which stands apart from the government and criticises it. During the eighteenth century, up to and after the Reform Act of 1832, it was a chamber which contained members who, though nominally either Tory or Whig, were ready to pay more attention to individual argument than to claims of party. This is less so now. Moreover, there is another factor. Wise criticism of taxation must spring from a balancing of the burden against the value of the service rendered, and to do this the critic must know the weight of the burden. But Parliament has become less representative of the citizen as a taxpayer than it used to be. No doubt in the unreformed Parliament neither industry nor wealth, unless it were landed wealth, received their fair representation: but the very fact that many boroughs were rotten and privately owned made them purchaseable, and did, by a devious and unsavoury path, result in taxable wealth being represented. Now, however, owing to subsequent extensions of the franchise, a change is apparent. Large bodies of the electorate consider, on the one hand, that other classes do or ought to bear the bulk of the burden, and on the other are calling out for increased expenditure. This demand reacts on members, and on members of all parties, not of one alone, with the consequence that the House of Commons becomes less and less the watchdog of the taxpayer.

But still, after discounting this, the House of Commons, representing the electorate, can make its wishes very forcibly known to governments

and compel them to listen to it upon taxation. It carries a very real weight. Moreover, tax questions excite interest, and are debated with information and fairness. Altogether, in spite of the overwhelming power of governments, the House of Commons, either directly or indirectly, does supply upon taxation that external critical authority which all governments need.

But it cannot be repeated too often that taxation is conditioned by expenditure, and therefore the power of the House of Commons in the matter of taxes does not take it very far. What is its position with regard to expenditure? Here the distinction which we noted between the two aspects of expenditure must be kept in mind. The House of Commons is a body highly competent to judge the objects of expenditure, but it is ill-suited to criticise its manner. The first is a question of policy. The government draws up a scheme of the services which it proposes to provide out of public money, and the House can judge this scheme on its merits. It can weigh the value of the services against the cost. Moreover, it can express its judgment without the certainty of provoking resignation. For on such questions, though matters of high policy, governments are more ready to accept the decision of a hostile House. A measure can be rejected and the government need not resign. Consequently on the question of what services should be provided, the opinion of the House of Commons carries real weight. Its influence may be used more often in favour of spending than of saving, but still the private member is in the position to form and to express a judgment. If a government

propose to give pensions to widows, the advantage can be placed on one side and the cost on the other. The question is put in a simple form: Is the benefit worth the cost? with the further question, Can the country afford it? On such questions the House is as competent to decide as any body in the world. It is more difficult for it, however, to give a judgment on the extension or curtailment of an existing service. The fact of its existence is strong evidence that it is necessary, and the only question is whether it is too big or too small. This is a hard matter to judge. The private member cannot easily determine the proper size of an essential service, such as the Army, and on such an issue the government cannot afford to be beaten. If beaten it must resign. In such discussions it is hard for the House either to stand apart from the government, or to possess materials for effective criticism. The government knows so much more.

But it is on the second question—How can the money be laid out to the best advantage?—that the House of Commons is really ineffective. The estimates are made up by the departments and the Treasury. They show the cost of running each service in detail, though, as we have seen, the form in which they are presented does not facilitate criticism. And it is here that criticism is needed. We want to know that no more is spent on a service than is required, that daily administration is economical, that the staff of an office is equated to the work to be done. But it is at this point that Parliamentary control breaks down. The House of Commons cannot provide the criticism

which is needed. All the influences mentioned above, which incline members to give a favourable eye to expenditure, unfit them to be stern judges of the daily cost of running the government. Indeed it is hardly too much to say that the House is unsuited to pass such judgments because it wants expenditure. For one suggestion for saving you have ten for spending. This is no vice of the House of Commons. It is the temper of the times. And therefore at the outset the House generally is unfitted to be a critic. But the matter does not rest there. Had it the best will in the world it has little power. For one thing the estimates do not offer the private member material on which to form an opinion. For another he has not sufficient knowledge. He only knows what he can pick up from outside. The minister has a skilled staff behind him and all the requisite information at his service : that makes the attack difficult, but what renders it nearly hopeless is that the defendant has been through it all before. It is perfectly certain that the attacker can raise no point which the minister has not himself examined with its officials, or which the Treasury have not queried. The material has been sifted through a finer sieve than any which the House of Commons can apply. The private member is further handicapped in that he comes too late. The government have fixed upon the estimates many months before the discussion, and in their decision the House of Commons took no part. It was then that economy was made or marred, for having once published the estimates to the world the government stand or fall by them. Governments are too strong. They use their

strength to the full. If a vote on a big estimate is rejected or reduced they resign. This looks like accepting the will of the House, but in reality is bludgeoning it. If it wanted to bow its head it should consent to the rejection of the expenditure. By threatening to resign, it puts to its supporters the alternative of either swallowing an expenditure they dislike, or of turning them out, with the consequence that a hostile government is put in power, or a general election is entailed, with all its expense, toil and uncertainty, or else both evils fall together on the unlucky private member. Faced with this choice of evils, he chooses what he thinks the lesser. He votes for the expenditure. He does not wish to turn out a government in other respects so admirable. He is not allowed to stand critically apart and pass judgment on finance alone. The government throw a sword into the scale. You need never listen to a critic unless he can be unpleasant if you do not, and they make it nearly impossible for the House of Commons to be such a critic, except in rare and extraordinary circumstances. The result is that once an expenditure appears in an estimate it nearly always passes.

It may be thought that this is a debased and cynical view to take of the House of Commons. It may be said that members should regard themselves as representing all interests: that they should consider the taxpayer, and above all should never forget the reaction of high taxation on industry, on prices, and in fact on all branches of national life: and that they should not carry party allegiance too far. But in truth the view is neither sordid nor untrue. No one can have been a member of

Parliament without coming away with an immense respect for that body. No legislature in the world is its equal in impartiality or in critical ability. But to try to erect it into a critic of daily government expenditure is to ask it to do work for which by constitution and by circumstance it is unfitted. It chooses a government. If that government were wildly extravagant, it could and would turn it out. As long as it remains in, it has to trust it.

Indeed the shortcomings of the House of Commons have been pointed out in words far more forcible than those used above. Sir Herbert Samuel, at present High Commissioner in Palestine, was long a member of the House; he held high Cabinet office, he was Chairman of the Select Committee on National Expenditure, and yet he could write as follows: 'So far as the direct control of expenditure is concerned, the estimates might as well not be submitted to Parliament at all.'¹ Mr. Hilton Young, one of the ablest of Financial Secretaries to the Treasury, says that 'Once the estimates have been published the taxpayer's fate is sealed.'² That the House of Commons does not supervise expenditure in detail is shown by the fact that half the yearly estimates are passed undiscussed. That it could not do so is equally apparent. Opinion on this point is weighty and unanimous.

Attempts have been made to give the House of Commons more material for criticism and more power to enforce it. For instance, before a government move a Financial Resolution (see p. 55) they

¹ See his Introduction to *Parliament and the Taxpayer*, by E. H. Davenport, 1918.

² *System of National Finance*, p. 23.

are pledged to circulate a White Paper, giving an explanation and the amount of the proposed charge. This is valuable, for the amount of money involved is not usually stated in the resolution, and for this reason, and also because parliamentary terminology does not make criticism easy, examination of it was difficult formerly. This concession, which was recommended in the Ninth Report of the Select Committee on National Expenditure, is perhaps a slight one, but it is in the right direction. So much for material. As to power, three reforms attempt this. One has failed. The others have succeeded, and succeeded to a degree which is perhaps not realised. The first, the failure, is the setting up of the Estimates Committee: the successes are the appointment of the Comptroller and Auditor-General, and the Public Accounts Committee.

The Estimates Committee is a committee of fifteen members of the House, drawn from all parties. They were first appointed in 1918. They can examine any estimate they like and report what economies may be effected therein 'consistent with the policy implied in these estimates.' These are limiting words: the committee cannot discuss policy: it cannot say, for example, that we are building too many cruisers: all it can insure is that not too much money has been allotted, and that it is being prudently spent. Now all big expenditure comes from policy, and this the committee cannot discuss. Moreover, it is advisory only: it cannot, like the French Budget Committee, reject an estimate and bring in a new one. Its criticism does not condemn the minister in charge, nor does its approval absolve him of responsibility.

But above all, it appears too late on the scene. It does not examine the estimate till long after it has been presented. For the reasons given above, it cannot then be altered. Consequently the Estimates Committee has proved of little use as an instrument of economy.

But fortunately this is not the case with the Comptroller and Auditor-General nor with the Public Accounts Committee. The work of these two has undoubtedly added to the control which the House of Commons can exercise over finance. Neither are concerned with the formulation of policy nor with the type of economy which springs therefrom. But in this matter the House itself, as we have seen, is in a position to exercise a powerful influence over governments. What these two are able to provide is a criticism on the outlay of public money, and this is the aspect of expenditure where criticism is more particularly needed. Both are concerned to see that government expenditure is confined to the schedule approved by Parliament. But this part of their work, though of fundamental importance in our financial system, is by no means their only function. The safeguards against misapplication of public money are so complete that it is now almost impossible for a government to spend without the authority of Parliament. The danger is that with the authority of Parliament they may spend in an uneconomic way, and it is in criticisms of the lack of economy that the work of the Comptroller and Auditor-General and of the Public Accounts Committee is particularly valuable.

The Comptroller and Auditor-General is the servant of the House of Commons and is responsible

to no minister. The office was created by the Exchequer and Audit Act, 1866. No government can override or dismiss him. He sees that no department either misspends or diverts a grant. His reports to the Public Accounts Committee criticise the spending departments with a refreshing candour. More and more in his work as Auditor is he concerned with efficiency—with the merits as distinct from the regularity of expenditure. He cross-examines the accounting officers on all points where payments appear to him questionable, and as a result of his examination and enquiries he is often able to detect cases of waste and extravagance. But as we have already seen it is only the more glaring misspending that can be brought to light by his audit. He cannot examine the merits of each transaction nor measure the efficiency of any department's daily expenditure. He has neither the material nor the specialised knowledge required for such criticism. But in spite of this limitation his examination of expenditure is of great value, and is an important factor in the prevention as well as in the detection of extravagance. And there is another point. Should he discover anything really wrong, should he find some department or member of the government breaking the law, he would report to the Speaker, who would tell the House of Commons. A civil servant, in similar case, would have to go to his political chief, himself a member of the delinquent government: the Comptroller and Auditor-General goes over the head of any government, straight to the House of Commons.

