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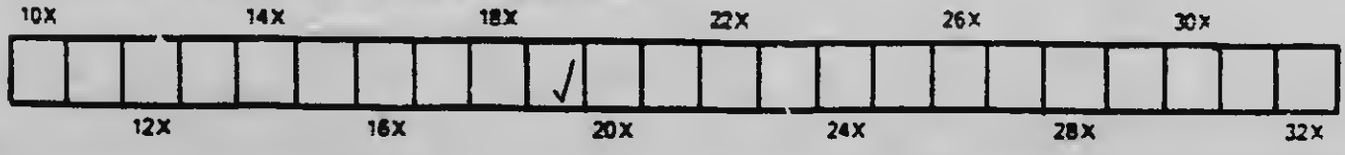

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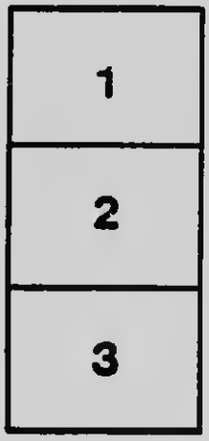

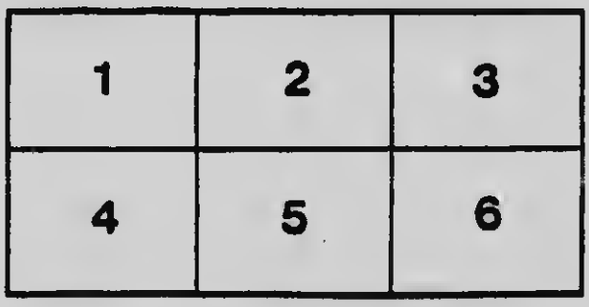

ECONOMICS

LESSON 19

By

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SHAW CORRESPONDENCE SCHOOL

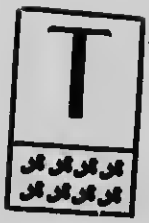
TORONTO, - CANADA

ECONOMICS

LESSON XIX.

Public Finance.

Part I.



THE first thought of the student who, through all the stages of the previous lessons has reached this point, may possibly be, "What has the Government to do with Economies?" If, however, he will think over his previous work, he will be ready to admit that a Government has a good deal to do with the monetary and banking systems, with grants of land from the Crown, with labour, transportation and monopoly problems. Under Socialism, of course, the Government would be all-powerful in the sphere of economies. But far removed from Socialism as we are, careful consideration of the subject will show the vast influence which a Government has upon the economic affairs of the citizens.

Functions of Government at Their Minimum.

Even though, as Adam Smith desired, the functions of Government were to be reduced to the minimum (affording protection to the life and property of the citizens against domestic or foreign enemies, and undertaking such public works as are too great for individuals and yet necessary to the community, for example, the Panama Canal), yet we should find that by its method of performing or neglecting to perform those functions, the Government would exercise an enormous influence over the economic welfare or adversity of its subjects. In Turkey, for instance, life and property are far from being secure, and the result is that no one cares to save up capital or to invest it there, with the further consequence that the transportation service, etc., of that country is inadequate, that the country, in spite of enormous natural resources

which once supported a dense population, is now thinly settled and backward.

The Increase in the Functions of Government.

Much greater is the influence of a Government which, like most modern Governments, considers that its functions embrace, besides the foregoing, education of various kinds, the construction of great public works, the management of great public services, and the control of the great industries of the country. Such a Government can, by an enlightened and progressive policy, rapidly increase the production of wealth, or by a mistaken policy, though with the best intentions, bring the country to the verge of ruin.

All governments require for the proper discharge of their functions, large sums of money which are collected from the inhabitants of the country. All the public revenue is collected from the pockets of individuals either in return for some special service performed by the government (such as the postal service) or as taxation. The study of the best methods of its collection and expenditure is called Public Finance.

Increase of Revenue Necessary to Perform Functions.

Now as the functions of the State in almost all civilized countries are being extended, it is evident that the cost of supporting the State must be increasing. And this is what we find. In ten or fifteen years the cost of central and local government in the United Kingdom has doubled, partly because of the South African war and increased expenditures for defence, but principally because of the lavish expenditure on education, municipal tramways, waterworks, lighting and on the housing of the poorer classes. So, too, the ordinary expenditure of the Dominion Government has increased from $42,975,000 in 1900 to $98,161,000 in 1912. In all civilized countries the state is appropriating an increasing part of the individual's income.

