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JAS. J. SALMOND
Managing Director

FRED. W. FIELD
Editor

A. E. JENNINGS
Advertising Manager

Serial Bonds and the Sinking Fund Method

SURPRISING *Difference in Cost of Public Financing Under the Sinking Fund and Serial Bond Methods Demonstrates the Great Superiority of the Latter—Boston and New York Taking Action—How Millions of Dollars Could Have Been Saved to the Taxpayers.*

AFTER century intervals public sinking funds, beginning with Sir Robert Walpole's in 1716, (who raided it for half a million in 1732) conducted on an enormous scale by the younger Pitt, but proved to be useless by Dr. Hamilton in 1813, were prohibited in Massachusetts in 1913; and now in 1915 the New York State Constitutional Convention, recently convened at Albany, advises the abandonment of sinking funds in the Empire State. The electorate of New York were to vote thereon November 2.

A $500,000,000 credit to the Anglo-French Allies has just been arranged in New York by international financiers. This loan is to stabilize exchange and affects vast intercontinental relations of the gravest concern to humanity. The Financial Chronicle of New York says of this that "the magnitude of the amount required is itself such as to stagger the senses, and it outranks everything of the kind ever attempted in the United States."

Yet, Mr. Alfred D. Chandler, of Boston, points out in an instructive article in the New York Annalist, the bonded debt of New York State alone and of its municipalities is already about $2,000,000,000, or about four times the sum of this memorable international undertaking. New York City's bonded debt is about $1,500,000,000, and is increasing at from 50 to 100 millions a year. This makes an interesting contribution to the discussion of the matter in recent issues of *The Monetary Times*. Mr. Chandler continues:—

Like England, New York, as a rule, has sanctioned the archaic sinking fund method of financing public loans until its recent Constitutional Convention was led to take radical action thereon, even on one proposition anticipating Massachusetts, which led the world in anti-sinking fund legislation.

New York now would not only forbid future public sinking funds, if the convention's advice is adopted, but would authorize the permissive refunding or exchanging of hundreds of millions of dollars of outstanding sinking fund bonds into serial bonds as a measure of prudence and economy.

The impressive example now offered for the abolition of public sinking funds by our two most heavily indebted states—Massachusetts and New York—incites imitation elsewhere in North and South America. Public sinking funds have proved to be too precarious for sound finance, and with long-time bonds the excessive cost of that method over the serial-bond method is responsible for repudiations and even revolutions.

Notwithstanding sinking funds, the municipal county, and state repudiations, scalings down, and interest defaults in the United States are reported to have exceeded $1,000,000,000, suggesting toleration for some Latin-American countries. To-day eight states of our Union are reported to be in default, principal and interest, for $70,000,000 *more* than is Mexico! (41st Annual Report Corporation of Foreign Bondholders, London, 1915, pages 335, 368-9.) This does not include "Confederate bonds" or war debts.

Legislators have been dilatory or irresponsive upon this subject. In Massachusetts—to its great loss—thirty-one years elapsed, from 1882 to 1913, between the original optional and the final compulsory serial bond act; optional (1) in 1882 with municipalities; (2) in 1903 with the state, excluding the metropolitan district; (3) in 1905 with the metropolitan district, and, finally (4) in 1913 compulsory for all public loans. Earlier favorable state action upon this far-reaching fiscal issue would have spared the payment by taxpayers of millions of dollars, and the credit of the state and of its subdivisions would have been thereby strengthened.

When it was revealed to the finance committee of the New York Constitutional Convention that for every $100,000,000 of New York's standard fifty-year sinking-fund bonds at 4 per cent. the difference in interest between the sinking-fund and the serial-bond method was the astounding sum of $98,000,000, while the difference in actual cost if the sinking fund earned the accepted 3½ per cent. was $35,690,800, or even if it could earn 6 per cent. was $14,934,400, it brought that convention to an impressive realization of New York's past neglect on this score and of the needless expense attached to its present outstanding bonded debt, state and municipal, of about $2,000,000,000, or about double the bonded debt of the United States.

The convention was not misled by the cursory fallacy that as serial bonds usually require larger payments in the earlier years of their term than do sinking-fund bonds money might be 'worth more' to a taxpayer then than later, an expression far too ambiguous to justify the subversion of a sound fiscal principle; or by that other fallacy that a long loan, to be paid by tens of