The Public Accounts Committee is a committee

of the House of Commons, appointed at the beginning of the session. It consists of fifteen members. Its task is the 'examination of the accounts showing the appropriation of the sums granted by Parliament to meet public expenditure.' Its chairman is generally a distinguished representative of the opposition, often a former Financial Secretary to the Treasury, and the actual Financial Secretary to the Treasury is only a private member of it. Its service is onerous, but sought after. Many distinguished men have sat on it. Party differences affect it little. Meeting year after year, sitting in private, withdrawn from clamour and publicity, its members acquire a sense of corporate responsibility and corporate self-respect. It was instituted by Gladstone in 1861, and is reappointed every January or February when the session begins. Its work is perhaps the most valuable part of parliamentary control of finance. True, it does not sit till long after the money has been spent. But it renders future misfeasance more difficult. Its business is to see that all parliamentary grants, including supplementary grants, have been applied to the objects which Parliament prescribed. But in reality it does more. It looks into causes as well as consequences. It censures improper expenditure as well as improper accounting. It exposes waste and inefficiency. It has before it the reports of the Comptroller and Auditor-General, and with these in view it carefully examines the accounts, administering advice, reproof and even punishment should it be necessary. The Comptroller and Auditor-General sits with it: so does a high Treasury official. Disagreements are rare, either

among its members or with the Comptroller or with the Treasury. Nearly all its enquiries, indeed, are on points raised by the Comptroller, one more proof of the usefulness of this high officer of the House of Commons. It can call for any papers, and it examines the Accounting Officers who, having signed the appropriation accounts, are responsible for their correctness. It questions them as to the expenditure of the grants in their charge, and the Accounting Officers have to justify and explain the payments made by their departments. It will be remembered that they are themselves personally responsible for all expenditure from the grant, and unless some payment has been authorised by their superior against their advice and in face of their written objection, the blame for misapplication or misspending of public money falls upon their heads. The practice of appointing a high officer, often the permanent head of the department, as accounting officer is of great assistance to the examination of the committee. For such a person is conversant with the policy of the department and knows the reasons which led to the adoption of a particular course of action. He can put the case of the department with knowledge and understanding. In addition to the examination of the Accounting Officers, the committee can call any other witness and examine him personally. Such examinations can be a most unpleasant ordeal for the official concerned.

When it has finished its scrutiny, the Public Accounts Committee reports to Parliament. These reports are exceedingly frank and plain spoken. On their receipt, there are two ways in which the

sinner may be brought to book. The report can, and should, be discussed in the House of Commons. Very seldom is it discussed. Want of time, lateness in the session, the fact that the misdeeds disclosed are ancient history, and the natural wish of governments to escape blame, all tend to prevent it, and this way is little used. But there is another, very effective and always used, Treasury censure. The Treasury do not spare the rod. The committee's reports are driven home with force and energy. A Treasury Minute, reporting what action has been taken, is presented to Parliament. The Treasury have probably been preaching the same sermon before, but their hearers have not listened. Now it is not they who thunder, but the mighty House of Commons.

The only shackle on the efficacy of the Public Accounts Committee is the late date at which they can operate. We are now in the year of 1925. The estimates laid before the House of Commons in February 1925 have been prepared in November or December 1924. They cover a year which, beginning 1st April, 1925, ends 31st March, 1926. When it has closed, the appropriation accounts will be got out, but so great is the work involved that they will not be presented to the House till February or March 1927, when the Public Accounts Committee will get to work on them. The committee will then be criticising expenditure which in fact was crystallised nearly two and a half years earlier. Their enquiry is perhaps an inquest. But inquests have their value. They detect crime and disclose disease.

Such are the powers of the House of Commons

with regard to finance. On questions of policy it is in a position to pass judgment and to make its decisions effective. But, even taking into account the Comptroller and the Public Accounts Committee, it must be admitted that the House of Commons has very little control over the way—inefficient or economic—in which public money is spent. It cannot judge whether contracts are placed too high, whether labour costs are excessive, nor whether any office is overstuffed. For the efficient solution of such problems and for the economy of day to day administration, we must rely on the departments themselves, and on Treasury control. Within the departments economy mainly depends on three persons—the parliamentary chief, the permanent head, and the Accounting Officer, who may or may not be the permanent head. Perhaps the parliamentary chief has least influence over economy. It may be thought that he bears the same relation to his Permanent Secretary as the board of directors of a big enterprise bear to their business manager, and if the one system results in efficiency and economy, why should not the other? But this analogy, as do all analogies between government and private enterprise, breaks down at the start, for a board of directors have two powers which do not belong to a minister. They can judge their manager's work by the definite measure of money profit: government offices produce no profit. They can dismiss their manager: a civil servant's rights are, quite properly, protected more strongly. Therefore, though the influence of an able, broad-minded and experienced man of affairs at the head of a government office may be

immense, though he may exercise a great power for good over the whole of the staff under him, he has neither the measure nor the control which an ordinary employer possesses. Consequently economy must be left almost entirely to the Permanent Secretary. A Permanent Secretary is moved by two influences: an honest belief in the importance of his office and the desirability of extending its beneficent activities, and an honest desire to economise. Without the first he is uninspired, without the second he may be expensive. His action is the resultant of the two conflicting attractions. If the Accounting Officer is competent and so inclined, he has considerable scope for making the expenditure of his department efficient. But there is no measuring rod wherewith to judge him, and much must depend on the initiative and personality of the individual.

But while each department is naturally impressed with the value of its own activities, the Treasury must co-ordinate the expenditure of all. It must see that lavish cost in one direction does not involve starvation in another. It has to consider the work of all departments and is able to form a shrewd idea of the money required for the service rendered. It scrutinises every item in the estimates submitted by the departments and its sanction must be obtained before any new charge can be included. This gives it a very real control over expenditure, and it is in a position to bring expert knowledge to the examination. Seeing the estimates of all spending departments year after year, the Controller of Supply Services can compare costs in different years and in different departments. He is thus

able to form a fairly accurate judgment as to what costs are excessive and what are justifiable. The Controller of Establishment can at once put his finger on a case of redundant staff. He is the final arbiter of the establishments of all the departments. Thus through its highly trained personnel, its long experience, and its power to take a general survey, the Treasury carries a weight even greater than its wide actual powers. Its control rests not on rules only, but on character and influence, and the continual insistence on economical management and frugal spending. But the Treasury cannot be stronger than its Chancellor, and here we come back to the government again. For the Chancellor is a member of the government, and without his support Treasury control cannot be made effective. If he allows the First Lord of the Admiralty or the Minister of Health, or whoever at that moment may be the most clamorous raider on the public purse, to overpersuade or overbear him in enforcing economy, the work of the Treasury falls to nothing and the watchman has wakened in vain. And the Prime Minister must support the Chancellor. He, of course, must view all subjects from a wide standpoint. Economy, with its consequences in the reduction of taxation, is but one of many factors. He cannot always yield to the Chancellor's pleading. But what he can and should do is to help as far as he can. Above all, he should not listen to appeals behind the Chancellor's back. In recent years there have been occasions when the chiefs of the spending departments have known that the Prime Minister was approachable in private and would always lend a ready ear to suggestions

which cost money. There should be nothing of that sort. It may be necessary to spend. The Prime Minister must decide. But let him do so openly and let the Chancellor of the Exchequer be there.

Great is the power of governments: and any one of them that wants to economise has, in the civil service and the Treasury, a most efficient instrument at command. Under a prudent administration, efficiency and cheapness are well combined. But if a government is not economical, it is difficult for the House of Commons to make it so. Since the war there has been much talk of saving, and expenditure has been satisfactorily reduced: but more of the work has been done by governments through the Treasury, moved and aided, it is true, by a strong body of opinion outside, than by the efforts which the House of Commons itself has made in that direction, which in truth have not been very successful. Perhaps, for reasons given above, they never could be successful.

Such is our machinery for economy. No one, either student or politician, regards it as perfect. Reform is difficult: for no government, of whatever colour, consents to divide its sovereignty, and, unless it does, it confers nothing of value on the House of Commons or any committee of it. The problem is narrow: if governments want more than advice, if they desire a critic who can enforce his objection, they alone can create him. It is no use clamouring for the critic and at the same time making certain that he is still-born.

PART II
CURRENCY

CHAPTER IX

OUR PRESENT CURRENCY SYSTEM

This chapter was written and printed some time before the government decided to return to a gold standard. It is therefore out of date as a description of our existing system; but it has been thought well to leave it unchanged, as it is felt that an account of the system as it was before April 1925 will be of value.

BEFORE the war it would not have been necessary to write this chapter. Under a gold standard the state did not create our currency,¹ it merely coined all gold that was brought to it for that purpose. Any person who had gold to dispose of could take it to the Mint and there get it converted into sovereigns without any charge. The amount of legal tender depended on the amount of gold in the country, which was a matter independent of state action. Gold flowed to us from abroad when (owing to relative prices and interest rates in this and other countries) the exchange moved so far in our favour as to reach the gold import point. Conversely, when the exchange moved against us gold flowed out of the country. There were other forms of money in circulation, but all were convertible into gold, and their quantity was determined by

¹ With the exception of subsidiary coins—silver and copper, which were only legal tender up to a limited amount. They were not freely coined but were supplied by the mint according to the requirements of the banks.

the amount of gold. The basis of the credit created by the banks was gold, and though the Bank of England issued notes, the number of such notes that could be issued without a pound for pound gold backing was limited by the Bank Act of 1844. The Bank of England could regulate the flow of gold to and from this country by movements of the bank rate. If its reserve was threatened by a drain of gold abroad it raised the bank rate, and the movement attracted gold to London to earn the higher rate of interest here. The movement also caused a restriction of credit, and prices tended to fall, which was a further check to gold leaving the country. But the state was not implicated in the matter. It could not determine the amount of currency, which depended on the supply of gold, and the supply of gold depended on the production of the mines, the demand for gold in other uses and relative prices and interest rates in this and other countries.