Now, so far as the State is giving increased value for this increased burden on the individual, the increase is not

in itself an evil. If the State performs certain functions for the individual better and cheaper than a corporation could perform them, as in the case of the Post Office, the increase of State functions is a positive good. In fact the whole question of municipal and public ownership is a question of expediency in each individual case. Whether ownership is public or private the receipts of the enterprise come from the pocket of the individual citizen. If he gets more for less money under public ownership, then public ownership should be adopted. If not, it should not be adopted.

All Public Money Comes From the Individual.

All the public money, as we have said, comes from the pockets of the individual. How shall we decide how much of the individual's income the State may take? There is no logical limit to the State's demands; it may logically demand not only a man's property, but his life for its service (in Canada every man between 18 and 60, with a few exceptions, is liable to be called upon to serve in the defence of the country). But in practice we find that its demands upon the people of a country are regulated by the amount of money which those in authority find it necessary to expend in the public service.

So, then, we have one great difference between individual and State economy. The individual has to regulate his expenditure by his income; the State regulates its income more or less by its necessary expenditure. The individual says: "I can spend so much;" the Finance Minister, "I have to raise so much." As it is, therefore, the amount and kind of expenditure which determines the amount and kind of the revenue, we shall deal first with expenditure.

Expenditure—Defence.

The first duty of a Government is, says Adam Smith, the protection of its subjects from the violence and invasion of other independent societies. This is a duty which can be discharged only by the maintenance of a

considerable body of armed men, and if the nation be a maritime one, it should keep up also a navy proportionate to its needs.

This is, no doubt, the greatest single item of expenditure among all world powers, and the cost of preparation for war, in these days of inventions, continues to increase with startling rapidity.

In 1914 the United Kingdom was spending about $400,000,000 per annum on its army and navy; the military and naval expenditure of the United States in 1913 was $288,000,000, besides $163,000,000 in pensions—a total of $453,000,000. Germany, apart from the extraordinary levy of $250,000,000 in 1913, spent $350,000,000, and France in 1913 $283,000,000 on her army and navy. Russia, Italy, Austria-Hungary and Japan are also groaning under the burden of armaments. Nor in spite of the efforts of statesmen to secure a limitation of armaments, does it appear that the end is yet reached.

Canada has so far got along with remarkably little expenditure in this direction—only about $16,000.000 at the present time. She has probably been wise in restricting her military expenditures hitherto, but it does not seem that she can do so for long. The enormous increase in military expenditure on the part of Japan and the United States, the new world-powers, makes it necessary for us to reconsider our position. As Great Britain cannot afford to keep a large fleet in the Pacific, it seems necessary that we should co-operate with Australia and New Zealand, which, like ourselves, are threatened by the advance of the yellow races, to maintain a squadron in the Pacific.

In respect of this first item of expense, therefore, it would appear that Canada's expenditure for defence is altogether inadequate, when we consider the magnitude of the interests and the rich and fertile territories which she has to defend. Thus far, at least, she is indebted to the Motherland for her protection.

Expenditure—Administration of Justice.

The second great function of the State is the maintenance of internal security, or in other words, the preservation of law and order, the necessity of which is admitted by all except advanced anarchists. All civilized people accept this as a necessary function of government.

This duty of the State necessarily involves considerable expense, and there has been a great deal of controversy as to how the money necessary for this purpose should be raised. In the Middle Ages it was raised by the fee system, that is by collecting high fees from all persons who resorted to the law courts for legal remedies. This system has at first sight much to recommend it. The public revenue is exempt from any charge, the persons who are presumed to gain have to pay for service rendered; the judges are stimulated to diligence by the hope of reward. So plausible is this idea that it was maintained by Adam Smith.

But it is now generally held that the judge's toil is not for the benefit of the particular suitors who appear before him, but for that of society at large. All private property is more valuable than it would be if there were no laws and judges to secure its enjoyment to its possessors. Therefore, all private property should pay for its protection. Furthermore, the fee system gives an immense advantage to the rich over the poor, and on this account alone it is objectionable. It seems proper, therefore, that the cost of the administration of justice and the maintenance of the police should be borne by the ordinary public revenues.

Expenditure—Administrative Supervision.

The third great division of the functions of Government is given the name of Administrative Supervision, that is, the maintenance of inspectors of mines, factories, shipping and food, etc.