We are no longer on a gold standard. Our currency is provided by the state. The Treasury issues £1 and 10s. notes, and these are legal tender throughout the country. They are technically convertible into gold, but as the export of gold is prohibited, their value has been divorced from that of gold. On what does it depend? How far is it determined by the action of the state?

The value of money, like that of any other commodity, depends on demand and supply. People's demand for money depends on their total resources and the proportion of this total which they choose to keep in the form of money. If their total resources increase, or if they find it convenient to keep a greater proportion in the form of money,

then the demand for money will go up. But if demand remains constant the value of money will vary with the supply. While we had a gold standard the supply depended, as we have seen, on the gold that came into the country; for the amount of credit money and notes were conditioned by the gold reserves. Under present conditions the supply of money consists practically of currency notes and credit money. Therefore, demand remaining the same, the value of money depends upon the supply of these two. The Treasury issues the notes and the banks create the credit.¹ But the two are not entirely independent. The banks create credit on the basis of their reserves at the Bank of England, but the creation of credit involves a demand for legal tender. Therefore as long as the supply of legal tender is not unlimited there is a limit to the amount of credit which can be created by the banks. Thus, demand remaining the same, the value of currency notes depends on the number of these notes and the amount of credit created; and the amount of credit is limited by the amount of currency notes available. This being the case, it becomes obvious that the issue of currency notes is a most important function, for by limiting the quantity issued, a control over the value of money can be secured. Now we have seen that the Treasury creates currency notes; how far the quantity created is regulated by the state we shall see more clearly when we have considered the machinery by which the notes are put into circulation.

¹ A fuller explanation of this subject, and a clear analysis of the whole question of currency will be found in Mr. J. M. Keynes' *Monetary Reform*, 1924.

Currency notes are not put directly into circulation by the state, that is to say the Treasury do not print notes and pay the country's bills with them. What happens in effect is this: the joint stock banks buy the notes that they require from the state, and the Bank of England serves as intermediary. The number of notes that are required by the banks depends upon the needs of their customers for cash. The public deposit money with the joint stock banks, and they draw upon these deposits when they make payments. This they may either do by cheque or by the withdrawal of cash. Large transactions are settled by cheque, but for the payment of wages, retail transactions, travelling expenses and the like, the public draw legal tender from the banks. When prices are high and trade is active they need more cash for making these current payments. Now the joint stock banks must meet the demands of their customers, whether it be for the withdrawal of cash or for cheque payments. To this end they keep a certain proportion of reserves against their liabilities. These reserves are made up of cash in their tills and balances at the Bank of England. The amount they keep in their tills depends on the day to day requirements of their customers. Before the war, when gold was in circulation, the banks kept sufficient gold in their tills for current requirements, and this supply they replenished by drawing gold, as they required it, from their balances at the Bank of England. What happens now that the banks no longer draw upon the gold reserve of the Bank of England is as follows. They still need a supply of legal tender currency, wherewith

to meet the demands of their customers, and they still want to replenish this supply as occasion arises. What they do is to buy supplies of currency notes from the government as they require them. They keep in their tills a store of currency notes sufficient for day to day requirements, and when this store needs replenishing they apply to the Bank of England for currency notes. The Bank of England supplies the notes and debits their balance by that amount, and it credits an account of the state, known as the Currency Note Redemption Account, with the same amount. By this process the banks have merely changed the form of their reserves, they have converted cash at the Bank of England into cash in hand. The state meanwhile has a balance at the Bank of England equivalent to the number of notes issued. But the Bank of England, be it noted, is in exactly the same position as before, except that a credit in its books has been transferred from the banks to the state. And this is of importance in that it marks a change from the old system, because when gold was in circulation the withdrawal of cash by the banks meant a reduction in the gold reserve of the Bank of England. Consequently, the Bank of England was warned of credit inflation by the danger signal of a reduced gold reserve. This caused it to raise its bank rate and the credit inflation was checked. Now, however, the withdrawal of cash does not affect the Bank's reserve, for it holds no notes in its reserve, and the withdrawal of notes merely means a cross entry in its books. Therefore, as long as the currency notes which it can obtain from the Treasury are unlimited, the Bank of England is not concerned

with the number that go into circulation, and it has no longer the simple and obvious measure of inflation provided by a dwindling gold reserve.

But if the above account told the whole story of currency notes there would be no reason to suppose that their issue led to any increase in the amount of money available. So far, as we have seen, it has not brought about an increase in the cash of the joint stock banks, as they have merely changed cash at the Bank of England for cash in hand. They have no increased reserves on which to create credit. Furthermore, the part played by the state in the matter has been purely passive ; it has merely issued the notes demanded, and the quantity issued has been determined by the requirements of the banks. All this would be a true and complete picture of the process as long as the state kept the amount received in payment for currency notes as an idle balance at the Bank of England. In fact, however, it does not do this. The funds in the Currency Note Redemption Account are used to make Ways and Means Advances or to buy Treasury Bills and other government securities. Only a small working balance is kept at the Bank of England. In effect, therefore, the government borrows nearly the whole amount of the money received by the issue of currency notes. By so doing it may be able to reduce its loans from other sources. For instance, it may borrow less from the Bank of England on Ways and Means Advances, or less from the public and the joint stock banks on Treasury Bills. In so far as it does this no additional money is created by the issue of notes and the use of their purchase price by the government. But

when the government borrows more money from the Currency Note Reserve Account than it would otherwise have borrowed, then the money released by that loan is a net addition to the money in circulation in the country. For the money borrowed by the government is used in making payments, and goes into the bank balances of the government's creditors. Thus the reserves of the banks are swollen by the amount which the government has borrowed from the Currency Note Redemption Account, and on the basis of these increased reserves the banks are able to create additional credit.

This additional credit tends to increase the demand for legal tender, and consequently to further application from the banks for currency notes. When this happens the whole process can be repeated. The banks buy more notes from the government, the government uses the money, and the money finds its way back into the reserves of the banks, where it forms the basis for further credits. During the period of war inflation this cumulative process added to the general expansion of purchasing power, and as long as expanding credit brought about an increased demand for notes there was no check to their issue; for, as we have seen, the drain of notes into circulation did not affect the reserves of the Bank of England.

In 1918 the Cunliffe Committee reported on the currency position. They were strongly in favour of a speedy return to the gold standard, and as a step in this direction, they recommended that, after the war, there should be a legal limitation of the note issue. At the close of 1919 the Treasury acted on this recommendation, and ruled (Treasury

Minute, 15th December, 1919) that 'the actual maximum fiduciary circulation of currency notes in any year shall be the fixed maximum for the following year.' As a result of this ruling the amount of currency notes which can be issued without a gold backing is no longer unlimited. The limit is the maximum number of uncovered notes that were issued in the previous year. The depression set in soon after this ruling was given, and during its course the limit was not effective. For the contraction of credit resulted in a decreased demand for currency, and the banks, in fact, asked for fewer notes than they could have obtained under the legal limitation. With reviving trade, however, the limitation begins to be of practical importance. The Bank of England is bound to supply legal tender to the banks when they demand to draw from their balances in that form. The Treasury may not supply more than the fixed number of currency notes unbacked by gold or by Bank of England notes. Consequently if the joint stock banks were to apply for a number of notes greater than the maximum fiduciary issue, the Bank would supply them, but the Treasury would hold Bank of England notes against the additional currency notes issued. That is to say, instead of buying securities with the credit placed to the account of the Currency Note Redemption Fund by the issue of these notes, it would take bank-notes or gold from the Bank of England. This would affect the Bank's reserve in the same way that the withdrawal of gold would have done under the old system, and if the process continued, and the reserves were seriously diminished, the Bank would have to take

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steps to reduce the amount of credit outstanding. Thus when the amount of currency notes in circulation approaches the legal maximum, the issue becomes a matter which affects the position of the Bank of England, and in order to protect its reserve the Bank must step in and take control of the situation.

We have now examined the machinery by which currency notes are issued, and are in a position to answer the questions which we put at the beginning of this chapter. How far can the state regulate the amount of notes issued? And how far can it control the value of these notes? The last question is not entirely dependent on the first, even when we ignore demand, because the total supply of money is made up of currency notes and of the volume of credit, and credit is not based on currency notes.

The state, as we have seen, does not issue any amount of notes which it chooses; it issues, up to a limit, the amount demanded by the joint stock banks. The amount which is demanded by the banks depends upon the volume of credit outstanding, the state of trade and the price level. But this does not mean that the state cannot affect the number of notes issued. It can in two ways. First, it fixes, by the Treasury Minute of 15th December, 1919, a maximum limit to the number of fiduciary notes issued, and when the number approaches the limit the Bank of England is forced to take steps to reduce the volume of credit and consequently the demand for currency notes. Secondly, the state can affect the volume of credit and the demand for currency by the amount of its short-term borrowings. It can borrow from the

Currency Note Redemption Account, or from the Bank of England on Ways and Means Advances, or from the public and the joint stock banks on Treasury Bills. By increasing the total amount of its borrowing from these sources it increases the volume of credit and the demand for currency notes ; by diminishing this total, it tends to decrease the demand for notes. Thus by alterations in the volume of its short-term borrowings, the state can affect the number of notes issued. By the same means it can affect their value. Their value depends, demand remaining constant, on the total supply of money—that is of currency notes and credit combined. By increasing or diminishing its short-term loans the state can add to or diminish the volume of credit. But advances to the state only account for a portion of the credit created. How much is created in addition to the amount borrowed by the government is a matter which depends upon the actions of the Bank of England and not upon those of the government. The Bank, by alterations in the volume of its assets, can increase or decrease the amount of deposits which the joint stock banks hold in its books, and it is on the bases of these deposits that the banks create credit. Consequently the control of the value of our currency is shared between the Bank and the state. When the number of currency notes approaches the maximum, however, the figure fixed by the state determines the amount of credit which the Bank of England can safely allow. If it chose, therefore, the state could vary this figure, and so make its control effective, at least for downward movements of the value of money. But in fact the Bank and the Treasury

work together. Since the war the two bodies have been in very close touch, and have carried out an agreed, though informal, policy. This is of importance, because together they can control the value of money. The future of the pound is in their hands. They can work towards making its value equal to that of gold, or towards keeping it stable in terms of commodities. Anyhow the power is theirs, and a power which could be used to maintain stable prices is one not to be discarded lightly. It is an instrument which has been put into the hands of the state by the abandonment of the gold standard. If we return to that standard as we knew it before the war, the value of our currency will again become dependent on the value of gold. In that case the state will have lost a power which it might have used with great advantage to the stability of trade and the well-being of the country. Whatever the advantages of the gold standard may be, this is a factor which must be taken into account.

The process by which currency notes are repaid is exactly the reverse of their issue. If the joint stock banks have more notes than they require for their day-to-day reserves of legal tender, they pay them back into the Bank of England. Now the Bank, as we have seen, keeps no currency notes in its reserves. The returned notes, therefore, are cancelled and the balance of the returning bank is credited with their value. The balance of the Currency Note Redemption Account is debited with the like amount. If there is not a free balance in that account sufficient to cover the amount, the Treasury must realise some of the fund's assets. A great part of these are in liquid form and can be

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called in at short notice. This enables the account to be worked with a very low balance at the Bank of England. The interest earned on advances and investments forms part of the assets of the Currency Note Redemption Account. It is paid as it accrues into a special fund known as the Investments Reserve Account. A part of this fund is kept as a reserve against the depreciation of securities held against currency notes, and the remainder (with the exception of a small balance) is paid into the Consolidated Fund.

PART III

DEBT

CHAPTER X

NATIONAL DEBT IN GENERAL

A NATIONAL debt seems to be the price of civilisation, and yet most of the amount is represented by cost of wars. Very little is due to remunerative purchases or beneficial undertakings. We borrowed £20,000,000 in 1836, in order to abolish slavery. The Irish famine in 1848 increased our debt by £9,000,000. Disraeli paid borrowed money for the Suez Canal Shares which he bought. But wars represent by far the greater proportion. The Seven Years' War and various wars with France and Spain between 1688 and 1775 added £128,000,000, the American War of Independence about £132,000,000, and the wars with Napoleon about £607,000,000. In 1816 our dead-weight debt was £846,000,000; from then down to 1914, in spite of the Crimean War, the Indian Mutiny and the South African War, we had on the whole reduced it, and on the outbreak of the Great War it stood at £651,000,000. In 1920 it was £7,829,000,000. Therefore the Great War added £7,178,000,000 to our burdens.¹ Against the immense cost of war, debt spent remuneratively is a grain of sand.

¹ The figures are given in *British Finance, 1914 to 1921*, by A. W. Kirkaldy, 1921.

INTERNAL DEBT

There are different kinds of debt. The first great division is between internal and external debt, between money borrowed from your own citizens, interest on which is paid in the country, and money borrowed from foreigners, whose interest is paid abroad. For the first time, Great Britain has a big external debt, and this is a point the importance of which is not always recognised. What is the real difference between external and internal debt? The answer usually given is that in one case you have to send interest abroad while in the other case you keep it at home. Or it is said that internal debt involves a transfer only, for what you take from people in taxes you return to them in interest. Or it is said, picturesquely but inaccurately, that you are merely moving money from one pocket to another. These statements all contain some truth. But it is necessary to probe deeper.

Assume that the Great War will mean a net loss to us of six thousand millions. Assume that it will have cost that, after giving credit for what we get from German ships and German property and German reparations, and deducting what our allies will repay us, and the extra savings which were created through increased efforts and diminished consumption during the war. The figure is optimistic, but it will do. Of these six thousand millions, five were borrowed at home and one in America. That also is a rough figure, but it will serve. All are lost, lost as absolutely as if we had blown them off as fireworks. Now the five thousand millions which we raised here were all taken from wealth and goods and labour

here. We are poorer by the net amount. Our productive wealth is less by that sum. And it always will be less. True we may save, until we have built up another fund of that value, but that is making new wealth, not remaking the old. The old cannot be remade : it is destroyed, as completely as fire destroys a haystack. It has disappeared from the world, and nothing that we can ever do can recreate it.

But, that being so, the loss of the five thousand millions of wealth is our whole loss. The fact that we have erected that five thousand millions into a debt, and pay interest and sinking fund on that debt, and tax our people heavily to provide them, is not the loss. For the money that we raise for the service of the debt is not lost to the country as the original war expenditure is lost. It is taken from one person and given to another ; and though the process of transfer may be injurious, as will be shown presently, the fact of the transfer does not diminish the total wealth of the community. That sounds paradoxical. The man who sees half his income taken away in income-tax and super-tax will exclaim that it is untrue. Without taxation there would be no loss at all, he will say. But this is not really so. It may be true in the individual case, it is not true of the country as a whole. The loss to the country is the original destruction of wealth, with the diminished productive power and depleted capital reserves which that entails. The fact that we have erected that lost wealth into a debt, that we have taken that dead thing and made it look alive again, makes no difference to the loss. We have done so of course in order that those who lent the money

may have security. They get their interest and ultimately their capital back. But that is not an additional burden on the community. This is proved by the fact that if we repudiated our internal debt, or ceased to pay interest, or paid interest at only half rates, we should be no better off. We should gain certain indirect advantages, shortly to be discussed, but on the main issue we should be exactly where we are. Of course, we should have destroyed our credit, and no one would lend us money again except on usurious terms, and we should have been extremely dishonest. But the point is that the direct burden of loss is not increased by payment of interest on debt and the taxation it entails, and is not diminished by ceasing to pay, and reducing taxation. Certain classes, of course, would gain, and certain would lose, by repudiation. The taxpayer would gain, the holder of war loans would lose. If a man were in the position that he paid in war taxes over the period of debt redemption exactly what he received in war loan interest and repayment, he would be precisely where he is now. And the country as a whole, the government and the people considered as one unit, is in the position of that man. The loss is the destruction of five thousand million pounds' worth of wealth, not the payment of interest. And although we now pay interest on that sum in pounds that represent more purchasing power than did the pounds which we originally spent, our direct loss is not increased thereby. Because what the taxpayer loses by paying money that has appreciated in value, the bondholder gains by receiving it. Thus, changes in the value of money affect the national debt by altering the distribution of wealth

as between taxpayers and bondholders, but do not affect the total of the country's loss. The result of such changes is of importance because of the relative uses to which taxpayer and bondholder put their money, and this point applies to the whole question of transfer from one set of persons to the other. If taxpayers as a whole are poorer than bondholders as a whole, the payment of interest on war debt makes the distribution of wealth more uneven than it would otherwise be. This is injurious to the real wealth of the community. Moreover, if the bondholder as a class puts money to less productive uses than the taxpayer as a class, the process of transfer does decrease our total resources, although the fact of transfer does not do so. Since the reserves of public companies and the profits of private business are subject to income tax, this sort of injury does in fact arise, for money is taken from productive uses and paid over to people who may spend rather than save it. Thus though no direct burden is imposed on the country as a whole by the service of our debt, there is an indirect burden. This is increased by the fact that high rates of taxation tend to reduce people's desire to work and save and hence to check production. If people know that a proportion of the income which they earn will be taken by the government they may be less eager to work and save in order to add to that income. The greater the proportion taken, the greater the check to productive effort. Smaller production means higher prices, and smaller savings mean less and dearer capital for industry. Consequently the heavy rate of taxation which is necessary to meet our debt obligations is a real burden to the country.

and if the real rate of taxation is increased while the nominal rate remains the same (as is the case when prices fall), this indirect burden is increased. It is lightened as we pay off our debt or as we reduce, by conversion, the interest to be paid upon it. Thus though repayment of debt cannot make good the loss that we have suffered, it can and does lighten the burden of taxation and consequently reduces the check to work and saving which that burden involves. Another weighty reason for reducing debt is that the more you reduce, the lower interest on the remainder will holders be willing to accept. Moreover, should another emergency arise which necessitates further borrowing, the state will be able to obtain its loans more cheaply if it has not already pledged a large part of the taxable capacity of its citizens for the repayment of existing debt. But whether repayment should be accomplished quickly or over a long series of years is a matter of debate. It may be better to impose a special levy in one or a series of years, such as will enable a great part of the debt to be repaid, with the result that high rates of taxation and the check to saving are not prolonged into the future. On the other hand, it may be thought that annual taxation, even at a high rate, is less injurious to industry than the more drastic method. But whichever course we adopt, this fact remains the same. By repaying debt we are only taking money from the taxpayer and giving it to the bond-holder, we are not making good our past losses nor increasing our present wealth. What we are doing is to increase our prospective wealth, through the encouragement to industry which will result from lower rates of taxation.

EXTERNAL DEBT

So much for internal debt. An external debt is its opposite. The burden is not the original loss of wealth, but payment of interest and repayment of capital. When we borrowed one thousand millions from the United States and blew it off into the air, we suffered no immediate loss. The money formed no part of our wealth. It was not withdrawn from our industry. Its destruction did not deplete our capital. We do not feel the loss until we pay interest and sinking fund. Then we do diminish our wealth. Each year that we send thirty million pounds and more across the Atlantic we lessen the resources in this country by that amount. Payment of interest and repayment of capital is the real burden of external debt. It is continuous. When you lose your own money, you feel the loss once and for all. The tooth is pulled out. In the other case it goes on aching. And it will continue to ache until 1984. The only way to stop it is to repay the capital, and that means losing another tooth from our depleted set.