Here we are on more debatable ground. Many of the laisser faire economists of the nineteenth century protest against all such supervision as an infringement of indi-

vidual liberty. Their maxim was Caveat emptor, "let the purchaser look out for himself." But in these days of imitations and adulterations, when it is possible to produce artificially food stuffs so like the natural foods as to deceive any average individual, is it reasonable to expect that the ordinary man shall be able to detect these frauds? The civilized countries of the present day have generally agreed to answer this question in the negative. Modern public opinion demands that ignorant or unprincipled producers shall not be allowed to endanger public health by the sale of food products—especially meat and milk—which are unfit for human consumption. So too out of regard for the safety of its citizens the State insists on reasonable care in the operation of mines, the equipment of factories and the conduct of shipping. Possibly the work of factory inspection might be handed over to the Trades Unions, but in such a case it is unlikely that we should have uniform administration of the law, which is absolutely essential.

Expenditure—Poor Relief.

Poor relief is in most countries a charge on the public revenue. Why is it not left to individual charity as the laisser faire school recommended, instead of being made a compulsory charge on the public purse? The answer is (1) That private charity is too precarious and uncertain to be relied on for long periods of time; (2) That indiscriminate giving is likely to relieve the most persistent applicants rather than the most needy; (3) That private charity means a heavy burden on the more generous-minded and no burden at all on the niggardly; (4) that under our present penal system a destitute man may always secure the means of living by committing a crime. To deny to the pauper what is thus guaranteed to the criminal amounts to an inducement to crime.

The objections raised to State relief are :(1) that to give support to the non-worker is communistic; (2) that State relief demoralizes the receivers more than private charity; (3) that all relief discourages thrift. These

arguments have great force, but not enough to invalidate the foregoing considerations. Practically all economists are agreed, however, that poor relief should be more carefully and discriminatingly applied. The events of the winters of 1907-8 and 1913-14 in Toronto and other Canadian cities show that in many ways poor relief can be more efficiently administered by the State than by private charity.

Expenditure—Education.

The recognition of education as one of the natural functions of the State, is partly due to the decline of the church, but still more to the rise of the modern spirit of democracy. It is agreed by all progressive nations that the State ought to provide an elementary education for all its children, that is, for its future citizens, because uneducated citizens are a great danger to any democratic community. Secondary education has, however, in Europe at least, been left very largely to private initiative or to voluntary effort. The same is the case with university education. Even in our own country where State education is dominant, many complain that its influence is too largely secular and too stifling to the individual character—that an individual who has passed through it is, as it were, the product of a machine. Consequently various religious denominations have built up secondary schools and universities of their own, where, they claim, more attention is paid to the individual and his needs than in the State institution. In spite of the fact that many hold this point of view, the balance of opinion is certainly in favour of regarding education as one of the main functions of the state.

Expenditure—Religion.

The maintenance of a national form of religion is still in many countries regarded as a proper object of public expenditure, but the support of religion is obviously becoming more and more a matter of voluntary effort. The disestablishment of the Church of Ireland in 1870 shows this strong tendency, as do also the proposals to disestab-

lish the Church in Wales. In our own country we may regard the tax exemption given to all property owned by religious denominations as a species of establishment of religion in general.

Expenditure—Aiding of Industry.

One of the most important functions of government is the aiding of industry. This is performed in many ways: by maintaining a monetary system, a system of weights and measures, post offices and telegraphs, and in some countries government railways and steamship lines, and by the maintenance of a consular service. A more debateable method of aiding industry is by paying bounties on domestic production or levying protective import duties on commodities brought from abroad. Both of these, which are usually conceived to be temporary in their character, we have already considered under the subject of "International Trade."

Expenditure—Extraordinary.

We have now dealt with all the ordinary expenses of Government. But we know that any Government may at any moment be compelled to incur extraordinary expenditures, usually for the defence of the nation against its enemies. There have been no more peace-loving or economical governments in the history of the world than that of the younger Pitt before 1793, or that of Lord Aberdeen in 1854, when Gladstone was Chancellor of the Exchequer. But even these governments found themselves compelled to go to war and to incur enormous expenses in the defence of their country. These vast expenditures cannot be raised by taxation without disorganizing the whole financial system of the country and consequently Finance Ministers generally resort to loans for the purpose of carrying on war. They have usually judged it expedient, however, as did Mr. Gladstone, to make the people feel the cost of the war by imposing heavy war taxes at the time—a measure which has had a very good influence in abating the jingoism of the people,

and is entirely commendable from a financial point of view.