There is another disagreeable feature of external debt. Interest must be paid and capital refunded abroad, and in a foreign currency. We pay not in sterling in London, but in dollars in New York. We must buy those dollars, and questions of exchange come in.¹

¹ Since our debt is expressed in dollars, the number of pounds to be paid varies with the dollar-sterling exchange. So long as the movements of this exchange correspond to movements of the relative purchasing power of money in Great Britain and America, this fact is of no real consequence. For if prices rise in this country, and the pound falls in terms of dollars, although we have to spend a greater number of pounds on the service of the debt, each pound that we take from the

That is the fundamental division of debt, into internal and external. The others are cross divisions. Debt, internal or foreign, can be treated under different heads. The most convenient division, the one adopted here, is into Funded, Redeemable, Intermediate, and Floating Debt. All kinds of debt fall broadly into one class or the other.

HOW DEBT IS HELD

The actual holder of any national debt (except floating debt) can hold it in three different ways. It may be inscribed stock or registered stock or bearer bonds. The holder of inscribed stock has his name written in the books of the Bank of England. This is his title. He holds no document of title. If he sells and wants to transfer to his purchaser, he either attends personally at the Bank, where he must be identified by some person known to the Bank, his London banker, or more usually his London stockbroker. His name is struck out and that of the new holder inscribed : or what more usually happens, he appoints an agent to carry through the transaction. The agent is called his attorney, and the document appointing him a power of attorney. It must be signed by him in the presence of a witness. The attorney must be known to the Bank and therefore again must be either a London banker or stockbroker, usually the latter. The disadvantage

taxpayer is worth less, and consequently the real burden of taxation is not increased. But so long as the exchange is not in equilibrium with relative price movements, and for short periods and with changing price levels this is often the case, the country stands to lose or gain on the exchange transactions.

of this method of holding is that the owner has to go to the Bank personally, which is very inconvenient if he lives out of London. In nearly all cases he sells through a broker, and he can only sell through a London broker. Consols are mostly inscribed. Dividends are paid by sending the holder a warrant by post which he can cash like a cheque or, if he prefers, they are paid direct to his bank.

In registered stock the holder's name is similarly written in the Bank's register, but he also holds a stock certificate, made out in his name. His certificate is his document of title; but when he sells he must do more than hand this certificate to the buyer. He must transfer the stock to him by an ordinary transfer deed, signed in the presence of a witness. The buyer sends certificate and transfer to the Bank, and they send him a new certificate in his own name. This form of holding, the common form of most limited companies, was introduced for Consols in 1911. It is popular. The holder need not attend at the Bank, nor employ a London stock-broker, and everyone understands it. It should be noted also that it is a safe system. Should a certificate be stolen, the thief cannot deal with it without forgery, which, since the true owner's signature is known to the Bank, should be detected easily. Again, if a holder lose his certificate he does not lose his stock. He can get a new one by proving his loss to the Bank and indemnifying them against a double claim. Dividends are paid in the same manner as on inscribed stock.

The third form of holding is a bearer bond. This can be passed from hand to hand like a five-pound note. The bond constitutes the only title of the

holder. Holders are not registered at the Bank. Attached to the bond are coupons for interest payments, and these, when dividends fall due, are cut off and either presented to the Bank or passed through the holder's own bank. Bearer securities are convenient, but risky. If lost, they cannot be replaced: if stolen, the thief can easily find a market, and if the buyer takes in good faith and for value he gets a good title. They are used much more in other countries than in Great Britain.

In technical terms, inscribed stock is said to be transferable in the Bank books, registered stock transferable by deed and bearer bonds transferable by delivery.

HOW DEBT IS CREATED

The House of Commons alone can authorise borrowing. The authority may be a continuing one, as it is now under the War Loan Acts, in the case of loans raised to repay existing obligations. Or it may be special, as it was in the case of Consols issued before the war. Some authority from the House of Commons there must be. For an addition to the national debt a resolution is introduced in Committee of Ways and Means, authorising the loan. This passes committee and report, and is then embodied in a special act, or in the next Consolidated Fund Act or Appropriation Act. However, the Treasury are allowed to issue the loan as soon as the resolution has passed Committee of Ways and Means, without waiting for the act: but the act must have passed before the first payment of interest is made on the new stock. Accordingly the Treasury issue

a warrant to the Bank, who create the stock by entries in their books, either inscribed or registered, or print bearer bonds. Then a prospectus is issued inviting subscriptions. This is important, for it contains the terms upon which lenders advance money, and the government is as much bound by every word of it as is a board of directors. Its terms are settled between the Treasury and the Bank: they include price of issue, rate of interest, date and terms of repayment if there are any, and other essential conditions. Subscribers apply for stock in the ordinary way, paying a deposit to the Bank. If the loan is oversubscribed, small applicants usually get an allotment in full, large ones a proportionate amount. They all pay over the balance, the Bank enters their name in its books or issues a certificate or bond as the case may be, and the transaction is over. The bank pays straight into the Consolidated Fund all amounts received.

That is how national debt is created. We have seen how it is held and of what varieties it may consist. These must now be considered in detail.

CHAPTER XI

OUR NATIONAL DEBT

EXTERNAL DEBT

EXTERNAL debt can be of any character, funded, redeemable or floating. Our existing debt to the United States is really a Terminable Annuity, a special class of indebtedness to be described shortly. Much of it was originally borrowed as floating debt, that is, money repayable at call. This was the original character of the large advances the United States made to us after April 1917 when they entered the war. And from that year onwards we placed a regular weekly quota of \$15,000,000 three month Treasury Bills on the New York market. The rest of our debt was borrowed on short dated loans, the terms of which varied from five years downwards. There were in addition large sums owing for armaments and food, secured by various means. Some indebtedness was repaid by 1923: but when Mr. Stanley Baldwin, then Chancellor of the Exchequer, and the Governor of the Bank of England met the American authorities in January of that year, the total with accrued interest was agreed at \$4,600,000,000. Under the Funding Agreement of 18th and 19th June, 1923, we undertook to pay

interest on that amount half-yearly starting from 15th December, 1922, at the rate of 3 per cent. for the first ten years and thereafter at $3\frac{1}{2}$ per cent. till 1984. The principal is repayable by yearly instalments, beginning with \$23,000,000 in 1923 and rising to \$175,000,000 in 1984. We have the right to repay earlier, on giving short notice.

FUNDED DEBT

This is debt on which there is no obligation to repay capital as long as interest is paid. Interest and capital are secured by a perpetual annuity. On 3rd August, 1914, by far the greater part of our debt was funded debt in a form known as Consols. The other permanent debt was small and not worth mentioning. Since Goschen's great conversion of 1888, Consols need never be repaid, for so long as interest is regularly met, the holder cannot call for the capital. He merely has the right to receive his interest, now £2 10s. a year, for each nominal £100. If he wants his capital he must sell his stock for what it will fetch. Before 1923 we could not pay him off against his will, but since that date the government have the right to do so. That is to say they can give the holder £100 cash for each £100 nominal of stock, a thing they would never do so long as Consols are below par, for it would be cheaper to buy stock in the market and cancel it. Consols can be bought and sold in amounts of any size from one penny upwards. Interest is paid quarterly, on the 5th January, April, July and October.

TERMINABLE ANNUITIES

This is one of our very oldest methods of borrowing, and one of our newest. We raised money that way in the wars with Napoleon: we are repaying our American debt on the same model. Terminable annuities are not funded debt, but as they have a resemblance to it, will be described here. The system is that the lender advances a capital sum to the government, and gets in return an annual sum paid over a period of years, of an amount which will pay interest and an instalment of capital, so that at the end of the period the total capital is repaid. In other words, these yearly payments cover interest and sinking fund. It is a useful way of borrowing money and spreading the cost of repayment over several years. Government both lend and borrow on this system. The Ministry of Agriculture advance moneys to landowners for drainage or improvements, taking a thirty year charge. The four and a quarter millions which the Anglo-Persian Oil shares cost were so raised. Capital for light railways is so obtained. The bulk of the cost of telegraph and telephone construction is financed by this method. These annuities are charged on the Post Office Vote and appear in the estimates: the capital sum is received by the Post Office and spent on works. In the estimate for the British Museum on pp. 32-33 is shown an annuity (sub-head J) created in order to buy land and charged on the Vote. These terminable annuities are not sold in the open market. Most are bought by the National Debt Commissioners, who have large sums to invest, including savings bank deposits. The

Commissioners, of course, separate and invest such part of each annual receipt as represents capital. The annual payments on the American debt are an annuity: they, and other annuities, are charged on the Consolidated Fund.

The government also do a large life annuity business, like any insurance office. Anyone can buy an annuity from the National Debt Commissioners. The government's commitments to annuitants, however, are hardly a liability, for the Commissioners buy government stock with the purchase price of the annuity and cancel it, and the terms given to the annuitant are calculated on the market price of government stock. In fact the government gets more favourable terms than those obtained by leading insurance offices. Life annuities are charged on the Consolidated Fund.

Terminable annuities are created by Votes in Committee of Supply, or by a Financial Resolution, according as they are charged on estimates or on the Consolidated Fund. In returns made up showing the totals of national debt, terminable annuities are assessed at their capital liability. This amount is never large: in January 1925 it was only 14 millions. They used to be a way of raising money which the investor found popular. This is no longer the case, and they have ceased to be used for general government loans. For war finance they would have been useless.

REDEEMABLE DEBT

This is debt which the lender can compel you to repay at a fixed date. This date may be near or distant. The sum you have to repay may vary.

You may have the obligation to repay him on a certain day, but the right to do so earlier. There may be many other conditions attached to the loan, as we shall see. But all such loans must have one essential feature, that on some definite day the holder can call for his money.

In war time money must be borrowed on redeemable loans. They suit both investor and government better than funded loans. The investor, however patriotic (and our war record is a fine one), could not have been expected to lock up what was perhaps the bulk of his fortune in an irredeemable stock, which paid the then current rate of interest; for as money got scarcer interest was sure to rise and he would suffer a heavy capital loss when he had to sell. The government, too, had it borrowed on irredeemable stock, might have saddled the country for all time with the high war rates of interest. Consequently, in addition to temporary borrowing which will be described later, there were large issues of redeemable debt during the war. There were four great war loans, those of 1914, 1915, 1917 and the Victory Loan of 1919. The problem of war finance was to raise very large sums at as low a rate of interest as possible. To do this three principles must be observed. First, your terms must be progressively better. That is a necessity. In fact, interest rose from over 4 per cent. in 1914 to a rate between £5 6s. 8d. and £5 11s. 4d. per cent. in 1917.¹ In war finance interest goes up. It is the contrary of the post-war process of conversion, as we shall see. In conversion the interest does, or should, get progressively less.