Division of Functions Between Central and Local Government.

Up to the present, nothing has been said of the division of duties between the central and the local government. All public expenditures are really one in kind and it is impossible to draw a precise and definite line between central and local expenditure. For instance, our provincial and municipal governing bodies take part in supporting the state system of education, and our Dominion and Provincial Cabinets have each a Minister of Agriculture. There is no theoretical reason from a financial point of view, why all the municipalities of Canada should not be ruled from Ottawa as Napoleon ruled all France from Paris and Frederick the Great decided the minutest affairs of a Prussian town from Berlin. But in practice our Anglo-Saxon ideas of self-government have resulted in the adoption of the working principle that each community shall manage its own local affairs. What precisely are "local affairs" is somewhat difficult to determine and the distinction is usually made by a somewhat arbitrary rule. For instance, in rural communities, bridges over a certain length are built and maintained by the county and shorter ones by the townships. In Canada the line of division of powers between our Provincial and Dominion Governments was practically decided at the time of confederation by the necessity of leaving to Quebec those political and religious institutions which were peculiar to the French-Canadians. But these are political considerations having nothing to do with our subject. We must repeat, then, our conviction that there is, from a financial point of view, no definite division between the functions of local and central government.

Revenue—"Economic" and Tax Revenue.

After dealing with the expenditure of the State, we turn naturally to consider how the revenue necessary to meet this expenditure ought to be raised.

The revenues of the State are of two main kinds: (1) There is the revenue which is obtained by the State in its various functions as a great corporation or legal "person" operating under the ordinary conditions that govern individuals and companies; (2) that taken by the sovereign from the subjects by taxation. To the former class belong the rents received by the State as landlord, the interest on its investments, and the earnings of its great services such as the Post Office. In the second class have to be placed all taxes of whatever kind.

Classes of "Economic" Revenue.

It is with the former class—the "economic" receipts of the State—that we shall be concerned in this lesson. These may be divided into three classes. First, we all know that the State may be landlord and receive a rent from its tenants for the use of land or of other natural resources. Secondly, the State may be a Capitalist, when, for instance, it lends funds to municipalities or to corporations (as in the Sault Ste. Marie loan of $2,000,000) and receives interest therefor. Thirdly, the State may be an Entrepreneur, an undertaker of industrial enterprises, and may receive a profit from them over and above any rent and interest charges. The State operates the post office in practically all countries, the telegraph and telephone lines in Great Britain and various other countries, and the railways in Prussia, Australia, Russia, British India and other countries. We will consider briefly these classes of "economic" receipts.

I. The State as Landlord.

The public domain—the ager publicus of the Romans—was throughout ancient and mediaeval times regarded as the basis of public income. The feudal king was the greatest, and indeed in the case of William the Conqueror, the only landowner in his dominions. All men held their land from him on condition of military service and rents in kind or in money: hence land rent in his day constituted the main revenue of the State. In time, many land-

owners redeemed their land tax by paying a lump sum; others still pay the tax, which, though now insignificant in amount, is a recognition of the State's part-ownership of the land. In France the State lands were greatly reduced in extent at the time of the Revolution. Prussia and the other German States, Austria and Russia still possess considerable amounts of State land which is largely in forest. By the practice of scientific forestry, Prussia derives a net revenue of $15,000,000 and Bavaria of $10,000,000 per annum.

In the newer countries, the United States, Canada, and Australia, it has been found that the very best way to attract immigrants is to allow free access to the land. The immigrant coming into our own North-West, pays only $10 for his quarter-section, an amount which would not cover the cost of surveying it and keeping open the land offices. But it is felt that the stimulus given to production and improvement in this way offsets any advantage which the State might derive from merely leasing the land to the immigrant and charging him a rent which would increase with the development of the district. The immigrant who becomes an owner rather than a renter is more likely to be a permanent and valuable citizen, and the income derived from him by the State in the form of taxes is likely to be quite as great as that which would have been derived in the form of rent.

The apparent advantages of a large state revenue derived from land and the peculiar nature of the income—the rent received for the use of it—have suggested the advisability of dispossessing private owners, either with or without compensation, and reverting to the single or land tax. But such a project, if it were carried out, would result in a widespread feeling of insecurity. Compensation would be practically impossible, and confiscation without compensation would lead to revolution. (See also Lesson XI.)

State Ownership of Forests.

Adam Smith strongly condemned state property because it was badly managed and recommended the sale

of it to meet extraordinary expenses only, not ordinary expenses, which should be met from current taxation—a rule which in Canada is more honoured in the breach than in the observance. Only in one case, that of forests, must we make an exception to this rule. The individual farmer does not love the forest. He can hardly hope to reap in his own lifetime the benefits of creating it, and has no conception of the important natural advantages which accrue to a country that preserves its forests. There is practically a consensus of competent opinion in favour of state action for the purpose of increasing the areas under trees, and directly administering these areas by a skilled and well-organized staff.

II. The State as Capitalist.

The business of banking is in so many ways connected with the State, that the public management of banks appears to have much to recommend it. The ordinary method has, however, been that of granting concessions to privileged companies which are bound to afford facilities to the State in return for the advantages which they enjoy. England, France and Germany adopt this policy, and the pure "State-bank," where the capital of the undertaking is supplied from the State funds, is found only in Russia and Sweden. The Post Office Savings Bank is another instance of State action along this line. The chief reason for its establishment is that it affords an absolute security to innumerable persons of the poorer classes who would otherwise be often victimized by untrustworthy institutions. The great process by which Irish land is at the present time being transferred from the landlords to the peasants by the use of the State's credit, is another instance of the State acting as a Capitalist.

The great advantage which is derived from the State's action as a capitalist, is security; this is seen in the case of the Post Office Savings Bank and the Dominion Government Annuities. The great disadvantage is that State advances to individuals are likely to become an object of

political wire-pulling and certain individuals or classes may be favoured at the expense of others. It is for instance very questionable whether the Irish peasants will ever be called upon to repay to the State all the money advanced them to pay off their landlords. Some government may find it worth its while to remit these payments —or part of them—in return for the political support which such action would gain them in Ireland. While in this particular case the good accomplished might as a matter of general policy justify the expenditure, this instance illustrates the danger of possible unfairness in the action of the State as Capitalist.*

III. The State as Entrepreneur.

This is a much wider field of State action than either of the preceding. In several States the Government owns and works a number of mines—for instance, Prussia, which in 1902 derived $43,000,000 revenue from this source.

The modern State, however, has not confined its activity to extractive industries. In almost all countries it has gone in for manufacturing, especially for the manufacturing of the articles needed to supply its own military and naval needs. This is defended on the ground that it is the only way of guaranteeing the goodness of the arms or clothing on which depend the lives of the soldiers.

Desirability of State Operation of Industries.

In fact, the whole question of whether a State should undertake industrial functions must be answered thus: there is always a presumption in favour of private owner-

*One of the best examples of the State deriving a revenue from investments is the United Kingdom's revenue from Suez Canal shares. These were purchased not for financial but for political reasons—in order to acquire control of the shortest route to India. However, they have turned out a splendid investment, and, besides paying excellent dividends, could now be sold for far more than was paid for them. The Dominion's interest on its investments was, in the fiscal year 1912, $1,281,000.

ship as being more economical and businesslike, but this general principle cannot be considered as in itself conclusive and must be abandoned when it is shown that the interests of the community will be furthered by governmental action.

In what industries is it possible that the interests of the community might be furthered by government action? First, in the case of those industries in which there is a natural tendency to the creation of monopoly; second, in those industries which deal with communication and transportation.

Municipal Operation of Public Utilities.

The first class of these industries, i.e., those which are likely to become monopolies, fall mainly within the domain of local rather than that of central government. Perhaps the most important of them is the supply of water, which has of late years tended to become a municipal enterprise throughout the civilized world. Only three English cities still have private water companies and only forty-four out of one hundred and thirty-five cities in the United States. The public ownership of lighting plants is also very general and tends every year to become more popular. This is well illustrated by the widespread adoption of the power applied by the Hydro-Electric Commission for lighting and manufactures in the Province of Ontario.

State Operation of Post Office, Telegraphs and Telephones.