Interest on temporary advances rose substantially higher.

Secondly, you must allow earlier subscribers to share the profit of later issues, otherwise they will hold back in the hope of more favourable terms. Thirdly, you must give the public what they want and treat them fairly. All these rules we followed. In successive loans we offered various attractions to induce lenders to subscribe. Many were offered at a premium. Others were issued below par and made redeemable by annual drawings. This gave a speculative interest to the investment, as such stock as was drawn at an early date brought a handsome bonus on repayment. Another attractive feature was the fact that certain loans were accepted at par in payment of death duties. One loan was offered free of income tax. This gave the investor a certain return not subject to tax increases. Again, in order that people should not hold back from earlier loans, in the hope that better terms might be obtained as the war went on and the rate of interest rose, the right was given to holders to convert their holdings of earlier loans into new issues on favourable terms. Finally, certain loans had substantial sinking funds attached to them to be used in buying up and cancelling stock. This steadied the capital value of such loans. When we consider the huge sums that were needed for financing the war, it must be admitted that these arrangements were undoubtedly successful. On the whole we borrowed cheaply and our credit stood the strain in a manner which is astounding.

INTERMEDIATE DEBT

This comes half-way between redeemable and floating debt. It tends to merge into one or the

other, but the distinction is this : it is less permanent, and usually for a shorter term, than redeemable debt : and yet it is an investment, usually subscribed out of real savings and not a creation of credit like a Treasury Bill. In other words, it is held by the investor, not by banks or discount houses, but though an investment it is, owing to its short date, not a 'lock-up.' The distinction is rough and ready, but fits the facts. Of course, as redeemable debt approaches the redemption date, it approximates to the intermediate class. All our intermediate debt is the result of war finance or is the aftermath of war. Exchequer Bonds, National War Bonds and War Expenditure Certificates were methods of raising money for war and nothing else. War (now National) Savings Certificates cover the post-war period also ; Treasury Bonds came into use after the war, but they arose in order to lessen a consequence of war, our enormous floating debt.

Exchequer Bonds were first issued in March 1915. They were repayable in five years and sold by tender, a process which will be described when we come to Treasury Bills. On and after December 1915 Exchequer Bonds at five per cent. were on sale daily, this being the then method of raising short loans, and a very successful method too. These and later bonds could, like some war loan issues, be used to pay not only Death Duties, but Excess Profits Duty and Munitions Levy. All Exchequer Bonds were discontinued in 1917 until after the war, when a further issue was made.

National War Bonds took their places, the change being an intentional change of name. It was felt that a National War Bond would appeal to an

investor, to whom the expression Exchequer Bond was recondite and alarming. They were on sale daily not only at the Bank of England, but at all banks. The amount raised by National War Bonds was immense, and ultimately reached over seventeen hundred millions. The bonds are redeemable at various dates up to 1929.

War Expenditure Certificates were issued for about six months after June 1916, at a rate of interest varying with the bank rate. They were never popular, and soon dropped.

War Savings Certificates are a very different story. They were novel, ingenious and successful. Their object was to attract small savings and to give the humble investor a certain return without capital loss, and they accomplished both points. For a payment of 15s. 6d. a purchaser got the right to receive £1 at the end of five years. But he could draw his money out earlier if he wanted it, 15s. 6d. during the first year, 15s 9d. at the end of one year and an additional 1d. for each succeeding month. It is therefore money at call. If not withdrawn, his certificate continues to earn interest up to ten years. He is given a book, like his post office savings bank book, which is so well understood, and in this payments and withdrawals are entered. At first War Savings Certificates were on sale at any Money Order Office of the Post Office, but later at banks also. No income tax is payable on interest, but no one is allowed to hold more certificates than will give him £500 on repayment. Their name was changed to National Savings Certificates in 1920, and the price raised to 16s. on 1st April, 1922.

So much for war and immediate post-war finance.

The next item arose after the war, but as a consequence of war conditions.

Treasury Bonds were started in 1920, and have been issued occasionally since. Originally they were for fifteen years, with an option both to government and holder to effect repayment at the end of any year after the first five: now they are for ten years certain. They were issued in order to reduce Treasury Bills and therefore to deflate, about which more will be said. The policy succeeded, for nearly five hundred millions of these bonds was outstanding in January, 1925. They are usually sold by tender at the same time as Treasury Bills.

That concludes the description of debt of all classes, except floating debt. It will be noticed that our peace finance was almost entirely effected by funded loans, war finance by redeemable ones. It is safe to prophesy that funded debt will again be our ordinary method. The $3\frac{1}{2}$ per cent. Conversion Loan of 1921 is funded, for though the government can redeem in and after 1961, a holder has never any right to call for his capital. Thus do we return to peace conditions.

CHAPTER XII

FLOATING DEBT

FLOATING debt is money borrowed for a short time, not by means of a loan in which the public invest their savings, but by a bill of exchange or bank overdraft or similar means. Before the war short-time borrowing was confined to occasions when payments out of the Consolidated Fund were heavier than revenue receipts. It was therefore not really a part of our national debt, but was used to fill a temporary gap between expenditure and income. Such temporary borrowing there must always be, for the stream of payments into and out of the Consolidated Fund never exactly coincide, and the authority to anticipate revenue in this way is given in each Consolidated Fund Act and Appropriation Act. But at present our floating debt is not confined to advances of this temporary nature. During the war very large sums were borrowed on short-term loans, and much of this borrowing has been continuously renewed, and is still outstanding. Fresh issues have also been made to meet maturing liabilities. The result is that our floating debt is now very large, a legacy of war, and quite a substantial part of our obligations.

In the financial columns of *The Times* for

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Wednesday, 4th February, you may have read the following:

Floating Debt	(000's omitted.)		
	Jan. 31, 1925	Jan. 24, 1925	Feb 3rd, 1924
Ways and Means	£	£	£
Advances :—			
Advanced by Bank of Eng- land	—	—	4,750
Advanced by Public Depart- ments	155,185	157,435	187,905½
Treasury Bills outstanding . .	680,715	683,155	647,505
Total	785,860	790,590	839,960½

That statement, properly understood, contains the whole history of floating debt. Let us examine it somewhat closely.

The statement shows the current floating debt in the first column, that of the previous week in the second, and that of a year ago in the third, and therefore increases or decreases are seen at a glance. That is simple: but what is the meaning of the elements of which that debt is made up, and who settles the amount of each item? Let us see. At 4 o'clock every afternoon the Treasury balance the Consolidated Fund which, we may remind ourselves, is the same as the Exchequer Account kept at the Bank of England. If taxes have been coming in slowly, or if the departments have asked the Paymaster-General to pay heavy bills, or still more if there is due one of the big dividends on war loan, the government's balance may run low or the account be in danger of being overdrawn. The Treasury therefore have to feed it. This they can do from three sources, Advances from Public

Departments, Ways and Means Advances from the Bank of England, and Treasury Bills. These three sources combined make up our floating debt.

ADVANCES FROM PUBLIC DEPARTMENTS

The Treasury look round and see which departments have credit balances. The National Debt Commissioners may have savings bank money waiting for investment; the Paymaster-General holds cash which the spending departments may not want at once: there may be a balance in the Currency Note Redemption Account: the Public Trustee may have funds in hand: or there may be some other source available. The Treasury therefore borrow temporarily from these accounts. All these balances are of course kept at the Bank of England, so the money is merely transferred. During the war very large advances were obtained from the departments in this way. Some of these have been repaid, but a considerable part has been continuously renewed, and still contributes to the increased volume of our floating debt. Interest is limited by statute to 5 per cent., and at present is less. The Paymaster-General, however, gets no interest. He does not want it. All he needs is money to pay the nation's bills, and that he has already.

WAYS AND MEANS ADVANCES FROM THE BANK OF ENGLAND

If the amount that can be obtained from the departments' balances is insufficient to replenish
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the Consolidated Fund, the Treasury can borrow on Ways and Means Advances from the Bank of England. That is a roundabout expression for a bank overdraft. The Treasury ask the Bank to allow them to overdraw, and the Governor agrees. The required sum is credited to the government. The Bank enter it in their books as an advance on government securities, which in fact it is, for the security is the taxpayer. Interest is paid at a rate agreed upon by the government and the Bank according to the Bank's official rate of discount: it must never exceed 5 per cent. Before the war Ways and Means Advances from the Bank were used as sparingly as possible, but during the war these borrowings reached an enormous size, and were often renewed when the date of payment arrived. Now, however, they have been reduced and, as before the war, are only used to meet a temporary deficiency.

TREASURY BILLS

It will be seen, however, that most of the floating debt is in Treasury Bills. A bill of exchange is a common mercantile method of raising money. It is a promise to pay the sum named upon the bill, at some specified future date, to the then holder of the bill. The drawer or holder borrows on the bill by selling it, for a bill is a negotiable instrument, and if the names upon it are good it can be readily sold. A Treasury Bill is a bill of exchange payable at a date usually three months ahead. Let us assume the bill is for £100. The Treasury then ask bankers, bill discounters and lenders of money generally how much they will give them for the

bill, that is, how much they will pay down in cash for the right to receive £100 in three months. This sum of course is less than £100, and the difference between the two is what the government pay for the use of the money for three months. Strictly, they have discounted a three months bill, and the rate they pay is called the rate of discount. This, stripped of technicalities, is the process of raising money on Treasury Bills. It is very simple.

Before the war, which immensely increased Treasury Bills and created our present floating debt, they were used in two ways. There was a permanent amount of about £14,000,000 always outstanding borrowed under the Treasury Bills Act, 1877 and other acts. These bills were regularly renewed, for the act of 1877 gives the Treasury power to renew bills as they mature, but, if they are not then renewed, the power lapses and they cannot subsequently be renewed. This amount of bills, therefore, really formed part of our national debt. Then after the South African war, when large sums had to be borrowed to meet war expenditure, the practice arose of inserting a section in the Consolidated Fund and Appropriation Acts, allowing the Treasury to borrow by Treasury Bills or otherwise up to the amount of which the act authorised the issue. All bills issued under such authority must mature during the current financial year and cannot be renewed under the act of 1877.