The second group of industries—those dealing with communication and transportation—includes the best known and most generally accepted of all State employments, the Post Office. Even Adam Smith regards it as an exception to his rule of the inexpediency of State action in the field of industrial enterprise, and declares that it is the only mercantile project which has been successfully managed by every form of government. The general principle which has governed its operation is that of supplying the means of communication at the lowest

possible rate to all the citizens of the State. The United Kingdom, however, derives a net revenue of $20,000,000 and Germany of $10,000,000 from their post offices.

Along with the post office come the allied telegraph and telephone industries, which have been much less successful under public ownership. The British telegraph rate—twelve words for sixpence to any place in the British Isles—has not proved sufficient to meet the cost of the very efficient service, but public opinion seems opposed to an increase of the charge. The British telephone system, originally in private hands, has recently been taken over by the State; here neither private company nor State management have, so far as can be learned, proved satisfactory.

State Operation of Railways.

The most important subject, under this head, and that which has given rise to most controversy, is the public ownership of railways. The United Kingdom and the United States have agreed to consider railways as merely a particular form of industry like banks, shipping, mining, dependent for their special privileges on the direct act of the legislative power. The continental countries of Europe have, on the other hand, recognized a much closer connection between the State and the railways. France has the reversion of her railways, most of which will become State property between 1950 and 1960; Prussia owns and operates 90% of hers, deriving a net revenue of about $75,000,000 thereby. Austria and Russia also receive large surpluses from their Government railways. The Scandinavian countries too have adopted State ownership of railways with indifferent success from a financial point of view. The experiment in this line which interests us most is the State ownership of the railways in Australia and New Zealand. In Australia the railway returns of the various States for the year ending June 30, 1910, show a surplus of receipts over working expenses of $30,000,000, which constitutes a fair interest rate of slightly over 4% on the cost of construction and equipment, $730,000,000.

This would probably cover the interest on the capital borrowed from Great Britain for building and equipping the lines, and it may reasonably be expected, that the growth of population will in future largely increase the railway receipts in all these colonies without proportionally raising the working expenses. The passenger rates, for such a new country, are exceedingly low, averaging 1½ cents per mile. On the Victoria lines at least students are carried in and out from the Melbourne University free. All these railroads are under the management of expert commissions.

On the whole, the conclusion, from a purely financial point of view, is against state ownership of railways, but so many considerations of development and unity of management and, most important of all, of public service, come into the question, that it is impossible to pronounce a general verdict one way or the other. One thing, however, our experience with the Intercolonial and the example of Australia have taught us: If government ownership is to be a success, the details of railroad management must be left in the hands of a non-partisan commission of railway experts.

Municipal Street Cars.

What the railway system is to the nation, the street railway is to the city or town, and it is quite in accordance with the general trend of events that there should be an attempt to municipalize these means of communication. A large number of British cities own their street railways, but in many of these cases the lines are leased to companies. In the United States only a small number of cities own their street car lines, though the number is growing. In Canada, many of our smaller cities, such as Guelph and St. Thomas, own their street cars, but the experiment is too recent to warrant any very definite conclusions.

Note.—The student must bear in mind that public ownership tends to swell the revenues, the expenditure and the debt of the state. Therefore, in comparing the finances of

countries which own their public service and those which do not own them, we must always make the necessary deductions from the accounts of the former, as, for example, in a comparison of Australia and Canada. The debt of Australia is over $1,000,000,000, and ours in 1912 was only $340,000,000, but Australia's railways are probably worth the difference.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XIX.

1. What was Adam Smith's idea of the proper functions of Government? How far do we differ from him and why?

2. What are the chief differences between state and individual finance? Discuss.

3. What is the justification for taxing the citizens to provide defence? Outline the present position of Canada with regard to this question.

4. What have been the principal ideas as to who should pay for the administration of justice? What is your idea?

5. What is meant by administrative supervision? How do you account for its growth in the past generation?

6. What are the arguments for and against state expenditure on charity? On education?

7. What are the main functions of the Dominion, Provincial and Municipal Governments? Can you draw a clear line between them?

8. What are the three classes of Economic Revenue? How do they arise?

9. What do you think of state ownership of land? Where is it most approved, and why?

10. Write a note on "The State as Capita[illegible]". Ought the Western Provinces to borro[illegible] money in order to make [illegible]ans to farmers at a cheaper rate than the farmers [illegible]uld otherwise have to pay?

11. Wh[illegible] are all nations operating the post office as a government department?

12. How far are the arguments applied to the post office applicable to government operation of railways and municipal operation of street railways?