Under these two authorities, £15,000,000 of Treasury Bills were outstanding on 1st August, 1914, and this was an average amount. At the present day there are about £630,000,000 outstanding, as you will see from the extract from

The Times. The Bills have changed in character and the power to issue them has changed in unison. Only a very small proportion of those now in circulation represent borrowing for temporary deficiencies. By far the greater part is due to the large sums borrowed on Treasury Bills during the war. Many of these bills have been renewed, while fresh issues have been made to meet other maturing liabilities. In this way they have become a large part of our national debt. Renewals and fresh issues of Treasury Bills are authorised by the War Loans Act, 1919, which empowers the Treasury to raise money to any extent wherewith to repay existing obligations. Since large blocks of redeemable debt are continually falling due for payment, the Treasury must have power to borrow money to meet these liabilities; and by the War Loans Act they are enabled to renew all bills as they mature or to issue fresh ones as need arises. This in effect supersedes all other powers. It is probably essential that there should be this general authority to re-borrow, and, since the Treasury can only do so to the extent of maturing debt, total debt is not increased. But it is noticeable that the old control of the House of Commons over each individual issue of Treasury Bills has lapsed. It has granted a general authority, and it is a debatable point whether the time has not come to recall it.

Treasury Bills are issued by the Bank of England. The Treasury send a warrant to the Bank, which is countersigned by the Comptroller and Auditor-General, who has to see that Parliament has authorised the issue. The Bank then publishes a notice in the *London Gazette* setting out the amount

of the bills and their date of repayment, and inviting tenders. At the present time issues are made every Friday of bills at three months. Tenders are sent in and opened on a certain day. A tenderer says how much he will pay down for the right to receive £100 three months hence. The Treasury accept the cheapest tenders. If there are not enough offers at this rate to give them all the money required, they have to take a proportion of those that give worse terms. The result is announced in the press. Tenderers whose offers are accepted pay the amounts into the Bank of England.

During the war, when money had to be raised in blocks, the government at certain periods kept up a continuous sale of bills at a fixed rate of discount. Anyone could call at the Bank any day, pay his money and get his bill. This method has survived the war in what is known as the 'tap rate.' After an issue, the Treasury offer any more bills which the public may want at a fixed rate of discount, always slightly below the rate at which the last Treasury Bills were allotted. They turn the 'tap' on or off, as the national banking account requires. During the war, when Treasury Bills carried a high rate of interest, they were held by the investing public as well as by big banks and discount houses. Now, however, they are taken up entirely by the latter.

FLOATING DEBT, INFLATION AND DEFLATION

There is one aspect of floating debt which it is important to understand. The various forms of short-term borrowing which have just been described

are not loans made out of the real savings of the public, they are advances made by the Bank of England, by government departments and by the joint stock banks. In varying degrees they all are creations of credit which add to the supply of money available. That is to say, their use tends to have an inflationary effect. The extent to which this is the case differs with the various forms of floating debt. Ways and Means Advances from the Bank are bank overdrafts; that is to say, new or invented money. But the total supply of money made available thereby is not limited to the amount of the Ways and Means Advances. It is that amount multiplied many times. The reason is as follows: the Bank lends, say, £100 to the government, the government spends the money, for the Paymaster-General pays it out to contractors or soldiers or local authorities or to anyone to whom the departments owe money. These persons pay the sums which they receive into their own banks, and therefore within a few days the money flows back into the accounts which all these banks keep at the Bank of England. Now the joint stock banks treat the balances which they hold at the Bank of England as a cash reserve, on the basis of which they create credit, either by advances to traders, purchase of bills, or investments. It is their custom to keep their cash reserve (at the Bank and in their tills) at about 12 per cent. of their deposit liabilities.¹ Consequently when their reserves at the Bank of England are increased by the expenditure of the money created for the government they are able to increase

¹ As to the figure of 12 per cent., see Mr. J. M. Keynes' *Monetary Reform*, 1924, p. 178.

the volume of their credit ; and for every pound that their accounts at the Bank of England are increased, they are able to increase their credits by about eight pounds. Consequently each pound of Ways and Means Advances causes an inflation, not of one pound only, but of nine. In Part II on Currency it has been shown that Ways and Means Advances from the Currency Note Redemption Account have exactly the same effect as Ways and Means Advances from the Bank. By borrowing the money paid to them as the purchase price of currency notes, the government increases the quantity of money, and its expenditure swells the accounts of the banks at the Bank of England, so that on the basis of this increased cash reserve the banks are able to create increased credit. The position is different where money is borrowed from the Paymaster-General or from the National Debt Commissioners. In the case of the Paymaster-General no fresh money is created by the government, but a balance which would otherwise have been lying idle is used for current expenditure. Its use does not increase the amount of money, but it increases its rapidity of circulation. Until it is spent, money held by the Paymaster is money locked up. The borrowing of the money by the government merely transfers it to the deposits of the joint stock banks more quickly than it would otherwise have been transferred. It is probable that money borrowed from the Debt Commissioners would have been invested in some other way if it had not been lent to the government, therefore, in so far as such advances are an alternative use for money, there is no inflationary element in this form of borrowing.

And now as to Treasury Bills. At present these are taken up, for the most part, by the joint stock banks. The banks pay over the price of the bill to the government, and hold the Treasury Bill as security against the loan. So far the position is exactly the same as it would be had they bought trade bills. But Treasury Bills are an even more liquid asset than the ordinary commercial bill. The security is the best that can be offered, and they can be realised at any moment. Consequently the banks treat Treasury Bills almost as if they were cash, they use them as a backing for further credit. When therefore the government issue fresh Treasury Bills, they spend the money which the banks advance. The banks advance it on the basis of their cash reserves, but their lending capacity is not reduced as it would be by any other loan, for the Treasury Bill held against the advance is considered to be almost as good as cash.

Ways and Means Advances from the Bank are only used as need arises, but a large part of our national debt is now in the form of Treasury Bills, always outstanding and renewed as they fall due. But sometimes they are repaid, and from repayment important results follow. When the Treasury repays, it does so with money taken from the taxpayer or with money obtained from the public by a long-term loan.¹ In either case the money is drawn from the reserves of the banks at the Bank of England, it is transferred from 'Other Deposits' to 'Public Deposits' at the Bank of England, and

¹ If the Treasury is forced to repay Treasury bills by unwillingness of the banks to renew their holdings, it may then have to find the money by borrowing from the Bank of England or from Public Departments.

as the Treasury Bills are repaid it is handed back to the banks again. So far therefore the reserves of the banks—the bases of credit—are the same as they were before. But the banks no longer hold the Treasury Bill, and therefore an asset against which credit could be created has been destroyed. In this way the repayment of Treasury Bills has a deflationary effect. But with regard to this point there is something to be said on the other side. The government is not the only issuer of bills of exchange, and it may be that the banks hold fewer commercial bills than they would otherwise do, as a result of their large holdings of Treasury Bills. First-class commercial bills are almost, though not quite, as liquid an asset as Treasury Bills, and it might be that if, by the repayment of Treasury Bills, the banks were enabled to hold a larger quantity of such first-class bills, very little deflation would result from the repayment. It must not be forgotten, however, that in a period of depression such as the present, any deflation, bringing in its train falling prices, is a serious hindrance to trade. The activities of trader and manufacturer are alike discouraged by the fact that goods are sold at a level of prices lower than that at which the manufacturer bought his raw material or the shopkeeper bought his stock.

But unless Treasury Bills are paid off, floating debt will never be reduced. It must be reduced. It is a danger and a weakness. No doubt we raise money on Treasury Bills cheaply; but that is due to the fact that owing to trade slackness manufacturers are not borrowing much, and the banks have plenty to lend to the government and therefore

they get it cheap. But that state of things may not last. Trade will revive, money will be scarce, and the government will have to pay more. That is the danger, and there is a weakness too in a large floating debt hanging over a government's head, when they have so many conversions in front of them and may want a great deal of money quickly. For these reasons our floating debt must be reduced. But it must be done with the least possible hindrance to trade. We must choose our times; and we must have regard, not only to the burden of the debt, but to the effect of repayment upon trade and commerce.

CONTINGENT LIABILITIES

Besides dead-weight debt, the state has undertaken certain guarantees and commitments under which it might possibly have to find money and thus add to the national debt. However, most of these, though large in amount, are small in burden. They fall roughly into three classes.

First of all are guarantees given to enable foreign powers to raise money in London. An example of this will be in everybody's mind: the reconstruction loan issued to Austria under the auspices of the League of Nations, of which we guaranteed about one quarter. This loan, however, is so well secured upon Austria itself that it is unlikely that we shall ever be called upon to pay anything. In the same class come certain earlier guarantees which we have given for loans to Greece, to Turkey, to the Transvaal, to Northern Ireland and to other countries. In none of these cases is our burden likely to be an actual one.

In the second class there is the government's guarantee of interest on, and some responsibility for the capital of Local Loans Stock. This is a fund formed to re-lend to the smaller local authorities who, if they had to borrow individually, would have to pay heavily for their money. The fund has been formed by the creation of Local Loans Stock, held partly by investors and partly by the National Debt Commissioners. The fund is managed by a special body called the Public Works Loans Commission. The government guarantee interest on the stock, but since the Public Works Loans Commission re-lend to the local authorities at a higher rate the fund is self-supporting. Should, however, a capital loss be made through a bad debt, a Vote might have to be taken to replace the amount, but, as a matter of fact, the government's guarantee is not a burdensome liability either for interest or for principal.

In the third class comes the Guaranteed Irish Land Stock issued by various governments to buy out the Irish landlords, which might become a liability if the Irish farmers, who have bought their land on the instalment system, should fail to pay their instalments. It is remarkable, however, that in spite of the disturbed state of parts of Ireland instalments are paid with great regularity.

Lastly, in the same class, come the two post-war expedients, Trade Facilities and Export Credits. Under the Trade Facilities Acts, 1921 to 1924, the Treasury can, on the recommendation of an advisory committee, guarantee both principal and interest on loans for capital enterprises or manufactures in the United Kingdom, if such loans are calculated to

reduce unemployment. This plan is, therefore, for the encouragement of home trade : and the system of Export Credits is designed as a similar encouragement for foreign trade. The Board of Trade, under the Overseas Trade Acts, 1920 to 1922, after consultation with an advisory committee, can grant credits to British traders in respect of the export of British manufacturers to the new European countries, within a limit of twenty-six million pounds.

This is not the place to discuss whether such measures really help trade or really reduce unemployment. Their usefulness in both respects has been questioned: the aspect of them, however, which concerns us here is financial. On this it is too early to say whether there will be much loss to the state ; there will certainly be some, at any rate on Export Credits but it is impossible to say how much. Whether the benefits secured will be greater than the loss time alone can show.

CHAPTER XIII

CONVERSION AND REPAYMENT OF DEBT

THE war has left us with a large amount of redeemable debt outstanding. Some of this carries a high rate of interest, all of it has to be paid off at some future date. This means that the government has to find very large sums when one of the loans falls due, but this gives an opportunity to effect a saving on interest rates, which would not be possible with funded debt. For when a repayment date arrives the money needed for the transaction must usually be raised by further borrowing, and if the value of money has fallen since the original loan was issued, a reduction in the rate of interest is possible.

In war time a government has to reckon that an investor, knowing that money will get scarce and interest rise, may hold off in order to get the higher rate. So he has to be given a loan for a short period, with a right to profit by any rise in the rate of government borrowings. In peace time, with money getting more plentiful and interest falling, he wants the reverse. He likes an investment for as long as possible at current rates, for he knows that as time runs on these rates, owing to the fall in the price of money, will be higher than he can get in the market. Supposing he has an investment,

a legacy of war, carrying 5 per cent. interest, and that the government have the right to pay it off in two years. Suppose too that the current rate of interest is 4 per cent., and will probably fall to $3\frac{1}{2}$ per cent. in two years. If the government comes forward and offers him instead a $3\frac{3}{4}$ per cent. stock, running for twenty years, he will most likely take it. He will lose $1\frac{1}{4}$ per cent. for two years, but he will stabilise his investment for twenty years at $3\frac{3}{4}$, whereas if he waited till he was paid off and then reinvested, he might only get $3\frac{1}{2}$ or less. That is the advantage from his point of view. From the government's there are two; first, an immediate reduction in the rate of interest: and second, it has not got to find cash to pay him off. Finding cash to pay off the immense war loans we raised would be impossible. Consequently the operation suits both investor and government. It is called a conversion. Let us follow one in working.

At the beginning of 1921 the Chancellor of the Exchequer knew that he had to find £632,000,000 in order to repay National War Bonds which fell due between 1922 and 1925. How was he to find it? Taxation, already terribly high, could not be increased: trade had slumped badly: he could hardly raise the money by Treasury Bills, for our floating debt was already little under the staggering sum of thirteen hundred millions. He must induce holders of National War Bonds to take another investment in exchange. He must, that is to say, convert. He could not compel the bondholders to convert. Therefore he had to make them an offer which they would accept. What was this

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offer? It was an exchange which gave them over 5½ per cent. for forty years.¹ Those terms seem to us to-day extraordinarily high. Yet they were wise terms. Let us see why they were given.

First, they had to be such as the bond-holder would take. It was good policy to make them very favourable. Second, they had to be offered some time ahead, that is some time before repayment was due, for otherwise the government might have been squeezed. Hence the government could not wait and take advantage of the fall of interest which everyone knew would occur. Third, if they had had actually to find the £632,000,000, it would have cost them more than 5½ per cent. Fourth, the debt would be off their minds till 1961, and would not be hanging over their heads. Those were sound and prudent reasons. But there is a further explanation of the seemingly extravagant terms, not generally realised. The Conversion Loan of 1921 was the first great conversion of war debt. It would not be the last. Huge blocks of war debt were falling due in the next few years. All of these had to be converted. The terms of subsequent conversions had to be progressively worse for the investor. If they were not, he would wait and not convert. He must know that if he did not take the government's offer he would get less next time. Therefore the first offer had to be very high, to allow of this scaling down.

That is made clearer by reminding ourselves of what happened at the beginning of the war.

¹ For each £100 of National War Bonds holders were offered from £160 to £165 (varying with the date of repayment of the bond) of 5½ per cent. Conversion Loan 1961. This gave them interest from 43 12s. to 45 12s. per cent.

Then the process was reversed. Investors were likely to hold back because interest would rise. That was met by allowing those who subscribed to an early loan at a low rate to exchange into a later one at a higher. There was therefore no inducement to hold back. After the war investors were likely to refrain from converting, if they thought they would get better terms later. It was essential that this should not be so. It would have jeopardised all future conversions. The Chancellor of the Exchequer in 1921 had in mind not only the immediate operation, but a whole series of them, reaching out to 1949. He had to pitch his terms so high, that each subsequent offer might be progressively lower, and yet not so bad that the investor would refuse it. This demanded an ample margin. That is the principle of post-war conversion. In previous operations, such as Goschen's great conversion of Consols in 1888, the problem was simpler. Then the government was anxious only to reduce interest. It had no obligation to repay, although it could do so. There the offer to the Consol-holder was this: will you take a stock paying $2\frac{3}{4}$ per cent. for fourteen years and $2\frac{1}{4}$ per cent. thereafter, in place of your present holding which pays 3 per cent., or will you be paid off in cash at par? In those happy days, so good was our credit, so low the rate of interest, that nearly all Consol-holders preferred conversion.

SINKING FUNDS

But conversion itself does not pay off debt, for though it reduces interest, it actually postpones

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repayment. This is not the occasion to discuss whether it is better to tax the country heavily, as we are doing, and pay off much debt, or to tax lightly and pay off little or even increase it, as France does. Each country must settle for itself. Few, however, could dispute that our course, though a stony one, is the more profitable for us. We have started on repayment of debt. Our Chancellors of the Exchequer have a long vista of conversions ahead, and regular debt repayment improves credit and cheapens conversion. Moreover it steadies capital values and consequently attracts investors and improves credit still more. Therefore debt repayment there must be. And since you cannot pay off great blocks of war loan at once, you do it gradually by a sinking fund.

A sinking fund, a favourite policy of the younger Pitt, is an old and tried friend. It consists in putting aside a small amount of revenue every year in order to pay off debt. It has a long history, but the war has made so big a change that most of this has ceased to be of practical interest. Only two features of the old system have survived, the Old Sinking Fund, and certain special funds allotted to individual liabilities, too small to be worth describing. The Old Sinking Fund will be explained later, for though first in time it is by no means first in importance.

Since the war, we rely for debt repayment either on the special sinking funds attached to various war loans or on the New Sinking Fund, 1923, which was set up by the Finance Act, 1923. By this act a fixed sum is set aside every year for debt repayment, £40,000,000 for the first year, £45,000,000

for the second, and £50,000,000 for the third and every subsequent year, until the House of Commons otherwise determine. The money must be issued within the financial year to the National Debt Commissioners and applied by them within nine months 'in the purchasing, redeeming or paying off of debt charged on the Consolidated Fund,' excluding Ways and Means Advances, which have been described under Floating Debt.

The National Debt Commissioners buy stock and cancel it. They employ a well-known firm of stock-brokers known as the Government Brokers, who of course buy prudently, so as to avoid raising the price against themselves, and they take advantage of every fall in value. The actual amount of day to day purchases is settled in consultation between them and the National Debt Commissioners. Only stocks directly charged upon the Consolidated Fund can be bought, not stocks for which we are merely guarantors, such as Local Loans or Guaranteed Irish Land Stock. When stock is bought, the entry in the books at the Bank of England is cancelled and the operation is complete. The country is free from so much more debt.

The New Sinking Fund, 1923, which is £45,000,000 for the year ending 31st March, 1925, includes all the special sinking funds attached to various war and conversion loans, among them the sinking fund on the American debt, under which we have to repay capital to the amount of twenty-four million dollars in 1925. It also includes all war loan surrendered in payment of death duties. But, though all the special sinking funds are thus merged in the New Sinking Fund, one of them has a potential importance over

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and above the New Sinking Fund. That is the one attached to the second war loan issued in 1917. This is one-eighth per cent. per month, or say $1\frac{1}{2}$ a year, on the amount of the loan outstanding. It must be used for buying and cancelling stock whenever the market price falls below the issue price, which is 95 per cent. and par respectively on the two classes of the loan. Sinking fund is suspended when the unexpended balance reaches £10,000,000. Now the amount of stock on 1st January, 1925, was £2,056,449,000, and though the stock stands now over issue price, and the sinking fund is suspended, still there is a potential sinking fund at the rate of over £25,000,000 a year, if it falls below it. In that case the amount of the New Sinking Fund would have to be increased, for it would not then be enough to pay this new charge, and the other special sinking funds as well.

Those are the methods in operation to get rid of war debt. In addition certain pre-war measures still survive, of which the only important one is the Old Sinking Fund. It is automatic. If there is a credit balance on the revenue side of the Exchequer Account at the end of the year, it goes in reduction of debt. The Exchequer Account, we may remind ourselves, is the Consolidated Fund. Into this all receipts should go and out of it all payments be made. But many of these entries will not be revenue of the year, for all repayments of loans, Treasury Bills, and other capital outgoings, are passed through it, and so are all capital receipts. The balance which goes in reduction of debt is the excess of revenue for the year over expenditure for the year. Revenue is taxes,
Nc*

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customs duties and so on. Expenditure is Supply and Consolidated Fund Services. The balance only of revenue and expenditure is taken for the Old Sinking Fund, which balance may be a very different thing from that of the whole Exchequer Account. This balance is struck at 3 p.m. on 31st March, on which day, it will be remembered, the country closes its accounts. The money, however, may have been issued earlier, for owing to the large size of our national accounts since the war, great inconvenience is felt by the money market if big sums are locked up by the government for a long time.

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